Analysis of RBI Directions on Compounding of Contraventions under FEMA

Introduction and Background

The Reserve Bank of India (RBI) has long been the principal regulatory body governing foreign exchange in India. The foundation of this regulatory framework lies in the Foreign Exchange Management Act (FEMA), 1999, which replaced the earlier Foreign Exchange Regulation Act (FERA) of 1973. FEMA was introduced to facilitate external trade, promote orderly development and maintenance of the foreign exchange market in India, and align with a more liberalized economic environment. One of the critical aspects of FEMA is its approach towards handling contraventions through the process of compounding, which aims to simplify and expedite the resolution of regulatory breaches.

Historical Perspective

The concept of compounding under FEMA was initially established to offer individuals and businesses a way to voluntarily admit contraventions and settle them without getting entangled in protracted legal proceedings. The need for compounding arose as India's economy expanded and globalization brought in increased foreign investments, resulting in a growing number of foreign exchange transactions. The objective was to promote compliance with FEMA regulations while minimizing the need for punitive legal measures and ensuring quick resolution of inadvertent violations.

Powers Conferred under FEMA for Compounding

Under Section 12 of FEMA RBI has been conferred with power to issue direction[1]. Section 15[2] vests the RBI with the authority to compound specific contraventions related to foreign exchange violations, except those related to unauthorized dealings in foreign exchange or foreign securities. This statutory provision empowers the RBI to lay down rules and guidelines for compounding contraventions in a structured manner, allowing entities to regularize their transactions by paying a penalty. Compounding, in this context, means voluntarily admitting the contravention, paying a specified amount, and seeking administrative closure of the issue without facing formal adjudication.

Notification of the Foreign Exchange (Compounding Proceedings) Rules, 2024

On September 12, 2024, the Government of India notified the Foreign Exchange (Compounding Proceedings) Rules, 2024 in supersession of the erstwhile Foreign Exchange (Compounding Proceedings) Rules, 2000. The New Rules are designed to bring greater clarity, efficiency, and uniformity to the compounding proceedings, aligning them with contemporary business practices and regulatory expectations.

The New Rules include key enhancements, such as increasing the monetary limits for compounding various types of contraventions, broadening the scope of eligible offenses, and providing clear exclusions for non-compoundable cases. The focus is on enabling quicker resolution of contraventions, thereby reducing the backlog of cases and allowing businesses to regularize their affairs without delay.

---

[1] 11. Reserve Bank’s powers to issue directions to authorised person .—(1) The Reserve Bank may, for the purpose of securing compliance with the provisions of this Act and of any rules, regulations, notifications or directions made thereunder, give to the authorised persons any direction in regard to making of payment or the doing or desist from doing any act relating to foreign exchange or foreign security. (2) The Reserve Bank may, for the purpose of ensuring the compliance with the provisions of this Act or of any rule, regulation, notification, direction or order made thereunder, direct any authorised person to furnish such information, in such manner, as it deems fit

[2] 15. Power to compound contravention.—(1) Any contravention under section 13 may, on an application made by the person committing such contravention, be compounded within one hundred and eighty days from the date of receipt of application by the Director of Enforcement or such other officers of the Directorate of Enforcement and officers of the Reserve Bank as may be authorised in this behalf by the Central Government in such manner as may be prescribed.

Objective

Compounding under the FEMA allows individuals and entities to voluntarily settle violations of foreign exchange regulations by admitting the contravention and paying a penalty. It has a significant impact on how FEMA violations are addressed, providing several advantages compared to legal adjudication:

Resolution Without Legal Proceedings

- **Simplified Process:** Compounding enables the violator to resolve FEMA contraventions without undergoing lengthy litigation or facing criminal prosecution.
- **Voluntary Admission:** By admitting the contravention and accepting the penalty, the violator acknowledges the breach of FEMA regulations and agrees to settle the matter through a formal yet straightforward administrative process.

Reduced Penalties and Fixed Costs

- **Standardized Penalty Structure:** The penalties imposed through compounding are generally lower and more predictable compared to the fines that might be levied through adjudication by the Enforcement Directorate (ED).
- **Fixed Penalty Calculation:** The RBI provides guidelines and a standardized matrix for calculating the compounding amount, which reduces ambiguity and ensures fairness in the process.

Avoidance of Criminal Proceedings

- **No Criminal Liability:** The compounding process leads to administrative closure of the matter, ensuring that no additional punitive action is taken for the same contravention.

Legal Finality and Administrative Closure

- **Conclusive Settlement:** Compounding provides a final settlement to the specific FEMA violation, meaning that the contravention is considered resolved upon payment of the compounded amount.

Limitations of Compounding

- **Not Applicable for Serious Violations:** Compounding is not available for severe offenses like money laundering, terror financing, or cases involving national security breaches under FEMA.
- **No Appeal Mechanism:** There is no formal provision to appeal against the compounding order once the penalty is decided.

Faster Compliance Process

- **Quick Resolution:** The entire compounding process under FEMA is designed to be completed within 180 days, ensuring that violations are resolved swiftly.
- **Electronic Processing:** The RBI's introduction of online submission and payment options for compounding applications further expedites the process, making it more efficient and user-friendly.

New Directions Issued by the RBI on Compounding of Contraventions under FEMA

On October 1, 2024, the Reserve Bank of India (RBI) issued new directions regarding the compounding of contraventions under the Foreign Exchange Management Act (FEMA), 1999[3]. These new directions, part of the updated Foreign Exchange (Compounding Proceedings) Rules, 2024, mark a significant evolution in the regulatory framework governing foreign exchange violations in India.

The updated directions focus on enhancing the efficiency of the compounding process by providing clear procedures, increasing monetary thresholds, and allowing for faster resolutions of minor and procedural breaches of FEMA.

[3] https://www.rbi.org.in/Scripts/NotificationUser.aspx?Id=12736&Mode=0

Key Highlights of the New Directions

- **Increased Monetary Limits:** The revised guidelines have raised the monetary limits that determine which level of RBI officers can handle the compounding of various contraventions, making the process more efficient by allowing lower-ranking officers to handle a greater number of cases.
- **Enhanced Digital Processing:** The directions now allow the use of electronic modes of payment such as NEFT, RTGS, and other online payment options for the payment of fees and penalties, speeding up the resolution of cases and making the process more user-friendly.
- **Clear Guidelines on Non-Compoundable Offenses:** The new rules provide specific details on offenses that cannot be compounded, such as those related to money laundering, terror financing, and serious violations.

Key Changes in the Revised RBI Directions (2024)

Below is a summary of the significant changes:

Aspect	Previous Guidelines	Updated Guidelines (2024)
Monetary Limits for Compounding	Limits up to INR 10 lakhs for AGM, INR 1 crore for GM	Enhanced limits: Up to INR 60 lakhs for AGM, INR 5 crores for GM, beyond INR 5 crores for CGM
Compounding Application Fee	INR 5,000	Revised to INR 10,000 plus applicable GST
Mode of Payment	Only through Demand Draft	Now allows NEFT, RTGS, and other online payment modes
Adjudication Proceedings	Could continue even after compounding	Revised to stop all adjudication upon completion of compounding
Non-compoundable Offenses	Limited guidance	Clear exclusions for cases involving money laundering, terror financing, or sovereignty issues
Appeals Against Orders	No clear stance on appeals	Explicitly states that appeals against compounding orders are not allowed

Conditions and Compliance for Compounding

The updated guidelines specify that certain conditions must be met before a contravention can be compounded:

- **Pre-requisite Approvals**: The applicant must ensure that all required approvals and rectifications are in place before applying for compounding.
- **Sensitive Cases Excluded**: Cases involving sensitive issues such as suspected money laundering, terror financing, or affecting the sovereignty of India are not eligible for compounding.
- **Voluntary Admission:** The contravention must be voluntarily admitted by the applicant, and the applicant must agree to the penalty amount as specified in the order.

Step-by-Step Process for Compounding

The process for compounding under the updated RBI guidelines involves several key steps:

- **Submission of Application:** The applicant must submit the compounding application in the prescribed format either physically or through the PRAVAAH portal, along with the required documents.
- **Payment of Fees:** The application fee of INR 10,000 plus GST should be paid via NEFT, RTGS, or demand draft. If the payment is made through electronic means, an email confirmation must be sent to the respective RBI office.
- **Review by Compounding Authority:** The compounding authority will review the application and may ask for additional information if needed. The review process considers factors like the nature of the contravention, the extent of economic gains, and past conduct of the applicant.

- **Personal Hearing (Optional):** Applicants may opt for a personal hearing (either in person or virtual). If the applicant decides not to attend, the application will be decided based on the submitted documents.
- **Issuance of Compounding Order:** The order will specify the amount to be paid and the provisions of FEMA that were contravened.
- **Payment of Compounding Amount:** The applicant must pay the compounded amount within 15 days of receiving the order.
- **Conclusion and Compliance Certificate:** Once the payment is realized, a compliance certificate is issued by the RBI, and the matter is closed.

Non-Compoundable Cases

The updated guidelines now explicitly list out cases that cannot be compounded:

- **Money Laundering and Terror Financing:** Offenses that have implications for national security and financial integrity.
- **Cases falling under Rule 9 of Foreign Exchange (Compounding Proceedings) Rules, 2024, are not eligible for compounding by the Reserve Bank.**
- **Section 3(a) Violations:** Contraventions under this section relate to unauthorized dealings in foreign exchange or foreign securities, which are strictly non-compoundable.
- **Adjudicated Cases:** Cases where an order imposing a penalty has already been passed by an adjudicating authority are excluded from compounding.

Consequences of non-compliance with compounding orders

The consequences of non-compliance with compounding orders under FEMA and RBI guidelines can be significant:

- **Rejection of Compounding Application:** If the compounding application is not complete or does not meet the requirements specified by the RBI, it may be rejected.
- **Referral to Enforcement Directorate (ED):** If the compounding amount specified in the compounding order is not paid within the stipulated time (usually 15 days), the case will be referred to the ED or other enforcement agencies.
- **Financial Penalties and Fines: If** rejection or non-compliance occurs, any fees paid during the compounding application process are non-refundable. When the matter is adjudicated by the ED, the fines or penalties imposed can be significantly higher than those under the compounding process, which would have been lower and more standardized.
- **Criminal Proceedings**: Non-compliance with the compounding order could trigger criminal proceedings if the contravention also constitutes a violation under criminal statutes, such as money laundering or unauthorized foreign exchange transactions.
- **Impact on Future Compliance and Eligibility:** If an entity or individual has a history of non-compliance with FEMA regulations, it may impact their eligibility for future compounding applications. The RBI may impose stricter scrutiny or outright reject any future requests for compounding.
- **Administrative and Regulatory Consequences**: The RBI and other regulatory bodies may increase monitoring and surveillance on entities that fail to comply, subjecting them to regular audits and scrutiny. The entity's ability to undertake capital account transactions, foreign direct investments, or external commercial borrowings could be restricted.

Thus, the new directions issued by the RBI on compounding of contraventions under FEMA mark a progressive shift in India's regulatory landscape for foreign exchange management. By enhancing monetary limits, streamlining digital payments, and providing clear guidelines on non-compoundable offenses, the RBI has taken significant steps to simplify compliance for businesses and individuals. These changes encourage voluntary adherence to regulations and align with global best practices, making India a more attractive destination for foreign investments.

We trust you will find this an interesting read. For any queries or comments on this update, please feel free to contact us at insights@elp-in.com or write to our authors:

***Mukesh Chand, Senior Counsel – Email –** mukeshchand@elp-in.com*