CUTS International

COMMENTS
on
REPORT OF THE WORKING GROUP ON DIGITAL LENDING INCLUDING LENDING THROUGH ONLINE PLATFORMS AND MOBILE APPS

Consumer Unity & Trust Society (CUTS) expresses its gratitude to the Reserve Bank of India (RBI) for inviting comments from stakeholders and members of the public on the Report of the Working Group on digital lending including lending through online platforms and mobile apps

At the outset, we commend RBI's working group for dealing with the nascent digital lending ecosystem and protecting the financial customers from widespread unethical practices and ensuring orderly growth. Being a consumer-oriented organisation, CUTS humbly submits its response as follows-

CUTS comments-

Suggestion No.	Specific Comments
3.4.1.1	**Balance Sheet Lending -** The report has suggested to restrict balance sheet lending through DLAs to entities regulated and authorized by RBI or entities registered under any other law for specifically undertaking lending business. While the suggestion is with right intent to protect consumers, restricting digital lending to currently regulated entities may adversely impact innovation and competition in the market, consequently restricting access to finance for consumers. Thus, the regulator should extend its scope of direct and indirect (outsourcing) regulation to optimally regulate entities currently outside its scope. Adoption of evidence informed risk based regulatory approach, along with strong monitoring, supervision, enforcement, and grievance redress framework, could help the stated objective without unintended adverse consequences.
3.4.1.2	**Loan Servicing and Repayment-** The report suggests that all loan servicing, repayment, etc., should be executed directly in a bank account of the balance sheet lenders and borrowers having only PPI account and no bank account can be disbursed loan if the PPI accounts are fully KYC compliant. The facility of loan repayment and servicing should be flexible for convenience of the borrower. Therefore, choice should be given to the consumers to opt for either the bank account or KYC compliant PPI account.

3.4.2.1	**Composition and Powers of the Nodal Agency -** The report has recommended setting up of an independent body styled as Digital India Trust Agency (DIGITA) which will be primarily responsible for verifying the technological credentials of DLAs of the balance sheet lenders and LSPs operating in the digital lending ecosystem. Moreover a nodal officer has to be named who will deal with FinTech related issues with customers as well as regulators, SRO, law enforcement agencies, etc. The Report should suggest the composition and the method of appointment of the members of the Nodal Agency. As the members of the Nodal Agency and the Nodal Officers will be responsible for verifying technological credentials, there is a need for qualified members to accomplish these tasks, therefore RBI should suggest a transparent method of appointment of the members of DIGITA and the nodal officer, their powers, minimum qualifications, expertise, etc. As the number of DLAs approved by the nodal agency will directly affect the access of digital lending services by consumers, it is important to ensure that the nodal agency has consumer representatives as members, and follows due process and principles of natural justice, while carrying out its functions. A process of verification of the DLAs should be clearly laid down in the public domain. To strike a balance, RBI should also introduce provisions holding the nodal agency accountable for its actions.
3.4.2.4	**Composition of Self-Regulatory Organisation-** The report has recommended setting up of a Self-Regulatory Organisation (SRO) covering Digital Lending Apps (DLAs)/ Lending Service Providers (LSPs). The SRO will be responsible to formulate a code of conduct for the recovery agents, make a grey/negative list for erring members, conduct periodic review of the conduct of the LSPs, etc. The report has described the role of SRO but is unclear about it's powers and authority. Given that consumers are critical stakeholder groups, it is important to ensure that it has a broad based representation from the industry as well as consumers.
3.4.2.5	**Separate legislation for illegal digital lending -** The report has recommended that the Central Government may consider bringing a separate legislation 'Banning of Unregulated Lending Activities (BULA) Act' which would cover all entities not regulated and authorized by RBI for undertaking lending business or entities not registered under any other law for specifically undertaking public lending business. In the past, similar legislations, like the Banning of Unregulated Deposit Scheme Act, 2019, have been introduced. It is not clear if such legislations have had desired impacts, owing to design, implementation, and enforcement challenges. Consequently, the decision to introduce such legislations should be informed by

	evidence. Moreover, since there is no tradeoff between preventing abuse and promoting innovation, the RBI should work on strengthening the existing monitoring and supervisory architecture, instead of recommending a separation legislation to curb illegal digital lending. In this regard, partnership with civil society and consumer organisations should be strengthened for real time feedback as well as grievance redressal.
3.4.3.1	**First Loan Default Guarantee (FLDG)-** The report has suggested that to prevent loan origination by unregulated entities, regulated entities (REs) should not be allowed to extend any arrangement involving a synthetic structure, such as, the FLDG to such entities. This move may have significant unintended consequences. In the absence of such arrangements, regulated lenders may shrink from lending to creditworthy borrowers, who may not have credit history or collateral. This will adversely impact the regulatory objective of financial inclusion and democratising credit. In an FLDG setup, the credit risk is borne by the loan service provider (LSP) without maintaining any regulatory capital. The LSPs have information about the creditworthiness of the borrower therefore they can bear the risk through FLDGs. Therefore, a total prohibition on such arrangements could impact credit expansion. Moreover the prohibition could lead to some unintended consequences for example depriving financial consumers of their ability to take more risk (as there's a guarantee on some portion of the loan). Such a prohibition would also deprive the borrowers from necessary credit, which they otherwise would not be able to raise. To address the problem of credit risk, instead of a total ban, the RBI should work towards better monitoring, enforcement, supervision, and grievance redress. As consumer organisations work on ground, they can be the eyes and ears of regulators therefore give relevant inputs, in this regard.
4.4.2.1	**Compliance with Baseline Technology Standards-** The report has suggested that Baseline technology standards for DLAs of REs should be defined. The standards for DLAs should include secure application logic and secure application code, keeping a log of every action that the users perform along with their geolocation, IP address, and device information, multi-step approval process for critical activities and monitoring of transactions passing through the App in an auditable manner. In the fintech sector, technology is continuously evolving with innovation.

	Therefore, there is a need to ensure that prescription of technology standards does not adversely impact innovation. Such standards may need to constantly reviewed in consultation with stakeholders and therefore should be introduced with sunset clauses.
4.4.2.2	**Data Localisation and Data Security-** The report has suggested that the data should be stored in the servers located in India to enhance the security. It should be noted that data localisation doesn't necessarily ensure data security. Moreover, data localisation restrictions might have adverse effects on security and individual rights.
4.4.3.1	**Data Protection Authority -** The report has suggested that the Data Protection Authority (DPA) as proposed in the Personal Data Protection (PDP) Bill could serve as a regulatory body to oversee the financial apps in the future. Although there is a need for DPA to oversee the digital lending ecosystem, at the same time there should be a collaborative and consultative dialogue between DPA and the RBI to address various consumer concerns like processing user's data without consent, right of users to correct/erase the data, time period for data storage, extent of personal information used in credit rating, etc. Both the DPA and RBI should regularly communicate on the nuances of data protection and its impact on DLAs and the financial consumers.
5.4.1.3	**Disclosures about the Proposed Credit Facility-** The report has suggested that the lender should provide a key fact statement (KFS) in standardized format for all digital lending products and should also send SMS/ email with a summary of product information. India has a high number of language (linguistic) and numeral illiteracy (numeracy). Therefore, the complex nature of KFS and the language used in the SMSs/emails can be a major reason for exclusion of vulnerable borrowers. The information about the digital lending products, summary of product information, etc should be consumer friendly and therefore be available in all the official languages. Apart from SMSs and emails, the RBI should communicate via other modes too, such as audio, video, pictures, and consumer friendly labels.
	General Comments
	Financial Stability and Credit Risk - In the digital lending ecosystem, the lending standards could weaken due to wider credit access and higher competition. Since FinTech lenders give advances from debt and equity rather than from deposits, such credit could be more procyclical and volatile due to lack of standard credit guidelines. Further, credit activity outside the prudential

	regulation space could render credit-related countercyclical policies less effective. Moreover, Small and Medium-sized Enterprises (SMEs) are more likely to deal with digital banks as they tend to lend quickly and remotely without much compliance. At the same time SMEs cannot bear the risk of the lender's volatility and less credibility as this may result in loss of the whole business. With the expansion of fintechs, there is a higher potential for system-wide risks in the fintech sector. The RBI in collaboration with the proposed SRO should ascertain the impact of FinTech on financial stability. This can be done by introduction of standard credit guidelines, which differentiates risky credit from others.
	Participation of Consumers- The RBI in their Press Release[1] has mentioned that 'The thrust of the report has been on enhancing customer protection and making the digital lending ecosystem safe and sound while encouraging innovations'. Moreover the report has stressed on introduction of measures for enhanced consumer protection. Therefore, the RBI, in order to safeguard consumer interest should set up a separate stakeholder group majorly composed of consumers. The consumer stakeholder group can meet regularly with the regulator via online or offline platforms to discuss the issues faced by financial consumers in regard to digital lending. The report has suggested development of a separate National Financial Consumer Protection Regulation under the Consumer Protection Act, 2019[2]. Financial inclusion is still a challenge for India, therefore development of a separate legislation for financial consumers is the need of the hour. Consumer stakeholder groups can actively participate in the formulation of such legislation which provides adequate recourse to financial consumers. In addition, digital lending has a potential to increase financial inclusion in India but with low levels of digital literacy, it may come at the expense of privacy and consumer welfare. Simply introducing new technologies without addressing the underlying digital divide among the consumers would further aggravate the problem. Low digital literacy levels can aggravate the already existing issues of

[1] November 18, 2021 RBI releases the Report of the Working Group on digital lending including lending through online platforms

[2] CUTS International, MEMORANDUM TO MINISTRY OF FINANCE, GOVERNMENT ON INDIA DURING PRE-BUDGET CONSULTATIONS ON 5th JUNE, 2014 available at http://www.cuts-international.org/pdf/CUTS_Memorandum_to_Ministry_of_Finance_Government_on_India_during_Pre-Budget_Consultations_05-June-2014.pdf

	structural exclusion. Therefore, to decrease the digital divide, like other regulators[3] the RBI should introduce seller beware models, organise consumer outreach programmes, awareness programmes, seminars, etc. to address the risk of digital lending.

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CUTS International looks forward to assisting RBI in its endeavours of preparing a regulatory framework for digital lending in India.

For queries and clarification, please write to-

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[3] Telecom Regulatory Authority of India (TRAI) TRAI regularly organizes consumer outreach programmes (COPs), seminars and Open House Discussions (OHD) etc. with a view to educate the consumers about various initiatives taken by it to protect consumers and to elicit their views on import issues.