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RESERVE BANK OF INDIA
www.rbi.org.in

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July 2, 2007

The Chief Executives of

i) All scheduled commercial banks (excluding RRBs and LABs) and
ii) All India Notified Financial Institutions

Dear Sirs,

Master Circular on Wilful Defaulters

As you are aware, the Reserve Bank of India has, from time to time, issued a number of circulars to banks and financial institutions (FIs) containing instructions on matters relating to wilful defaulters. In order to enable the banks/FIs to have all the existing instructions on the subject at one place, this Master Circular has been prepared. The Master Circular incorporates all the instructions/ guidelines issued on cases of wilful default, which are operational as on date. The Master Circular has also been placed on the RBI web-site (http://www.rbi.org.in).

Yours faithfully,

(Vinay Baijal)
Chief General Manager

Master Circular on 'Wilful Defaulters'

Purpose

The Reserve Bank of India decided in April 1999 to introduce a scheme under which the banks and notified All India Financial Institutions were required to submit to RBI the details of the wilful defaulters with outstandings of Rs.25 lakh and above. This was pursuant to the instructions of the Central Vigilance Commission for collection of information on wilful defaults of Rs.25 lakhs and above by RBI and dissemination to the reporting banks and FIs. This circular prescribes the norms for declaring an individual borrower a wiful defaulter, penal measures that can be taken against a willful defaulter, roles and responsibilities of a audit and inspecting teams while they deal with such accounts and a mechanism by which the grievance can be addressed if any party feels aggrieved on account of inclusion of its name in the wilful defaulters list. The circular also deals with the criminal action that a bank can take against the willful defaulters and precautions a bank can take in this regard before giving credit facilities to the borrowers.

Previous instructions :

The Master Circular incorporates all the instructions/ guidelines issued on cases of wilful default, which are operational as on date.

Application :

To all scheduled commercial banks (excluding RRBs and LABs) and All India Notified Financial Institutions.

Structure :

1. INTRODUCTION

Pursuant to the instructions of the Central Vigilance Commission for collection of information on wilful defaults of Rs.25 lakhs and above by RBI and dissemination to the reporting banks and FIs, a scheme was framed under which the banks and notified All India Financial Institutions were required to submit to RBI the details of the wilful defaulters. Wilful default broadly covered the following:

a) Deliberate non-payment of the dues despite adequate cash flow and good networth;
b) Siphoning off of funds to the detriment of the defaulting unit;
c) Assets financed either not been purchased or been sold and proceeds have misutilised;
d) Misrepresentation / falsification of records;
e) Disposal / removal of securities without bank's knowledge;
f) Fraudulent transactions by the borrower.

The above scheme came into force with effect from 1st April 1999. Accordingly, banks and FIs started reporting all cases of wilful defaults, which occurred or were detected after 31st March 1999 on a quarterly basis. It covered all non-performing borrowal accounts with outstandings (funded facilities and such non-funded facilities which are converted into funded facilities) aggregating Rs.25 lakhs and above identified as wilful default by a Committee of higher functionaries headed by the Executive Director and consisting of two GMs/DGMs. Banks/FIs were advised that they should examine all cases of wilful defaults of Rs 1.00 crore and above for filing of suits and also consider criminal action wherever instances of cheating/fraud by the defaulting borrowers were detected. In case of consortium/multiple lending, banks and FIs were advised that they report wilful defaults to other participating/financing banks also. Cases of wilful defaults at overseas branches were required be reported if such disclosure is permitted under the laws of the host country.

The above scheme was in addition to the **Scheme of Disclosure of Information on Defaulting Borrowers of banks and FIs** introduced in April 1994, vide RBI Circular DBOD.No.BC/CIS/47/20.16.002/94 dated 23 April 1994.

2. Guidelines issued on wilful defaulters (May 30, 2002)

Considering the concerns expressed over the persistence of wilful default in the financial system in the 8th Report of the Parliament's Standing Committee on Finance on Financial Institutions, the Reserve Bank of India, in consultation with the Government of India, constituted in May 2001 a Working Group on Wilful Defaulters (WGWD) under the Chairmanship of Shri S. S. Kohli, the then Chairman of the Indian Banks' Association, for examining some of the

recommendations of the Committee. The Group submitted its report in November 2001. The recommendations of the WGWD were further examined by an In House Working Group constituted by the Reserve Bank. Accordingly, the banks/FIs were advised on May 30, 2002 for implementation, with immediate effect, as under.

2.1 Definition of wilful default

The term "wilful default" has been redefined in supersession of the earlier definition as under:

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

(a) The unit has defaulted in meeting its payment / repayment obligations to the lender even when it has the capacity to honour the said obligations.

(b) The unit has defaulted in meeting its payment / repayment obligations to the lender and has not utilised the finance from the lender for the specific purposes for which finance was availed of but has diverted the funds for other purposes.

(c) The unit has defaulted in meeting its payment / repayment obligations to the lender and has siphoned off the funds so that the funds have not been utilised for the specific purpose for which finance was availed of, nor are the funds available with the unit in the form of other assets."

2.2 Diversion and siphoning of funds

The terms “diversion of funds” and “siphoning of funds” should construe to mean the following:-

2.2.1 Diversion of funds, referred to at para 2.1(b) above, would be construed to include any one of the undernoted occurrences:

(a) utilisation 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 corporates 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.

2.2.2 Siphoning of funds, referred to at para 2.1(c) above**,** should be construed to occur if any funds borrowed from banks / FIs are utilised 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 decision as to whether a particular instance amounts to siphoning of funds would have to be a judgement of the lenders based on objective facts and circumstances of the case.

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 categorised as wilful must be intentional, deliberate and calculated.

2.3 Cut-off limits

While the penal measures indicated at para 2.5 below would normally be attracted by all the borrowers identified as wilful defaulters or the promoters involved in diversion / siphoning of funds, keeping in view the present limit of Rs. 25 lakh fixed by the Central Vigilance Commission for reporting of cases of wilful default by the banks/FIs to RBI, any wilful defaulter with an outstanding balance of Rs. 25 lakh or more, would attract the penal measures stipulated at para 2.5 below. This limit of Rs. 25 lakh may also be applied for the purpose of taking cognisance of the instances of 'siphoning' / 'diversion' of funds.

2.4 End-use of Funds

In cases of project financing, the banks / FIs seek to ensure end use of funds by, *inter alia*, obtaining certification from the Chartered Accountants for the purpose. In case of short-term corporate / clean loans, such an approach ought to be supplemented by 'due diligence' on the part of lenders themselves, and to the extent possible, such loans should be limited to only those borrowers whose integrity and reliability are above board. The banks and FIs, therefore, should not depend entirely on the certificates issued by the Chartered Accountants but strengthen their internal controls and the credit risk management system to enhance the quality of their loan portfolio. Needless to say, ensuring end-use of funds by the banks and the FIs should form a part of their loan policy document for which appropriate measures should be put in place. The following are some of the **illustrative measures** that could be taken by the lenders for monitoring and ensuring end-use of funds:

(a) Meaningful scrutiny of quarterly progress reports / operating statements / balance sheets of the borrowers;

(b) Regular inspection of borrowers' assets charged to the lenders as security;

(c) Periodical scrutiny of borrowers' books of accounts and the no-lien accounts maintained with other banks;

(d) Periodical visits to the assisted units;

(e) System of periodical stock audit, in case of working capital finance;

(f) Periodical comprehensive management audit of the 'Credit' function of the lenders, so as to identify the systemic-weaknesses in the credit-administration.

(It may be kept in mind that this list of measures is only illustrative and by no means exhaustive.)

2.5 Penal measures

In order to prevent the access to the capital markets by the wilful defaulters, a copy of the 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.

The following measures should be initiated by the banks and FIs against the wilful defaulters identified as per the definition indicated at paragraph 2.1 above:

a) No additional facilities should be granted by any bank / FI to the listed wilful defaulters. In addition, 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.

b) The legal process, wherever warranted, against the borrowers / guarantors and foreclosure of recovery of dues should be initiated expeditiously. The lenders may initiate criminal proceedings against wilful defaulters, wherever necessary.

c) Wherever possible, the banks and FIs should adopt a proactive approach for a change of management of the wilfully defaulting borrower unit.

d) A covenant in the loan agreements, with the companies in which the banks / notified FIs have significant stake, should be incorporated by the banks / FIs to the effect that the borrowing company should not induct a person who is a promoter or director on the Board of a company which has been identified as a wilful defaulter as per the definition at paragraph 2.1 above and that in case, such a person is found to be on the Board of the borrower company, it would take expeditious and effective steps for removal of the person from its Board.

It would be imperative on the part of the banks and FIs to 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 are 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.

2.6 <u>Guarantees furnished by group companies</u>

While dealing with wilful default of a single borrowing company in a Group, the banks / FIs should consider the track record of the **individual company**, with reference to its repayment

performance to its lenders. However, 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.

2.7 Role of auditors

In case any falsification of accounts on the part of the borrowers is observed by the banks / FIs, and if it is observed that 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.

With a view to monitoring the end-use of funds, if the lenders desire a specific certification from the borrowers' auditors regarding diversion / siphoning of funds by the borrower, the lender should award a separate mandate to the auditors for the purpose. To facilitate such certification by the auditors the banks and FIs will also need to ensure that appropriate covenants in the loan agreements are incorporated to enable award of such a mandate by the lenders to the borrowers / auditors.

2.8 Role of Internal Audit / Inspection

The aspect of diversion of funds by the borrowers should be adequately looked into while conducting internal audit/inspection of their offices/branches and periodical reviews on cases of wilful defaults should be submitted to the Audit Committee of the bank.

2.9 Reporting to RBI / CIBIL

Bank/FIs should submit 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 to Credit Information Bureau (India) Ltd. (CIBIL) and/or any other credit information company which has obtained / would obtain certificate of registration from RBI in terms of Section 5 of the Credit Information Companies (Regulation) Act, 2005 and of which it is a member, from the quarter ended on March 31, 2003. Banks/FIs should, however, submit the quarterly list of wilful defaulters where suits have not been filed only to RBI in the format given in Annex 1.

3. Grievances Redressal Mechanism

Banks/FIs should take the following measures in identifying and reporting instances of wilful default :

(i) With a view to imparting more objectivity in identifying cases of wilful default, 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.

(ii) The decision taken on classification of wilful defaulters should be well documented and supported by requisite evidence. The decision should clearly spell out the reasons for which the borrower has been declared as wilful defaulter vis-à-vis RBI guidelines.

(iii) The borrower should thereafter be suitably advised about the proposal to classify him as wilful defaulter along with the reasons therefor. The concerned borrower should be provided reasonable time (say 15 days) for making representation against such decision, if he so desires, to a Committee headed by the Chairman and Managing Director.

(iv) 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.

4. Criminal Action against Wilful Defaulters

4.1 J.P.C. Recommendations

Reserve Bank examined, the issues relating to checking wilful defaults in consultation with the Standing Technical Advisory Committee on Financial Regulation in the context of the following recommendations of the JPC and in particular, on the need for initiating criminal action against concerned borrowers, viz.

a. It is essential that offences of breach of trust or cheating construed to have been committed in the case of loans should be clearly defined under the existing statutes governing the banks, providing for criminal action in all cases where the borrowers divert the funds with malafide intentions.

b. It is essential that banks closely monitor the end-use of funds and obtain certificates from the borrowers certifying that the funds have been used for the purpose for which these were obtained.

c. Wrong certification should attract criminal action against the borrower.

4.2 Monitoring of End Use

Banks / FIs should closely monitor the end-use of funds and obtain certificates from borrowers certifying that the funds are utilised for the purpose for which they were obtained. In case of wrong certification by the borrowers, banks / FIs may consider appropriate legal proceedings, including criminal action wherever necessary, against the borrowers.

4.3 Criminal Action by Banks / FIs

It is essential to recognise that there is scope even under the existing legislations to initiate criminal action against wilful defaulters depending upon the facts and circumstances of the case under the provisions f Sections 403 and 415 of the Indian Penal Code (IPC) 1860. Banks / FIs are, therefore, advised to seriously and promptly consider initiating criminal action against wilful defaulters or wrong certification by borrowers, wherever considered necessary, based on the

facts and circumstances of each case under the above provisions of the IPC to comply with our instructions and the recommendations of JPC.

It should also be ensured that the penal provisions are used effectively and determinedly but after careful consideration and due caution. Towards this end, banks / FIs are advised to put in place a transparent mechanism, with the approval of their Board, for initiating criminal proceedings based on the facts of individual case.

5. Reporting names of Directors

5.1 Need for Ensuring Accuracy

RBI / CIBIL disseminate information on non-suit filed and suit filed accounts respectively, as reported to them by the banks / FIs and responsibility for reporting correct information and also accuracy of facts and figures rests with the concerned banks and financial institutions. Therefore, banks and financial institutions should take immediate steps to up-date their records and ensure that the names of current directors are reported. In addition to reporting the names of current directors, it is necessary to furnish information about directors who were associated with the company at the time the account was classified as defaulter, to put the other banks and financial institutions on guard. Banks and FIs may also ensure the facts about directors, wherever possible, by cross-checking with Registrar of Companies.

5.2 Position regarding Independent and Nominee directors

Professional Directors who associate with companies for their expert knowledge act as independent directors. Such independent directors apart from receiving director's remuneration do not have any material pecuniary relationship or transactions with the company, its promoters, its management or its subsidiaries, which in the judgment of Board may affect their independent judgment. As a guiding principle of disclosure, no material fact should be suppressed while disclosing the names of a company that is a defaulter and the names of all directors should be published. However, while doing so, a suitable distinguishing remark should be made clarifying that the concerned person was an independent director. Similarly the names of directors who are nominees of government or financial institutions should also be reported but a suitable remark 'nominee director' should be incorporated.

Therefore, against the names of Independent Directors and Nominee Directors, they should indicate the abbreviations “Ind" and "Nom" respectively in brackets to distinguish them from other directors.

5.3 Government Undertakings

In the case of Government undertakings, it should be ensured that the names of directors are not to be reported. Instead, a legend "Government of -------- undertaking" should be added.

Annex I

Format for submission of data on cases of wilful default (non-suit filed accounts) of Rs.25 lakh & above to RBI on quarterly basis:

The banks/FIs are required to use the following structure (with the same field names) while submitting data of wilful defaulters (non-suit filed accounts) in floppy diskettes to RBI on quarterly basis:

Field	*Field Name*	*Type*	*Wi-dth*	*Description*	*Remarks*
1	SCTG	Numeric	1	Category of bank/FI	Number 1/2/4/6/8 should be fed 1 SBI and its associate banks 2 Nationalised banks 4 Foreign banks 6 Private Sector Banks 8 Financial Institutions
2	BKNM	Character	40	Name of bank/FI	Name of the bank/FI
3	BKBR	Character	30	Branch name	Name of the branch
4	STATE	Character	15	Name of state	Name of state in which branch is situated
5	SRNO	Numeric	4	Serial No.	Serial No.
6	PRTY	Character	45	Name of Party	The legal name
7	REGADDR	Character	96	Registered address	Registered Office address
8	OSAMT	Numeric	6	Outstanding amount in Rs. lakhs (Rounded off)	
9	SUIT	Character	4	Suit filed or not	Type 'SUIT' in case suit is filed. For other cases this field should be kept blank.
10	OTHER_BK	Character	40	Name of other banks/ FIs	The names of other banks/FIs from whom the party has availed credit facility should be indicated. The names may be fed in abbreviated form e.g. BOB for Bank of Baroda, SBI for State Bank of India etc.
11	DIR1	Character	40	Name of director	(a) Full name of Director should be indicated. (b) In case of Government companies the legend "Govt. of _____ undertaking" alone should be mentioned. (c) Against the names of

					nominee directors of banks/ FIs/ Central Govt./ State Govt., abbreviation 'Nom' should be indicated in the brackets. (d) Against the name of independent directors, abbreviation 'Ind' should be indicated in the brackets. (e) In the case of Directors who held office at the time the account of the borrower entity was classified as defaulter, but are no longer on its Board, the symbol @ should be indicated in brackets against their names.
12	DIR2	Character	40	Name of director	--- do ---
13	DIR3	Character	40	Name of director	--- do ---
14	DIR4	Character	40	Name of director	--- do ---
15	DIR5	Character	40	Name of director	--- do ---
16	DIR6	Character	40	Name of director	--- do ---
17	DIR7	Character	40	Name of director	--- do ---
18	DIR8	Character	40	Name of director	--- do ---
19	DIR9	Character	40	Name of director	--- do ---
20	DIR10	Character	40	Name of director	--- do ---
21	DIR11	Character	40	Name of director	--- do ---
22	DIR12	Character	40	Name of director	--- do ---
23	DIR13	Character	40	Name of director	--- do ---
24	DIR14	Character	40	Name of director	--- do ---
		Total bytes	**841**		

(1) If total numbers of directors exceed 14, the name of additional directors may be entered in blank spaces available in the other directors' columns.

(2) The data / information should be submitted in the above format **in 3.5" floppy diskette as .dbf file only.** While submitting the floppy diskette, the banks/FIs should ensure that :

- the floppy is readable and is not corrupted / virus-affected.
- the floppy is labeled properly indicating name of the bank, name of the list and period to which the list belongs, and the name of list indicated on label and in the letter are same.
- the name and width of each of the fields and order of the fields is strictly as per the above format.

- records with outstanding amount of less than Rs.25 lakh have not been included.

- no suit-filed account has been included.

- use of following types of words have been avoided (as the fields can not be properly indexed) : ‘M/s’, ’Mr’, ‘Shri’ etc.
- the words ‘Mrs’, ‘Smt’, ‘Dr’ etc. have been fed at the end of name of the person, if applicable.

- Except for field "SUIT" and some of the fields from DIR1 To DIR 14, as applicable, information is completely filled in and columns are not kept blank.

(3) In case of 'Nil' data, there is no need to send any floppy and the position can be conveyed through a letter/fax.

(4) A certificate signed by a sufficiently senior official stating that ‘the list of wilful defaulters has been correctly compiled after duly verifying the details thereof and RBI’s instructions in this regard have been strictly followed’ is sent along with the floppy.

Annex II

List of Circulars consolidated by the Master Circular

Sr. No.	Circular No.	Date	Subject	Para No.
1.	DBOD.No.DL(W). BC.12/20.16.002(1)/98-99	20.02.1999	Collection and Dissemination of Information on Cases of Wilful Default of Rs.25 lakh and above	1
2.	DBOD.No.DL.BC. 46/20.16.002/98-99	10.05.1999	Disclosure of information regarding defaulting borrowers - Lists of Defaulters/ Suit filed accounts and Data on Wilful Default	Annex
3.	DBOD.No.DL(W).BC 161/20.16.002/99-2000	01.04.2000	Collection and Dissemination of information on defaulting borrowers of banks and Financial Institutions	5 and Annex
4.	DBOD.No.DL.BC.54 / 20.16.001/2001-02	22.12.2001	Collection and dissemination of information on defaulters	5
5.	DBOD.No.DL(W).BC110/20.16.003(1)/ 2001-02	30.05.2002	Wilful defaulters and action thereagainst	2, 2.1 to 2.8
6.	DBOD.No.DL.BC.111 / 20.16.001/ 2001-02	04.06.2002	Submission of Credit Information to Credit Information Bureau (CIB)	2.9
7.	DBOD.No.DL(W).BC 58 / 20.16.003/2002-03	11.01.2003	Wilful defaulters and Diversion of funds - Action thereagainst	2.1, 2.2
8.	DBOD.No.DL.BC. 7 / 20.16.003/2003-04	29.07.2003	Wilful Defaulters and action thereagainst	3
9.	DBOD.No.DL.BC. 94/20.16.003/2003-04	17.06.2004	Annual Policy Statement: 2004-05 - Wilful Defaulters – Clarification on Process	3
10.	DBOD.No.DL.BC.16 / 20.16.003/2004-05	23.07.2004	Checking of wilful defaults and measures against Wilful Defaulters	4