

Framework for Compromise Settlements and Technical Write-offs

[Circular dated June 8, 2023](#) on 'Framework for Compromise Settlements and Technical Write-offs'

A. COMPROMISE SETTLEMENT IN WILFUL DEFAULT AND FRAUD CASES

1. Is it true that the Reserve Bank, vide the above circular, has introduced a new clause permitting lenders to enter into compromise settlement with borrowers classified as fraud or wilful defaulter?

No. The said provision enabling banks to enter into compromise settlement in respect of borrowers categorised as fraud or wilful defaulter is not a new regulatory instruction and has been the settled regulatory stance for more than 15 years. This enabler is already available to banks as per the extant instructions, as given under:

- i. RBI had advised IBA vide [letter dated May 10, 2007](#) that, "(i) banks may enter into compromise settlement with wilful defaulters/ fraudulent borrowers without prejudice to the criminal proceeding underway against such borrowers; (ii) All such cases of compromise settlements should be vetted by Management Committee/ Board of banks."
- ii. [Master Circular on Wilful Defaulters dated July 1, 2015](#) envisages lenders agreeing to compromise settlement with borrowers classified as wilful defaulters and states that such cases need not be reported to Credit Information Companies provided inter alia that, "the borrower has fully paid the compromised amount."
- iii. [Master Directions on Frauds dated July 1, 2016](#) provides for compromise settlement with borrowers classified as fraud, subject to the condition that, "No compromise settlement involving a fraudulent borrower is allowed unless the conditions stipulate that the criminal complaint will be continued."

2. Does the above RBI circular dilute the penal measures applicable to borrowers classified as wilful defaulter or fraud?

No. The penal measures currently applicable to borrowers classified as fraud or wilful defaulter in terms of the [Master Directions on Frauds dated July 1, 2016](#) and the [Master Circular on Wilful Defaulters dated July 1, 2015](#), respectively, remain unchanged and shall continue to be applicable in cases where the banks enter into compromise settlement with such borrowers.

Such penal measures entail inter alia that no additional facilities should be granted by any bank/ FI to borrowers listed as wilful defaulters, and that such companies (including their entrepreneurs/ promoters) get debarred from institutional finance for floating new ventures for a period of five years from the date of removal of their name from the list of wilful defaulters. In addition, borrowers classified as fraud are debarred from availing bank finance for a period of five years from the date of full payment of the defrauded amount.

3. Does the minimum cooling period of 12 months prescribed in the above circular imply that even borrowers classified as fraud or wilful defaulter will be able to borrow fresh funds from the lenders after the cooling period?

No. The cooling period has been introduced as a general prescription for normal cases of compromise settlements, without prejudice to the penal measures applicable in respect of borrowers classified as fraud or wilful defaulter as per the [Master Directions on Frauds dated July 1, 2016](#) and the [Master Circular on Wilful Defaulters dated July 1, 2015](#), respectively, as mentioned at (2) above.

4. What are the safeguards to ensure that the provisions of compromise settlement with borrowers classified as fraud or wilful defaulter, are not mis-utilized?

Compromise settlement is not available to borrowers as a matter of right; rather it is a discretion to be exercised by the lenders based on their commercial judgement.

The prudential guidelines provide sufficient safeguards with regard to such settlements considered by the lenders:

- All such decisions are required to be taken by lenders as per their Board approved policies, instead of adopting an ad-hoc approach in each case;
- The circular further strengthens the regulatory guidance by mandating that all such cases of compromise settlement involving borrowers classified as fraud or wilful defaulter must be approved by the Board;
- Such settlements shall be without prejudice to the criminal proceeding underway or to be initiated, if under consideration of the lenders against such borrowers;
- As already mentioned, the extant penal provisions continue to remain applicable in such cases.
- Wherever recovery proceedings are pending before a judicial forum, any settlement arrived at with the borrower shall be subject to obtaining a consent decree from the concerned judicial authorities.
- The Boards of lenders have been entrusted with the oversight of the overall trends in approvals of all compromise settlements, including specifically the breakup of accounts classified as fraud, red-flagged, wilful defaulter and quick mortality accounts.

These guidelines will ensure greater transparency of the whole process.

5. From a public policy perspective, what is the rationale for permitting lenders to enter into compromise settlement with borrowers classified as fraud or wilful defaulter?

The primary regulatory objective is to enable multiple avenues to lenders to recover the money in default without much delay. Apart from the time value loss, inordinate delays result in asset value deterioration which hampers ultimate recoveries. Compromise settlement is recognized as a valid resolution mechanism under the [Prudential Framework on Resolution of Stressed Assets dated June 7, 2019](#). The imperatives for lenders are no different when it comes to recovery from borrowers classified as fraud or wilful defaulter. Continuing such exposures on the balance sheets of the lenders without resolution due to legal proceedings would lock lenders' funds in an unproductive asset, which would not be a desirable position. As long as larger policy concerns are suitably addressed and the costs of malafide actions are made to be borne by the perpetrators, early recoveries by lenders should be a preferred option, subject to safeguards. Further, continuation of criminal proceedings underway or to be initiated against the borrowers classified as fraud or wilful defaulter, would ensure that perpetrators of any malafide action do not go scot-free.

6. As per [Prudential Framework for Resolution of Stressed Assets dated June 7, 2019](#), lenders are not permitted to restructure borrower accounts classified as fraud or wilful defaulter, except in case of change in ownership. Why a different treatment is prescribed for compromise settlements for such borrowers?

Restructuring in general entails the lenders having a continuing exposure to the borrower entity even after restructuring and hence, in case of borrowers classified as fraud or wilful defaulter, permitting lenders to continue their credit relationship with the borrower entity would be fraught with moral hazard. On the other hand, a compromise settlement entails a complete detachment of the lender with the borrower. Therefore, permitting lenders to settle with the borrowers as per their commercial judgement would enhance recovery prospects.

B. TECHNICAL WRITE-OFF

7. The circular also permits the lenders to undertake technical write-offs of amount outstanding relating to borrowers in default. Doesn't such a practice encourage default behavior, as the costs of default are borne entirely by the lenders and defaulting borrowers do not face any consequences?

No. As defined in the circular, technical write-off refers to cases where the NPAs remain outstanding at borrowers' loan account level, but are derecognised by the lenders only for accounting purposes. Technical write-off is a normal banking practice undertaken by the lenders to cleanse the balance sheets of bad debts which are either considered unrecoverable or whose recovery is likely to consume disproportionate resources of the lenders. However, such technical write-offs do not entail any waiver of claims against the borrower and thus the lenders' right to recovery is not undermined in any manner. Therefore, the defaulting borrowers are not benefited in any manner and their legal obligation as well as the costs of such defaults for them remain unchanged vis-à-vis the position prior to technical write-offs.

The circular only provides clarity on definition of technical write-off and a broad guidance on the process to be followed by the lenders for technical write-offs, which will ensure consistency in the approach followed by various lenders.

C. GENERAL

8. What are the key objectives that the above circular seeks to achieve?

The circular is intended to achieve the following objectives:

- i. It rationalises the existing regulatory guidance to banks on compromise settlements, consolidating various instructions issued over the years. It also tightens some of the related provisions and ensures greater transparency.
- ii. By providing a clear regulatory framework, it enables other regulated entities, particularly cooperative banks, to undertake compromise settlements as part of the normal resolution efforts.
- iii. It provides clarity on definition of technical write-off and provides a broad guidance on the process to be followed by the regulated entities for technical write-offs, which is a normal banking practice.
- iv. As a disincentive to both the lenders and the borrowers, it introduces the concept of cooling period for normal cases of compromise settlement during which the lender undertaking settlement shall not take any fresh exposure on the borrower entity. In case of borrower accounts classified as wilful defaulter or fraud, the debarment to obtain fresh finance, as explained at (2) above, will apply.