



FEFI — Certificate Examination in Foreign Exchange Facilities for Individuals

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CH-1 Evolution of FEMA

Topic 1 — Evolution of Foreign Exchange Regulation in India

- **Scarce resource** — Foreign exchange was long treated as a **scarce, controlled resource**.
- **Reason** — India held very limited reserves.
- **State control** — The State therefore regulated every use and flow of foreign currency.
- **Shift** — Policy later moved from **control** to **management**.

Stage	Development	Significance
1939	Exchange control introduced	Under the Defence of India Rules during World War II to control foreign currency use
1947	Foreign Exchange Regulation Act (FERA)	Gave legal authority to regulate forex transactions
1973	Comprehensive FERA 1973	Strong regulatory powers to RBI and Government
1991	Economic reforms	Liberalisation begins; strict controls reduced
1993	FERA amendment	Forex rules relaxed
1999	FEMA passed	Focus shifts from control to management
1 June 2000	FEMA in force	FERA repealed; savings clause keeps past proceedings alive

Basis	FERA, 1973	FEMA, 1999
Nature	Control of forex	Management of forex
Type of offence	Criminal	Civil (generally)
Presumption	Person presumed guilty	Person presumed innocent
Objective	Prevent misuse of forex	Facilitate external trade and payments
Consequence	Imprisonment possible	Monetary penalty ; civil detention only for unpaid penalty (s.14); one specified criminal provision (s.13(1C))

Example: Under FERA, an Indian company paying a foreign supplier needed specific RBI permission. Under FEMA, such a **current account** payment is generally freely allowed through an Authorised Dealer bank.

Topic 2 — Switch from FERA to FEMA

- **FERA era** — FERA was enacted when reserves were very weak and imposed extremely strict restrictions.
- **After 1991** — Following the **1991 reforms**, foreign trade grew and global integration began.
- **Stronger position** — **Reserves improved** and **foreign investment rose**.
- **Need** — A law suited to an open economy was therefore needed.
- Foreign exchange transactions became **easier**.
- **Current account** transactions are permitted, subject to the Current Account Transactions Rules.
- Focus shifted from **regulation to management**; RBI renamed its **Exchange Control Department** as the **Foreign Exchange Department**.

Example: Import of machinery: earlier RBI permission was needed; now the **AD bank** processes the payment without RBI approval, within the applicable rules.

Topic 3 — Need for Foreign Exchange Management

- **Size** — The forex market is the **largest and most liquid** financial market in the world.
- **Participants** — **Governments, banks, corporates and individuals**.
- **Why manage it** — The market is highly **volatile**, so it must be managed.

Reason	What it means
Rupee stability	RBI maintains stability of the external value of the rupee; sharp depreciation makes crude oil and other imports costlier
Smooth market functioning	Central bank ensures orderly transactions and curbs excessive volatility
Adequate reserves	To pay for imports such as crude oil, electronics, machinery
Export growth	Policy moved from import substitution to export promotion to earn more forex

Topic 4 — Main Features and Objectives of FEMA

Feature	Position under FEMA
Foreign payments	Payments to and receipts from persons outside India are regulated; Government can restrict when required
Residents' dealings	Residents cannot freely hold foreign securities, deal in forex or own foreign property except as permitted
Authorised persons	Dealings only through authorised persons — authorised dealers or money changers — subject to permissions and exceptions
Current account	Free, but Government may restrict transactions in public interest (e.g. gambling remittances)
Capital account	FDI, overseas investment, borrowing abroad: debt instruments regulated by RBI ; non-debt instruments by Central Government rules, in consultation with each other
Foreign assets	Held only as permitted; Section 6(4) protects assets acquired or held while non-resident , or inherited from a person resident outside India
Export reporting	Exporters furnish prescribed export declarations to the specified authority so that export proceeds are realised in India

FEMA has three objectives: **facilitate external trade and payments**, promote the **orderly development and maintenance of the forex market**, and **simplify** foreign exchange transactions.

Example: A student's tuition remittance abroad must go through an **authorised bank**; a textile exporter shipping to Europe must file the export declaration with shipping bill details.

Topic 5 — Statutory Framework and Residence

Section s	Subject
3–4	Dealings in forex and holding of foreign exchange, securities and property outside India — only as permitted
5	Current account transactions (Government may restrict)
6	Capital account : RBI for debt, Government for non-debt instruments; 6(4) and 6(5) protect assets of persons who were non-resident
7–9	Export declarations, realisation and repatriation , exemptions
10–12	Authorised persons , RBI directions and inspection
13–15	Penalties, enforcement of orders, compounding

- **Person resident in India** (Section 2(v)) — One residing in India for **more than 182 days** in the **preceding financial year**.
- **Excluded** — A person who has gone out or stays outside India for **employment** or **business or vocation**.
- **Also excluded** — One staying outside for any purpose showing an intention to stay outside for an **uncertain period**.
- **Included** — One who comes to India for such purposes.
- **Person resident outside India** (Section 2(w)) — One who is not resident in India.

Remember this

- FEMA residence depends on **stay plus intention**, not citizenship, and differs from income-tax residence.
- An Indian leaving for a foreign job becomes non-resident under FEMA from departure.

Topic 6 — Current Account Transactions Rules – Three Schedules

The **FEM (Current Account Transactions) Rules, 2000**, as amended, classify current account transactions into three schedules with different effects.

Schedule	Effect	Examples
I	Prohibited (Rule 3)	Remittance of lottery winnings , purchase of lottery tickets and banned magazines. Football pools, sweepstakes and racing/riding income. Drawal of forex for travel to Nepal or Bhutan . Specified transactions with residents of Nepal/Bhutan.
II	Need Government of India approval	Prescribed cultural tours and certain government-related remittances
III	Within prescribed limits ; beyond them RBI approval unless an exception applies	For resident individuals within LRS (USD 2,50,000 per financial year) ; education, medical treatment and emigration can have higher allowances on actual estimates

- **Limited exceptions** — Rules 4–5 allow some payments from **RFC** and **EEFC** accounts.
- **EEFC** — The Rule 6(2) exceptions apply to **EEFC** accounts.
- **No legalising** — These exceptions never legalise **Schedule I** transactions.

- **No blanket permission** — A foreign currency account does not give blanket permission to remit.
- Branch check-list: **residence, purpose, source account, limits, approvals, KYC/AML**.
- Delegation to the bank does not waive prohibitions or reporting.

Topic 7 — Liberalised Regime and Facilities for Individuals

- **Liberalised regime** — After FEMA, India adopted a **liberalised forex regime**.
- **Purpose** — It eases international transactions and integrates India with the global economy.
- **Authorisation** — **RBI** authorises dealers to handle permitted forex activities.
- **Licence** — The licence defines the scope and conditions of their business.
- **AD banks** — Banks such as SBI, ICICI, HDFC and Axis buy and sell forex for customers.
- Removed: **licensing requirements, quantitative restrictions** and **procedural complexities**.
- Residents may use forex for **travel, higher education, medical treatment, business meetings and conferences**, and setting up **joint ventures** abroad.
- Residents may keep **foreign currency accounts in India** (e.g. **EEFC** for an IT exporter) and credit permitted forex receipts.

Topic 8 — Recent Initiatives in the Banking System

Initiative	Key point
Heterogeneous (differentiated) banking	Universal banks, Small Finance Banks (MSMEs, small borrowers, rural areas) and Payments Banks improve inclusion and competition
Universal bank licensing	New private banks such as Bandhan Bank and IDFC Bank (now IDFC FIRST Bank) licensed in 2014
Basel III	Strengthens stability, risk management and capital adequacy; capital ratios maintained continuously

Basel III in India: minimum **CRAR 9%** plus **Capital Conservation Buffer (CCB) 2.5%** (fully phased in from **October 2021**), so total capital required is **11.5%** of risk-weighted assets (RWA):

$$\text{Minimum Capital} = \text{RWA} \times (9\% + 2.5\%)$$

Example: RWA ₹800 crore: minimum capital including CCB = $800 \times 11.5\% = \text{₹92 crore}$.

Topic 9 — Foreign Investment in India

Foreign investment comes as **FDI, Foreign Portfolio Investment (FPI), Depository Receipts (ADR/GDR)** and foreign investment in securities. It is a **non-debt** instrument governed by Government rules.

Measure	Position
Sectors open	Almost all; prohibited : atomic energy, railway operations, lottery, gambling and betting , chit funds, Nidhi companies, real estate business, tobacco products manufacture
Ownership	100% subsidiaries allowed in many sectors (e.g. Amazon, Microsoft)
Route	Automatic route : no prior Government approval; others under Government route

Measure	Position
FPI	Equity, G-secs, T-Bills, corporate bonds, mutual funds; a single FPI group holds below 10% of a company's equity; aggregate FPI limit = sectoral cap by default (the old 24% FII ceiling is historical)
NRIs	Invest on repatriation or non-repatriation basis (shares, real estate)
Depository Receipts	Indian companies issue GDRs/ADRs abroad (e.g. Infosys, ICICI Bank ADRs)

Topic 10 — Overseas Direct Investment (ODI)

- **Law** — Indian entities may invest abroad under the **Overseas Investment Rules and Regulations, 2022**.
- **General cap** — Total **financial commitment** is generally capped at **400% of net worth**.
- **Net worth basis** — Net worth is taken as per the last audited balance sheet.
- **RBI approval** — Commitment above **USD 1 billion** in a **financial year** needs **prior RBI approval**, even within the 400% ceiling.

Headroom = 400% × Net Worth – Existing Financial Commitment

Example: Net worth ₹250 crore; existing commitment ₹620 crore. Cap = 4 × 250 = ₹1,000 crore; further commitment possible = **₹380 crore** (subject to the USD 1 billion yearly approval trigger).

Topic 11 — External Commercial Borrowings (ECB)

ECBs are loans raised by eligible Indian entities from **recognised non-resident lenders**, a **debt** instrument regulated by RBI, to access cheaper global funds (e.g. infrastructure projects).

Lenders	Forms
Foreign banks; international financial institutions; foreign investors; overseas branches of Indian banks	Commercial bank loans · Buyers' credit · Suppliers' credit · Securitised instruments · FCCBs · FCEBs

Topic 12 — Liberalised Remittance Scheme (LRS)

- **Who may remit** — Resident individuals, **including minors**; the guardian countersigns for a minor.
- **Limit** — Up to **USD 2,50,000 per financial year (April–March)**.
- **Not available** — Corporates, partnership firms, **HUFs** and **trusts** cannot use LRS.
- **See** — Ch 8 (p. 26) for permitted uses, prohibited items and the full LRS rules.

Balance Available = USD 2,50,000 – ∑ Remittances in the FY

Example: Remitted USD 1,40,000 for fees and USD 65,000 for shares abroad this FY. Balance = 2,50,000 – 2,05,000 = **USD 45,000**.

Topic 13 — Currency Futures and Indian Depository Receipts

Item	Currency futures	Indian Depository Receipts (IDRs)
Nature	Exchange-traded derivative to hedge exchange-rate risk	Instrument representing shares of a foreign company , listed in India
Venue / issuer	NSE, BSE , Metropolitan Stock Exchange (formerly MCX-SX) and others authorised	Issued through a domestic depository
Regulator	RBI and SEBI jointly	SEBI, with approval of sectoral regulators
Use	Exporter expecting USD in 3 months locks the rate	Foreign company raises capital from Indian investors

Topic 14 — Exchange Rate Policy in India

The **exchange rate** is the value of one currency in terms of another (illustration: USD 1 = ₹83, not a current quote). India's regime evolved with economic conditions.

Phase	System
Post-Independence	Fixed rate ; rupee pegged to Pound Sterling (strong UK trade links)
Early 1970s	Bretton Woods collapse; many countries move to flexible rates
September 1975	Rupee delinked from Sterling and linked to an undisclosed basket of trading-partner currencies
1991	BoP crisis; rupee devalued in two stages
March 1992	LERMS – dual rate: part of forex earnings at official rate, rest at market rate
1 March 1993	Unified market-determined rate set by demand and supply

- **No fixed rate** — RBI does **not fix** a rate or target a level.
- **Aim** — It maintains **orderly conditions** and curbs **excessive volatility**.
- **Method** — It **buys or sells** foreign currency, directly or through public sector banks.
- **Example** — If the rupee falls sharply, RBI **sells USD**, adding dollar supply.

Permitted hedging derivatives: **forward contracts**, currency **futures**, currency **options**, currency **swaps**, **interest rate swaps**, **cross-currency options** and **Forward Rate Agreements**.

Topic 15 — Foreign Exchange Reserves Management

- **Law** — RBI manages reserves under the **RBI Act, 1934**.
- **Components** — **Foreign Currency Assets**, **gold**, **SDRs** and the **Reserve Tranche Position in the IMF**.
- **Uses** — Reserves pay for imports and stabilise the currency.
- **Protection** — They absorb external shocks and sustain investor confidence.

Principle	Meaning
Safety	Protect capital invested
Liquidity	Funds readily available
Return	Reasonable income — only after safety and liquidity

- Permitted investments: deposits with **BIS** and other central banks; deposits with foreign commercial banks; **sovereign or sovereign-guaranteed** debt with residual maturity **up to 10 years**; other instruments approved by RBI's **Central Board**; certain derivatives.
- Management is more complex because reserves have grown and global **exchange and interest rates** are volatile.
- Transparency: RBI periodically publishes reserves, external assets and liabilities, and earnings on reserves.

Topic 16 — Authorised Persons under Section 10(1)

Category	Who	Permitted business
AD Category-I	Mainly commercial banks	All permitted current and capital account transactions: trade payments, foreign investment, remittances
AD Category-II	Upgraded FFCs, travel/forex companies, some co-operative and RRBs	Specified non-trade current account transactions plus all money-changing activities
AD Category-III	Select financial institutions	Forex transactions incidental to their business (e.g. trade finance)
FFMC	Companies with an RBI money-changing licence (registration under Companies Act alone is not enough)	Buy forex from residents and non-residents; sell forex for private and business travel (airport counters, students, tourists)

Topic 17 — Penalties, Adjudication and Compounding

Penalty under Section 13(1)

- Quantifiable sum** — Penalty **up to three times** the sum involved.
- Non-quantifiable sum** — Penalty **up to ₹2 lakh**.
- Continuing contravention** — Further penalty **up to ₹5,000 per day** after the first day.

$$\text{Max Penalty} = 3 \times \text{Sum Involved}$$

$$\text{Max Penalty (non quantifiable)} = 2,00,000 + 5,000 \times (d - 1)$$

Example: Sum involved ₹18 lakh: maximum = $3 \times 18 = ₹54$ lakh. Non-quantifiable default continuing 31 days: $2,00,000 + 5,000 \times 30 = ₹3,50,000$.

- Section 14:** unpaid penalty within **90 days** can lead to **civil detention** — up to **3 years** if the demand exceeds **₹1 crore**, otherwise up to **6 months**.
- Section 13(1C):** foreign assets held in contravention above the notified threshold — imprisonment up to **5 years** and fine; **Section 37A** allows seizure of equivalent assets in India.
- FEMA's civil character is therefore the rule, not an absolute bar on detention.

Compounding is voluntary settlement of an admitted contravention under the **FEM (Compounding Proceedings) Rules, 2024** and RBI's **Master Direction — Compounding of Contraventions under FEMA, 1999**.

Point	Rule
Who compounds	RBI, for all eligible contraventions except Section 3(a) (Enforcement Directorate)
Application	Physically or through PRAVAAH , with fee ₹10,000 + 18% GST ; corrective administrative action must be complete
Order	Within 180 days of a complete application (not a filing deadline)
Payment	Compounded amount within 15 days of the order; non-payment means the application fails
Not compoundable by RBI	Similar repeat within 3 years ; non-quantifiable sums; Section 37A cases; already adjudicated; serious money-laundering, terror-financing or national-security concerns
Non-reporting relief	Amount may be capped at ₹2 lakh per regulation/rule for specified non-reporting contraventions — discretionary, not a blanket ceiling
Offices	Regional Offices: foreign investment; FED CO Cell, New Delhi: LO/BO/PO and non-resident accounts; CEFA, Mumbai: other cases

$$\text{Application Fee Payable} = 10,000 \times (1 + 18\%)$$

Example: Fee payable = $10,000 \times 1.18 = ₹11,800$; this is separate from the compounded amount fixed in the order.

FEFI | Module A | CH-1 | MCQs

Q1. Mr. Rao, an Indian citizen, left India on a 3-year overseas employment contract last month after living in India all his life. His FEMA status is: [Ref: Topic 5, p. 3]

- Resident, because he stayed over 182 days in the preceding financial year
- Non-resident from the date of departure for employment
- Resident until he becomes a foreign citizen
- Non-resident only after 182 days abroad

Q2. An individual asks his bank to remit his lottery winnings abroad from his RFC account. The bank should: [Ref: Topic 6, p. 3]

- Allow it as RFC funds are freely usable
- Allow it within the LRS limit
- Refuse — it is a Schedule I prohibited transaction
- Allow it with Government approval under Schedule II

Q3. A company has net worth ₹90 crore (last audited) and existing overseas financial commitment ₹310 crore. Ignoring other conditions, the further ODI commitment it can make under the general cap is: [Ref: Topic 10, p. 4]

- ₹50 crore
- ₹40 crore
- ₹360 crore
- Nil

Q4. A resident individual remitted USD 1,80,000 for a flat abroad and USD 45,000 for travel this financial year. How much more can he remit under LRS? [Ref: Topic 12, p. 4]

- USD 70,000
- USD 25,000
- USD 2,50,000
- Nil

Q5. An adjudicating authority finds a FEMA contravention involving ₹7.5 lakh. The maximum penalty under Section 13(1) is: [Ref: Topic 17, p. 5]

- ₹2 lakh
- ₹7.5 lakh
- ₹22.5 lakh
- ₹15 lakh

Q6. A non-quantifiable FEMA contravention continued for 16 days. The maximum penalty including the daily component is: [Ref: Topic 17, p. 5]

- ₹2,00,000
- ₹2,80,000
- ₹3,50,000
- ₹2,75,000

Q7. An HUF wants to remit USD 50,000 abroad for investment under LRS. The bank should: [Ref: Topic 12, p. 4]

- (a) Decline — LRS is only for resident individuals
- (b) Allow it as HUF is a resident
- (c) Allow it with karta's declaration
- (d) Allow it up to USD 25,000

Q8. A forex company wants to sell foreign currency for travel and also handle specified non-trade current account remittances. The authorisation it needs is: [Ref: Topic 16, p. 5]

- (a) AD Category-I
- (b) AD Category-II
- (c) AD Category-III
- (d) FPMC licence only

Q9. The rupee depreciates sharply in a single day. The RBI action consistent with its exchange rate policy is: [Ref: Topic 14, p. 4]

- (a) Fix the rupee at a target rate
- (b) Buy US dollars in the market
- (c) Suspend currency futures trading
- (d) Sell US dollars from reserves to curb volatility

Q10. Which instrument is NOT a permitted avenue for RBI's forex reserve investment? [Ref: Topic 15, p. 4]

- (a) Equity shares of foreign companies
- (b) Deposits with the BIS
- (c) Sovereign debt with residual maturity up to 10 years
- (d) Deposits with foreign commercial banks

Q11. An exporter expecting USD in three months wants an exchange-traded hedge. The instrument and its regulators are: [Ref: Topic 13, p. 4]

- (a) Forward contract — RBI alone
- (b) Currency swap — SEBI alone
- (c) Interest rate swap — IRDAI
- (d) Currency futures — RBI and SEBI jointly

Q12. A firm files a complete FEMA compounding application with RBI. Which statement is correct? [Ref: Topic 17, p. 5]

- (a) Fee is ₹10,000 plus GST, and the compounded amount must be paid within 15 days of the order
- (b) No fee is payable
- (c) The compounded amount is always the maximum Section 13 penalty
- (d) RBI can compound Section 3(a) contraventions

Q13. A bank customer contravened FEMA and compounded a similar contravention 2 years ago. The RBI compounding position is: [Ref: Topic 17, p. 5]

- (a) Automatically compounded at ₹2 lakh
- (b) Generally not compoundable as it is a repeat within 3 years
- (c) Compoundable only by the Regional Office
- (d) Compoundable without any fee

Q14. A person fails to pay a FEMA penalty demand of ₹1.5 crore within 90 days. The maximum civil detention under Section 14 is: [Ref: Topic 17, p. 5]

- (a) 6 months
- (b) 1 year
- (c) 3 years
- (d) 5 years

Q15. Which foreign investment would be refused because the sector is prohibited for FDI? [Ref: Topic 9, p. 3]

- (a) Software services company
- (b) Pharmaceutical manufacturing
- (c) Single-brand retail
- (d) Lottery business

Answer key

Q	Ans	Q	Ans	Q	Ans	Q	Ans	Q	Ans
1	b	4	b	7	a	10	a	13	b
2	c	5	c	8	b	11	d	14	c
3	a	6	d	9	d	12	a	15	d

CH-2 Inward Remittances

Topic 1 — Inward Remittance and its Purposes

- **Cross-border remittance** — Transfer of money from one country to another.
- **Inward remittance** — Money received in India from abroad.
- **Start point** — The process starts in the foreign country with the **consent of the remitter**.
- **Channel** — Funds must reach India through a **permitted channel**.
- **Receipt** — Receipt need not always be into a bank account.

Term	Position
Sender / remitter	Person sending money from the foreign country
Beneficiary	Person receiving the money in India
Main senders	NRIs ; the USA, UAE and UK are leading source countries
Main purpose	Family support is the largest share (about two-thirds); the rest is for investment and business

India is one of the **largest remittance-receiving countries** in the world; its exact rank and annual inflow vary from year to year.

Example: An Indian working in Dubai sends ₹50,000 to his parents in Punjab. For India this is an inward remittance.

Topic 2 — Channels for Sending Money to India

Method	Speed	Risk	Typical use
Bank wire transfer	Fast	Low	Most common route
Money transfer agents (MTSS)	Very fast	Moderate	Quick personal transfers
Bank money order	Slow	Low	Small personal transfers
Foreign currency cheque	Slow	Low	Personal transfers
Foreign currency draft	Medium	Low	Business payments, payees unknown to remitter
Remittance card	Fast	Low	Frequent family transfers
Direct deposit / ACH	Automatic	Low	Regular monthly payments

Bank wire transfer