



**KARNATAKA STATE FINANCIAL  
CORPORATION**  
**HEAD OFFICE:**  
KSFC Bhavana, No.1/1, Thimmaiah Road,  
Bangalore – 560 052. Tel.No.080-22263322



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Date: 05.12.2017

### **C I R C U L A R N O. 929**

#### **Sub:Identification & Declaration of Wilful Defaulters.**

The Board in its meeting held on 03.11.2017 deliberated on the Master Circular dated 01.07.2015 issued by Reserve Bank of India as directed by SIDBI vide their letter dated 03.05.2017 regarding identification of Wilful Defaulters and to disseminate their credit information with Banks and Financial Institutions through Credit Information Companies, so as to ensure no further bank finance is made available to them.

The Board approved the following guidelines for adoption in the Corporation and constituted two Committees as under :

A) Identification Committee consisting of following members :

1. Executive Director (I) : Chairman
2. Executive Director (II) : Member
3. General Manager (Circle-IV) : Member
4. General Manager (Circle-II) : Member
5. Gen.Manager (IA) : Convener
6. Special Officer to Chairman : Special Invitee

B) Review Committee :

The Executive Committee of the Board will be the Review Committee.

The detailed guidelines to proceed with is as follows :-

#### **1.1 Definition of Wilful Default :**

A wilful default would 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 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) 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.

d) The unit has defaulted in meeting its payment / repayment obligations to the lender and has also disposed off or removed the movable fixed assets or immovable property given for the purpose of securing a term loan without the knowledge of the Lender.

The identification of the Wilful Default should be made keeping in view the track record of the borrowers and should not be decided on the basis of isolated transactions / incidents. The default to be categorised as Wilful must be intentional, deliberate and calculated.

**1.2 Diversion of funds :** 'Diversion of funds' would include any one of the under noted 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 borrowed 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 the lenders.

f) Shortfall in deployment of funds vis-a-vis the amounts disbursed / drawn and the difference not being accounted for.

**1.3 Siphoning of funds :** Siphoning of funds should be construed to occur if any funds borrowed from the Corporation are utilised for purposes unrelated 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 instant amounts to siphoning of funds would have to be a judgment of the lenders based on objective facts and circumstances of the case.

Except in very rare cases a non-whole time director should not be considered as a wilful defaulter unless it is conclusively established that :

i. He was aware of the fact of wilful default by the borrower by virtue of any proceedings recorded in the minutes of meeting of the board or a Committee of the Board and has not recorded his objections to the same in the minutes, or

ii. the wilful default had taken place with his consent or connivance.

The above exception will not apply to a promoter director even if not a whole time director.

**1.4 Cut-Off Limits :** Any wilful defaulter with an outstanding balance of Rs.25.00 lakhs or more would attract penal measures. This limit of Rs.25.00 lakhs may also be applied for the purpose of taking cognizance of the instances of siphoning / diversion of funds.

**1.5 End Use of Funds :** The Corporation should not depend entirely on the certificates issued by the Chartered Accountants but strengthen their internal controls and the credit risk management systems to ensure end use of funds and to enhance the quality of that loan portfolio.

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, incase of working capital finance.
- f) Periodical comprehensive management audit of the 'credit' function of the lenders so as to identify the systematic weaknesses in their credit administration.

#### **1.6 Penal Measures :**

The following measures should be initiated by Financial Institutions against the wilful defaulters identified :

- a) No additional facilities should be granted to the listed wilful defaulters. In addition, such companies (including their entrepreneurs / promoters) where Corporation has identified siphoning / diversion of funds, mis-representation, falsification of accounts and fraudulent transactions should be debarred from institutional finance from the scheduled commercial banks, financial institutions, NBFCs, for floating new ventures for a period of 5 years from the date of removal of their name from the list of wilful defaulters as published / disseminated by RBI / Credit Information Companies (CICs).
- b) The legal process, wherever warranted, against the borrowers / guarantors and foreclosure for recovery of dues should be initiated expeditiously. The lenders may initiate criminal proceedings against wilful defaulters, wherever necessary.
- c) Wherever possible, the Corporation should adopt a pro-active approach for change of management of the wilfully defaulting borrower unit.
- d) A covenant in the loan agreements, with the companies to which the Banks / FIs have given funded / non-funded credit facility, should be incorporated by the Banks / FIs to the effect that the borrowing company should not induct on its board a person whose name appears in the list of wilful defaulters and that in case, such a person is found to be on its board, it would take expeditious and effective steps for removal of the person from its board.

It would be imperative on the part of the Corporation 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 are kept to the barest minimum. It should also be ensured that a solitary or isolated instant is not made the basis for imposing the penal action.

## **2.0 Role of Internal Audit / Inspection :**

The aspect of diversion of funds by the borrowers should be adequately looked into while conducting Internal Audit / Inspection of their offices / branches and periodical reviews on cases of wilful default should be submitted to the Audit Committee of the Corporation.

## **3.0 Mechanism for Identification of Wilful Defaulters :**

a) Default Review Committee meetings shall be held under the chairmanship of concerned GMs / EDs at Branch level & HO (Recovery) and wherever the definition of wilful default satisfies, a list of such defaulters with their available details shall be forwarded to the Convener of Identification Committee to place it before the Committee for deliberations.

b) Identification Committee constituted by the Board if concludes that an event of wilful default has occurred, it shall issue a Show Cause Notice to the concerned borrower and the promoter / whole time director and call for their submissions and after considering their submissions, issue an Order recording fact of wilful default and the reasons for the same. An opportunity should be given to the borrower and the promoter / whole time director for a personal hearing if the Committee feels such an opportunity is necessary.

c) The Order of the Identification Committee should be reviewed by Executive Committee of the Board chaired by Chairman / Chairman & Managing Director or the Managing Director and the order shall become final only after it is confirmed by the said Review Committee. However, if the Identification Committee does not pass an order declaring a borrower as a wilful defaulter, then the Review Committee need not be set up to review such decisions.

## **4.0 Reporting to Credit Information Companies :**

Corporation should submit the list of suit filed accounts and non-suit filed accounts of wilful defaulters of Rs.25.00 lakhs & above on a monthly or more frequent basis to all the four credit information companies. This would enable such information to be available to the Banks / FIs on a near real time basis.

## **5.0 Publishing of Photographs of Wilful Defaulters :**

Corporation can consider publication of photographs of only those borrowers including proprietors / partners / directors / guarantors of borrower firms / companies, who have been declared as wilful defaulters following the mechanism set out in the RBI instructions as mentioned above. This shall not apply to the non-whole time directors who are exempted from being considered as wilful defaulters unless the special conditions, in accordance with these instructions are satisfied. Prior approval of the Managing Director shall be obtained before publication of photographs.

## **6.0 Criminal Action against Wilful Defaulters :**

It is essential that offences of Breach of Trust or Cheating construed to have been committed in the case of loan should be clearly defined under the existing statutes, providing for criminal actions in all cases where the borrowers divert the funds with malafide intentions.

In order to monitor end use of funds, it is advised that Financial Institutions should closely monitor the end use of funds and obtain certificates from borrowers certifying that the funds are utilised for the purpose for which they were obtained. In case of wrong certification by the borrowers, consider appropriate legal proceedings, including criminal action wherever necessary against the borrowers.

It should also be ensured that the penal provisions are used effectively and determine but after careful consideration and due caution. Financial Institutions are advised to put in place a transparent mechanism in this regard with the approval of the Board for initiating criminal proceedings based on the facts of individual case.

## **7.0 Prevailing procedure in the Corporation :**

While issuing the guidelines, Board noted that Corporation is in practice of publishing the photographs of missing defaulted clients in order to get information from general public regarding their whereabouts and personal property details. This practice will continue to identify the whereabouts of missing promoters.

*Euroop Can*  
MANAGING DIRECTOR

TO :

All the BMs/AGMs/DGMs of BOs,  
All the AGMs of IACs.  
All the Departmental Heads in Head Office  
General Managers  
Executive Directors