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THE FINTECH FRENZY: PROSPECTS AND CHALLENGES

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As we are passing through an era of fast technological innovations and unprecedented digital transformation, the financial sector catches itself at the crossroads of innovation and disruption. With the emergence of "Fintech" (the convergence of finance and technology), rewriting conventional banking, investment, and payment systems worldwide.

The regulatory architecture also faces increasing challenges as the fintech landscape in India continues to progress. The regulatory framework must strike a fine balance, encouraging innovation and competition while upholding the integrity and stability of the financial system.

The so-called JAM trinity, the trinity of bank accounts (Jan Dhan); Aadhaar, (bio-metric identification system); and mobile phone connectivity has transformed India's fintech ecosystem in terms of financial inclusion, digitization of financial services. Moreover, the fintech structure is quite diverse, ranging from enterprise (banking, lending, payments, regtech, wealthtech, insurtech) and B2B (e.g. Zaggle, Indifi etc.) to B2C (Fibe, slice, Groww etc.) level.

One of the fastest growing fintech segments is the digital lending that has seen exponential growth in the last decade. Nearly 140 million customers were added to the new-to-credit category between the financial year ending in 2019 and that ending in 2022, with 57 per cent of these consumers concentrated in rural and semi-urban areas.[1] According to some reports, payments landscape in India is expected to reach US$ 100 trillion in transaction volume and US$ 50 billion in terms of revenue by 2030.[2]

In 2024, India's Unified Payments Interface (UPI) saw a 45 per cent yearly (YOY) increase in payments, with a total transaction value of over ₹20 trillion for three months incessantly. In June 2024, the total value of UPI transactions was ₹20.07 trillion, and in May it was ₹20.44 trillion.[3] In July 2024, the average daily transaction value was ₹466 million. Moreover, the buy-now-pay-later (BNPL) segment in India demonstrates a positive trajectory, with its gross merchandise value projected to grow from USD 11.6 billion in 2022 to USD 25.4 billion in 2028.[4]

In January 2022, RBI created a fintech department to identify prospects and challenges associated with the fintech sector. Major achievements in this regard includes (a) phased pilots of central bank digital currencies (“CBDCs”); (b) setting up several digital banking units (“DBUs”) in various Indian districts, that are bank-owned brick-and-mortar establishments that enable access to digital financial services.

The Reserve Bank Innovation Hub is a wholly owned subsidiary of the Reserve Bank of India (RBI) set-up to promote and facilitate an environment that accelerates innovation across the financial sector. National Payments Corporation of India (NPCI), an umbrella organisation for operating retail payments and settlement systems in India, is an initiative of Reserve Bank of India (RBI) and Indian Banks’ Association (IBA) under the provisions of the Payment and Settlement Systems Act, 2007, for creating a robust Payment & Settlement Infrastructure in India.

GROWING CHALLENGES WITH FINTECH REGULATIONS:

With the proliferation of fintech, regulatory challenges have increased manifold. Challenges like data security & privacy, platform downtimes, lack of concrete regulatory frameworks, possibility of frauds, illegal apps etc; have increased. RBI has also come out with guidelines for fintech. For instance, to encourage self-regulation in the FinTech sector, the Reserve Bank of India (RBI) had released a 'Draft framework for recognising Self-Regulatory Organisations (SRO) for fintech sector on 15th January 2024.

[1] “Fintech round-up 2023-24” (2024) Khaitan & Co report
[2] EY Fintech Report.
[3] According to media updates.
[4] ibid

Initially, in 2020, the Securities and Exchange Board of India (SEBI) introduced a framework for regulatory sandbox to promote innovation in the securities market. The data protection bill of 2022 is aimed at protecting data collected by fintech companies. Further, in 2022, the Reserve Bank of India (RBI) issued guidelines on digital lending to protect consumers from rapacious lending practices.

These guidelines require digital lenders to comply with various norms, such as disclosing all fees and charges upfront, providing adequate customer protection measures, and using fair and transparent practices for debt collection. On 16 August 2024, the RBI has published a review of the Directions regarding peer-to-peer (P2P) lending laid down in 2017, where it has been observed that some of these platforms have adopted certain practices which are violative of the said Directions.

Such practices include, among others, violation of the prescribed funds transfer mechanism, promoting peer to peer lending as an investment product with features like tenure linked assured minimum returns, providing liquidity options and at times acting like deposit takers and lenders instead of being a platform. Such violations, when observed, have been dealt with bilaterally by the Reserve Bank of India for remediation, hence in this regard, amended provisions have been elaborated vi-a-vis each existing provisions. Going forward, the regulatory affairs need to be carefully framed, given the growing nature and sophistications of fintech adoption.