



Compromise Settlement for Wilful Defaulter: RBI

For Prelims: [Debt Recovery Tribunals \(DRTs\)](#), [NPA](#), [National Asset Reconstruction Ltd \(NARC\)](#), [The Reserve Bank of India \(RBI\)](#), [India Debt Resolution Company Ltd](#), [SARFAESI Act](#), [Insolvency and Bankruptcy Code \(IBC\)](#), [Banking Regulation Act, 1949](#)

For Mains: Challenges of NPA, Provisions to NPA resolution

Why in News?

Recently, The [Reserve Bank of India \(RBI\)](#) has introduced a circular allowing wilful defaulters and companies involved in fraud to opt for compromise settlements or technical write-offs.

- The circular provides guidelines for banks and finance companies in handling such cases.

What are the Key Points Related to Circular?

▪ About the Circular:

◦ **Compromise Settlements and Technical Write-Offs:**

- Banks and finance companies can undertake **compromise settlements or technical write-offs** for accounts **categorized as wilful defaulters or fraud**, irrespective of ongoing criminal proceedings against the debtors.
- The RBI's circular **enables these settlements** while **ensuring that criminal proceedings remain unaffected**.

◦ **Cooling Period for Fresh Loans:**

- Banks are required to impose a **minimum cooling period of 12 months** before granting fresh loans to borrowers who have undergone compromise settlements.
- The **cooling period** also **applies to exposures other than farm credit**, with regulated entities having the authority to set longer cooling periods based on their board-approved policies.

▪ Concerns:

◦ **Potential Loss of Public Money:**

- Banks have **previously approved compromise settlements** resulting in **significant losses** due to substantial **haircuts** on outstanding payments.
- There are concerns that allowing compromise settlements may **encourage big fraudsters and defaulters**.
- Allowing compromise settlements will bring low NPA artificially, even though financial policies are unstable.
- The Public sector banks account for a major share of the total Gross NPAs. The **NPAs of Public sector banks constitute around 72%** of the total, with the Private Sector Banks, Foreign Banks & Small Financial Institutions accounting for the rest.
 - PSBs are recapitalised by Govt. Which leads to loss of public money.

◦ **Issues with Debt Recovery Tribunals (DRTs):**

- Instances have been reported where banks entered into compromise settlements

without informing [Debt Recovery Tribunals \(DRTs\)](#).

- The **DRT, Ernakulam** observed a case where a settlement was reached, but the bank failed to obtain the consent decree and concealed the settlement from the DRT for an extended period.
- It is also **diluting importance of both Asset Reconstruction Company and IBC**.
- **Benefits of Compromise Settlements:**
 - **Reduces Cost:**
 - Compromise **settlements facilitate early recovery of dues and save costs** for banks by reducing legal expenses and other associated costs.
 - The underlying objective is to recover dues to the maximum extent possible within a shorter time frame.
 - **Technical Write-Offs and NPA Reduction:**
 - Banks have utilized write-offs to reduce [non-performing assets \(NPAs\)](#) over the past decade, resulting in lower reported NPA levels.
 - **Write-offs were used for accounting and tax purposes**, but concerns exist that this practice **allowed banks and corporates to "evergreen" their loan books**.
 - Compromise Settlements **aims to provide vital humanitarian assistance** to financially burdened companies facing Non-Performing Assets (NPA) resulting from unforeseen market risks.

What is a Non-Performing Asset?

- **About:**
 - NPA **refers to a classification for loans or advances** that are in **default or are in arrears on scheduled payments of principal or interest**.
 - In most cases, **debt is classified as non-performing, when the loan payments have not been made for a minimum period of 90 days**.
 - For agriculture, if principle and interest is not paid for two cropping seasons, the loan is classified as NPA.
 - **Gross NPA:**
 - Gross NPAs are **the sum of all the loans that have been defaulted by the individuals**
 - **Net NPA:**
 - Net NPAs are the **amount that is realised after provision amount has been deducted from the gross non-performing assets**.
- **Laws and provisions related to NPAs:**
 - **Bad Bank:**
 - The bad bank in India is called [National Asset Reconstruction Ltd \(NARC\)](#).
 - This NARC will **work as an asset reconstruction company**.
 - It will buy bad loans from the banks, relieving them of the NPA. NARC will then attempt to sell the stressed loans to distressed debt buyers.
 - The government has already set up [India Debt Resolution Company Ltd \(IDRCL\)](#) to sell these stressed assets in the market. Accordingly, IDRCL will attempt to sell them in the market.
 - **The Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest (SARFAESI) Act, 2002:**
 - The [SARFAESI Act](#) **allows banks and financial institutions** to take possession of collateral assets and sell them to recover outstanding dues without the intervention of the court.
 - It **provides provisions** for the **enforcement of security interests** and **allows banks to issue demand notices** to defaulting borrowers.
 - **The [Insolvency and Bankruptcy Code \(IBC\), 2016:](#)**

- The IBC **provides a comprehensive framework** for the insolvency and bankruptcy resolution process in India.

- It **aims to facilitate the time-bound resolution** of stressed assets and promote a creditor-friendly environment.

- Under the IBC, **a debtor or creditor can initiate insolvency proceedings** against a defaulting borrower.

- It establishes the National Company Law Tribunal (NCLT) and the [Insolvency and Bankruptcy Board of India \(IBBI\)](#) to oversee the process.
- **The Recovery of Debts Due to Banks and Financial Institutions (RDDBFI) Act, 1993:**
 - The RDDBFI Act **establishes Debt Recovery Tribunals (DRTs)** for the expeditious adjudication and recovery of debts due to banks and financial institutions.
 - DRTs have the power to hear and decide cases related to the recovery of defaulted loans exceeding a specified threshold.
- **The Indian Contract Act, 1872:**
 - The Indian Contract Act **governs the contractual relationship between lenders and borrowers.**
 - It establishes the **legal framework for loan agreements, terms and conditions, default, and remedies** available to lenders in case of non-payment.

Way Forward

- **Recovery Proceedings and Consent Decree:**
 - Banks must consider **ongoing recovery proceedings under judicial forums** while negotiating compromise settlements.
 - Settlements **should be subject to obtaining a consent decree** from the relevant judicial authorities.
- **Importance of NPA Recovery:**
 - The recovery of NPAs is **crucial to protect the interests of depositors** and stakeholders.
 - Compromise settlements **should prioritize the maximum recovery of dues** with minimal expense and within a shorter timeframe.
- **Consideration of Public Interest:**
 - During compromise settlements, banks, being public sector entities, **should consider the interests of the tax-paying public over the borrowers'** interests.

Who is Wilful Defaulter?

- When the borrower (individual or company) defaults on their payment obligation, even when it has the capacity to honour the said obligations. There is a deliberate intention of not repaying the loan.
- When the funds are not utilized for the specific purpose for which finance was availed but the borrower is found to have diverted the availed funds for a purpose other than what was defined in the loan agreement.
- When the funds are suspected to be siphoned off by the borrower and have not been used for the purpose for which it was borrowed. Further, no assets are available that justify the usage of such funds.
- When the funds acquired by the buyer/ lender have been sold off without the knowledge of the bank/lender.

UPSC Civil Services Examination, Previous Year Question (PYQ)

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)

Exp:

- The government has done capital infusion in state owned banks to support credit expansion and to help them tide over losses resulting from the provisions that are to be made for non-performing assets (NPAs). But the capital infusion trend in state-owned banks has not been specific in a direction, like increasing or decreasing trend. While it has increased in some years, it has also decreased in a few years. Hence, statement 1 is not correct.
- Union Government in February 2017 had approved the merger of five associate banks along with the Bharatiya Mahila Bank with SBI. The purposes of the merger were rationalisation of public bank resources, reduction of costs, better profitability, and lower cost of funds leading to a better rate of interest to the public at large and improve productivity and customer service of the public sector banks. Parliament passed the State Banks (Repeal and Amendment) Bill, 2017 to merge six subsidiary banks with State Bank of India to affect rationalisation of public bank.
- Hence, statement 2 is correct.

Source: IE

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