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# NPA Resolution & Debt Restructuring



## RESOLUTION STRATEGY

- NPA ASSESSMENT
- DEBT RESTRUCTURING
- STAKEHOLDER ALIGNMENT
- VALUE REALISATION
- SUSTAINABLE RECOVERY

*Signature*

- ASSESS
- RESTRUCTURE
- RESOLVE
- RECOVER

# NPA Resolution & Debt Restructuring

*OTS Negotiation, RBI Prudential Frameworks, ARC Transactions & Wilful Defaulter Defence — The Complete Practitioner's Guide*

Booklet III of VI — Indian Banking & Finance Sector Legal Series

Advocates & Legal Consultants — Ultra-Premium Client Advisory Series

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## CHAPTER ONE

# NPA Recognition and the RBI Prudential Framework: Classification, Upgradation and Restructuring Triggers

*RBI Master Circular — IRAC Norms, 90-Day Overdue Criterion, Restructured Account Classification, Standstill Benefits and Upgradation Conditions*

*For a stressed corporate borrower — a promoter-managed manufacturing group whose cash flows have been disrupted by market shifts, regulatory changes, or the COVID-19 economic shock — the NPA classification date is not merely an accounting event. It is the moment that triggers a cascade of legal consequences: the bank's SARFAESI enforcement rights crystallise, the borrower's credit*

*bureau record is irrevocably damaged, the bank's provisioning requirements increase, and the regulatory machinery for compelled resolution begins to turn. Every day before NPA classification is a day in which the borrower retains negotiating flexibility. Every day after classification is a day in which the borrower's leverage decreases and the bank's enforcement options multiply. The practitioner who understands the IRAC framework's technical mechanics — its precise triggers, its upgradation conditions, and its intersection with restructuring frameworks — is the practitioner who can most effectively protect the stressed borrower's interests in the pre-NPA period and most credibly challenge the NPA classification's validity in the enforcement period.*

## **1.1 The 90-Day Overdue Criterion: Mechanics and Exceptions**

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The primary NPA trigger for term loans under the RBI's IRAC Norms is the 90-day overdue criterion: a term loan where interest or principal instalment remains overdue for a period exceeding 90 days is classified as a Sub-Standard Asset (the first NPA category). For cash credit and overdraft accounts — which do not have fixed repayment schedules — the NPA trigger is the "out-of-order" condition: a CC/OD account is out-of-order, and becomes NPA, if: the outstanding balance remains continuously in excess of the sanctioned limit or drawing power for 90 or more days; or interest is not serviced within 90 days from the date it was charged to the account; or where the stock and debtors statements are not submitted regularly, the drawing power computed from these statements is significantly lower than the book balance, and the shortfall exceeds the threshold for 90 or more days. The 90-day criterion is calculated from the due date of the instalment or interest payment — not from the sanction date or the account opening date — and the precision of the calculation is critical: a bank that declares an NPA on day 88 rather than day 91 has acted prematurely, and the NPA declaration is invalid for SARFAESI purposes. For large term loan accounts with complex repayment schedules — quarterly instalments, bullet payments, and deferred commencement of repayment — the calculation of the 90-day overdue period requires a careful reconciliation of the sanction letter's repayment schedule against the actual payment history, accounting for any sanctioned moratorium periods, restructuring-approved repayment deferrals, and RBI-mandated standstill benefits.

## **1.2 COVID-19 Moratorium and Its NPA Implications**

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The RBI's COVID-19 regulatory package — specifically the Moratorium circular of 27 March 2020 and subsequent extensions — granted all borrowers with outstanding loans a moratorium on payment of instalments falling due between 1 March 2020 and 31 August 2020, with the express provision that moratorium-period payments would not be classified as overdue for NPA purposes and would not be reported to credit bureaus as defaults. The Supreme Court in *Gajendra Sharma v. Union of India* (2021) held that the interest accruing during the moratorium period could not be treated as overdue for NPA computation, and directed the government to implement the interest-on-interest waiver scheme for eligible borrowers. For borrowers whose accounts were pushed into NPA during the COVID period — or whose NPA dates were artificially

advanced because moratorium credits were not properly accounted for — the RBI COVID circulars provide a basis for challenging the NPA classification: if the bank declared an NPA without correctly applying the moratorium standstill to the overdue calculation, the NPA declaration is factually incorrect, the Section 13(2) demand amount is wrong, and the entire SARFAESI enforcement is founded on a defective factual basis.

### **1.3 Substandard, Doubtful and Loss Assets: The Provisioning Escalation and Its Strategic Implications**

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Once classified as NPA, the asset progresses through the RBI's three-tier classification: Sub-Standard (first twelve months of NPA status — bank required to provision 15 per cent of outstanding for unsecured accounts, 10 per cent for secured accounts with specified reductions for collateral coverage); Doubtful (NPA for more than 12 months — provisioning from 25 to 100 per cent depending on collateral and doubtful duration); and Loss Asset (identified as uncollectable even if not yet written off — 100 per cent provision required). The escalating provisioning requirement creates a powerful incentive for banks to pursue OTS settlement of Doubtful and Loss category assets: a Loss asset that has been 100 per cent provisioned costs the bank nothing additional if it accepts an OTS at 30 per cent of face value — because the provisioning has already effectively written off 100 per cent. The OTS amount negotiated for a Loss category asset can therefore be substantially lower than the outstanding on a Substandard asset where the bank has provisioned only 15 per cent and faces a larger accounting loss if it accepts a deep haircut. For borrowers negotiating OTS, the NPA category — and the bank's provisioning level — is a key input into the settlement pricing analysis: a well-advised borrower's counsel knows that a bank with 100 per cent provisioning on a fully written-off Loss account is more receptive to a 25-30 per cent OTS than a bank that has not fully provisioned for the account and faces a direct P&L impact from accepting a deep discount.

#### **KEY PROVISION**

RBI Master Circular on IRAC Norms (2015, updated 2023): "A Non-Performing Asset (NPA) shall be a loan or an advance where: (i) interest and/or instalment of principal remain overdue for a period of more than 90 days in respect of a term loan; (ii) the account remains 'out-of-order', in respect of an Overdraft/Cash Credit (OD/CC); (iii) the bill remains overdue for a period of more than 90 days in the case of bills purchased and discounted; (iv) the instalment of principal or interest thereon remains overdue for two crop seasons for short duration crops; (v) the amount of liquidity facility remains outstanding for more than 90 days, in respect of a securitisation transaction."

### **1.4 Restructuring and NPA Standstill: The Regulatory Framework**

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An account that has been restructured — through elongation of the repayment period, reduction of interest rate, conversion of interest to a funded interest term loan (FITL), or other modification of the original loan terms — receives a "standstill" benefit under the pre-2015 RBI

restructuring framework: the restructured account is not required to be classified as NPA during the standstill period, provided the borrower demonstrates viability and the restructuring is implemented within the prescribed timelines. The RBI's June 2019 Prudential Framework replaced this standstill-based approach with a new architecture: accounts that are in default must be resolved through a Board-approved resolution plan within 180 days of the Review Period (30 days from the first default), failing which the lender must make additional provisioning of 20 per cent. For borrowers who entered into restructuring agreements before the June 2019 Circular — and whose accounts were classified as "Restructured Standard Assets" under the earlier framework — the transition to the new framework requires careful analysis: accounts that were performing under pre-2019 restructuring plans were grandfathered, but a subsequent default after the June 2019 Circular brings the new framework's timeline and provisioning requirements into play, and the bank's obligation to initiate the ICA-based resolution process within 30 days of the new default is mandatory.

# One-Time Settlement: OTS Negotiations with PSU Banks, RBI Circulars and the Legal Architecture of Compromise

*OTS Policy Framework, Compromise Settlement Circular 2023, Minimum Settlement Amount, Board Approval Requirements & Legal Enforceability of OTS Agreements*

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*The one-time settlement is the most commercially efficient resolution instrument available to a stressed borrower with assets of value but insufficient liquid resources to repay the full outstanding debt. A well-negotiated OTS eliminates the NPA classification, avoids SARFAESI enforcement, prevents IBC proceedings, and — crucially — releases the personal guarantees of the promoter, restoring the promoter family's personal financial freedom from the bank's coextensive guarantee liability. The OTS negotiation is also the terrain where legal counsel's practical knowledge of the bank's regulatory constraints and internal approval requirements is most commercially valuable: a borrower whose counsel understands the bank's OTS policy framework, the RBI's compromise settlement guidelines, and the approval thresholds that require Board versus DGM versus Zonal Committee sign-off can negotiate more effectively and close settlements more quickly than a borrower whose counsel treats the OTS as a purely commercial negotiation.*

## 2.1 RBI's Compromise Settlement Circular 2023: Scope and Mandatory Provisions

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The RBI's Circular on Compromise Settlements and Technical Write-Offs (August 2023) — replacing the earlier ad hoc framework — establishes a comprehensive, legally binding framework for regulated entities' OTS policies. The Circular requires every scheduled commercial bank, small finance bank, and NBFC to have a Board-approved policy for compromise settlements that includes: minimum settlement amounts for different NPA categories (Substandard, Doubtful, Loss); cooling-off period requirements (the borrower who has settled an NPA account cannot obtain fresh credit from the same lender for a specified minimum period post-OTS); credit bureau reporting obligations (settled accounts must be reported to credit information companies as "settled" rather than "written off," with the distinction maintained in the credit bureau record for seven years); and escalation thresholds for settlement approvals (accounts above specified outstanding amounts require higher-level approval — zonal committee, MD and CEO, or Board committee). The 2023 Circular explicitly permits compromise settlement even with wilful defaulters and fraud-classified borrowers — a significant liberalisation from the pre-2023 position that effectively prohibited settlement with wilful defaulters — provided the lender follows enhanced due diligence, obtains required law enforcement permissions, and reports the settlement to the relevant law enforcement agencies. For practitioners advising clients who have been classified as wilful defaulters — previously the

most significant bar to OTS — the 2023 Circular's liberalisation opens a pathway to settlement that must now be actively explored.

## **2.2 Negotiating Minimum Settlement Amounts: The Valuation Anchor**

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The minimum OTS amount that a PSU bank's internal policy will accept — and that its Board committee will approve — is anchored to two primary reference points: the net present value of the bank's expected recovery through enforcement (SARFAESI sale proceeds or IBC liquidation value, discounted for the cost and time of enforcement), and the bank's own provisioning level for the account (since an account that is 100 per cent provisioned effectively costs the bank nothing to settle at any positive amount). For the borrower's counsel, the negotiating strategy must be built around a realistic assessment of what the bank's enforcement recovery would be: obtain independent valuations of all mortgaged assets; compute the realistic e-auction discount (typically 20-30 per cent below market value in a distressed sale); deduct the enforcement costs (SARFAESI legal costs, Authorised Officer fees, auction management costs, and the time value of a 2-3 year enforcement process); and present the resulting "enforcement net present value" as the economic baseline below which any settlement offer creates value for the bank compared to enforcement. Where the bank's provisioning is high and the enforcement NPV is low — as is typically the case for Doubtful and Loss category accounts in the manufacturing sector, where the secured assets are specialised industrial equipment that commands limited liquidation value — the economic case for an OTS at 25-35 per cent of outstanding is compelling and can be presented quantitatively to the bank's credit committee.

### **PRACTITIONER NOTE**

PSU banks' OTS approval processes are institutional bureaucracies that require evidence-based file submission — not relationship-based negotiation alone. A well-prepared OTS proposal file should contain: audited financial statements for the last three years showing the company's deterioration; an independent valuation report of all secured assets; a cash flow projection showing the proposed OTS payment schedule; the borrower's explanation for the default (market factors, regulatory changes, COVID impact — all documented); and a comparison of the OTS amount to the bank's expected enforcement recovery. This file must be internally defensible to the bank's vigilance department, which reviews all OTS approvals above threshold amounts for risk of undue favours — a file that demonstrates objective commercial justification for the settlement amount is the practitioner's most effective tool for securing prompt institutional approval.

## **2.3 Legal Enforceability of OTS Agreements: Conditions Precedent and Guarantee Release**

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An OTS agreement — once signed by the bank's authorised signatory — is a binding contract under the Indian Contract Act, 1872: it constitutes an accord and satisfaction of the debt obligation, extinguishing the bank's claim to the extent provided in the settlement. However,

OTS agreements routinely contain conditions precedent (payment of the first instalment within a specified period, maintenance of security until full payment, no fresh litigation against the bank during the settlement period) whose non-fulfilment allows the bank to treat the settlement as void and revert to enforcement. The practitioner drafting or reviewing an OTS agreement for a borrower must: ensure that the conditions precedent are achievable within the borrower's financial constraints; negotiate clear language on what constitutes "full and final" settlement (specifically addressing the release of all guarantees, including personal guarantees by promoters and their family members); confirm that the bank's signatory is specifically authorised under the board resolution to enter into OTS agreements of the relevant amount; and verify that the agreement provides expressly for the execution and delivery of the NOC (No Objection Certificate) by the bank upon final payment — since the bank's internal processes for NOC issuance are frequently delayed and the agreement should specify a deadline and a remedy for non-issuance.

#### **LEADING CASE**

Central Bank of India v. Ravindra (2002) 1 SCC 367: The Supreme Court held that a compromise decree or settlement agreement with a bank, once entered into by the bank's authorised officer in accordance with its board-delegated authority, is binding on the bank — the bank cannot subsequently repudiate the settlement on the ground that its internal OTS policy was not followed, provided the borrower has acted on the settlement. This ruling protects borrowers who have paid settlement amounts in reliance on bank communications and prevents banks from renegeing on agreed OTS terms on bureaucratic grounds after partial settlement payments have been received.

# RBI's Prudential Framework for Resolution: June 2019 Circular, ICA Mechanics & 180-Day Deadline

*June 7 2019 RBI Circular, Inter-Creditor Agreement, Review Period, Resolution Period, Additional Provisioning Consequences & ICA Voting Mechanics*

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## 3.1 The June 2019 Framework: Architecture and Mandatory Timelines

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The Reserve Bank of India's Prudential Framework for Resolution of Stressed Assets, issued on 7 June 2019 (the "June 2019 Circular") — replacing the earlier February 2018 Circular that was struck down by the Supreme Court in *Dharani Sugars and Chemicals Ltd. v. Union of India* (2019) 5 SCC 480 — establishes the mandatory framework within which lenders must pursue resolution of accounts that are in default. The Framework applies to all scheduled commercial banks, all-India financial institutions, small finance banks, and systemically important NBFCs (with aggregate exposure above Rs. 15 crore). When a borrower defaults, the Framework requires: (i) a 30-day "Review Period" during which the lender assesses the situation and decides on the resolution approach — IBC referral, SARFAESI enforcement, or a bilateral/ICA-based restructuring; (ii) if a ICA-based resolution plan is chosen, a 180-day "Resolution Period" within which the plan must be implemented; and (iii) if implementation does not occur within 180 days, additional provisioning of 20 per cent, escalating to 35 per cent at 365 days. The June 2019 Circular's mechanism — unlike the struck-down February 2018 Circular, which mandated IBC referral for accounts above Rs. 2,000 crore after a 180-day deadline — operates through provisioning incentives rather than mandatory IBC referral, preserving lender discretion while creating strong financial incentives for timely resolution.

## 3.2 Inter-Creditor Agreement: Signing Obligation and Binding Effect on Dissenting Lenders

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The June 2019 Circular requires all lenders in a consortium or multiple banking arrangement to enter into the RBI's prescribed Inter-Creditor Agreement (ICA) as a condition of implementing an ICA-based resolution plan. The ICA — the standard form of which was developed by the Indian Banks' Association — requires each signatory lender to: participate in good faith in the resolution process; share all information about the borrower with other ICA parties; be bound by the decisions of lenders representing 75 per cent of the total outstanding debt (by value) and 60 per cent by number on resolution plan approval; and refrain from independent enforcement action during the Resolution Period unless the ICA majority decides to proceed with IBC or SARFAESI. The binding effect of the ICA majority on dissenting lenders — a lender that votes against the resolution plan but is in the minority is legally bound by the majority's decision and

cannot proceed independently — is the ICA's most significant structural feature for consortium recovery management. A dissenting minority lender whose interests are overridden by the majority ICA vote has two options: (a) challenge the resolution plan's commercial terms through the review mechanisms in the ICA; or (b) exit the ICA by selling its exposure to another lender or ARC before the binding vote. For practitioners advising foreign banks, cooperative banks, or smaller NBFCs that are minority participants in large consortium agreements, the ICA's binding nature means that the institution's interests must be actively protected through the voting process — a passive minority lender that fails to engage with the resolution deliberations may find itself bound by a plan whose recovery terms are substantially less favourable than what might have been negotiated with active engagement.

# Debt Restructuring Instruments: FITL, WCTL, OFCD and Interest Subvention Structures

*Funded Interest Term Loan, Working Capital Term Loan, Optionally Fully Convertible Debentures, Restructuring Package Design & RBI Treatment of Restructured Instruments*

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## 4.1 FITL: Converting Accumulated Interest into Funded Debt

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The Funded Interest Term Loan (FITL) — one of the most frequently used instruments in corporate debt restructuring in India — is a mechanism by which the accumulated overdue interest on a borrower's existing credit facilities is converted into a separate term loan, allowing the borrower's working capital account to be regularised by eliminating the overdue interest balance and starting afresh. The FITL is created by the bank debiting the borrower's existing accounts for the accumulated overdue interest and creating a corresponding credit entry in a new FITL account — effectively converting a past-due obligation (interest that could not be paid) into a new term loan that will be repaid over an agreed schedule. From the bank's perspective, the FITL allows the account to be upgraded from NPA to Standard (provided all other conditions for upgradation are met) — the creation of the FITL technically cures the interest overdue that triggered the NPA, and the borrower's accounts return to performing status with a new debt obligation. The legal characterisation of the FITL is critically important for subsequent enforcement: the FITL is a "financial debt" within Section 5(8) of the IBC (a debt disbursed against time value of money — the FITL represents the bank's forbearance in not immediately enforcing the interest claim) and is a "secured debt" if the FITL documentation includes a security interest extension covering the FITL in addition to the original loan. Practitioners drafting restructuring packages must ensure that the FITL documentation explicitly: extends the existing security interest to cover the FITL principal; creates a fresh CERSAI registration for the FITL security; and specifies the repayment schedule and default consequences for the FITL in terms consistent with the SARFAESI enforcement regime.

## 4.2 WCTL and the Working Capital Restructuring

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The Working Capital Term Loan (WCTL) — converting the irregular portion of a cash credit or overdraft facility into a term loan — is the companion instrument to the FITL in a comprehensive debt restructuring package. A borrower whose cash credit account has been chronically overdrawn or out-of-order carries an "excess over limit" portion that represents borrowing above the sanctioned working capital — an amount that the bank has technically over-advanced and that creates an ongoing NPA risk. The WCTL converts this excess portion into a separate term loan with a structured repayment schedule, simultaneously reducing the cash credit limit to the

appropriate working capital level and eliminating the out-of-order status that is triggering the NPA classification. The combination of FITL (for overdue interest) and WCTL (for the over-drawn working capital) is the standard restructuring toolkit for stressed manufacturing sector borrowers in Gujarat, where large MSME and mid-corporate borrowers frequently have both accumulated interest backlogs and chronically over-utilised working capital facilities — conditions created by the combination of falling revenues, fixed cost structures, and slow debtors' collection that characterise manufacturing sector distress.

### **4.3 OFCD Structures: Converting Debt to Quasi-Equity**

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Optionally Fully Convertible Debentures (OFCDs) — debt instruments that carry an option (exercisable by the holder or the issuer) to convert the principal amount into equity shares at a predetermined conversion ratio and timeline — are used in complex debt restructuring packages to provide the bank with an equity upside in the event the corporate debtor's business recovers, compensating the bank for the haircut it has accepted in the restructuring. The OFCD is typically structured so that: the bank's restructured claim (after haircut) is partially repaid in cash (over the restructuring period) and partially converted into OFCDs; the OFCDs carry a coupon rate lower than the original loan rate; and at the end of the OFCD tenure, the bank can elect to convert the OFCD balance into equity at the agreed conversion price, giving it a shareholding in the revived company. The SEBI's regulatory framework for OFCDs — classified as "hybrid" instruments under the SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018 for listed companies — requires compliance with SEBI's disclosure and pricing norms for any OFCD issued by a listed entity. For unlisted companies, OFCDs are governed by the Companies Act 2013's provisions on debentures and the RBI's regulatory framework for bank investments in non-SLR instruments — which impose investment limits on banks' equity-like exposures to corporate borrowers.

# ARC Transactions: SARFAESI Assignment, SR Pricing, Redemption & NARCL Structures

*SARFAESI Section 5 Assignment, Security Receipts, Trust Structure, RBI ARC Guidelines, NARCL Government Guarantee & SR Redemption Dispute Resolution*

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## 5.1 ARC Assignment: The Section 5 Legal Framework

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An Asset Reconstruction Company (ARC) — a SARFAESI-licensed entity established under Section 3 of the SARFAESI Act to acquire NPAs from banks for the purpose of reconstruction and recovery — acquires stressed loans from banks through an assignment of the financial assets (the loan agreements and associated security documents) under Section 5 of the SARFAESI Act. The bank-to-ARC assignment transfers: the bank's rights as "secured creditor" under the SARFAESI Act (including the right to issue Section 13(2) notices, take possession, and sell the secured asset); the bank's rights as "financial creditor" under the IBC (including the right to file Section 7 applications and participate in CoC); and all contractual rights under the loan agreements, security documents, and guarantee instruments. From the borrower's perspective, the ARC assignment fundamentally changes the recovery dynamic: an ARC is a commercial entity focused purely on recovery maximisation, without the public sector bank's institutional constraints on deep haircut acceptability, relationship lending considerations, or political exposure in distressed large industry matters. ARCs — particularly the private-sector ARCs such as ARCIL, Edelweiss ARC, Phoenix ARC, and CFM ARC — are aggressive commercial recovery platforms that will deploy every available enforcement tool simultaneously and will pursue OTS settlements only at prices that reflect their acquisition cost and targeted IRR. For borrowers whose debt has been assigned to an ARC, the negotiating strategy must be recalibrated for the ARC's commercial parameters — the bank's OTS benchmark (NPV of enforcement recovery) is replaced by the ARC's break-even calculation (acquisition price plus management costs plus target return), which is frequently higher than the bank's enforcement NPV and creates a tighter negotiating range for settlement.

## 5.2 Security Receipts: Legal Character and Investor Rights

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The ARC finances its NPA acquisition by issuing Security Receipts (SRs) — instruments representing the beneficial interest in the financial assets held in a SARFAESI trust — to qualified institutional buyers (QIBs) who provide the acquisition consideration. The SR structure separates ownership of the financial asset (held by the SARFAESI trust managed by the ARC) from the risk of recovery (borne by the SR holders). Under RBI's ARC regulations, banks that assign NPAs to ARCs can retain a portion of the SRs (up to 100 per cent, subject to RBI limits on

SR retention), effectively financing the ARC's acquisition and maintaining their own exposure to the NPA's recovery through the SR mechanism. The valuation of SRs — notoriously difficult to determine in the absence of an active secondary market — is a recurring point of dispute between ARCs and their SR-holding bank investors: the bank marks its SR holding at "net asset value" (determined by the ARC based on its assessment of recovery prospects), and a bank that marks SRs at an optimistic value is effectively understating its NPA provisioning. The RBI's requirement that banks provision for SR holdings based on the ageing of the SRs — regardless of the ARC's NAV estimate — creates a provisioning override that disciplines over-optimistic SR valuations. For legal practitioners advising on ARC dispute matters — SR redemption delays, ARC management fee disputes, and governance disputes between ARC and SR holders — the SARFAESI trust's legal architecture, the ARC's fiduciary obligations to SR holders, and the RBI's regulatory framework for ARC conduct are the relevant legal framework.

# Wilful Defaulter Classification: RBI Master Circular, Show-Cause Procedure & High Court Challenges

*RBI Wilful Defaulter Definition, Identification Committee, Review Committee, Consequences of Classification & Judicial Review at High Courts*

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## 6.1 Wilful Defaulter: Definition and the Four Categories

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The RBI's Master Circular on Wilful Defaulters (updated July 2023, consolidated from earlier directives) defines a "wilful default" as occurring in any of four circumstances: (i) the unit has defaulted in meeting its payment obligations despite having the capacity to honour them; (ii) the unit has defaulted and has diverted funds advanced to it for purposes other than those for which finance was sanctioned; (iii) the unit has siphoned off funds so that the funds have not been utilised for the specified purpose and the money is not available with the unit in the form of other assets; or (iv) the unit has disposed of or removed the movable fixed assets or immovable assets given as security, without the bank's knowledge or consent. The wilful defaulter classification is the most consequential regulatory designation in Indian banking law — a promoter or director tagged as a wilful defaulter is, by RBI directive, ineligible for new credit facilities from any bank or financial institution, faces IBC Section 29A CIRP disqualification, cannot be appointed as director of any other company (under Companies Act 2013 MCA directions), and faces the public stigma of publication of the WD classification on the RBI's wilful defaulter list. The personal reputational and commercial consequences of wilful defaulter classification for the individual promoter — as distinguished from the company's NPA classification — make it the highest-stakes regulatory proceeding in the banking law context, and it commands the highest level of legal representation and strategic engagement.

## 6.2 The Identification and Review Committee Process

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The RBI's Master Circular mandates a two-stage internal committee process before a borrower is formally classified as a wilful defaulter: the Identification Committee (senior bank officers, typically at the General Manager level) makes an initial finding of wilful default and issues a show-cause notice to the borrower specifying the grounds for the proposed classification; the borrower is given an opportunity to make a personal representation before the Identification Committee; the Identification Committee then makes a decision; and the decision is reviewed by the Review Committee (a higher-level committee, typically chaired by the Chairman/MD of the bank). The show-cause notice stage is the critical intervention point for the borrower's legal counsel: the response to the show-cause notice — which must be filed within the specified period

(typically 21 days) and can be supplemented by an in-person representation — is the primary opportunity to: challenge the factual basis for each of the four wilful default categories alleged; present evidence refuting the allegation of fund diversion (by demonstrating that utilisation of funds was consistent with the sanctioned purpose); demonstrate that the default resulted from external market factors beyond the borrower's control rather than willful non-payment despite capacity; and challenge the bank's characterisation of asset disposals as "removal without consent" where the disposals were part of ordinary commercial operations conducted with the bank's implicit or explicit knowledge. The quality of the show-cause response — and the personal representation before the Identification Committee — is the most important determinant of whether the wilful defaulter classification proceeds or is withdrawn.

#### LEADING CASE

*Mahendra Kumar Jajodia v. State Bank of India (2022)*, Calcutta High Court: The High Court quashed a wilful defaulter classification where the bank's Identification Committee had issued the show-cause notice without providing adequate particulars of the alleged fund diversion — the notice stated only that "funds have been diverted" without specifying the transaction, amount, or destination of the alleged diversion. The Court held that natural justice requires the show-cause notice to give specific and sufficient particulars of each allegation, enabling the borrower to respond meaningfully. This ruling establishes a minimum particularity standard for wilful defaulter show-cause notices that practitioners can use to challenge inadequately particularised notices at the threshold.

### 6.3 High Court Challenge: Grounds and Prospects

High Court challenges to wilful defaulter classifications are maintainable under Article 226 of the Constitution — the wilful defaulter classification is a quasi-judicial determination by a statutory authority (the bank acting under RBI's regulatory directive) that affects the borrower's fundamental civil rights and liberties, including the right to carry on a trade or profession (Article 19(1)(g)) and the right against arbitrary state action (Article 14). The grounds on which High Courts have quashed wilful defaulter classifications include: failure to provide adequate particulars in the show-cause notice; failure to give the borrower a genuine opportunity for personal representation; reliance on irrelevant material or evidence not disclosed to the borrower; making a classification that is not supported by the evidence even on the bank's own case; and failing to consider the borrower's evidence refuting the diversion or siphoning allegations. The High Court's review is not limited to procedural grounds — courts will also examine whether the factual basis for the classification meets the legal definition of wilful default, and have quashed classifications where the alleged "fund diversion" was in fact an ordinary commercial transaction (payment to a related party for genuine goods or services) that the bank's committee had characterised as diversion without adequate analysis.

defence are the three pillars of stressed asset advisory practice in the banking sector. The IRAC Norms' technical mechanics — 90-day criterion, COVID moratorium credits, provisioning escalation — determine both the legal validity of NPA classifications and the economic parameters of OTS negotiations. The June 2019 Prudential Framework's ICA mechanism creates a mandatory 30-day review and 180-day resolution timeline that structures consortium debt resolution. ARC transactions, NARCL assignments, and SR disputes require specialist knowledge of the SARFAESI trust structure and RBI ARC regulations. Wilful defaulter proceedings — with their career-ending and credit-barring consequences — demand the most rigorous show-cause response practice and aggressive High Court challenge where procedural or substantive grounds are available.