

Loan Recovery from Fugitive Offenders

July 3, 2021

The Enforcement Directorate (ED) recently came out with a statement saying that it has seized assets worth ₹18,170.02 crore belonging to three fugitive businessmen. The seized assets belong to liquor baron Vijay Mallya and diamond traders Nirav Modi and Mehul Choksi – all three left India before law enforcement agencies could nab them for fraud. The process of loan recovery from fugitive offenders thus becomes important for IAS aspirants.

In news: Will the money recovered from Vijay Mallya, Nirav Modi and Mehul Choksi help banks?

Placing it in syllabus: Economy

Dimensions

- Crony lending
- Systemic problems of banks
- Laws associated with loan recovery
- ED's role in recovery
- How would banks recover their losses?
- Recovery and the delay

Content:

Crony Lending

- The allocation of credit by banks on “soft” terms to friends and relatives rather than on the basis of “hard” market criteria is often termed **Crony Lending**
- Crony Lending gives preferential access to long term bank credit for firms with close ties to banks i.e. the financial sector decides to actually lend to a particular borrower who is more connected, but may not

be creditworthy

- Firms with “crony” ties to banks and politicians get greater access to long-term debt than firms without such ties.
- Crony lending exacerbates bad loans and also deprives a worthy borrower of funds/credit, because an undeserving one has already cornered it.
- The indiscriminate lending to unworthy cronies has created the bad loan crisis in India.
- These politicians meddle in banks and compel them to lend to the cronies, the system’s favourites, even if they are unworthy/ineligible for the loans given to them.
- India’s Chief Economic Adviser Krishnamurthy Subramanian, while speaking at a FICCI event said that such lending to cronies was resulting in capital flowing to entities that were not the most creditworthy and this impaired the quality of lending on large loans.

Cronyism:

- Politically, “cronyism” is derogatorily used to imply buying and selling favors, such as: votes in legislative bodies, as doing favors to organizations, giving desirable ambassadorships to exotic places, etc.
- Whereas cronyism refers to partiality to a partner or friend, nepotism is the granting of favour to relatives

Crony Capitalism

- It is an economic system in which businesses thrive not as a result of free enterprise, but rather as a return on money amassed through collusion between a business class and the political class.
- This is often achieved by the **manipulation of relationships with state power** by business interests rather than unfettered competition in obtaining permits, government grants, tax breaks or other forms of state

intervention over resources.

- Thus, business interests exercise undue influence over the state's deployment of public goods

Systemic Problems of Banks

Political Inference in PSBs

- Currently, India's banking industry is dominated by public sector banks, which are heavily prone to political influence of various kinds, according to experts.
- This affects the health of banks, which are forced to lend as per special interests while ignoring any business sense.
- A large portion of the big ticket bad loans today involve loans by public sector banks (which control over 70% of the sector) to cronies patronised by the ruling political party of the time.

Huge NPAs

- The Indian banking system has been infected with bad loans or NPAs as they are popularly known.
- According to the RBI, the total size of bad loans in the balance sheets of Indian banks has declined over the last few years. NPAs at a gross level was just around ₹9 lakh crore as of March 31, 2020, down significantly from over ₹10 lakh crore two years ago.
- But, analysts point out that it is mostly the result of larger write-offs rather than due to improved recovery of bad loans or a slowdown in the accumulation of fresh bad loans.

Laws Associated with Loan Recovery

Prevention of Money Laundering Act (PMLA) 2002

The PMLA was enacted in 2002 and it came into force in 2005.

The **Directorate of Enforcement (ED)** in the Department of Revenue, Ministry of Finance is responsible for investigating the cases of offence of money laundering under PMLA.

The chief objectives of this legislation are:

- To prevent and control money laundering.
- To confiscate and seize the property obtained from the laundered money; and
- To deal with any other issue connected with money laundering in India

Following actions can be taken against the persons involved in Money Laundering:-

- Attachment of property, seizure/ freezing of property and records
- Persons found guilty of an offence of Money Laundering are punishable with imprisonment for a term which shall not be less than three years but may extend up to seven years and shall also be liable to fine
- The prosecution or conviction of any legal juridical person is not contingent on the prosecution or conviction of any individual.

Insolvency and Bankruptcy Code (IBC) 2016

- The bankruptcy code is a one stop solution for resolving insolvencies, which previously was a long process that did not offer an economically viable arrangement.
- The code aims to protect the interests of small investors and make the process of doing business less cumbersome.
- Centre introduced the IBC in 2016 to resolve claims involving insolvent companies.
- IBC was intended to tackle the bad loan problems that

were affecting the banking system.

- The IBC process has changed the debtor-creditor relationship. It provides for a time-bound process to resolve insolvency.
- When a default in repayment occurs, creditors gain control over debtor's assets and must take decisions to resolve insolvency.
- Under IBC, debtor and creditor both can start 'recovery' proceedings against each other.
- Companies have to complete the entire insolvency exercise within 180 days under IBC. The deadline may be extended if the creditors do not raise objections on the extension.
- For smaller companies, including startups with an annual turnover of Rs 1 crore, the whole exercise of insolvency must be completed in 90 days and the deadline can be extended by 45 days.
- If debt resolution doesn't happen the company goes for liquidation.

The Fugitive Economic Offenders Act, 2018 (FEOA)

- The main intent of FEOA is to provide for measures to deter fugitive economic offenders from evading the process of law in India by staying outside the jurisdiction of Indian Courts.
- Since most economic offences pertain to non-payment of loans which have weakened the Indian economy, the FEOA has been put in force to curb the shortcomings in the civil and criminal laws, to deal with such offenders staying offshore.

Under the FEOA an individual may be declared as a Fugitive Economic Offender ("FEO") upon two important criteria i.e. if

- an arrest warrant has been issued against the person for any Scheduled Offences where the value involved is over

Rs 100 crore, and

- He has left the country and refuses to return to face prosecution.

To declare an individual as an FEO, an application has to be filed in a “Special Court” (designated under the Prevention of Money-Laundering Act, 2002) containing details of the properties to be confiscated, and any information about the individual’s whereabouts.

The Special Court shall issue notice to the individual to appear at a specified place in at least six weeks from issuance of notice. Proceedings will be terminated if the individual appears.

FE0A allows designated authorities to provisionally attach properties of an accused, while the application is pending before the Special Court.

Upon declaration as an FEO, properties of the individual may be confiscated and vested in the Central Government, free of encumbrances (rights and claims in the property).

Further, the FEO or any company associated with him may be barred from filing or defending any civil claims.

ED’s Role in Recovery:

The ED is a multi-disciplinary association delegated with the task of securing proceeds of crime under various financial laws, such as – Foreign Exchange Management Act, 1999 (FEMA) and Prevention of Money Laundering Act, 2002 (PMLA), and more recently the Fugitive Economic Offenders Act, 2018 (FE0A).

The main functions of ED under these laws are: –

- To Investigate the contravention of provisions of any law resulting in financial fraud/crimes like Hawala transactions, money laundering, financing terrorist activities or others affecting the sovereignty and

- integrity of the nation;
- To Confiscate or attach the properties and other proceeds of crime on sufficient evidences under the FEMA and PMLA;
 - Prosecuting the suspected offenders and bringing them to justice under all the laws;
 - Rendering cooperation to the foreign countries regarding fugitive economic offenders according to the recently enacted law of FEOA.
 - And all other powers of investigation like summons, search and seizure etc conferred on an Income Tax Authority under the IT Act, 1961.
 - To realize penalties imposed on conclusion of adjudication proceedings.
 - To provide and seek mutual legal assistance to/from contracting states in respect of attachment/confiscation of proceeds of crime as well as in respect of transfer of accused persons under PMLA.

In 2019, the ED managed to convince the courts to declare Mr. Mallya and Mr. Modi as fugitive economic offenders under the Fugitive Economic Offenders Act, 2018, allowing it to seize assets owned by them.

Of the ₹18,170.02 crore seized by the ED under the PMLA, assets worth ₹9,041.5 crore have already been handed over to banks according to the agency. The ED estimated that the seized assets would help public sector banks recuperate about 80% of their losses from the loans given to companies connected to these three individuals.

It also noted that assets worth 40% of the total loss amount had already been handed over to the concerned banks. This includes cash worth approximately ₹6,600 crore obtained through the sale of shares.

How would banks recover their losses?

- The actual cash worth ₹6,600 crore transferred by the ED will obviously help public sector banks, which have been troubled by bad loans, to recoup some of their losses
- However, the recovered amount is unlikely to have any major impact on the overall health of banks.
- This is simply because bank losses attributed to these fugitives are tiny compared to the overall amount of bad loans in the books of banks.
- It is estimated that the total bad loans of Indian banks stood at more than ₹8 lakh crore at the end of September 2020.
- Some believe it could easily cross ₹10 lakh crore by the end of the financial year 2021 due to the impact of the two waves of the COVID-19 pandemic on repayments.
- The seizure and the liquidation of assets may help in paying back a significant share of the liabilities that these fugitives owe to banks.

Recovery and the delay

Case Burden:

- Despite laws such as the Insolvency and Bankruptcy Code (IBC), 2016, recovery of dues from defaulters remains a prolonged process for banks as courts are burdened with cases.
- Under the new regime, the amount lenders have managed to recover from defaulters has improved significantly when compared to the pre-IBC regime.
- However, cases have been piling up and the existing Benches of the National Company Law Tribunal have been unable to dispose of cases within deadlines.
- This may extend the resolution process of troubled companies into several years, which was the case before the IBC regime.

Absence of Robust Market:

- Further, when the resolution of a company is deemed infeasible and the company is liquidated, the recovery made by lenders is abysmal due to the absence of a robust market for the sale of stressed assets.
- For example, when banks tried several times in the past to sell assets such as various properties owned by Mr. Mallya, the sales did not attract significant buyer interest.
- So, it is likely that banks may face hurdles trying to sell illiquid assets owned by the fugitive offenders and may not actually be able to recover the amounts cited by the ED

Mould your thought: How does crony lending affect the banking system in India? Discuss the problems associated with recoveries of loans in India.

Approach to the answer:

- Introduction
- Define Crony Lending
- Discuss the problems created by crony lending in India with examples
- Discuss the laws related to recovery and ED in brief
- Write about the reasons for delay in recoveries
- Conclusion