

Newsletter

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Editor's note

Dear Readers,

I am pleased to share with you our Newsletter for the month of January, 2024, which covers significant legal and regulatory developments.

The recent rulings by various High Courts in India shed light on significant aspects of arbitration law. The Allahabad High Court's ruling regarding interest reduction reaffirms the sanctity of arbitration awards and the illegality of unauthorized modifications. It emphasizes the need for strict adherence to established legal principles, preserving the integrity of arbitration outcomes. In contrast, the Jharkhand High Court's decision provides clarity on the grounds for setting aside arbitral awards. By emphasizing the requirement of patent illegality, the court ensures that awards are scrutinized only for egregious violations. Overall, these rulings provide valuable guidance to parties, arbitrators, and courts involved in arbitration proceedings, enhancing the efficacy and fairness of the arbitration process.

The Ministry of Corporate Affairs (MCA) continues to work towards enhancing transparency and stakeholder engagement. MCA's invitation for stakeholder comments on the draft amended Recruitment Rules for the Indian Corporate Law Service (ICLS) reflect MCA's commitment to inclusivity and participatory governance. By seeking input from stakeholders, MCA aims to ensure that the recruitment process for the ICLS aligns with evolving industry needs and best practices. Further, the introduction of a policy for Pre-Legislative consultation and comprehensive review of existing rules and regulations marks a pivotal step towards promoting transparency and accountability in rule-making processes. Furthermore, the Companies (Listing of equity shares in permissible jurisdictions) Rules, 2024, signify MCA's efforts to streamline listing procedures and facilitate cross-border investment opportunities for companies.

The Reserve Bank of India (RBI) has undertaken a series of noteworthy measures to foster a robust and resilient banking and financial framework. RBI's decision to exempt transfers of receivables acquired as part of the 'factoring business' from Minimum Holding Period (MHP) requirements underscores its efforts to stimulate secondary market operations and promote liquidity in the financial market. Additionally, RBI's initiatives such as the issuance of Master Circulars and revisions to eligibility norms for inclusion in the Second Schedule to the Reserve Bank of India Act, 1934, reflect its ongoing efforts to streamline regulatory processes and ensure compliance with evolving regulatory standards. These measures are likely to bolster the resilience and efficiency of the financial sector, while fostering a conducive environment for sustainable growth and stability in the Indian economy.

The Securities and Exchange Board of India (SEBI) has recently introduced several amendments and frameworks within the securities market. SEBI's guidelines for Alternative Investment Funds (AIFs) regarding holding investments in dematerialized form and appointing custodians aim to foster liquidity and streamline operational processes within the AIF space. SEBI's frameworks for short selling and foreign investment in AIFs demonstrate its commitment to facilitating diverse investment strategies and fostering a conducive regulatory environment for market participants. Moreover, SEBI's initiatives to streamline regulatory reporting by Designated Depository Participants (DDPs) and Custodians, as well as the extension of the timeline for verification of market rumors by listed entities, reflect its ongoing efforts to enhance market integrity and investor confidence.

The proactive steps taken by the Regulators help on various fronts all the stake holders at large with public being the largest beneficiary. It is to be noticed that whereas MCA focuses on corporate governance and transparency; RBI continues to work towards maintaining stability and resilience in the financial sector, and SEBI on regulating the securities market and protecting investor interests.

I hope you will find this edition useful.

Best wishes,

Rajesh Narain Gupta

Managing Partner,
SNG & Partners

A. ARBITRATION & CONCILIATION ACT, 1996:

1. Calcutta High Court: Parties to Arbitration Agreement must clearly state their intention to Arbitrate

The Calcutta High Court, while dismissing a petition for appointment of an arbitrator under Section 11 of the Arbitration & Conciliation Act, 1996, observed that parties to an arbitration agreement must clearly state their intention to arbitrate through a resounding yes and there cannot be any ifs and buts or an undecided mumble.

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2. Allahabad High Court: Reduction of interest is a modification of the original award and is illegal

The Allahabad High Court, while setting aside an order which reduced the interest awarded by the arbitrator, observed that the reduction of interest is nothing but a modification of the original arbitration award, and accordingly, the same is illegal and against the principles established by the Supreme Court.

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3. Jharkhand High Court: Mere contravention of substantive law of India, by itself, is not a ground to set aside an Arbitral Award

The High Court of Jharkhand, while dismissing an appeal directed against the judgment dated 25th February 2020 passed by the learned Presiding Officer, Commercial Court, in Commercial Case, dismissing the petition filed on behalf of the appellant under Section 34 of the Arbitration and Conciliation Act, 1996 challenging the award dated 11th March 2018 passed by the learned Arbitrator, held that an arbitral award may be set aside if the Court finds that it is vitiated by patent illegality appearing on the face of the award.

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4. Andhra Pradesh High Court: Use of word may in Section 34 of CPC confers a discretion of the Court to award or not to award interest or to award interest at such rate as it deems fit'

The single Judge Bench of the Andhra Pradesh High Court held that the use of word may “in Section 34 of Civil Procedure Code (CPC) confers a discretion of the Court to award or not to award interest or to award interest at such rate as it deems fit”.

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B. INSOLVENCY AND BANKRUPTCY CODE (IBC)

1. NCLAT, New Delhi: Even if OTS offer made on a without prejudice basis, it does not dilute the acknowledgment of debt

The National Company Law Appellate Tribunal (NCLAT), Principal Bench New Delhi observed that the Equated Monthly Instalment (EMI) appropriation from the Fixed Deposit Receipts (FDR) cannot be treated as automatic regularization of the loan account and that this was clear evidence of debt and default.

It was opined that even if the One-time Settlement (OTS) offer were made on a “without prejudice” basis, it does not dilute the acknowledgment of debt. Further, the OTS proposals, which undisputedly fall within the three- year period from the date of default, clearly provided for a fresh period of limitation of three years. Therefore, application was not time barred.

It was noted that in the present case, the default was committed by the Corporate Debtor prior to commencement of Section 10A of Insolvency and Bankruptcy Code, 2016 period. The default having been committed before the bar of Section 10A came into play, the Corporate Debtor was clearly not entitled to claim that the Section 7 application was not maintainable.

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2. NCLAT, New Delhi: MoU and ledger extracts insufficient to accept claims as financial debt

The NCLAT, Principal Bench New Delhi observed that the MoU mentioned the immovable properties, which was claimed to be owned by the Corporate Debtor for which the Second Party is the Appellant.

The MoU stated that the Appellant approached the Corporate Debtor for purchasing and or jointly developing the properties. The MoU, which was the basic document submitted by the Appellant to prove financial debt, did not indicate that transactions are covered by Section 5(8) of the Insolvency and Bankruptcy Code, 2016 (IBC).

Further, the ledger extracts also did not make the transaction as financial debt.

It was opined that the Appellant could not be treated as a real estate allottees on the basis of MoU, as per the definition of Section 5 (8)(f) Explanation of the IBC.

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C. MINISTRY OF CORPORATE AFFAIRS (MCA)

1. Inviting comments of stakeholders on draft amended Recruitment Rules for recruitment of Indian Corporate Law Service (ICLS) in different offices of the Ministry of Corporate Affairs

MCA has invited stakeholders to expedite their comments/objections or suggestion on the draft rules: Recruitment Rules for recruitment of Indian Corporate Law Service (ICLS) in different offices of the Ministry of Corporate Affairs.

The draft amended rules are available on the MCA's website.

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2. Policy for Pre-Legislative consultation and comprehensive review of existing rules and regulations

To bring greater transparency and involvement of the stakeholders, there is a need for public consultation in rule/regulation making exercise.

Therefore, the Ministry has decided to frame a policy for Pre-Legislative consultation and comprehensive review of existing rules and regulations. This policy is advisory in nature and shall be effective from January 01, 2024.

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3. Companies (Listing of equity shares in permissible jurisdictions) Rules, 2024

The Companies (Listing of equity shares in permissible jurisdictions) Rules, 2024 have been notified on January 24, 2024.

They shall be applicable to all unlisted public companies and listed companies- which issue securities for the purposes of listing on permitted stock exchanges in permissible jurisdictions.

Section 4 of the said rules provide for Listing on permitted stock exchanges in permissible jurisdictions. Section 5 sets out companies which are not eligible for issuing equity shares for listing in accordance with the rules.

The first schedule sets out the permissible jurisdictions and permitted stock exchanges.

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D. RESERVE BANK OF INDIA (RBI)

1. MHP Exemption for Transfer of Receivables

RBI has decided it has been decided that transfer of receivables acquired as part of 'factoring business' by eligible transferors will be exempted from Minimum Holding Period (MHP) requirement, subject to fulfilment of the following conditions:

- i. The residual maturity of such receivables, at the time of transfer, should not be more than 90 days, and
- ii. As specified under clauses 10 and 35 of these directions, the transferee conducts proper credit appraisal of the drawee of the bill, before acquiring such receivables.

This is being done to develop secondary market operations of receivables.

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2. Fair Lending Practice - Penal Charges in Loan Accounts: Extension of Timeline for Implementation of Instructions

RBI issued a circular dated August 18, 2023 on 'Fair Lending Practice - Penal Charges in Loan Accounts' (Reference: DoR. MCS.REC.28/01.01.001/2023-24).

The instructions were to become effective from January 01, 2024.

There were clarifications being sought by regulated entities in respect of reconfiguration of internal systems, therefore, it has been decided to extend the timeline for implementation in respect of all the fresh loans availed from April 1, 2024 onwards.

In case of existing loans, it has been decided that the switchover to new penal charges regime shall be ensured on the next review/renewal date falling on or after April 1, 2024, but not later than June 30, 2024.

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3. Basel III Framework on Liquidity Standards – Net Stable Funding Ratio (NSFR) – Review of National Development Banks

After a review, RBI has decided that All India Financial Institutions (AIFIs) i.e. EXIM Bank and National Bank for Financing Infrastructure and Development (NaBFID) shall be considered as National Development Banks (NDBs) for Net Stable Funding Ratio (NSFR) computation.

Under the existing NSFR framework, NABARD, NHB and SIDBI are considered as NDBs.

Further, unencumbered loans to NDBs with a residual maturity of one year or more than that would qualify for a 35 per cent or lower risk weight under the Standardised Approach for credit risk shall be assigned a Required Stable Funding (RSF) factor of 65 per cent (as against 100 per cent currently).

The present circular is applicable to all Scheduled Commercial Banks (excluding Payments Banks and Regional Rural Banks).

The circular shall come into force with immediate effect.

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4. Classification of MSMEs

RBI has made the following amendment in the Master Direction- Lending to Micro, Small & Medium Enterprises (MSME) Sector dated July 24, 2017 (updated as on July 29, 2022):

Existing Para 2.2

All the above enterprises are required to register online on the Udyam Registration portal and obtain 'Udyam Registration Certificate'.

Amendment to Para 2.2

All the above enterprises are required to register online on the Udyam Registration portal and obtain 'Udyam Registration Certificate'. For PSL purposes banks shall be guided by the classification recorded in the Udyam Registration Certificate (URC).

Further, Para 2.4 to 2.7 has been deleted.

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5. Master Direction – Reserve Bank of India (Commercial Paper and Non-Convertible Debentures of original or initial maturity upto one year) Directions, 2024

RBI has issued Master Direction titled as Master Direction – Reserve Bank of India (Commercial Paper and Non-Convertible Debentures of original or initial maturity upto one year) Directions, 2024.

These Directions shall be applicable to all persons/agencies dealing in Commercial Paper and/or Non-Convertible Debentures of original or initial maturity upto one year.

The said Direction shall come into force with effect from April 01, 2024.

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6. Amendment to the Master Direction (MD) on KYC

RBI in its circular dated February 25, 2016 titled as Master Direction (MD) on KYC provided the definition of Politically Exposed Persons (PEPs) in Section 3(a)(xvii).

To provide better clarity, it has been decided to include the definition of PEPs as an explanation to Section 41 of the Master Direction as under:

“Explanation: For the purpose of this Section, “Politically Exposed Persons” (PEPs) are individuals who are or have been entrusted with prominent public functions by a foreign country, including the Heads of States/Governments, senior politicians, senior government or judicial or military officers, senior executives of state-owned corporations and important political party officials.”

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7. Streamlining of Internal Compliance monitoring function – leveraging use of technology

TRBI observed that Supervised Entities (SEs) have adopted varying levels of automation to support this function, ranging from use of macro-enabled spreadsheets to workflow-based software solutions.

The review brought out that automation of the compliance monitoring process in SEs remains a work in progress with various aspects of this function being carried out with significant manual intervention.

There is, thus, a need to implement comprehensive, integrated, enterprise-wide and workflow-based solutions/ tools to enhance the effectiveness of this function.

Accordingly, Regulated Entities (REs) are advised to carry out a comprehensive review of the existing internal compliance tracking and monitoring processes and institute necessary changes to existing systems or implement new systems latest by June 30, 2024.

An appropriate monitoring mechanism may also be put in place to review the progress of its implementation.

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8. Master Circular- Exposure Norms and Statutory / Other Restrictions – UCBs

RBI has uploaded a master circular consolidating all the guidelines and notifications pertaining to Exposure Norms and Statutory / Other Restrictions – UCBs.

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9. Second Schedule to the Reserve Bank of India Act, 1934 – Norms for inclusion

RBI decided to revise the eligibility norms for inclusion of (urban) co-operative banks (UCBs) in the Second Schedule to the Reserve Bank of India Act, 1934 to bring them in conformity with the Revised Regulatory Framework.

Eligible UCBs satisfying the following criteria shall be considered for inclusion in the Second Schedule:

- a. CRAR of at least 3 per cent more than the minimum CRAR requirement applicable to the UCB; and
- b. No major regulatory and supervisory concerns.

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E. SECURITIES AND EXCHANGE BOARD OF INDIA (SEBI)

1. Guidelines for AIFs with respect to holding their investments in dematerialised form and appointment of custodian

The amendments in SEBI (Alternative Investment Funds) Regulations, 2012 has been notified on January 05, 2024.

As per Regulation 15(1)(i), Alternative Investment Funds (AIF) shall hold their investments in dematerialised form, subject to such conditions as may be specified by the Board from time to time.

The following has been specified:

- a. Investment by AIF on or after October 01, 2024 exempted from the requirement of being held in dematerialised form.
- b. Investment by AIF prior to October 01, 2024 shall be held in dematerialised form by the AIF on or before January 31, 2025.

In regard to appointment of custodians for AIFs, following has been specified:

- a. The custodian for a scheme of an AIF shall be appointed prior to the date of first investment of the scheme.

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2. Framework for Offer for Sale (OFS) of Shares to Employees through Stock Exchange Mechanism

The present framework regarding offering of shares to employees by the promoters of the company is as follows:

“19.1.2.2.4. Promoters of eligible companies shall be permitted to sell shares within a period of 2 (two) weeks from the OFS transaction to the employees of such companies. The offer to employee shall be considered as a part of the said OFS transaction.

19.1.5.3.2. The promoters may at their discretion offer these shares to employees at the price discovered in the said OFS transaction or at a discount to the price discovered in the said OFS transaction.

19.1.5.3.3. Promoters shall make necessary disclosures in the OFS notice to the exchange including number of shares offered to employees and discount offered, if any.”

Since the said procedure is inefficient and ineffective, it has been decided that the promoters can also offer the shares to employees in OFS through the Stock Exchange Mechanism.

The following is the procedure specified for this process:

- a. OFS to employees shall be on T+1 day along with the retail category under a new category called as “Employee”.
- b. While bidding, the employee shall select “Employee” category for employee bids.
- c. Certain number of shares shall be reserved for the employees and shall be mentioned in the OFS notice to the stock exchanges by the promoter.
- d. Bidding allowed during trading hours on T+1 day only.
- e. Floor price to be disclosed to Employee category.
- f. Employee shall place bids at cut-off price.
- g. Maximum bid amount INR 5,00,000.
- h. Each employee is eligible for allotment of equity shares up to INR 2,00,000. Provided that in the event of under-subscription in the employee portion, the unsubscribed portion may be allotted to such employees whose bid amount is more than INR 2,00,000, on a proportionate basis, for a value in excess of INR 2,00,000, subject to the total allotment to an employee not exceeding INR 5,00,000.

The circular shall come into effect from 30th day of issuance date of the circular. The issuance date is January 23, 2024.

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3. Framework for Short Selling

SEBI has provided Annexure 3 of the of the Chapter 1 of Master Circular dated October 16, 2023 (Ref No. SEBI/HO/MRD2/PoD-2/CIR/P/2023/171). The said circular contained framework on ‘Short Selling and Securities Lending and Borrowing Scheme’.

The Annexure 3 has been provided to describe broad framework for short selling which is defined as selling a stock which the seller does not own at the time of trade. All classes of investors are permitted to short sell.

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4. Foreign investment in Alternative Investment Funds (AIFs)

The threshold for determination of beneficial ownership as provided under the Prevention of Money Laundering (Maintenance of Records) Rules, 2005 were revised.

Therefore, amendments to the Chapter 4 of SEBI Master Circular No. SEBI/HO/AFD/PoD1/P/CIR/2023/130 dated July 31, 2023 for AIFs stands modified as below:

The investor, or its beneficial owner as determined in terms of sub-rule (3) of rule 9 of the Prevention of Money-laundering (Maintenance of Records) Rules, 2005, is not the person(s) mentioned in the Sanctions List notified from time to time by the United Nations Security Council and is not a resident in the country identified in the public statement of Financial Action Task Force as –

- (i) a jurisdiction having a strategic Anti-Money Laundering or Combating the Financing of Terrorism deficiencies to which counter measures apply; or*
- (ii) a jurisdiction that has not made sufficient progress in addressing the deficiencies or has not committed to an action plan developed with the Financial Action Task Force to address the deficiencies.*

The circular shall come into effect immediately.

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5. Ease of Doing Investments by Investors- Facility of voluntary freezing/ blocking of Trading Accounts by Clients

To enhance the ease of doing business and streamline the process of investing, SEBI has decided that the framework for Trading Members to provide the facility of voluntary freezing/blocking the online access of the trading account to their clients on account of suspicious activities shall be laid down on or before April 01, 2024, by the Brokers' Industry Standards Forum (ISF).

The guidelines shall contain:

- a. Detailed policy for voluntary freezing/blocking the online access of the trading account of the clients.
- b. Action to be taken by the trading member after the receipt of the request for freezing/blocking of the account.
- c. Process for re-enabling the client for trading.
- d. Intimation to be provided by the trading member to the clients.

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6. Ease of doing business- Changes in reporting

SEBI issued a master circular dated May 17, 2023 on stock brokers. Clause 15 of the said circular safeguards against misutilisation of clients' funds.

To bring in efficiencies in reporting and a step towards ease of doing business, certain reports are being discontinued.

The following changes are being made to the circular:

- a. Deletion of Clause 15.5.2
- b. Modification of Clause 15.5.3:

Stock exchanges shall put in place a mechanism for monitoring of clients' funds ('G' principle) lying with the stock brokers on the principle enumerated below:

G Principle: The total available funds i.e. cash and cash equivalent with the stock broker and with the clearing corporation/clearing member should always be equal to or greater than clients' funds as per the ledger balance.

- c. Deletion of Table 5, 6 and 7.

The circular shall come into effect immediately.

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7. Extension of timeline for verification of market rumours by listed entities

SEBI has decided to extend the timeline for effective date of implementation of the:

- a. proviso to regulation 30(11) of the SEBI (Listing Obligations and Disclosure

Requirements) Regulations, 2015 (LODR Regulations) for top 100 listed entities by market capitalization, to June 1, 2024 and for top 250 listed entities by market capitalization, to December 1, 2024.

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8. Streamlining of Regulatory Reporting by Designated Depository Participants (DDPs) and Custodians

TSEBI has provided time periods with respect to reports that are to be submitted on the SEBI Intermediary Portal (SI Portal) by DDPs and Custodians.

The format of the reports will be disclosed on the website of the Custodians and Designated Depository Participants Standard Setting Forum.

The provisions of this Circular shall come into effect from month ending February - 2024 onwards.

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E. FAQs on RBI's Fair Lending Practice - Penal Charges in Loan Accounts

The RBI had released guidelines on August 18, 2023 ([read notification](#)) which stipulated that the penalty for non-compliance with loan terms need to be treated as penal charges and not in the form of penal interest. Subsequently RBI issued another Circular on December 29, 2023 ([read notification](#)) to extend the timelines to comply with the said guidelines. Further, the Reserve Bank of India (RBI) has released a set of clarifications ([read notification](#)) to clear the air on penal charges on loan accounts as follows

- 1. Effective date for new loans and existing loans :** The switchover to the new penal charges regime for existing loans shall occur on the next review or renewal date falling on or after April 01, 2024 or within six months from April 01, 2024 whichever is earlier. The review or renewal date can be counted only after the effective date of circular.
- 2. Exclusions :** Penal charges are not applicable to products covered under RBI Master Direction on External Commercial Borrowings, Trade Credits from overseas vendors and Structured Obligations, Credit cards and Rupee/ foreign currency export credit and other foreign currency loans.
- 3. Material terms and conditions :** Material terms and conditions to be defined based on the credit policy of the Bank. They may vary across loan categories and lenders, determined by their own assessments.
- 4. Disclosure :** The quantum and reason for penal charges must be clearly disclosed in the loan agreement, most important terms and conditions or key fact statement.
- 5. Defaulted amount :** Guidelines apply to default and penal charges shall be based on default amount. Charges should be reasonable, applied uniformly, and not capitalized for further interest computation.
- 6. Unpaid Interest :** Interest on unpaid interest, including EMIs, is not considered penal interest. Lenders may charge interest on unpaid interest at the contracted rate until the date of remediation, not at a penal rate.
- 7. Variation :** Penal charges can vary within loan category as long as the policy is board approved and the structure is reasonable and commensurate with non-compliance. The structure of penal charge should be uniform irrespective of the borrower's constitution.
- 8. Outstanding Penal Charges :** Additional penal charges cannot be levied on earlier outstanding penal charges.
- 9. Cash Credit /Overdraft Facility :** There is no specific exemption for cash credit and overdraft facilities. This means that Penal Charges can be levied on these facilities.
- 10. Cap on Penal Charge :** There is no specific cap prescribed for Penal Charge, penal charges should be reasonable and commensurate with non-compliance, focusing on credit discipline rather than revenue enhancement.
- 11. GST on Penal Charge :** For GST aspect on penal charges, instructions from Central Board of Indirect Taxes & Customs (CBIC).

12. BG / LC Facilities : In case of funded facilities due to BG /LC invocation, appropriate interest may be charged, but penal charges may be levied on non-repayment.

13. NPA Accounts : In case of NPA accounts, penal charges shall be reversed to the extent uncollected, aligning with Master circular on Income Recognition, Asset Classification and Provisioning.

14. Accounting for Penal Charges : For according process of penal charges, instructions in Annexure II Part A (Notes and Instructions for compilations) for Schedule 13: Interest Income of Reserve Bank of India (Financial Statements – Presentation and Disclosure) Directions, 2021, Schedule 13 includes all types of interest for the banks. Banks will disclose fees and charges, including penal charges, in Schedule 14: Other Income.

15. Securitisation and co-lending portfolios : the said RBI Circulars applies to Securitisation and co-lending portfolios.

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