

LATEST DEVELOPMENT ON CIRCULARS FOR LOOKOUT, WILFUL DEFAULTERS AND FRAUD

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WILFUL DEFAULTERS

Briefly, a wilful defaulter is a borrower who, despite having the financial resources to repay a loan, deliberately defaults on payments. Additionally, it includes borrowers who misappropriate borrowed funds for purposes not sanctioned under the loan agreement. In both instances, a wilful defaulter is categorised by the deliberate / intentional failure to fulfill the financial debt despite possessing adequate resources.

The Reserve Bank of India (“**RBI**”) has periodically issued several circulars to banks and financial institutions, consolidating guidelines on wilful defaulters into a comprehensive Master Circular dated 1st July, 2014 (as updated on 7th July 2015) and the draft circular on Wilful Defaulters issued in September 2023.



**MASTER CIRCULAR ON WD ISSUED BY RBI DATED 1ST JULY, 2014
(UPDATED ON 7TH JULY, 2015)**

Banks have the authority to identify and classify borrowers as wilful defaulters based on specific criteria such as intentional defaults or diversion / siphoning of funds.

**DRAFT MASTER CIRCULAR ON WD ISSUED BY RBI DATED 21ST
SEPTEMBER, 2023**

After considering the various orders passed by the Hon'ble Courts, a revised circular has been published by the RBI to ensure a more transparent procedure, while conforming with the principles of natural justice.



MECHANISM FOR IDENTIFICATION OF WILFUL DEFAULTERS, 2015

Formation of Committees	A Committee is set up, this committee examines evidence to determine if a wilful default has occurred by the borrowing company/individual and, in the case of a company, its promoter/whole-time director.
Show Cause Notice	If the committee concludes that a wilful default has indeed occurred, it issues a Show Cause Notice to the borrower and the promoter / whole-time director / guarantor(s), if any. Such person is directed to issue its response / submissions to the Show Cause Notice, if any.
Opportunity for Hearing	The committee provides an opportunity for a personal hearing, to the borrower, if deemed necessary based on the submissions received.



MECHANISM FOR IDENTIFICATION OF WILFUL DEFAULTERS, 2015

Identification by the Committee	After considering the submissions and conducting any necessary hearings, the committee issues an order, identifying such person as a Wilful Defaulter, or dismissing the proceedings. The order passed is issued to the borrower for its representation on the same.
Review by Review Committee	The order issued by the identification committee, along with the borrower's representation, if any, is then forwarded to the review committee. This review committee is headed by the Chairman / CEO and MD and includes two independent directors of the bank.
Final Confirmation	The order of wilful default becomes final only after it is confirmed by the review committee, after due consideration on the representation received on the identification committee's order.



MECHANISM FOR IDENTIFICATION OF WILFUL DEFAULTERS, 2015

For Non-Promoter/Non-Whole Time Directors

For directors who are not promoters or whole-time directors, specific conditions apply:-

- a. They may be considered wilful defaulters only if it can be conclusively established that they were aware of the wilful default through board or committee proceedings and did not record their objection;
- b. if the default occurred with their consent or connivance.



IMPORTANT CASE LAWS

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

Ensured procedural fairness by mandating that borrowers declared as wilful defaulters must be notified of the decision, given an opportunity to respond within fifteen days before a Review Committee, and provided with a reasoned order based on evidence, thereby safeguarding their right to due process.

During hearings on wilful default, borrowers mainly present their version of events based on facts. Thereby, a lawyer being present may not be essential.



IMPORTANT CASE LAWS

Kanchan Motors and Ors. v. Bank of India and Ors, (2018) SCC

OnLine Bom 1761

It was clarified that both the Identification Committee and the Review Committee must issue reasoned orders, as non-speaking orders would be condemned.

Natwar Singh v. Directorate of Enforcement and Anr., 2010 SCC

OnLine SC 1128

Ensured transparency in the process by allowing parties to know the basis of initial inquiries and all evidence considered during adjudication.



IMPORTANT CASE LAWS

**Gaurav Dalmia v. Reserve Bank Of India And Others, 2020 SCC
OnLine Cal. 668**

It was held that when a Resolution Plan is passed and approved, and the default is absolved through Corporate Resolution Process and the company / entity is absolved, the default cannot continue *qua* the promoters / directors of the Company as the default has arisen from the same root cause thus, cannot be segregated.



IMPORTANT CASE LAWS

Milind Patel v. Union Bank of India and Ors., 2024 SCC OnLine Bom 745

The Master Circular requires disclosure of all relevant material, not limited to what is mentioned in the show-cause notice, to the noticee.

Banks must disclose the identities of members in the Identification and Review Committees to the noticee, and issue reasoned orders as per the court's directive.



DRAFT MECHANISM FOR IDENTIFICATION OF WILFUL DEFAULTERS, 2023

<p>Opportunity for Representation</p>	<p>The borrower can submit a written representation against any such proposal within a reasonable time (say 15 days) to the Review Committee.</p>
<p>Review Committee</p>	<p>The Review Committee shall take into consideration the proposal submitted by the Identification Committee and the representation made by the borrower.</p>
<p>Opportunity for Personal Hearing</p>	<p>The Review Committee shall provide an opportunity for a personal hearing to the borrower. If the opportunity is not availed, the Review Committee shall proceed with its decision.</p>
<p>Resolution framework</p>	<p>When a company / entity has undergone resolution and as a result of which there is a change in the management, the penal measure shall continue to apply to the erstwhile promoter(s)/ director(s)/ guarantor(s)/ persons who were in charge and responsible for the management of the affairs of the entity/ business enterprise.</p>



FRAUD

Fraud is a prevalent issue in the banking industry, posing significant threats to financial stability and public confidence. In this regard, the RBI has introduced stringent directives aimed at empowering banks to detect and promptly report fraudulent activities. These guidelines not only emphasize early detection and reporting to investigative agencies but also provide directives for internal controls and effective fraud risk management practices within banks. Empowered by these guidelines, the RBI proactively takes measures in the public interest to swiftly address fraudulent practices, thereby minimizing financial losses for banks.

The clauses within the Master Directions on Frauds are interpreted with a clear focus on their primary objective: facilitating the prompt detection, dissemination of information, and reporting of fraud, thus bolstering the resilience of the banking system against fraudulent activities.



**MASTER DIRECTION ON FRAUD (CLASSIFICATION AND
REPORTING BY COMMERCIAL BANKS AND SELECT
FINANCIAL INSTITUTIONS) ISSUED BY RBI DATED 1ST
JULY, 2016 (UPDATED ON 3RD JULY, 2017)**



MASTER DIRECTION ON FRAUD

Classification of Fraud	<ul style="list-style-type: none">a. Misappropriation and criminal breach of trust.b. Fraudulent encashment through forged instruments, manipulation of books of account or through fictitious accounts and conversion of property.c. Unauthorised credit facilities extended for reward or for illegal gratification.d. Cash shortages.e. Cheating and forgery.f. Fraudulent transactions involving foreign exchange.
	There is no requirement to issue a notice to the borrowing company or its promoters and directors
	Banks must quickly report fraud to competent authorities.



MASTER DIRECTION ON FRAUD

Penal Provision	The provision extends penal consequences, akin to those for willful defaulters, to fraudulent borrowers. This includes promoters, directors, and other full-time directors of the borrowing company
	An opportunity of hearing be provided to third parties involved in the alleged fraud.



IMPORTANT CASE LAWS

State Bank of India v. Rajesh Agarwal, (2023 SCC Online 342)

Before classifying a borrower's account as 'fraud' under the Master Directions, the borrower must be provided an opportunity to be heard.

This opportunity includes being informed of the allegations, explaining the evidence against them, and representing why the classification should not be made.



IMPORTANT CASE LAWS

SS Hemani v. The Reserve Bank of India, 2023 SCC OnLine Bom 1226

The court ruled that banks must provide an opportunity for borrowers to respond to allegations and evidence before labeling their accounts as fraudulent under regulatory guidelines.



LOOKOUT CIRCULAR

An LOC is a circular issued against an individual, wherein such an individual would be barred from leaving the borders/territory of India. Owing to an increase in the loan defaulters, vide an amendment in 2018, the MHA vide an amendment in 2018 broaden the scope of competent authorities, authorized to request for an LOC qua an accused person to incorporate - Chairman / Managing Director / Chief Executive Officer of Public Sector Undertaking Banks.



IMPORTANT CASE LAW

Viraj Chetan Shah v. Union of India & Anr and Connected Matters (W.P. No. 719 of 2020 before the Hon'ble Bombay High Court)

In a group of matters challenging the concerned LOCs and their constitutionality, issued at the instance of Public Sector Banks, the Hon'ble Bombay High Court held the following:

i. *Right to locomotion and right to travel abroad, is a fundamental right under Article 21 of the Constitution, and it cannot be curbed by an executive action without the presence of any statutory provision.*

ii. *The concerned OMs were ultra vires of Articles 14 and 21 of the Constitution.*

The OMs are ex-facie not "law"; Clause 6(B)(xv) as incorporated vide OM dated 22nd February, 2021 was arbitrary, unreasonable, and bad in law, and excessive powers were given to the executive.



IMPORTANT CASE LAW

Viraj Chetan Shah v. Union of India & Anr and Connected Matters *(W.P. No. 719 of 2020 before the Hon'ble Bombay High Court)*

All the LOCs issued at the instance of Public Sector Banks are quashed and set aside;

The Bureau of Immigration is also directed to refrain from acting upon any LOCs issued by any Public Sector Undertaking Banks;

The banks are at liberty to apply to any court or tribunal under applicable law for an order against a person indebted, restraining such person from traveling overseas. However, LOCs were not to continue against such persons.

