

FEMA and RBI

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The Foreign Exchange Management Act, 1999 (FEMA)

Amendments in Foreign Exchange Management (Non-debt Instruments) Rules, 2019

[Gazette Notification dated 16th August 2024](#)

The Ministry of Finance, Department of Economic Affairs, has vide the above notification, amended FEM (NDI) Rules, 2019 (**NDI Rules**), with the object of synchronizing provisions across existing FEMA regulatory framework.

The brief synopsis of amendments is enumerated here below:

- **Government approval on transfer of equity instruments under NDI rules (Rule 9)**

Under the erstwhile rule, if the Indian company is engaged in a sector i.e. under government approval route, then the transfer requires prior government approval. Pursuant to amendment in rule 9, prior government approval will be required for transfer or issue in all cases wherever Government approval is applicable and shall not limited to sector specific approval.

- **Share Swap transaction (Rule 9A)**

The existing NDI Rules allowed Indian company to 'issue' equity instruments to a Person Resident Outside India (**PROI**) in exchange for equity instruments from another Indian company. However, it did not explicitly permit the 'transfer' of equity instruments of an Indian Company between a Person Resident in India (**PRI**) and PROI, and it required prior government approval. To address this issue, Rule 9A has been added to the NDI Rules, and Schedule I has been revised to facilitate the swapping of equity instruments and equity capital between Indian company and foreign entities, allowing for cross-border share swap transactions which is in line with the FEM (OI) Rules, 2022 and this will allow swapping of equity capital of foreign entities.

- **Downstream investment on non-repatriable basis**

According to the NDI Rules, an investment made by an Indian entity which is owned and controlled by a non-resident Indian (**NRI**) on a non-repatriation basis, was not considered for calculation of indirect foreign investment. The said explanation has now been enhanced to include overseas citizen of India (**OCI**), a company, a trust or a partnership firm incorporated outside India and owned and controlled by an NRI or an OCI, on a non-repatriation basis in compliance with Schedule IV of these rules.

- **Foreign Portfolio Investments (FPI)**

The amended NDI rules now allow aggregate foreign portfolio investment by FPI up to the sectoral or statutory cap, and it will not require government approval or compliance with sectoral conditions as the case may be, if such investment does not result in the transfer of ownership and/or control of the resident Indian company. Prior to this amendment, aggregate investment by foreign portfolio investors up to 49% or sectoral cap was permissible pursuant to the government approval or subject to compliance with sectoral requirements.

- **White Label ATM (WLA) Operations**

Foreign Direct Investment (FDI), up to 100%, is allowed under the automatic route in the activity of WLA Operations pursuant to compliance with sectoral specific conditions.

Amendments Under the Foreign Exchange (Compounding Proceedings) Rules, 2024

[Gazette notification dated 12th September 2024](#)

The Ministry of Finance has issued the Foreign Exchange (Compounding Proceedings) Rules, 2024, aiming to streamline compounding application processing, including introduction of digital medium, so as to simplify the provisions. The rules replace the Foreign Exchange (Compounding Proceedings) Rules, 2000.

Key changes in the above rules are enumerated herein:

- **Enhanced Monetary Limits:** Modification of monetary caps for compounding authorities of RBI to compound various contraventions:

Rank of RBI officer	Limit of sum involved Contravention	
	Earlier (as per Rules, 2000) In Rs.	New (as per Rules, 2024) In Rs.
Assistant General Manager	Less than 10 Lakhs	Less than 60 Lakhs
Deputy General Manager	Less than 40 Lakhs	Less than 2.5 Crores
General Manager	Less than 1 Crores	Less than 5 Crores
Chief General Manager	1 Crore or more	5 Crore or more

- **Compounding Filing Fee & Penalty:** Payment of the amount compounded will be done electronically and within 15 days from the date of compounding order with the prescribed fee of Rs 10,000 plus GST (prior to amendment Rs 5,000).
- **Revision in Compounding Application Format:** The application of compounding can be done physically or through PRAVAAH portal of RBI either suo moto or based on a Memorandum of Contraventions issued by the RBI. (The form to be filed for compounding matter has been provided in the aforesaid notification)
- **Non-Compoundable Cases:** New rule 9 has been introduced, which provides that no contravention shall be compounded, where:
 - (i) the amount involved is not quantifiable; or
 - (ii) where the provisions of section 37A of the Act are applicable; or
 - (iii) where the Directorate of Enforcement is of the view that the matter relates to serious contravention and the case is to be handled by appropriate Adjudicating Authority for

adjudicating contravention under section 13; or

- (iv) where the matter is already adjudicated by adjudicating
- (v) the compounding authority is of the view that the contravention involved requires further investigation by the Directorate of Enforcement authority.

- **Discontinuation of adjudication:** The New Rules make it clear that where any contravention is compounded before the adjudication of such contravention under section 16, no inquiry or further inquiry shall be initiated or continued, as the case may be, for adjudication of such contravention against the person in relation to whom that contravention is so compounded.

The Reserve Bank of India (RBI)

Master Directions on Fraud Risk Management

The RBI has issued 3 revised master directions on fraud risk management for the regulated entities, which are as follows:

- [Master Directions on Fraud Risk Management in Non-Banking Financial Companies \(NBFCs\) \(including Housing Finance Companies\) \(HFCs\)](#) dated 15th July 2024 (MD- NBFCs)
- [Master Directions on Fraud Risk Management in Urban Cooperative Banks \(UCBs\) / State Cooperative Banks \(StCBs\) / Central Cooperative Banks \(CCBs\)](#) dated 15th July 2024 (MD-Cooperative Banks)
- [Master Directions on Fraud Risk Management in Commercial Banks \(including Regional Rural Banks\) and All India Financial Institutions \(AIFIs\)](#) dated 15th July 2024 (MD-Banks and AIFIs)

Applicability

The provisions of these Directions are applicable to:

MD- NBFCs

All NBFCs (including HFCs) in the Upper Layer, Middle Layer and in the Base Layer (with asset size of Rs.500 crore and above).

MD-Cooperative Banks

All Primary UCBs and Rural Cooperative Banks i.e. StCBs and CCBs.

MD-Banks and AIFIs

- All banking companies (including foreign banks, Local Area Banks (LABs), Small Finance Banks (SFBs), Payments Banks (PBs)). Corresponding New Banks, Regional Rural Banks (RRBs)) and State Bank of India; (collectively referred to as Commercial Banks); and
- Export-Import Bank of India (Exim Bank), National Bank for Agriculture and Rural Development (**NABARD**), National Bank for Financing Infrastructure and Development (NaBFID), National Housing Bank (**NHB**) and Small Industries Development Bank of India (SIDBI) (hereinafter referred to as AIFIs).

Purpose

These Directions are issued with a view to providing a framework for prevention, early detection and timely reporting of incidents of fraud to Law Enforcement Agencies (LEAs), RBI, HNB and NABARD and dissemination of information by RBI and matters connected therewith or incidental thereto.

Governance Structure for Fraud Risk Management

- There should be a Board approved Policy on fraud risk management which should ensure compliance with principles of natural justice in a time-bound manner which at a minimum should include issuance of show cause notice (**SCN**), reasonable time of at least 21 days to respond to SCN, well laid out system to issuance and examination of SCNs. Orders issued against SCNs should include details like relevant facts/circumstances relied upon and reason for classification as fraud with details on conclusion about fraud and its classification.
- The Fraud Risk Management Policy should be reviewed by the Board at least once in 3 years, or more frequently.

Framework for Early Warning Signal (EWS) and Red Flagging of Accounts (RFA)

Banks, AIFIs and Cooperative Banks should have a framework for EWS and RFA under the overall Fraud Risk Management Policy approved by the Board. NBFCs in the Upper Layer and Middle Layer should have a framework for EWS under the overall Fraud Risk Management Policy approved by the Board.

Credit facility / Loan account classified as Red-flagged Account and Reporting of Fraud

In case of a credit facility / loan account classified as red-flagged account or if there is a suspicion / indication of wrongdoing or fraudulent activity, help of an external audit or an internal audit should be used as per their Board approved Policy, for further investigation in such accounts.

Role of Auditors

- During the course of the audit, auditors may come across instances where the transactions in the account or the documents point to the possibility of fraudulent transactions in the account. In such a situation, the auditor should immediately bring it to the notice of the senior management and if necessary, to the Audit Committee of the Board of the bank for appropriate action.
- Internal Audit in banks should cover controls and processes involved in prevention, detection, classification, monitoring, reporting, closure and withdrawal of fraud cases, and also weaknesses observed in the critical processes in the fraud risk management framework.

Guidelines on treatment of Dividend Equalisation Fund (DEF)- Primary (Urban) Co-operative Banks (UCBs)

[Notification dated 30th July 2024](#)

The RBI has observed that some UCBs have created the DEF through appropriation of profits, with an intent to utilise these balances to pay dividends in future years, when profits are not sufficient or where the bank has posted a net loss. The current rules prohibit making dividend payments from previously accumulated profits or reserves.

In order to provide a better treatment of these balances for regulatory capital purposes, the RBI has decided, as a onetime measure, to permit UCBs to transfer the balances in the DEF to general reserves/free reserves. The credit balances in general reserves/free reserves will qualify as Tier-I capital.

Suitable disclosures should be made of such transfers in the 'Notes on Accounts' to the Balance Sheet in terms of [Reserve Bank of India \(Financial Statements -Presentation and Disclosures\) Directions, 2021 dated 30th August 2021](#).

This circular is applicable to all Primary (Urban) Co-operative Banks. The instructions will come into force with immediate effect.

Prudential Treatment of Bad and Doubtful Debt Reserve by Co-operative Banks

[Notification dated 2nd August 2024](#)

With a view to bringing about uniformity in the treatment of Bad and Doubtful Debt Reserve (**BDDR**) for prudential purposes, the RBI has issued revised instructions on BDDR, as under:

- With effect from the FY 2024-25, all provisions as per Income Recognition, Asset Classification and Provisioning (**IRACP**) norms, whether accounted for under the head BDDR or any other head of account, should be charged as an expense to the P&L account in the accounting period in which they are recognised.
- After charging all applicable provisions as per IRACP norms and other extant regulations to the P&L Account, banks may make any appropriations of net profits below the line to BDDR, if required as per the applicable statutes or otherwise.
- As a one-time measure, with a view to facilitate rectification and smoother transition to an AS compliant approach, the following regulatory treatment is prescribed:
 - ▲ The balances in BDDR as on 31st March 2024, representing such provisions as per IRACP norms (that have been created by directly appropriating from net profits instead of recognising as an expense in the P&L Account)

in the previous years (BDDR 2024) should be identified and quantified.

- ▲ As on 31st March 2025, to the extent of BDDR 2024, an appropriation should be made directly (i.e. below the line) from the P&L Account or General Reserves to provisions for Non-Performing Asset (**NPA**) (i.e. liability). Such provisions should be permitted to be netted off from Gross NPAs to arrive at Net NPAs.
- ▲ To the extent the balances in BDDR are not required as per applicable statute, the same can also be transferred to General Reserves/Balance in P&L Account below the line.
- ▲ After passing the above entries, the balances in the BDDR can be reckoned as Tier 1 capital. However, balance in the BDDR should not be reduced from Gross NPAs to arrive at Net NPAs.

This Circular is applicable to all Primary (Urban) Co-operative Banks, State Co-operative Banks and Central Co-operative Banks. The instructions are applicable with immediate effect.



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CNK & Associates LLP
Chartered Accountants

Mumbai

3rd Floor, Mistry Bhavan, Dinshaw Vachha
Road, Churchgate, Mumbai 400 020.
Tel: +91 22 6623 0600

501/502, Narain Chambers, M.G Road,
Vile Parle (East), Mumbai 400 057.
Tel: +91 22 6250 7600

Chennai: +91 44 4384 9695

GIFT City: +91 79 2630 6530

Pune: +91 20 2998 0865

Vadodara: +91 265 234 3483

Bengaluru: +91 91 4110 7765

Dubai: +971 4355 9533

Ahmedabad: +91 79 2630 6530

Delhi: +91 11 2735 7350

Abu Dhabi: +971 4355 9544