

Motilal Oswal Home Finance Limited (MOHFL)

Guidelines on 'Wilful Defaulters'

Approved

Board of Directors at its meeting held on October 29, 2020	
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INDEX

Sr. No.	Particulars	Page No.
1	Introduction	4
2	Mechanism for identification of Wilful Defaulters	11
3	Criminal Action against Wilful Defaulters	13
4	Reporting	14
5	Review/Revision of Policy	15

VERSION DETAILS

Sr. No.	Details of Changes	Date of Creation/Change	Department	Version Number	Approved By
1.	Original Document	October 29, 2020	Risk	Ver. 1.0	Board of Directors
2.	Amendment due to change in Regulation	July 27, 2022	Compliance	Ver. 1.1	Board of Directors

Motilal Oswal Home Finance Limited

Guidelines on 'Wilful Defaulter Policy'

(As approved by the Board of Directors of the Company)

1. Introduction

This has reference to the Master Direction - Non-Banking Financial Company - Housing Finance Company (Reserve Bank) Directions, 2021 issued by Reserve Bank of India (RBI), on advise of RBI and recommendation of the Puri Committee report, which states that HFCs may also report data on wilful defaulters to all the Credit Information Companies (CICs) because the exclusion of such entities from the guidelines of wilful defaulters may lead to arbitrage by the borrowers. Accordingly, RBI prescribed that guidelines to be put in place by HFCs and mechanism of reporting the information on wilful defaults of Rs.25 lakhs and above by HFCs to all CICs.

Accordingly, the Board of MOHFL decide to adopt the Guidelines on Wilful Defaulter for better caution in business and to minimize arbitrage by borrowers.

1.1 Definitions of 'Lender', 'Unit' and 'wilful default'

1.1.1 Lender: The term 'lender' means MOHFL to which any amount is due, provided it is arising on account of any banking transaction, including off balance sheet transactions such as derivatives, guarantees and letters of credit.

1.1.2 Unit: The term 'unit' includes individuals, juristic persons and all other forms of business enterprises, whether incorporated or not. In case of business enterprises (other than companies), MOHFL report (in the Director column of Annex 1) the names of those persons who are in charge and responsible for the management of the affairs of the business enterprise.

1.1.3 Wilful Default: 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 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 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 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 MOHFL.

The identification of the wilful default will be made by keeping in view the track record of the borrowers and not on the basis of isolated transactions / incidents. The default will be categorised as wilful must be intentional, deliberate and calculated.

1.2 Diversion and siphoning of funds

1.2.1 Diversion of Funds: The term 'diversion of funds' referred to a paragraph 1.1.3(b) above, should 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;

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- (c) transferring borrowed funds to the subsidiaries / companies in the same group or other corporates by whatever modalities;
 - (d) routing of funds through any 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.

1.2.2 Siphoning of Funds: The term 'siphoning of funds', referred to at paragraph 1.1.3(c) above, should be construed to occur if any funds borrowed from MOHFL 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 instance amounts to siphoning of funds would have to be a judgment of the lenders based on objective facts and circumstances of the case.

1.3 Cut-off Limits

While the penal measures indicated at paragraph 1.5 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 (CVC) for reporting of cases of wilful default, any wilful defaulter with an outstanding balance of Rs.25 lakh or more, would attract the penal measures stipulated at paragraph 1.5 below. This limit of Rs.25 lakhs may also be applied for the purpose of taking cognisance of the instances of siphoning / diversion of funds.

1.4 End-Use of Funds

In cases of project financing, the MOHFL ensure end use of funds by, *inter alia*, obtaining certification from the Chartered Accountants for the purpose. In case of

short-term corporate / clean 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 are above board. The MOHFL 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.

To ensuring end-use of funds, MOHFL made 'end use fund' of policy document. There are following illustrative measures 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 their credit administration.

(It may be kept in mind that this list of measures is only illustrative and by no means exhaustive.)

1.5 Penal Measures

The following measures may be initiated by the MOHFL against the wilful defaulters identified as per the definition indicated at paragraph 1.1.3 above:

- a. No additional facilities will be granted by MOHFL to the listed wilful defaulters. In addition, such companies (including their entrepreneurs / promoters) where MOHFL have identified siphoning / diversion of funds, misrepresentation, falsification of accounts and fraudulent transactions should

- be debarred from institutional finance from the HFCs, SCBs, FIs, 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/CICs.
- b. The legal process, wherever warranted, against the borrowers / guarantors and foreclosure for recovery of dues will initiate expeditiously. The MOHFL may initiate criminal proceedings against wilful defaulters, wherever necessary.
 - c. Wherever possible, the MOHFL 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 to which the MOHFL have given funded / non-funded credit facility, must be incorporated 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, if such a person is already 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 HFCs 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 instance is not made the basis for imposing the penal action.

1.6 Guarantees furnished by individuals, companies in the same group & not in the same group

While dealing with wilful default of a single borrowing company in a Group, MOHFL consider the track record of the individual company, with reference to its repayment performance to its lenders. However, in cases where guarantees furnished by the companies in the same Group on behalf of the wilfully defaulting units are not honoured when invoked by the HFCs, such companies in the same group should also be reckoned as wilful defaulters.

In connection with the guarantors, in terms of Section 128 of the Indian Contract Act, 1872, the liability of the surety is co-extensive with that of the principal debtor unless it is otherwise provided by the contract. Therefore, when a default is made in making repayment by the principal debtor, the lender will be able to proceed against the guarantor / surety even without exhausting the remedies against the principal debtor. As such, where a lender has made a claim on the guarantor on account of the default made by the principal debtor, the liability of the guarantor is immediate. In case the said guarantor refuses to comply with the demand made by the creditor/ lender, despite having sufficient means to make payment of the dues, such guarantor would also be treated as a wilful defaulter. This treatment of non-group corporate and individual guarantors was made applicable with effect from the date of this circular and not to cases where guarantees were taken prior to this date. MOHFL ensures that this position is made known to all guarantors at the time of accepting guarantees and it is part of Fair Practice Code (FPC) of HFCs.

1.7 Role of auditors

In case any falsification of accounts on the part of the borrowers is observed by MOHFL, and if it is observed that the auditors were negligent or deficient in conducting the audit, MOHFL may lodge a formal complaint against the auditors of the borrowers with the Institute of Chartered Accountants of India (ICAI) to enable the ICAI to examine and fix accountability of the auditors. Pending disciplinary action by ICAI, the complaints may also be forwarded to the NHB, RBI (Department of Regulation & Supervision), RBI (Department of Banking Supervision, Central Office) and IBA for records.

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 HFCs 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.

In addition to the above, HFCs are advised that with a view to ensuring proper end-use of funds and preventing diversion / siphoning of funds by the borrowers, lenders could consider engaging their own auditors for such specific certification purpose without relying on certification given by borrower's auditors. However, this cannot substitute a HFC's basic minimum own diligence in the matter.

1.8 Role of Internal Audit / Inspection

The aspect of diversion of funds by the borrowers will be adequately looked into while conducting internal audit / inspection of their offices / branches and periodical reviews on cases of wilful defaults should be submitted to the Audit Committee of the MOHFL.

1.9 Reporting to Credit Information Companies

- (a) RBI has advised its Master Direction - Non-Banking Financial Company - Housing Finance Company (Reserve Bank) Directions, 2021, all Housing Finance Companies (HFCs) that they shall become members of all CICs and submit requisite data to CICs.
- (b) MOHFL shall submit the list of suit-filed accounts and non- suit filed accounts of wilful defaulters of Rs.25 lakhs and above on a monthly or more frequent basis to all Credit Information Companies.

Explanation

In this connection, it is clarified that MOHFL need not report cases where

- (i) outstanding amount falls below Rs.25 lakhs and
 - (ii) in respect of cases where MOHFL have agreed for a compromise settlement and the borrower has fully paid the compromised amount.
- (c) Credit Information Companies (CICs) have also been advised to disseminate the

information pertaining to suit filed accounts of wilful defaulters on their respective websites.

2. Mechanism for identification of Wilful Defaulters

The mechanism referred to in paragraph 1.5 above should generally include the following:

- (a) The evidence of wilful default on the part of the borrowing company and its promoter / whole-time director at the relevant time should be examined by an Identification Committee headed by an Executive Director or equivalent or below the rank of Chairman / Chairman & Managing Director or the Managing Director & Chief Executive Officer / CEOs and consisting of two other senior officers of the rank of GM / DGM.
- (b) If the Identification Committee 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 the 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 another Committee called Review Committee, headed by the Chairman / Chairman & Managing Director or the Managing Director & Chief Executive Officer / CEOs and consisting, in addition, to two independent directors / non-executive directors of the HFCs 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.
- (d) As regard a non-promoter / non-whole time director, it should be kept in mind that Section 2(60) of the Companies Act, 2013 defines an officer who is in default to mean only the following categories of directors:

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- (i) Whole-time director
 - (ii) where there is no key managerial personnel, such director or directors as specified by the Board in this behalf and who has or have given his or their consent in writing to the Board to such specification, or all the directors, if no director is so specified;
 - (iii) every director, in respect of a contravention of any of the provisions of Companies Act, who is aware of such contravention by virtue of the receipt by him of any proceedings of the Board or participation in such proceedings and who has not objected to the same, or where such contravention had taken place with his consent or connivance.

Therefore, 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/she 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 objection to the same in the Minutes; or,
- II. the wilful default had taken place with his consent or connivance.

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

- (iv) As a one-time measure, MOHFL, while reporting details of wilful defaulters to the Credit Information Companies may thus remove the names of non-whole time directors (nominee directors / independent directors) in respect of whom they already do not have information about their complicity in the default / wilful default of the borrowing company. However, the names of promoter directors, even if not whole time directors, on the board of the wilful defaulting companies cannot be removed from the existing list of wilful defaulters.
- (e) A similar process as detailed in sub-paragraphs (a) to (c) above should be followed when identifying a non-promoter / non-whole time director as a wilful

defaulter.

3. Criminal Action against Wilful Defaulters

3.1 JPC Recommendations

Reserve Bank examined, the issues relating to restraining wilful defaults in consultation with the Standing Technical Advisory Committee on Financial Regulation in the context of the following recommendations of the JPC and in particular, on the need for initiating criminal action against concerned borrowers, viz.

- a. It is essential that offences of breach of trust or cheating construed to have been committed in the case of loans should be clearly defined under the existing statutes governing the banks, providing for criminal action in all cases where the borrowers divert the funds with malafide intentions.
- b. It is essential that banks closely monitor the end-use of funds and obtain certificates from the borrowers certifying that the funds have been used for the purpose for which these were obtained.
- c. Wrong certification should attract criminal action against the borrower.

3.2 RBI has felt that said recommendations are also be made applicable to HFCs. Accordingly, MOHFL are, as under:

(i) Monitoring End-Use of Funds

In reference to Para 1.4 of this circular, MOHFL 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, MOHFL may consider appropriate legal proceedings, including criminal action wherever necessary, against the borrowers.

(ii) Criminal Action by MOHFL

It is essential to recognize that there is scope even under the existing legislations to

initiate criminal action against wilful defaulters depending upon the facts and circumstances of the case under the provisions of Sections 403 and 415 of the Indian Penal Code (IPC), 1860. MOHFL seriously and promptly consider initiating criminal action against wilful defaulters or wrong certification by borrowers, wherever considered necessary, based on the facts and circumstances of each case under the above provisions of the IPC to comply with our instructions and the recommendations of JPC.

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

4. Reporting

4.1 Need for Ensuring Accuracy

Credit Information Companies disseminate information on non-suit filed and suit filed accounts respectively of Wilful Defaulters, as reported to them by the HFCs and therefore, the responsibility for reporting correct information and also accuracy of facts and figures rests with the concerned HFCs. For this MOHFL may also ensure that correct & accurate information reported to CICs and the facts about directors, wherever possible, by cross-checking with Registrar of Companies.

4.2 Position regarding Guarantors

MOHFL takes due care to follow the provisions set out in paragraph 2 of the this guidelines in identifying and reporting instances of wilful default in respect of guarantors also. While reporting such names to CICs, MOHFL may include 'Guar' in brackets i.e. (Guar) against the name of the guarantor and report the same in the Director column.

4.3 Inclusion of Director Identification Number (DIN)

MOHFL include the Director Identification Number (DIN) of persons whose name is appearing in the list of wilful defaulters, as one of the fields in the data submitted by them to Credit Information Companies.

It is reiterated that while carrying out the credit appraisal, MOHFL verify that whether the names of any of the directors appear in the list of defaulters / wilful defaulters by way of reference to DIN / PAN etc. Further, in case of any doubt arising on account of identical names, MOHFL should use independent sources for confirmation of the identity of directors rather than seeking declaration from the borrowing company.

4.4 Sharing of contact details of Nodal Officers dealing with CICs

MOHFL better coordination with CICs, forward the complete details of the nodal officers (name, designation, contact no., email id) to all the CICs. Further, also forward the details of the nodal officer with whom the CICs need to coordinate in respect of disputes/complaints on data reported.

5. Review/Revision of Policy

If at any point a conflict of interpretation / information between the Policy and any regulations, rules, guidelines, notification, clarifications, circulars, master circulars/directions issued by relevant authorities (“Regulatory Provisions”) arises, then interpretation of the Regulatory Provisions shall prevail.

In case of any amendment(s) and/or clarification(s) to the Regulatory Provisions, the Policy shall stand amended accordingly from the effective date specified as per the Regulatory Provisions. The Board and/or its Committee reserve(s) the right to alter, modify, add, delete or amend any of the provisions of the Policy.