

RAJASTHAN FINANCIAL CORPORATION
(FR SECTION)

No RFC/23FR/HO: Policy-28-C/806

Dated : 21.08.2008
22

CIRCULAR
(FR No. 531)

Reg : Wilful defaulters and action thereagainst

SIDBI vide circular FI No. 4/2008-09 dated 04.07.08 (copy enclosed at Annexure 'A') has redefined the term "Wilful default" pursuant to the orders of Hon'ble Supreme Court in civil writ petition No.291 of 1998 titled Common cause (a registered society) v/s Union of India & anothers. This term of "wilful default" has been redefined in supersession of earlier definition given vide circular No.2/2003-04 dated 27.05.2003 issued (copy enclosed at Annexure 'B') by SIDBI 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 utilized 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 utilized for the specific purpose for which finance was availed of, nor are the funds available with the unit in the form of other assets.
- d. The unit has defaulted in meetings its payment / repayment obligation to the lender and has also disposed off or removed the movable fixed assts or immovable property given by him or it for the purpose of securing a term loan without the knowledge of the bank/ lender.

Regarding penal measures, it has been reiterated that 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 for floating new ventures for a period of 5 years from the date the name of the defaulter is published in the list of wilful defaulters by the RBI.

Thus, there is no change in the penal measures to be initiated by the SFCs against the wilful defaulters and the earlier guidelines have been reiterated. However, a sub clause 'd' as reproduced below, has been added to the definition of wilful default:

"(d) The unit has defaulted in meeting its payment / repayment obligation to the lender and has also disposed off or removed the movable fixed assts or immovable property given by him or it for the purpose of securing a term loan without the knowledge of the bank / lender."

All concerned are advised to take necessary action as per revised guidelines issued by SIDBI vide referred circular FI No. 4/2008-09 dated 04.07.08. As a first step, they should screen the cases with regard to the unit having aggregate outstanding of Rs.25.00 lac and above. They are further directed to mention the justification in detail while categorizing the case in a particular category as wilful defaulter on the basis of proof in support of such justification. This information should reach GM(D) latest by 7th of every month positively so as to place it before "Default Review Committee" for taking a view.

The revised definition of wilful defaulters shall also be binding upon the one time settlement schemes and PG provisions.

All concerned are advised to take a note of above for strict compliance and send details about the "wilful defaulters" to the GM(D) on monthly basis.


(A.K.Garg)
Chairman & Managing Director

Encis. as above.

Copy to:

1. All ROs/BOs/SOs
2. DGM(A&I), (WZ), Ajmer / Jodhpur
3. Standard circulation at HO.



भारतीय लघु उद्योग विकास बैंक
SMALL INDUSTRIES DEVELOPMENT BANK OF INDIA

ANNEXURE "A"

संदर्भ सं. सिडबी / डीएफआईडी/एसएफसीज

Ref.No:SIDBI 1114 /DFID/ SFCs

जुलाई /July 4, 2008

राज्य वित्त निगमों के अध्यक्ष तथा प्रबंध निदेशक

The Chairman / MDs of SFCs

परिपत्र एफआईसं./Circular FI No. 4/ 2008-09

महोदया/प्रिय महोदय

Madam / Dear Sir,

इरादतन चूककर्ता और उनके खिलाफ कार्रवाई

Wilful defaulters and action thereagainst

कृपया दिनांक 27 मई, 2003 के हमारे परिपत्र सं. 2/2003-04 का संदर्भ लें, जिसमें 'इरादतन चूक' शब्द परिभाषित किया गया है। हम अब सूचित करते हैं कि कॉमन कॉज (एक पंजीकृत सोसाइटी) बनाम भारतीय संघ व अन्य शीर्षक वाली समादेश याचिका 1998 के सिविल सं. 291 के संबंध में, माननीय उच्चतम न्यायालय के आदेशों के अनुक्रम में, भारतीय रिजर्व बैंक ने 'इरादतन चूक' शब्द की अपनी पूर्व परिभाषा का अधिक्रमण करते हुए, उसे पुनः परिभाषित किया है, जो संलग्नक में दी गई है।

Please refer to our Circular No.2/2003-04 dated May 27, 2003 on the above subject wherein a term 'wilful default' has been defined. We now advise that in pursuant to the Hon'ble Supreme Court's Order relating to writ petition Civil No.291 of 1998 titled Common Cause (A registered Society) Vs Union of India & Anr., RBI has redefined the term 'wilful default' in supersession of its earlier definition, as given in Annexure.

2. इसके अलावा, हम आपका ध्यान बैंक के दिनांक 27 मई, 2003 के उपर्युक्त परिपत्र के अनुच्छेद 5 की ओर दिलाते हैं और यह भी दोहराते हैं कि बैंक/ वित्तीय संस्थाएँ सूचीबद्ध इरादतन चूककर्ताओं को कोई अतिरिक्त सुविधा मंजूर न करें। साथ ही, जिन उद्यमियों/प्रवर्तकों के बारे में बैंक/ वित्तीय संस्थाओं ने यह पहचान कर ली है कि उन्होंने निधियों को साइफन/निधियों का विपथन किया है, गलत रिपोर्टिंग की है, झूठा लेखांकन किया है और लेनदेन में धोखाधड़ी की है, उन्हें नए उद्यम शुरू करने के लिए संस्थागत वित्त से पाँच वर्ष तक वंचित रखा जाए। संस्थागत वित्त से वंचित रखने की उक्त पाँच वर्ष की अवधि की गणना भारतीय रिजर्व बैंक की इरादतन चूककर्ताओं की सूची में नाम प्रकाशन की तिथि से की जाएगी।

Rajasthan Financial Corporation
FINANCE SECTION

21/7/08

बैंक हिन्दी में पत्राचार का स्वागत करता है।

एसएनई विकास केन्द्र, सी-11, जी-ब्लॉक, बान्द्रा-कुर्ला कॉम्प्लेक्स, बान्द्रा (पूर्व), मुंबई - 400 051. दूरभाष: 022-67531100. फैक्स: 022-67531236.
SME Development Centre, C-11, G-Block, Bandra-Kurla Complex, Bandra (E), Mumbai - 400 051. Tel.: 022-67531100. Fax: 022-67531236.

www.sidbi.in

Further, we also invite your attention to para 5 of Bank's aforesaid Circular dated May 27, 2003 and reiterate that 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 for floating new ventures, for a period of five years from the date the name of the defaulter is published in the list of wilful defaulters by the RBI.

3. उक्त निर्देश तत्काल प्रभाव से लागू होंगे।

These instructions will come into force with immediate effect.

4. राज्य वित्त निगमों को सूचित किया जाता है कि वे यह परिषद निर्देशक मण्डल की अगली बैठक में सूचनार्थ प्रस्तुत करें।

SFCs are advised to place this Circular at the next meeting of the Board of Directors for information.

कृपया पावती भेजें।

Please acknowledge receipt.

भवदीय/Yours faithfully,

(के. सत्त्वानंदन /K. Sathianandan)

महाप्रबंधक/General Manager

अनु/Encl. : संलग्नक/Annexure

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संलग्नक/Annexure

दिनांक 27 मई, 2003 के सिडबी परिपत्र सं.2/2003-04 का आशोधित अनुच्छेद 1

Modified para 1 of the

SIDBI Circular No.2 /2003-04 dated May 27, 2003

उपर्युक्त परिपत्र में दी गई परिभाषा/दृष्टांत का अधिक्रमण करते हुए, 'इरादतन चूक' शब्द निम्नवत् पुनः परिभाषित करने का निर्णय किया गया है :

It has been decided to redefine the term 'wilful default', in supersession of the definition / illustrations contained in the above Circular, as follows :

1. परिभाषाएँ /Definitions

यदि निम्नांकित में से कोई घटनाक्रम घटित होता है /देखा जाता है, तो उसे इरादतन चूक माना जाएगा ।

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

- a. यदि इकाई अपने दायित्व पूरे करने में मग्न होते हुए भी ऋणदाता को देयताओं का भुगतान / चुकौती करने में चूक करती है ।

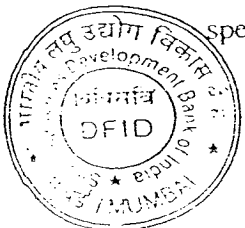
The unit has defaulted in meeting its payment / repayment obligations to the lender even when it has the capacity to honour the said obligations. ✓

- b. यदि इकाई ने ऋणदाता को देयताओं का भुगतान / चुकौती के अपने दायित्व में चूक की हो और जिस विशिष्ट उद्देश्य के लिए ऋणदाता से ऋण लिया था, उसके लिए उपयोग करने के बजाय, अन्य प्रयोजनों के लिए निधियों का विपथन किया हो ।

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. यदि इकाई ने ऋणदाता को देयताओं का भुगतान / चुकौती के अपने दायित्व में चूक की हो और निधियों को साइफन किया हो, जिसके फलस्वरूप जिस विशिष्ट उद्देश्य के लिए ऋणदाता से ऋण लिया था, न तो उसके लिए ऋण का उपयोग किया गया हो और न ही निधि इकाई के पास किसी अन्य आम्नि के रूप में उपलब्ध हो ।

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 ✓



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the unit in the form of other assets.

- d. यदि इकाई ने ऋणदाता को देयताओं का भुगतान / चुकौती के अपने दायित्व में चूक की हो और बैंक / ऋणदाता को सूचित किए बिना, सावधि ऋण की सुरक्षा के लिए उसके द्वारा प्रतिभूति के रूप में दी गई चल स्थिर आस्तियों अथवा अचल संपत्ति का निपटान कर दिया हो या उन्हें हटा दिया हो।

The unit has defaulted in meeting its payment / repayment obligation to the lender and has also disposed off or removed the movable fixed assets or immovable property given by him or it for the purpose of securing a term loan without the knowledge of the bank / lender.





Small Industries Development Bank of India
Barrister Bhawan 120, 1st Flr, K. Shah Marg, Nauman Point, Mumbai - 400 012

ANNEXURE "B" (3)

May 27, 2003

HO: 1339 / DFID/ OTS

The CMD/MDs of SFCs

Pt. put up on
concerned file

Dear Sir / Madam

Circular No. 2/ 2003- 04 Sl. No. Sharma

Wilful defaulters and action thereagainst

As you are aware, in May 2001 the Reserve Bank of India had, in consultation with the Government of India, constituted 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 Parliament's Standing Committee on Finance on Financial Institutions. Based on the recommendation of the Committee, RBI has already advised all scheduled commercial banks and notified All India Financial Institutions to implement the guidelines pertaining to wilful defaulters and actions there against. It has since been decided that SFCs should adopt similar guidelines with regard to identification of wilful defaulters. Accordingly, we now advise, for implementation by SFCs, with immediate effect, the following guidelines:

1. Definitions

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

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

हैलीफोन : 22851274 • फैक्स : 22835775 • टेलीक्स : 11-85016 • कार्ड / अनुविज्ञापन • पोस्ट बॉक्स नं. 99

Tel : 22851274 • Fax : 22835775 • Telex : 11-85016 • Telegram : "LAGHUMIKAS" • Post Bag No. 99

बैंक हिन्दी में प्रकाशित का प्रमाण प्रस्तुत है ।

2. Diversion and siphoning of funds

The terms "diversion of funds" and "siphoning of funds" should be construed to mean the following:-

2.1 **Diversion of funds**, referred to at para 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 **Siphoning of funds**, referred to at para 1(c) above, should be construed to occur if any funds borrowed from SFCs 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.

3. Cut-off limits

While the penal measures indicated at para 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, as on the date of this circular, would attract the penal measures stipulated at para 5 below. This limit of Rs. 25 lakh

(6) (2)

may also be applied for the purpose of taking cognisance of the instances of 'siphoning' / 'diversion' of funds.

4. End-use of Funds

In cases of project financing, the SFCs seek to ensure end use of funds by, *inter alia*, obtaining certification from the Chartered Accountants for the purpose. In case of short-term 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 were above board. The SFCs, 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 SFCs 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.

(This list of measures is only illustrative and by no means exhaustive.)

5. Penal measures

5.1 It is suggested that the following measures should be initiated by the SFCs against the wilful defaulters identified as per the definition indicated at paragraph 1 above:

- a. No additional facilities should be granted by any SFC to the listed wilful defaulters. In addition, the entrepreneurs /

promoters of companies where SFCs 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. Similarly, SFCs should also not entertain the proposals from the entrepreneurs / promoters whose name are figuring in the wilful defaulter list of 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 SFCs 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 SFCs have significant stake, should be incorporated by the SFCs to the effect that the borrowing company should not induct a person who is a director on the Board of a company which has been identified as a wilful defaulter as per the definition at paragraph 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.

5.2 It would be imperative on the part of the SFCs 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 is 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.

5.3 While dealing with wilful default of a single borrowing company in a Group, the SFCs 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 SFCs, such Group companies should also be reckoned as wilful defaulters.

6. Role of auditors

6.1 In case any falsification of accounts on the part of the borrowers is observed by the SFCs, they should lodge a formal complaint against the auditors of the borrowers with the Institute of Chartered Accountants of India (ICAI) if it is observed that the auditors were negligent or deficient in conducting the audit to enable the ICAI to examine and fix accountability of the auditors.

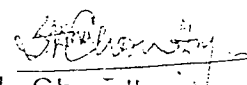
6.2 With a view to monitoring the end-use of funds, if the lenders desire a specific certification from the borrowers' auditors regarding diversion / siphoning of funds by the borrower, the lender should award a separate mandate to the auditors for the purpose. To facilitate such certification by the auditors, the SFCs 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.

7. In terms of definition of wilful default vide para 1 above, SFCs are advised to compile the list of wilful defaulters with aggregate principal outstanding of Rs. 25 lakh and above as on March 31, 2002 and 2003 and furnish the data to SIDBI.

8. SFCs are advised to place this circular at the next meeting of the Board of Directors for information. SFCs may also formulate suitable reporting system, along with the action taken thereon, to be put up to the Board periodically.

9. Please acknowledge receipt.

Yours faithfully,


(S. L. Choudhury)
General Manager