

The Business of Wilful Default*

C.P. Chandrasekhar

In the fourth round of what has become a periodic exercise, the All India Bank Employees Association (AIBEA), the “oldest and largest” trade union in the industry, has released a list of 5,610 wilful defaulters on debt they owe commercial banks. In the AIBEA’s view the failure to reduce, let alone prevent, such defaults is badly damaging bank balance sheets. The fact that attempts at recovery have also been tardy and quite unsuccessful is not helping either. The official listing of suit-filed accounts of wilful defaulters disseminated through the Credit Information Bureau (India) Ltd, reports 6,081 cases involving loans totaling Rs. 59,518 crore as of March 31, 2016.

While these data single out defaulters who have been declared as wilful ones by their creditors, the issue of wilful default is often lost in the overall discussion of stressed assets in the banking sector. Comprising of non-performing assets (NPAs) and restructured assets, stressed assets in the banking sector are placed at Rs. 733,000 crore or 14.34 per cent of bank advances. Non-performing assets at that point were estimated at Rs. 594,929 crore. Wilful defaults while large are, therefore, a small percentage of total NPAs. But they point to a deeper problem in the functioning of India’s market economy.

The Reserve Bank of India (RBI) defines a wilful defaulter as one who has diverted bank loans to activities other than one for which they were originally taken, siphoned funds out with no corresponding assets of any kind to show in the books of the company or who has not repaid loans despite having adequate resources to meet commitments. Thus, the crucial issue here is not default per se, but default that is intentional, deliberate and calculated. This makes wilful default a criminal offence. A default that results from a wrong investment decision, sheer mismanagement or unexpected changes in the business environment of a firm that does not have the liquidity to meet payments commitments would not fall in the “wilful” category.

Despite this restricted definition, wilful defaults are large. The total default in the 5,610 accounts revealed by the AIBEA adds up to Rs. 58,792 crore. This amounts to around 11 per cent of total non-performing assets in the banking system at the end of March 2016. As many as 4,738 of these accounts accounting for Rs. 47,351 crore of wilfully defaulted loans are with the public sector banks (including the State Bank of India group). In an answer to a Parliamentary question in the Lok Sabha in December last year, Finance Minister Arun Jaitley reported that in the case of loans of Rs.25 lakh and above from public sector banks alone, the number of cases of wilful default had risen by 44 per cent from 4929 at the end of March 2013 to 7265 at the end of September 2015, and the sum involved by a huge 150 per cent from Rs. 25,804 crore to Rs. 64,335 crore. Clearly, the credit boom during the years after 2004 has been exploited by a set of unscrupulous borrowers, who could avoid scrutiny because of the relaxation in scrutiny that is associated with a post-liberalisation debt spiral.

What is noteworthy about the numbers released by the AIBEA is that the top 106 borrowers (1.9 per cent of the total) responsible for wilful default on loans equal to or exceeding Rs. 100 crore each, together accounted for Rs. 23,093 crore or close to two-fifths (39.3 per cent) of the total sum in default as per this list. In fact this

concentration of a high level of wilful default among a few borrowers is an underestimate for two reasons. First, while firms borrow from different banks, not all of the banks may have declared them wilful defaulters. This keeps part of their debt out of the wilful default category. Thus, while Kingfisher Airlines' aggregate debt is estimated at around Rs. 9,000 crore, only State Bank of India, which accounts for around Rs. 1,200 crore of the total, had declared the company a wilful defaulter. Second, firms belonging to the same group do appear separately in the list of top defaulters. That makes concentration lower than it would have been if all "sister companies" were clubbed together. Such difficulties notwithstanding, the sum under default in the case of the top 10 wilful defaulters is Rs. 10,664 or as much as 18 per cent of the total.

This suggests that fraud that hurts India's banking system is rampant and has risen rapidly in recent times. While the government's attention is focused on the larger problem of non-performing assets in general, with emphasis on revealing the magnitude of the problem, ensuring that lost assets are provided for and recapitalizing banks to keep them fully solvent, these instances of outright fraud do not seem to be getting the attention they deserve. The Finance Minister's reply to the Lok Sabha question referred to above stated that while there were 7265 cases of wilful default reported as of 30 September 2015, FIRs had been filed only in 1624 cases, accounting for just about a quarter of the total sum in default. Criminal proceeding against these wilful defaulters seems to be extremely slow in coming.

The guidelines issued by the RBI on July 1, 2015 detailed the different ways in which wilful default can be disincentivised as follows: (i) restricting additional facilities to such defaulters from banks and financial institutions, (ii) barring of such borrowers from institutional finance, (iii) criminal action, (iv) removal of directors of such companies from boards and (v) change in management. Many of these actions may be pointless, because they may have lost their relevance by the time a defaulting borrower is identified as a wilful defaulter. Banks generally appear reluctant to proceed against defaulting borrowers in the belief that the inability to pay is a result of real difficulties and the hope that the company would be able to tide over those difficulties in time and begin meeting loan commitments. In fact, in many instances involving large borrowers the loan is restructured with extended repayment periods, lower interest rates and additional support. This reticence to recognize default for what it is increases when the issue is recognizing wilful default, since that would question whether the loan officers involved had exercised due diligence when they sanctioned the loan.

Given the tendency for delay in wilful default recognition, borrowers may end up accessing credit from other banks and financial institutions and the directors may obtain credit for other companies they are associated with. So the real difference would be made only if wilful default is recognized early, followed by quick action to change the management and launch criminal proceedings. Conviction, especially of the larger defaulters, would make an example of them and possibly dissuade likely future offenders.

Tardy responses in practice to wilful default are surprising given the nature of the offences committed by large defaulters. A look at the cases of some of the top ten defaulters is instructive. The audacity of the case involving Vijay Mallya and

Kingfisher Airlines, which he created and owned, has been widely reported. Kingfisher defaulted on its large debt pile despite the repeated efforts of bankers to the company to restructure this debt and even convert a part to equity so as to prevent “actual” default. Those efforts appear misplaced, given the allegations of the siphoning out of the company’s resources for personal enrichment after its final collapse and the inability to access much by way of collateral against the debt. Yet Mallya was able to leave the country just before his passport was impounded as has been widely reported.

In the case of Jatin Mehta, who headed the Winsome Group before he chose to step down in 2012 and relocate abroad, two of his companies, Winsome Diamonds and Forever Precious Jewellery and Diamonds, had defaulted on the tidy sums of Rs. 4,300 crore and Rs. 1,900 crore respectively. Mehta claimed this was because of default on payments to his companies by UAE based clients who were being proceeded against. But some allege that there is reason to believe that these “clients” were actually erstwhile group companies and the sums involved had been diverted abroad. Jatin Mehta and his wife, who are now citizens of the Federation of St Kitts and Nevis with which India does not have an extradition treaty, are alleged to have followed the money.

But it is not always that the default occurs because of visible fraud. Zoom Developers, another among the top ten, was involved in the unusual business of dismantling and either scrapping or relocating plants. Aggregators leased out the job of scrapping or relocating the plant to Zoom. In the first instance, Zoom was to offer a local bank guarantee to the aggregator, which was backed up with a bank guarantee from an Indian bank to the foreign bank. Zoom was supposed to settle all transactions and guarantees with the proceeds it obtained from the buyer of the scrap or of the relocated plant. After the financial crisis Zoom claimed that its buyers cut back on purchases creating cash flow problems for the company. However, investigations seemed to suggest that the promoters were “directly and knowingly involved in transferring the amounts received as mobilization advances to the account of SBBJ for purchase of property.” But, it also emerged that lenders had also issued bank guarantees to the company without due diligence and rolled over those guarantees without much collateral. When the value of bank guarantees was at around Rs 3,000 crore, the value of the collateral available was reportedly only Rs 150 crore. Loan loss was the result when Zoom chose to default.

This story of large lending to a wilfully defaulting entity by a consortium of banks seems true in many of the cases in the list of wilful defaulters. The fact that such adventurous lending followed by wilful default has become more common in recent years, suggests that it is linked to the change in banking practices and the pursuit of quick profits after liberalization. In many cases the kind of fraud committed makes it difficult to believe that the client concerned was a creditworthy borrower in the first instance. Further, in all these cases the legal proceedings to identify and liquidate collateral assets is taking enormous amounts of time, forcing banks to write off these assets. Meanwhile the perpetrators of the frauds are free and able to live the high life. Yet the government and the RBI are fearful that so-called “witch-hunts” of bankers involved in these transactions would make other loan officers risk-averse and

freeze funding to other investors needing large loans for risky investments. That only further delays prosecution of the perpetrators of fraud and incentivizes wilful default.

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