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Draft Reserve Bank of India (Treatment of Wilful Defaulters and Large Defaulters) Directions, 2023

On September 21, 2023, the Reserve Bank of India (“RBI”) published the Draft Reserve Bank of India (Treatment of Wilful Defaulters and Large Defaulters) Directions, 2023 (“**Draft Directions**”) in exercise of their powers under Chapter III-A of the Reserve Bank of India Act, 1934 read with Sections 21, 35A, and 56 of the Banking Regulation Act, 1949 read with Section 11 of the Credit Information Companies (Regulation) Act, 2005.

On 10 May 2019, in the judgment rendered by a Division Bench of the Hon’ble Supreme Court (“SC”) in the matter of **State Bank of India vs Jah Developers Private Limited, Civil Appeal No. 4776 of 2019**, the SC had rejected the borrower’s right of representation through counsel of choice before their declaration as a ‘wilful defaulter’ in terms of the RBI Master Circular on Wilful Defaulters dated July 01, 2015 (“**2015 Circular**”). The SC observed that the 2015 Circular ought to be construed reasonably considering the ‘drastic consequences’ of being labelled a ‘wilful defaulter’. Consequentially, after comparing the mechanism for identification of wilful defaulters under 2015 Circular with the mechanism provided under the RBI Master Circular on Wilful Defaulters dated July 01, 2013 (“**2013 Circular**”) and with a view to ensure substantive compliance with the principles of natural justice, the SC read the following requirements into the mechanism envisaged under the 2015 Circular: (i) the order passed by the first committee should be provided to the borrower as soon as it is made; (ii) the borrower must be provided a period of 15 days to submit its written representation (both on law and facts) to the review committee against the order passed by the first committee; and (iii) the review committee must pass a reasoned order which must be served on the borrower.

For ease of comparison, the mechanism for identification of ‘wilful defaulters’ as per 2013 Circular, 2015 Circular, and the Draft Directions is set out in the table below:

	2013 Circular	2015 Circular	Draft Directions
The First Committee or Identification Committee	<p>The First Committee shall be headed by the Executive Director and consist of two GMs/DGMs as decided by the board.</p> <p>The role of First Committee is to identify the borrowers as ‘wilful defaulters’ as per the 2013 Circular.</p>	<p>The First Committee shall be headed by the Executive Director or equivalent and consist of two other senior officers of the rank of GMs/DGMs.</p> <p>The role of First Committee is to issue an order classifying the borrower as a ‘wilful defaulters’ as per the 2015 Circular.</p>	<p>The Identification Committee shall be headed by Whole-Time Director (other than CEO) as the chairperson and consist of two other senior officials, not below two ranks of the chairperson.</p> <p>Different constitution may be prescribed for foreign banks having presence in India only through branches or for credit facilities below a suitable threshold.</p> <p>The role of the Identification Committee is to identify the borrowers as ‘wilful defaulters’ as per the Draft Directions.</p>



	2013 Circular	2015 Circular	Draft Directions
<p>The Review Committee or Grievance Redressal Committee</p>	<p>The Grievance Redressal Committee shall be headed by the Chairman and Managing Director and consist of two other senior officials.</p> <p>The role of the Grievance Redressal Committee is to finally decide on the classification of a borrower as 'wilful defaulter' basis the recommendation of the First Committee and the representation of the borrower.</p>	<p>A Review Committee shall be headed by the Chairman/ Chairman & Managing Director or the Managing Director & CEO/ CEO and consist of two independent directors/ non-executive directors.</p> <p>The role of the Review Committee is to finally decide on the classification of a borrower as 'wilful defaulter' by consideration the order of the First Committee.</p>	<p>The Review Committee shall be headed by a Whole-Time Director (who is the CEO) as the chairperson and two independent directors as members.</p> <p>Different constitution may be prescribed for foreign banks having presence in India only through branches or for credit facilities below a suitable threshold.</p>
<p>The Classification Process</p>	<p>The decision taken by the First Committee on classification of 'wilful defaulter' should be well documented, supported by requisite evidence, and clearly spell out the reasons for such classification.</p> <p>Upon recommendation of the First Committee to classify the borrower as a 'wilful defaulter', the borrower should be suitably advised and provided a reasonable time (of 15 days) for making representation against such decision, to the Grievance Redressal Committee. The Grievance Redressal Committee should give a hearing to the borrower if the borrower represents that they have been wrongly classified as 'wilful defaulter'.</p> <p>A final declaration as 'wilful defaulter' should be made only after the Grievance Redressal Committee has taken a view on the borrower's representation and the borrower should be suitably advised of the same.</p>	<p>If the first committee concludes that an event of 'wilful default' has occurred, it shall issue a show-cause notice to the borrower and call for their submissions.</p> <p>After consideration of the borrower's submission, the First Committee shall issue an order recording the fact of default along with the reasons for the same. An opportunity of hearing may be provided, if considered necessary by the First Committee.</p> <p>The Review Committee shall review the order issued by the First Committee and such order shall become final only upon confirmation by the Review Committee.</p>	<p>If the first committee concludes that an event of 'wilful default' has occurred, it shall issue a show-cause notice to the borrower and call for their submissions.</p> <p>After consideration of the borrower's submission, the First Committee shall make a proposal to the Review Committee for classification of the borrower as 'wilful defaulter' along with the reasons for the same.</p> <p>Upon recommendation of the First Committee to classify the borrower as a 'wilful defaulter', the borrower should be suitably advised and provided a reasonable time (of 15 days) for making representation against such decision, to the Review Committee.</p> <p>The Review Committee shall provide an opportunity of personal hearing to the borrower.</p> <p>A final declaration as 'wilful defaulter' should only be made through a reasoned order after the Review Committee has taken a view on the borrower's representation and the borrower should be suitably advised of the same.</p>



	2013 Circular	2015 Circular	Draft Directions
Opportunity of representation	Once. After the recommendation by the First Committee (to the Grievance Redressal Committee).	Once. Before the issuance of order by the First Committee (to the First Committee).	Twice. Before the recommendation of the First/ Identification Committee (to the Identification Committee) and before the consideration of Identification Committee's proposal by the Review Committee (to the Review Committee).
Opportunity of hearing	Once. Before the Grievance Redressal Committee.	Discretionary. Before the First Committee.	Once. Before the Review Committee.
Requirement of a reasoned order	Both by the First Committee and the Grievance Redressal Committee.	By the First Committee.	Both by the First Committee and the Review Committee.

It appears that the RBI, being cognizant of the possibility of judicial challenges on the grounds of violation of the principles of natural justice, has sought to lay down a watertight mechanism for classification of borrowers as 'wilful defaulter' that incontrovertibly provides a reasonable opportunity of hearing to the borrowers through the Draft Directions.

Incidentally, in the case of **State Bank of India vs. Rajesh Agarwal, Civil Appeal No. 7300 of 2022**, the SC had recently read the principles of natural justice into the Reserve Bank of India (Frauds Classification and Reporting by Commercial Banks and Select FIs) Directions 2016 ("**Fraud Directions**"). Therefore, a clarification might also be expected with respect to the Fraud Directions, given the RBI's pro-activeness in resolving the same issue vis-à-vis the 2015 Circular.

Please feel free to address any further questions or request for advice to:

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