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'Fintech': A Way Forward for Inclusive Financial Growth

Introduction

India has traditionally been a cash-driven economy with a large informal sector. However, in recent years, a collaboration between financial institutions and digital technology companies has revolutionised how financial transactions take place in the country. This phenomenon is popularly known as 'fintech'. It includes services like online banking, digital payments, credit scoring, online insurance, investment, and social security services. Additionally, the digital payments infrastructure has been particularly successful in facilitating direct benefit transfers from the government.[1]

Fintech gained particular momentum at the time of demonetisation and most recently through the pandemic, which has led a lot of people to use digital payments to avoid physical contact. It is predicted that the fintech industry will grow into a US$2.4bn market by the end of 2020, with participation from more than 400 fintech start-ups in India.[2]

While some predictions may need to be revisited in light of the COVID-19 pandemic, the industry will certainly experience impressive growth. As fintech reforms the finance landscape with technological disruption and enables financial inclusion, challenges remain with respect to digital finance adoption and usage, privacy and data protection regulations, and consumer grievance redress. It is crucial to address such challenges now more than ever, to lessen the digital divide and income inequalities that are likely to exacerbate owing to COVID-19. Already, there are signs of fintech usage in rural areas on account of the pandemic.[3]

In this regard, some of the key issues have been elaborated below.

Key Assessments

1. Digital Finance Adoption: There has been an increase in the use of the internet, smartphones, and the introduction of a myriad of digital payment applications offered by the banking sector (BHIM UPI) as well as a non-banking sector (Paytm and, Phone Pe). Along with this, there have been government schemes like Jan Dhan Yojana, which have included more people in the formalised banking system. However, the access, adoption, and usage of digital financial services for transactions such as payment of bills, transferring money, making online payments at retails stores have been relatively low in rural areas. In 2018, digital payments uptake stood at just 14 percent in rural areas, as compared to 44 percent in urban areas.[4] While the users of digital financial services are certainly increasing, the substantial ground is yet to be covered.

In this regard, a study was undertaken by Consumer Unity & Trust Society (CUTS International) on user perspectives on digital payments, that revealed while there has been an increase in avenues and tools for enhancing digital financial inclusion, these are not optimally designed and integrated in a way to ensure seamless adoption by users. Some of the issues that came out of the study were lack of awareness and low level of financial literacy, connectivity and infrastructure limitations, interoperability issues, transaction failures, user unfriendliness, and low level of trust of users on these services. These adversely affect the uptake of digital payment tools by consumers and small merchants. Additionally, Micro, Small, and Medium Enterprises (MSMEs) also face a high cost of integrating digital payments due to absence of appropriate incentives, limited access to technical knowledge and infrastructure limiting their adoption.

Furthermore, while there is a surge of fintech start-ups there is limited competition in the digital payments space. This is evident from the recent data released by the National Payment Corporations in India, which revealed that 90 percent of the digital payments through Unified Payments Interface (UPI) concentrated with three major players (Google Pay, Phone Pe, and Paytm).[5]

While some disruption is expected soon on account of recent investment by Facebook in Reliance Jio, such concentration leads to sub-optimal competition, which has the potential to reduce the quality of services for consumers, increase the cost of access and limit innovation.[6]

2. Privacy and Data Protection: There are increasing data protection concerns as Fintech companies collect and process sensitive data like bank account information, spending pattern, credit ratings, debt-related information, and transaction details. A PwC fintech survey reported that 56 percent of survey respondents were concerned about information security while using fintech services.[7] There have been instances of security breaches within companies like Credit fair and Chqbook.[8]

In this regard, an investigation[9] conducted for assessing the privacy policies and norms of 48 fintech companies revealed that a lot of companies are not fully compliant with the Information Technology Rules 2011.[10] It was pointed that the majority of privacy policies lacked compliance as they did not state clear opt-out options for its users, did not specify the type of data that will be collected, and provided inadequate details regarding retention of information. Moreover, privacy policies were not stipulated in regional languages, which made it difficult for consumers to comprehend and make an informed decision.[11]

There is a change expected in this regard with the forthcoming Personal Data Protection Bill 2019 (PDPB).[12] The PDPB categorises financial data as sensitive data and prescribes for notice and consent frameworks, purpose and storage limitation, data localisation (DL) among other obligations on service providers. Along with this, there is an existing RBI circular on the storage of payment system data (2018), which prescribes DL norms.

Concerning PDPB, fintech companies have raised concerns regarding the additional burden on them for categorising data and the adverse impact of DL norms. In this regard, a study conducted by CUTS International on the impact of DL observed that it could adversely affect consumers' privacy, increase cyber-security risks through making honeypots of data, thereby possibly reducing consumers' uptake of data-driven services.[13] Furthermore, a lot of fintech companies have overseas offices, and compliance with DL may affect their business and hamper innovation.[14]

3. Fraudulent Practices and Consumer Redress: The usage of digital payments and fintech services is gradually increasing, particularly in urban areas. Many first-time users have started to board the fintech bandwagon. However, a significant issue currently faced by the fintech sector is regarding emerging fraudulent practices and the absence of accessible grievance redress options.

A scam was reported on one of the most popular digital payments application 'Paytm' when funds were incorrectly transferred to another account without the user's permission.[15]Another incident was reported on 'CashApp', where hackers used fake accounts to get people to give their account details for winning an offer.[16] Such scams have also emerged during the COVID-19 pandemic with people making fake UPI accounts asking for donations.[17] Hence, an increase in the usage of fintech services has also escalated fraudulent practices in the sector.

Furthermore, since consumers are new to such services, there is a lack of awareness regarding digital frauds, identity thefts, fraudulent digital payments, fake donations, and online money laundering. At the same time, there is also a lack of a robust consumer grievance redress mechanism. At present, there exists an ombudsman, which covers both bank and non-bank services, and RBI recently also launched its digitised Complaint Management Systems[18] for lodging complaints online. However, there are procedural gaps, as most complaints do not reach the ombudsman, high cost of handling complaints[19], and lack of timely redressal.[20]

Recommendations

In recent years, the government has taken several initiatives to boost the fintech sector and increase financial inclusion within the country. These initiatives are pertinent as we must realise that fintech holds great potential to achieve sustainable development goals 8 and 9 aiming for more inclusive and sustained economic growth by fostering innovation and building resilient infrastructure. This is specifically relevant for consumers in rural areas, women, and small merchants. Fintech allows them to be more involved in the formalised financial system. The Steering Committee on Fintech Related Issues in India[21]and the High-Level Committee on Deepening Digital Payments[22] recently submitted their report with relevant suggestions and way forward. Regarding those, we make the following recommendations:

- There is a need to increase digital and financial literacy in rural areas. For this, the government should engage civil society organisations and fintech companies within its initiatives to build and maintain trust within consumers and MSMEs regarding digital payments and other fintech services. Going forward, contactless payments and withdrawals have the potential to meet safety and security needs arising in light of the pandemic.[23] However, awareness and capacity constraints among consumers, along with regulatory bottlenecks,[24] will need to be addressed to ensure the mass adoption of such safe payment options.

- Fintech companies should take feedback from consumers in rural areas to make their applications more user friendly, with voice commands, fingerprint scanning, and increase the interoperability mechanisms. Furthermore, the competition within the space can be increased through making provision for open Application Programme Interfaces,[25] which would make digital payment mechanisms and data open, through which other new entrants or e-commerce companies can use digital payment data to make services more interoperable. Design of standards and governance principles through comprehensive stakeholder consultation will be crucial to push for practices like interoperability and open APIs.[26]
- Obtaining feedback from the ground is relevant for policymakers and regulators as well. For instance, recently, the regulations have permitted customer verification and onboarding through the use of technology. However, it might be difficult to implement such changes in rural areas owing to infrastructure constraints and connectivity limitations.[27] Similarly, price regulations in the sector may have several unintended consequences and may stall the growth of the industry.[28]
- To decrease data protection and privacy risks within fintech applications, transparency must be ensured. This could be done by making notice and consent frameworks more consumer-friendly through the adoption of the privacy labels and the availability of regional language options for privacy policies. Additionally, there is a need to ensure regulatory fairness within the current and upcoming regulations related to data protection, e-commerce, and financial services. A cost-benefit analysis should be undertaken before imposing regulations on financial data flows and different stakeholders must be consulted like start-ups, MSMEs, merchants, and consumers in rural and semi-urban areas.
- As pointed out by the 'Report of Steering Committee on Fintech Related Issues' there should be a robust regulatory framework for consumer redress for fintech services. For this, a risk-based regulation and supervision mechanism (operational risk, financial risk, market conduct risk, efficiency risk) should be introduced, through which vulnerabilities at different levels with various players involved within the fintech ecosystem could be recognised. The government should also foresee the role of consumer rights organisations to act as a mediator for liaisoning with consumers. Also, a mechanism could be established on the lines of CUTS *Grahak Sahayta Kendra*[29] for operationalising online dispute resolution system as suggested by the High-level Committee on Digital Payments,[30] which could be coordinated with different banks and fintech service providers.

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4 https://government.economictimes.indiatimes.com/news/digital-payments/opinion-cashless-economy-cannot-be-achieved-without-on-boarding-rural-india/72923239

5 https://entrackr.com/2020/03/upi-processed-1-32-bn-transactions-february/

6 *CUTS International, Level the Playing Field to Leverage the Potential of Digital Payments, available at* https://cuts-ccier.org/pdf/Research_Report-Competition_assessment_of_payments_infra_in_India.pdf *User Perspective on Digital Payments, CUTS International, available at:* https://cuts-ccier.org/pdf/Presentation_for_RBI_Committee_on_Deepening_Digital_Payments.pdf

7 http://www.pwc.com/gx/en/industries/financial-services/fintech-survey/report.htm

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9 https://www.huffingtonpost.in/entry/fintech-apps-privacy-snooping *creditvidya_in_5d1cbc34e4b082e55373370a*

10 https://www.wipo.int/edocs/lexdocs/laws/en/in/in098en.pdf

11 https://thewire.in/tech/india-fintech-data-privacy

12 https://www.rbi.org.in/scripts/NotificationUser.aspx?Id=11244

13 https://cuts-ccier.org/consumer-impact-assessment-on-cross-border-data-flow/ *the study involved in depth interaction with 40 subject experts, and a survey of over 1200 consumers.*

14 https://inc42.com/buzz/redraft-personal-data-protection-bills-definition-of-sensitive-info-fintech/

15 https://inc42.com/buzz/paytm-security-under-scanner-after-user-loses-inr-5k-from-his-wallet/

16 https://www.zdnet.com/article/scammers-are-targeting-cash-app-users-hoping-for-free-money/

17 https://news.abplive.com/news/india/fake-facebook-account-under-pm-modis-name-asking-for-relief-funds-1195373

18 https://cms.rbi.org.in/cms/IndexPage.aspx?aspxerrorpath=/cms/cms/indexpage.aspx

19 https://www.rbi.org.in/Scripts/PublicationReportDetails.aspx?UrlPage=&ID=922

20 *Consumer Protection in a Digital Financial World – Initiatives and beyond, Annual Conference of Banking Ombudsman, Mumbai on June 21, 2019*

21 https://dea.gov.in/sites/default/files/Report%20of%20the%20Steering%20Committee%20on%20Fintech_2.pdf

22 https://www.rbi.org.in/Scripts/PublicationReportDetails.aspx?UrlPage=&ID=922

23 https://economictimes.indiatimes.com/industry/banking/finance/contactless-payments-digital-loans-make-kiranas-open-doors-to-fintech/articleshow/75462301.cms?from=mdr

24 https://economictimes.indiatimes.com/industry/banking/finance/banking/all-payments-via-cards-can-now-be-contact-free/articleshow/75483171.cms?utm_source=twitter_pwa&utm_medium=social&utm_campaign=socialsharebuttons&from=mdr

25 *Application program interfaces (APIs) are a set of defined methods and functions that allow one computer program to "talk" to another program to consume data, perform actions or both*

26 https://thepaypers.com/expert-opinion/indias-fintech-revolution-why-and-whats-next--1242049#.Xrl_sGfAmXk.twitter

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