Regulatory Reform in the Indian Fintech Space : An Overview

Author
Anuj Kaila | anuj.kaila@bgl.kochhar.com

Introduction

India has been the hub of fintech innovation over the past few years, and reports suggest there are over 2,000 fintech start-ups at present in the country. Fintech innovation is taking place across various industry verticals, which include banking, payments, insurance, asset management and brokerage. Fintech companies also focus on machine learning that analyses customer expectations and matches them with appropriate services. India has specifically taken significant strides in the payments industry and is a world leader in advance payment systems.

Regulatory Sandbox For Fintech

The Reserve Bank of India (RBI) set up an inter-regulatory working group to look into the granular aspects of fintech and its implications so as to review the regulatory framework and to respond to the dynamics of the rapidly evolving scenario of the market concerned. The working group recommended the introduction of an appropriate framework for a regulatory sandbox to provide an environment for developing fintech innovations and testing applications developed by banks and fintech companies.

Accordingly, the RBI, in August 2019, released regulations on a regulatory sandbox for fintech entities to enable and encourage innovation in the industry with minimum regulatory supervision. The innovative products permitted to be tested within the sandbox include retail payments, money transfer services, digital KYC, smart contracts, marketplace lending, financial advisory services, wealth management services, digital identification services, financial inclusion products and cyber security products. Any fintech company, including start-ups, banks, financial institutions, and any other company partnering with or providing support to financial services businesses, is eligible to apply under the regulatory sandbox. The relaxations extend to applicants dealing with liquidity requirements, board composition, management experience, financial soundness, and track record.

The Securities and Exchange Board of India, in May 2020, also released its own regulations on a regulatory sandbox for fintech companies in relation to securities markets. This sandbox deals primarily with seeking innovation in securities market-related data, which includes data from depositories (holding and KYC data), stock exchange data (transaction data, such as order logs and trade logs) and mutual fund data.

This regulatory acknowledgement of innovation comes as a boost for the industry, which has always been a few steps ahead of the regulatory framework. Many entities have already started testing their innovative products within these sandboxes.

Regulatory Bodies

While there is no universal regulatory body for fintech entities in India, by and large, fintech products and services can be considered to fall under the purview of the following regulators:

- the Reserve Bank of India (RBI);
- the Securities Exchange Board of India (SEBI);
- the Ministry of Electronics and Information Technology;
- the Ministry of Corporate Affairs; and
- the Insurance Regulatory and the Development Authority of India (IRDAI).

However, the RBI currently regulates the majority of fintech companies dealing with payment aggregation and gateways, account aggregation, peer-to-peer (P2P) lending, crypto currencies, payments, etc.

Analysis

Indian law regulates various types of fintech products, including prepaid payment instruments (e-wallets), payment systems, peer-to-peer lending, payment aggregators and account aggregators (entities which retrieve and consolidate financial information of a user). With exponential strides in the growth and adoption of Fintech in India, several conventional areas of the financial sector including consumer loans, loan trading, securitisation, and personal finance are gradually getting subsumed within Fintech. The past few years have also seen a surge in neobanking. A neobank is a completely digital bank without any branches. Indian regulations do not specifically recognise a complete digital bank and fintech players have tied up with traditional banks to provide these offerings. Neobanking has seen a significant rise in popularity since the covid-19 pandemic.

Recognising the disruptive potential of fintech, the key regulators such as RBI and SEBI have introduced a regulatory regime conducive to innovation in the industry. However, a stricter stance has been taken with payment aggregators and gateways. Payment aggregators are now required to be licensed to undertake the activity of payment aggregation. The definition of a payment aggregator is also extremely wide to cover entities and e-commerce players which traditionally would not be considered to be a payment aggregator. This was done primarily to protect small and marginal merchants who might be at the mercy of large corporations spearheading fintech.

Conclusion

In the course of the last few years, the Fintech sector in India has witnessed enormous growth, further propelled by Covid-19, causing more and more transactions to move online. Last year, the sector had attracted nearly $2.253 billion in investment[1]. As fintech takes to the skies (with the real economy including rural economy adopting technology at a scorching pace), two trends are becoming visible. Firstly, conventional sectors are being subsumed within Fintech at a rapid pace. Secondly, with increasing adoption, there is increased regulation from the Government of India, recognising that the efficacy of Fintech depends on cyber-security, data security and storage, and confidentiality. With the RBI stepping in to regulate most facets of the sector and taking a strict stance on violations (as seen with Mastercard and AmEx facing bans for flouting data localization norms), it is likely that heightened regulatory scrutiny and compliance will be the order of the day. Regulation in the fintech sector has so far been welcomed by industry and users for providing security, predictability, transparency, and stability in a rapidly evolving sector.

In preparing this article, Anuj Kaila was assisted by Navolina Mujumdar.

Anuj is a Partner and heads the Banking & Finance Practice at the Kochhar & Co Bangalore office.

Navolina is an Associate in Kochhar & Co New Delhi office. She is a member of the Firm's Infrastructure, Banking and Project Finance Practice Groups.

[1] https://www.ndtv.com/business/indias-fintech-sector-rakes-in-over-2-billion-in-first-half-of-2021-kpmg-report-2512691