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RBI INTRODUCES REVISIONS TO THE COMPOUNDING DIRECTION

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Compounding of contraventions under the Foreign Exchange Management Act, 1999 (FEMA) is governed by the Foreign Exchange (Compounding Proceedings) Rules, 2000 and the Reserve Bank of India's (RBI) Master Direction on Compounding of Contraventions under FEMA, 1999 dated 1 January 2016 (Compounding Direction). On 17 November 2020, the RBI issued a circular (RBI Circular) revising the Compounding Direction with the aim of inter alia aligning its provisions with the latest applicable laws, simplifying the regulatory framework, and regulating dissemination of information in the public domain.

The changes introduced by the RBI Circular are as follows:

a. *Alignment with the NDI regime*: Prior to the RBI Circular, the Compounding Direction inter alia dealt with contraventions of the provisions under Foreign Exchange Management (Transfer or Issue of Security by a Person Resident Outside India) Regulations notified in 2000 and 2017 (FEMA 20). Since the FEMA 20 regime has been superseded by the Foreign Exchange Management (Non-Debt Instruments) Rules, 2019 dated 17 October 2019 (NDI Rules) and the Foreign Exchange Management (Mode of Payment and Reporting of Non-Debt Instruments) Regulations, 2019 dated 17 October 2019 (MPR Regulations), there was uncertainty over the manner in which the compounding process would apply to the contraventions under this new regime. The RBI Circular has resolved this uncertainty and identified specific instances of contraventions under the NDI Rules and the MPR Regulations, where the power to compound will be delegated to the regional offices of the RBI. The details are as follows:

S. NO.	REGULATION	DETAILS
NDI Rules		
(i)	Rule 2(k) read with Rule 5	Permission for making investment in equity shares by a person resident outside India
(ii)	Rule 21	Pricing guidelines
(iii)	Paragraph 3(b) of Schedule I	Issue of shares without approval of the RBI or the Government (wherever required)
(iv)	Rule 4	Receiving investment in India from non-resident or taking on record transfer of shares by investee company

(v)	Rule 9(4) and Rule 13(3)	Transfer of equity instruments or units of an Indian company held on a non-repatriation basis to a person resident outside India by way of a gift
MPR Regulations		
(i)	Regulation 3.1(I)(A)	Purchase or sale of equity instruments of an Indian company by a person resident outside India
(ii)	Regulation 4(1)	Filing of Form Foreign Currency - Gross Provisional Return (FC-GPR)
(iii)	Regulation 4(2)	Filing of Annual Return on Foreign Liabilities and Assets (FLA)
(iv)	Regulation 4(3)	Filing of Form Foreign Currency - Transfer of Shares (FC-TRS)
(v)	Regulation 4(6)	Filing of Form LLP (I)
(vi)	Regulation 4(7)	Filing of Form LLP (II)
(vii)	Regulation 4(11)	Reporting requirement regarding downstream investment

b. *Classification of contraventions*: Prior to the RBI Circular, the RBI on becoming aware of any contravention would classify such contraventions under specified heads and deal with them in the manner set out below:

(i) Technical/ minor: By issuing an administrative/ cautionary advice;

(ii) Material: By requiring compounding of such offences following the compounding procedure; and

(iii) Sensitive/ serious: By referring these contraventions to the Directorate of Enforcement.

For completeness, in cases where a compounding application admitting a contravention was filed, such contraventions would not be considered technical or minor.

The RBI Circular has done away with classifying a contravention as 'technical' or 'minor'. All technical / minor contraventions will now be regularized by imposing minimal compounding amount as per the compounding matrix provided in the Compounding Direction. This move allows for greater transparency regarding the regulator's decision-making process.

c. *Disclosure of compounding orders*: In 2016, the RBI had decided to publicly disclose the compounding orders issued by it on its website, with a view to increasing transparency. Pursuant to the RBI Circular, the RBI has now decided to disclose summary information (instead of uploading compounding orders) for all orders passed on or after 1 March 2020. The information disclosed will still include details of the applicant, nature of contravention, and the amount imposed for compounding the contravention. This will address confidentiality concerns of certain applicants and, at the same time, continue to provide transparency to the approach adopted by the RBI for specific violations.

Comment

The changes introduced by the RBI Circular to the Compounding Direction seem to indicate the regulator's intention to ease the regulatory process and align the provisions of the Compounding Direction with the current exchange control regime. While some of the changes are clarificatory, the RBI Circular has also brought about certainty in the procedural aspects / manner of dealing with contraventions and also addressed confidentiality concerns regarding disclosures in the compounding orders.

While the option for classification of 'technical' / 'minor' contraventions has been expressly done away with, in practice, this was in any event not being implemented at the RBI's end. However, the amendment would now make the process more efficient, and parties can directly proceed with compounding for all violations including minor / technical violations.

- *Moin Ladha (Partner), Anvita Mishra (Senior Associate), Charu Singh (Associate)*

For any queries please contact: editors@khaitanco.com

Mumbai
One Indiabulls Centre, 13th Floor
Tower 1 841, Senapati Bapat Marg
Mumbai 400 013, India

T: +91 22 6636 5000
E: mumbai@khaitanco.com

New Delhi
Ashoka Estate, 12th Floor
24 Barakhamba Road
New Delhi 110 001, India

T: +91 11 4151 5454
E: delhi@khaitanco.com

Bengaluru
Simal, 2nd Floor
7/1, Ulsoor Road
Bengaluru 560 042, India

T: +91 80 4339 7000
E: bengaluru@khaitanco.com

Kolkata
Emerald House
1 B Old Post Office Street
Kolkata 700 001, India

T: +91 33 2248 7000
E: kolkata@khaitanco.com