Look-Out Circulars to Wilful Defaulters

For Prelims: Willful Defaulter**,** NPA**,** RBI**,** Public sector banks (PSBs).

For Mains: Challenges, Prevention of Wilful Defaulters, Provisions to NPA resolution, Banking Sector, Issues and Provisions related to Debt Recovery.

Source: IE

Why in News?

Since 2018, six **Public Sector Banks (PSBs)** have issued 1,071 **Look-out Circulars (LOCs)** in order to prevent **wilful defaulters** from absconding to other countries.

- Wilful defaulters are **borrowers who deliberately or intentionally fail to repay their debts,** even though they have the capacity to do so.

What is a Look-Out Circular (LOC)?

- **About:**
  - It is a notice to **stop any individual** wanted by the police, investigating agency or even a bank from leaving or entering the country through designated land, air and sea ports.
  - The **Bureau of Immigration**, under the Ministry of Home Affairs, is responsible for preventing such individuals from entering or leaving the country if there is a notification against them.
    - There are a total of **112 immigration check posts** located throughout the country.
- **Who Can Issue LOCs:**
  - A large number of agencies can issue lookout circulars;
    - **Central Bureau of Investigation (CBI)**
    - **Enforcement Directorate (ED)**
    - **Directorate of Revenue Intelligence (DRI)**
    - **Income Tax department**
    - **State police and intelligence agencies.**
  - The officer who issues a LOC should not be below the rank of a **district magistrate or superintendent of police** or a **deputy secretary** in the Union Government.
- **Modification & Validity:**
  - LOC can be modified; deleted or withdrawn only at the request of the **originator.**
  - LOC will remain valid for a **maximum of 12 months**, and if there is no new request from the agency, it will **not be automatically renewed.**
  - The Bureau of Immigration, is responsible for maintaining and taking action against individuals with LOC at **Immigration Check Posts (ICPs)** as directed by the originating agency.
- **Power of PSBs to Issue LOCs:**
  - Earlier, as of 2018, **banks were also authorised to issue LOCs** against individuals who

could potentially harm the economic interests of the country.
    - However, recently the Bombay **High Court** ruled that **PSBs** cannot issue LOCs against alleged loan defaulters, deeming it a violation of **fundamental rights** in the absence of a statute or law.
        - This ruling overturns the **2018 Government Office Memorandums**, which had empowered banks to issue LOCs.

Who are Wilful Defaulters?

- The **Reserve Bank of India (RBI)** defines wilful defaulters as borrowers who meet one or more of the following criteria:
    - **Deliberate non-payment** of dues despite having sufficient funds.
    - **Diverting loan funds** for purposes other than what they were borrowed for.
    - **Syphoning off loan funds** so they are unavailable for repayment.
- **Minimum Threshold:** The minimum loan amount for a borrower to be labelled a wilful defaulter is Rs 25 lakh and above.
    - A large defaulter **refers to a borrower with an outstanding balance of Rs 1 crore or more**, whose account has been categorized as doubtful or a loss.

What are the Economic Implications of Wilful Defaulters?

- **Credit Market Impact:**
    - **Liquidity Constraints**: Wilful defaulters struggle to secure new loans due to liquidity constraints. Lenders are hesitant to provide them with additional credit or financing for fresh business ventures.
    - **Market Reputation:** Being labelled a wilful defaulter tarnishes the borrower's reputation, affecting their ability to raise capital or secure loans in the future.
        - As of December 2023, banks had categorised 17,713 accounts involving loans of Rs 353,129 crore as wilful defaults.
- **Equity Markets and IPOs:**
    - **SEBI Restrictions:** The **Securities and Exchange Board of India (SEBI)** prohibits companies with wilful defaulters (including promoters or directors) from launching **Initial Public Offers (IPOs)** or issuing **equity shares.**
        - This restriction hampers companies' growth prospects and investor confidence.
- **Insolvency and Bankruptcy Code (IBC):**
    - Exclusion from Resolution Plans:
        - The IBC **specifically prohibits wilful defaulters from submitting resolution plans** for the company they defaulted on.
        - Allowing wilful defaulters to participate in resolution plans could create a moral hazard, risking creditors, and discouraging responsible borrowing.
- **NPA Accumulation:**
    - Wilful defaults contribute to the rise in **Non-Performing Assets (NPAs)** within the banking system which can reduce bank profits and shareholder value, affecting the overall economy.

How Wilful Defaulters can be Prevented by Banks?

- **Debt Recovery Tribunals (DRTs):**
    - It aims to provide a **fast-track mechanism for loan recovery,** where banks can file cases with DRTs for swift debt recovery and asset attachment.
        - It was established under the **Recovery of Debts Due to Banks and Financial Institutions Act 1993.**
- **IBC & National Company Law Tribunal (NCLT):**
    - For large defaults involving companies, banks can approach the **National Company Law Tribunal (NCLT)** under the **IBC 2016.**
    - The IBC provides a **time-bound framework** for resolving insolvency and recovering dues.
        - The success rate of loan recovery through the IBC has been improving. As of March 2023, the **Insolvency and Bankruptcy Board of India (IBBI)** reported a

resolution value of Rs 8.3 lakh crore (USD1.03 trillion) achieved through IBC cases.

- **Utilising the Securitization and Reconstruction of Financial Assets and Enforcement Securities Act, 2002:**
  - **SARFAESI Act** empowers banks to take possession of **secured assets** like land and buildings in case of defaults without lengthy court procedures. This can deter defaults by making the consequences of non-payment quicker and more tangible.
- **Reserve Bank of India (RBI) Guidelines:**
  - **RBI** guidelines on **KYC, Anti Money Laundering** emphasise thorough due diligence before loan approvals.
    - KYC requires banks to collect **detailed borrower information to identify individuals or businesses** with financial risks or suspicious activities.
    - Anti-Money Laundering provisions will help **identify potential money laundering schemes** and can avoid lending to those who might be planning to deliberately default.
- **Legal Action and Blacklisting**: Banks should initiate criminal proceedings against wilful defaulters when necessary.
  - By blacklisting a wilful defaulter will make it **very difficult to get any loans or investments in the future,** which discourages him from intentionally not paying back their loans.

Drishti Mains Question:

Q. Analyse the economic implications of wilful defaulters and suggest a comprehensive strategy to effectively deal with wilful defaulters.

UPSC Civil Services Examination, Previous Year Question (PYQs)

Prelims

Q. With reference to the governance of public sector banking in India, consider the following statements: (2018)

1. Capital infusion into public sector banks by the Government of India has steadily increased in the last decade.
2. To put the public sector banks in order, the merger of associate banks with the parent State Bank of India has been affected.

Which of the statements given above is/are correct?

(a) 1 only
(b) 2 only
(c) Both 1 and 2
(d) Neither 1 nor 2

Ans: (b)