

Banks should pass reasoned orders while declaring entity or person wilful defaulter: HC

MUMBAI: The Bombay High Court has said banks and financial institutions should pass reasoned orders before declaring an entity or person a wilful defaulter under the Reserve Bank of India's Master Circular.

A division bench of Justices B P Colabawalla and Somasekhar Sundaresan, in its order on March 4, noted that wilful defaulters are ostracized from access to the financial sector and hence, the discretion given to banks under the circular should be exercised with caution as mandated by the RBI.

"Banks and financial institutions that seek to invoke the Master Circular to declare occurrence of wilful default, must share the reasoned orders passed by its Identification Committee and Review Committee," the HC said.

The bench was hearing a petition filed by Milind Patel, former joint managing director of IL&FS Financial Services Limited (IFIN), challenging an order passed by the Union Bank of India in February 2023 declaring the firm and its promoters wilful defaulters under the 2015 Master Circular issued by the RBI.

The RBI's circular calls for banks/financial institutions to submit data on wilful defaulters on a quarterly basis, which



is also communicated to the Securities and Exchange Board of India (SEBI).

According to the plea, in July 2022, the Union Bank issued show cause notice to the IFIN and Patel saying it had formed a prima facie view that they deserved to be declared as wilful defaulters.

In February 2023, the bank's review committee passed an order declaring the firm and its promoters as wilful defaulters.

The high court said once a final order of declaring an entity or firm as wilful defaulter is passed, then multiple grave and serious penal consequences follow.

"In a nutshell, the wilful defaulters are ostracized from access to the financial sector. No additional facilities can be granted to such a person by any bank or financial institution," the HC said.

The circular itself explicitly contains a note of caution that it would be imperative on the part of banks and financial

institutions to put in place a transparent mechanism for the entire process so that penal provisions are not misused, it said.

The HC said the RBI in its circular has also mandated that evidence of wilful default must be examined by the bank.

"The discretion conferred on these banking entities to inflict penal consequences was meant to be kept to the bare minimum, which only underlines that the exercise of discretion has to be reasonable and not arbitrary," the bench said.

In any proceedings that can inflict serious civil consequences on a citizen, the person or entity should be provided with detailed and proper reasons, it said.

The objective of initiating proceedings against someone by issuance of a show cause notice was not to somehow find that person or entity guilty of wilful default but the objective is to arrive at the truth, the HC said.

In the present case, the final order was a near-verbatim reproduction of the show cause notice and was not a reasoned order, it said.

Pursuant to a suggestion from the court, the Union bank submitted that it would withdraw the order and continue the proceedings from the stage of the show cause notice. **AGENCIES**