

Wilful defaulters in the Indian banking system

¹ Sathisha HK, ² Sowmya GS

¹ Assistant Professor Government Ramnarayan Chellaram College of Commerce and Management Race course road, Bengaluru, Karnataka, India.

² Assistant Professor Vivekananda Institute of Management Rajajinagar, Bengaluru, Karnataka, India.

Abstract

It's not the poor farmers or the middle class who are defaulting on their loans. It's the country's super rich, businessmen and the upper middle class with loan amounts of over `1 crore who account for a staggering 73% of the unpaid loans to banks. A wilful defaulter is one who has essentially not used the fund for the purpose it has been borrowed or when he has not repaid when he can do so; when he has siphoned off the funds or when he disposed of the assets pledged for availing of loan without the bank's knowledge. In a developing country banking system, the borrowing unit underreports its true financial position and defaults wilfully. It is observed that higher the loan capacity of the bank, the higher is the incidence of wilful defaulters. It is also observed that percentage of wilful defaulters is more in public sector banks compared to private banks. This study covers the concept of wilful defaulter, process of declaring wilful defaulters by the banks, RBI's guidelines and action against wilful defaulters and also implications of wilful defaults on profitability of banks and ultimate decision making process of the banks.

Keywords: Public Sector Banks, Wilful Defaulter, Bank Regulation *JEL classification:* G20, G21, G28

1. Introduction

Being a developing country, India has felt the waves of liberalization and globalization since 1991. It soon leads to a compelling requirement of financial system and thus gave a spur to the credit requirement in the market. As the volume of credit, credit agencies and credit beneficiaries increased manifold, a simultaneous increase in the risks and fraud associated with the credits also followed.

Debt contracts specifies the borrower's promise to offer repayment of loans over a period of time, with the bank being allowed to seize the whole cash flow when the repayment cannot be made. Most of the debt contracts are characterized by asymmetric information between the lender and the borrower which is thought to be the key to the persistent problem of loan default and the resulting accumulation of NPAs in the balance sheet of banks. In general, default may arise for two reasons. Firstly, it may arise because borrowers who take out loans from the banks usually have much better information than the banks about the potential risk and return associated with the investment project that the borrower plans to undertake. Secondly, if the actual cash flow generated from the investment project is the private information only of the borrower, then default may arise.

1.1 Statement of the Problem

Banks, especially government-owned lenders are reeling under pile of bad loans. Most companies and individuals that fail to pay up, do so due to economic slowdown and things going horribly wrong for factors beyond their control. But, there are some truant borrowers — corporate and individuals — who, despite having the capability to repay money, do not cough up money. They are alleged to be doing it wilfully. For lenders, getting money from them is often a long legal battle. It's not the poor farmers or the middle class who are defaulting on their

loans. It's the country's super rich, businessmen and the upper middle class with loan amounts of over `1 crore who account for a staggering 73% of the unpaid loans to banks. In this era of growing loan defaults, this paper aims at discussing the concept of wilful defaults, the persons behind it and the present status of wilful defaulters in the Indian banking system.

2. Objectives of the study

- To understand the concept of wilful defaulter, process of declaring wilful defaulters.
- To analyse the penal and criminal actions against wilful defaulters
- To analyse the current status of wilful defaulters in the Indian banking industry.

2.1 Wilful Defaulter - meaning

A wilful defaulter is somebody who has essentially not used the fund for the purpose it has been borrowed or when he has not repaid when he can do so; when he has siphoned off the funds or when he disposed of the assets pledged for availing of loan without the bank's knowledge.

2.2 Process of declaring a Wilful Defaulter – as per RBI Master Circular

According to the RBI, a wilful default is deemed to have occurred in any of the following four circumstances:

1. When there is a default in repayment obligations by the unit (company/individual) to the lender even when it has the capacity to honour the said obligations. There is deliberate intention of not repaying the loan.
2. The funds are not utilised for the specific purpose for which finance was availed but have been diverted for other purposes.

3. When the funds have been siphoned off and not been utilised for the purpose for which it was availed. Further, no assets are available which justify the usage of funds.
4. When the asset bought by the lenders' funds have been old off without the knowledge of the bank/lender.

Further, in cases where a letter of comfort or guarantees furnished by group companies of wilfully defaulting units are not honoured when they are invoked by the lender, then such group companies are also considered to be wilful defaulters.

2.3 Reporting of Wilful Defaulters to RBI

There is no minimum amount to declare a borrower as wilful defaulter. However, for reporting purposes RBI has set certain limits.

- a. All cases of wilful default (non-suit filed account) with outstanding of `25 lakh & above are required to be reported to RBI on quarterly basis only upto September 2014. But as per Credit Information Companies (Regulation) Act, 2005, banks/FIs are advised to furnish the aforementioned data in respect of wilful defaulters (non-suit filed accounts) of `25 lakhs and above for the quarter ending December 31, 2014 to CICs and not to RBI. Thereafter, banks/FIs may continue to furnish data in respect of wilful defaulters to CICs on a monthly or a more frequent basis.
- b. Banks/FIs should submit the list of suit-filed accounts of wilful defaulters of `25 lakh and above as at end-March, June, September and December every year to a credit information company. (*Experian Credit Information Company of India Private Limited, Equifax Credit Information Services Private Limited, High Mark Credit Information Services Private Limited and CIBIL*)

2.4 Penal Actions against Wilful Defaulters

Any wilful defaulter with an outstanding balance of ` 25 lakh or more, would attract the penal measures stipulated by RBI.

2.6 Current Status of Wilful Defaulters in the Indian Banking system

Table 1: Top 10 Wilful Defaulters

Company	Industry	Outstanding Amount (crore)	Wilful Defaults	Key Creditor
Usha Ispat	Metals & Mining	16,911	5,093	LIC
Lloyds Steel	Steel	9,478	6,309	Bank of India
Hindustan Cables Ltd.	Telecom Cables	4,917	0	Bank of India
Hindustan Photo films MFG Co.	Photo films	3,929	0	LIC
Zoom Developers	Real Estate	3,843	137	Oriental Bank of Commerce
Prakash Industries	Mining, Steel and Power	3,665	2,233	LIC
Cranes Software International	IT	3,580	2,505	Bank of India
Prag Bosimi Synthetics	Textile	3,558	0	IDBI
Kingfisher	Aviation	3,259	0	Punjab National Bank
Malvika Steel	Steel	3,057	0	GIC

Source: RBI

As per the recent reports released by RBI, the above 10 companies are identified as top 10 wilful defaulters. Of the 10 companies, four are public sector undertakings: Hindustan Cables, Hindustan Photo Films, Prag Bosimi and Malvika Steel (which was bought over by SAIL from Usha Group in 2009). Both Hindustan Cables and Hindustan Photo Films are declared terminally sick, and the former may shut down soon. Prag Bosimi Synthetics is the only industrial venture of public-private partnership in the Northeast. It started operations in

The following measures are required to be initiated by the banks and FIs against the wilful defaulters as per RBI guidelines:

- 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.

2.5 Criminal Action against Wilful Defaulter by Banks / FIs

Banks can initiate criminal action against wilful defaulters under the provisions of Section 403 and 415 of IPC 1860, wherever considered necessary, based on the facts and circumstances of each case.

2012 after remaining shut for a decade. Public Sector Undertaking companies have defaulted the most to public sector banks and financial institutions, which means the taxpayer loses money twice over in case the Public Sector Undertaking shuts down.

Mismanagement is evident when it comes to both the lenders and the borrowers. It is not hard to imagine the lax standards followed when public sector banks lend to public sector companies, as well as the tolerance shown for their defaults. It

also points to the subjectivity of the wilful default classification as none of these companies are labelled wilful.

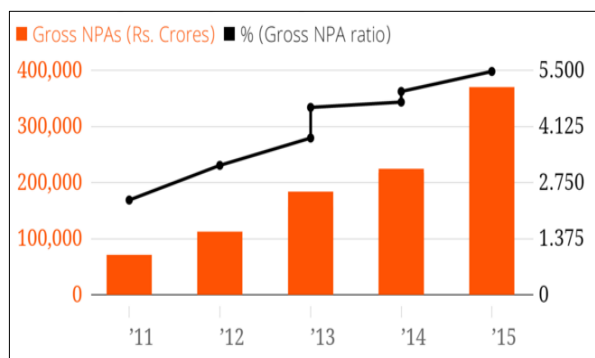
2.7 Role of Lenders, Auditors and Borrowers in Wilful Defaults

It is not normal practice the world over to put out bank defaulter names. In India it is different because the banks involved are state-owned and many of the companies are public sector undertakings. The size and seriousness of the NPAs in the Indian banking system, and public disclosure is a crucial way to put pressure on the powers that be to expedite important reforms in the way banks classify and treat defaults as well as in the way the legal system is geared to handle bankruptcies.

The lenders and the borrowers are indirectly involved in the defaults. The auditors' role in this regard is also evident from the recent incidences. Auditors are involved falsifying the borrowers' accounts, financial statements to help them in acquiring loans, showing negligence in conducting audit and reporting the actual facts and figures in their reports.

Mismanagement on the part of the borrowers is increasing day by day. The borrowers are using political influences to escape from the defaulters list.

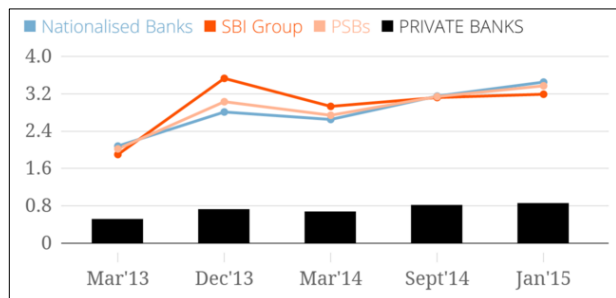
Bad debts and NPA's are shooting up in public sector banks now a days compared to private sector banks.



Source: RBI

Fig 1: Non-Performing Assets in Public Sector Banks

Non-performing assets in public sector banks rose more than five times to `3.6 lakh crore in 2015 from just `71,000 crore in 2011. Non-performing asset is one which stops generating income from a bank – such as loan instalments which aren't being received or interest payments defaults for more than 90 days of due date. As the NPAs in the banks rose, their quality of lending also seems to have worsened.



Source: RBI

Fig 2: Trends in Net Non-Performing Assets to Net Advances (%)

Private sector banks net NPA ratio is much lower than all other banks in the country. Nationalized banks NPA is 3.45% out of their net lending in 2015, Private Banks ratio is less than 1% even though it has risen over the years.

3. Conclusion

Weak monitoring and supervision of bank loans and poor enforcement mechanism characterize banking system in India. These help increase in the no. of loan defaults. Poor bankruptcy laws in the country encourage banks not to pursue efficient screening procedures. All these phenomena together help the borrowers to default willfully on their loan accounts and this in turn, leads to the mounting burden of NPAs in the balance sheet of banks which results in failure of the banking system.

The study shows that number of wilful defaulters are more in public sector banks compared to private sector banks. This may be because of carelessness in loan sanctioning procedure or may be poor recovery practices followed in public sector banks. The style of banking practices, stringent rules and regulations, proper handling of disbursement of loans and recovery practices followed by the private sector banks are much more transparent. Loan sanctioning and recovery mechanism of public sector banks needs to be improved. Public sector banks have to learn a lesson from these private sector banks.

On the other hand, the Government bailout programmes act as a safeguard against the failure of the banking system. Banks with the knowledge that they have the financial protection from the government, financial discipline on their part is weakening and threat of bankruptcy appears nothing to them. This attitude of the bankers adversely affects the health of the banking system in the country in turn affects the economy.

It is on the part of the regulators to decide whether to control NPAs in banks due to willful default or to allow the banks to extend loans as much as possible for the maximization of profit.

4. References

- Bardhan S, Marjit S. Nonperforming Assets of Indian Commercial Banks: An Analytical Exercise, in Rammohan TT, Nitsure RR, Joseph M. ed 2005.
- Becker G. Crime and Punishment: An Economic Approach, Journal of Political Economy. 1968; 76:169-217.
- Border CK, Sobel J. Samourai Accountant: A Theory of Auditing and Plunder, Review of Economic Studies, 1987; 54:525-540.
- Castelar PA, Cabral C. Credit Markets in Brazil: The Role of Judicial Enforcement and Other Institutions, in Marco Pagano, ed., Defusing Default: Incentives and Institutions, John Hopkins University Press, Washington, 2001, 157-188.
- Chan-Lee JH, Ahn S. Informational Quality of Financial Systems and Economic Development: An Indicators Approach for East Asia, ADB Institute Working Paper, 20, Tokyo, June, 2001.
- More curbs in offing for wilful defaulters Mint New Delhi. 2014
- PSU banks may shut out wilful defaulters Tiwari, Dheeraj The Economic Times Online, 2013
- RBI wants SEBI's action against wilful defaulters Accord Fintech Mumbai, 2014

9. Regulation of Financial Intermediaries in Emerging Markets, Response Books: A Division of Sage Publications, New Delhi, 210-249.
10. SBI takes battle against wilful defaulters to RBI. Mint, 2014
11. SBI wages war on wilful defaulters Mint New Delhi, 2013
12. SEBI bars wilful defaulters from markets, posts at listed firms The Economic Times Online. 2016
13. SEBI proposes restrictions on 'wilful defaulters' Mint New Delhi. 2015
14. SEBI set to get tougher with wilful defaulters Mint New Delhi. 2016
15. Wilful bank loan default crosses Rs70,000 CRORE (with top 50 defaulters owing Rs40,000 crore to public sector banks) India Business Insight Bangalore. 2014