GNLU CENTRE FOR LAW & ECONOMICS
Policy Recommendations

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Recommendations to the Reserve Bank of India on the WG Report on Digital Lending

Comments on behalf of the Research Group on Digital Lending, GNLU Centre for Law & Economics

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Recommendations to the RBI on the WG Report on Digital Lending Comments on behalf of the Research Group on Digital Lending, GNLU Centre for Law & Economics

Dear Sir/Ma'am,

GNLU Centre for Law & Economics (CLE) is a centre of excellence for research and training in the discipline of Law & Economics (also referred to as the Economic Analysis of Law). GNLU through its Centre for Law and Economics has been working towards creation of interest an awareness in the legal study using economic tools. The Centre values rigorous work in the discipline and aims to promote awareness and research in the field by organising courses and conferences for scholars, practitioners and students.

Under CLE research group team on RBI Digital Lending, we are hereby submitting comments on the *"Report of the Working Group on Digital Lending including lending through online platforms and Mobile Apps"*.

Centre Working Group Team

Prof. (Dr.) Ranita Nagar & Dr. Hiteshkumar Thakkar, GNLU Centre for Law & Economics

Centre Working Group Student Team

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The Centre has also organised a roundtable discussion on 28 December 2021 for discussing the recommendations advanced in the report with practitioners in the finance, fintech and financial industry.

We humbly submit our comments in the attached file and shall be obliged for the wonderful opportunity.

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I. Introduction

The Reserve Bank of India released the report on Report of The Working Group on Digital Lending Including Lending Through Online Platforms and Mobile Apps in November 2021, soliciting comments from stakeholders and members of the public. Keeping in mind the mandate of the Centre for Law and Economics at the Gujarat National Law University, Gandhinagar, an endeavor was made to study and analyze the Report in order to provide comments for regulating the crucial space of financial regulation, fintech and digital lending. There is a clear focus in the report to safeguard the general public and low/middle income borrowers from financial risk posed by such digital lenders, lending service providers, and their partner entities.

Therefore, the Centre for Law and Economics constituted a Research Group on Digital Lending to study the Report and research on the recommendations to suggest comments which would further guide the working of the digital lending and financial services segment in India. This document is a collection of the comments of the Research Group, where the focus of the group was to strike a balance between the trifecta of ensuring better access to credit, encouraging financial innovation, and safeguarding low- and middle-income borrowers/consumers. This was done through highlighting Efforts were made to collate and scrutinize the working of digital lenders in international jurisdictions, which are also incorporated in the Specific Comments advanced below. In order to bring a holistic picture to the table, the Centre also organized a Roundtable Discussion to discuss the recommendations of the Report with eminent practitioners in the financial industry.

II. General Comments

The present section provides certain general comments advanced by the Centre on the Report on Digital Lending. There is an urgent need to define the term of fintech transactions/fintech credit/peer-to-peer lending and loan-based crowdfunding, especially if there is a proposal to introduce a legislation in this respect. It would also provide a strong domestic framework for the DLAs and LSPs to comply with and aim to serve customers only within that definition. Our suggestion is a minimum requirement advanced to all forms of digital lenders, without prejudice to their activities or nomenclature. This minimum regulatory threshold must be met mandatorily.

We should be mindful that lack of financial innovation would not impact the economy is as severe a manner as a financial crisis triggered due to lax regulations/regulators, which would be devastating. There is also a higher cost of greater risk to low- and medium-income borrowers from such digital lenders, which outweighs the benefits it provides in terms of wealth redistribution and better access to credit. There is a need to delineate Digital Lending activity from any partnership or legal structure which would increase confusion. Through the regulation of algorithms by the RBI, bias in credit decisions would be curbed.

As a partnership with a smaller NBFC (which has lesser regulatory threshold) would need to be dealt with differently than an LSP partnering with a large NBFC subject to greater regulations. We propose that a novel structure be created to facilitate partnerships between DLAs and financial institutions, which would ensure that there is a partner taking the credit risk on its balance sheet. In a connected point, NBFC regulations must be modified to lay down disclosure requirements for NBFCs partnering with DLAs. The NBFC graph shows that while the % of total amount disbursed has increased by only a marginal level, the % of total number of loans have increased exponentially, which indicates that the average loan size is lesser. This further shows that Personal loans, others, BNPL (Buy Now, Pay Later) loans are the largest categories. Therefore, there is a need to define such credit instruments for appropriate disclosure and regulation.

There is the overarching concern of regulatory arbitrage. In their article in the Journal of Financial Economics, Buchak et. al. (2018) describe that the growth in shadow banking coupled with fintech platforms was due to increased regulatory burden placed on banks after the 2008-09 financial crisis.[1] As a result, lending activities by banks was confined to limited sectors, and this contraction of bank lending was filled by shadow banks in the US, as they were subject to lighter regulation. This was also the reason that shadow banks became a major partner of fintech platforms aiming to provide lending and financial services. The data between 2007 to 2015 shows an exponential increase in the number of fintech originations as a share of shadow bank originations. This is primarily caused due to stricter regulation on banking companies, which led to creation of a regulatory arbitrage, through which shadow banks have now assumed a major share in housing mortgages in the US. We can identify a similar regulatory arbitrage in India, as most digital lending platforms have partnered with NBFCs. Hence there is a need to keep the regulatory arbitrage in mind while formulating a framework for DLA/LSP and NBFCs.

With respect to the information of the borrower, the lender should be allowed to only collect a minimum requirement of information, and any information collected above that would require express consent of the borrower, and permission of the regulator. The current economy is severely underbanked, however directly thrusting risky credit instruments in the hands of retail borrowers would escalate credit risk. There are transaction costs incurred due to the limited credit facilities of public sector banks and other financial institutions, however they are static. There is a risk of incurring higher dynamic costs due to the threat of default and bankruptcy of such digital lenders which might trigger a crisis. Therefore, regulators must tread carefully, and ensure that a balance is struck between financial innovation and limiting credit risk of both borrowers and lenders.

[1] Greg Buchak, Gregor Matvos, Tomasz Piskorski, Amit Seru, *Fintech, regulatory arbitrage, and the rise of shadow banks*, JOURNAL OF FINANCIAL ECONOMICS, Volume 130, Issue 3, 2018, Pages 453-483.

III. Comments on Section 3 - Regulatory Policy Approach to Digital Lending

Section No.	RBI Proposal	CLE Research on Comments	Final Comment
3.4.1.1	The given section consists of two recommendations, the second one being the issue referred. It recommends that, to prevent regulatory arbitrage in digital lending, regulatory bodies for other authorized lenders such as credit societies, registered money lenders, non-banking non-finance companies (NBNCs), etc. may consider adopting guidelines that are proportionate to that of the RBI.	The given recommendation appears to fix the onus of adopting guidelines equivalent to those of the RBI on regulatory bodies for other authorized lenders. Considering that one of the key approaches of the given report is to minimize regulatory arbitrage; it would be desirable that the onus of ensuring a certain uniformity in regulation lies with the RBI. Instead the RBI recommendation places too much faith in the regulatory bodies, which as per other recommendations, could be self-regulatory organizations such as private industry level associations, etc.	The given recommendation appears to fix the onus of adopting guidelines equivalent to those of the RBI on regulatory bodies for other authorized lenders. Considering that one of the key approaches of the given recommendation, as well as the report itself, is to minimize regulatory arbitrage, it would be desirable that the onus of ensuring a certain uniformity in regulation lies with the RBI. Instead, the RBI recommendation places too much of reliance on other regulatory bodies. In the light of other recommendations (especially section no. 3.4.2.4), these regulatory bodies could even be self-regulatory organizations such as private industry level associations, etc. Thus, unless the guidelines of the regulatory bodies are subject to the supervision and scrutiny of the RBI, placing the onus of adopting guidelines that are proportionate to that of the RBI, may not solve the problem of regulatory arbitrage.
3.4.1.3	The given section	Final comment based on-	Under Section 3.3.1 of the

	aims to combat fringe lending by reaching out to formal digital lending channels and crowd out the fringe lenders.	Anand Sinha, "Regulation of Shadow Banking – Issues and Challenges" (Address by Mr. Anand Sinha, Deputy Governor, Reserve Bank of India at the event organized by the Indian Merchants' Chamber, Mumbai on January 07, 2013.), Bank of International Settlements https://www.bis.org/review/r130204g.pdf Under Section 3.3.1 of the report, Fringe Lenders have been defined as "shadow balance sheet lenders which operate without getting themselves registered for lending activities with the concerned authorities, thus creating an informal market." Further, shadow lending has been referred to in the report as "Conduct of financial service under digital anonymity and layering under regulated entities in varied forms is also a cause of concern." Thus Fringe lending and shadow lending and the associated anonymity has been observed as a threat as far as digital lending is concerned.	report, Fringe Lenders have been defined as "shadow balance sheet lenders which operate without getting themselves registered for lending activities with the concerned authorities, thus creating an informal market." Further, shadow lending has been referred to in the report as "Conduct of financial service under digital anonymity and layering under regulated entities in varied forms is also a cause of concern." Thus Fringe lending and shadow lending and the associated anonymity has been observed as a threat as far as digital lending is concerned. While the given recommendation may be effective, it is opined that this step may prove insufficient in the light of the risk posed by Fringe lenders and shadow lenders, especially considering that the digital space enables them to operate anonymously. However, the report ignores the advantages posed by shadow lenders and/or the shadow banking system The main advantages of shadow banks include lower transaction costs of operations of the shadow banks, their quick decision-making ability, customer orientation and prompt provision of services. NBFCs which form an integral part of the shadow banking system in India, play an important role in broadening

		While the given recommendation may be effective, it is opined that this step may prove insufficient in the light of the risk posed by Fringe lenders and shadow lenders, especially considering that the digital space enables them to operate anonymously.	access to financial services, and "enhancing competition and diversification of the financial sector." Further, the importance of NBFCs cannot be undermined as they enhance the strength of the financial system, making it resilient to system shocks. Thus rather, than shifting away from the shadow banking system, it is recommended that the focus must be to regulate the shadow banking system, to prevent systemic risks and regulatory arbitrage. At the same time, excess regulation must be avoided in order to prevent the stifling of free market and innovation.
3.4.2.4	The given section stresses on the role of RBI recognized Self-Regulatory Organizations (SRO) in regulating Digital Lending Applications/ Lending Service Providers. It includes industry level associations, incorporating best business practices, setting a code of conduct and ensuring compliance from its members. It is also stipulated	Guild, James. 2017. "Fintech and the Future of Finance" Asian Journal of Public Affairs10(1): e4. https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3021684 The given Report has arisen in lieu of the need to put in place a proper regulatory approach to regulate the unregulated players in the digital lending ecosystem. Peer to Peer Lending proves to be quite	The RBI report has arisen in lieu of the need to put in place a proper regulatory approach to regulate the unregulated players in the digital lending ecosystem. The given recommendation relies on the model adopted by China to regulate Peer to Peer Lending (P2P Lenders) Fintech Companies. *The model followed by China:* P2P Lending proves to be quite advantageous as, the Digital Lending Application (DLA) in this case has to simply match borrowers with the lenders, thus allowing these DLAs to not maintain capital reserves of their

	that Reserve Bank may provide general guidance and recognize such an SRO in respect of the RBI regulated entities and their outsourced agents. Further, the government may also undertake similar action in case of entities not regulated by the RBI.	advantageous as, the DLA in this case has to simply match borrowers with the lenders, thus allowing these DLAs to not maintain capital reserves of their own, as such loans need not be shown in the balance sheet. However, when such DLAs begin to operate on a much larger scale, they become an integral part of the economy and thus necessitate regulation. In lieu of this, China follows a tiered structure. This structure allows Fintech companies to operate freely in the field, until they attain a certain size, indicated by the assets and volume of transactions of the entity. Subsequently, they are required to partner with a larger and more established financial institution that is sufficiently capitalized, and further, have to comply with stricter financial regulations. This system gives certain leeway to the Fintech Companies, when they have limited potential to create system risks. Tougher licensing and controls are imposed to deter fraud, which	own, as such loans need not be shown in the balance sheet. However, when such DLAs begin to operate on a much larger scale, they become an integral part of the economy and thus necessitate regulation. In lieu of this, China follows a tiered structure. This structure allows Fintech companies to operate freely in the field, until they attain a certain size, indicated by the assets and volume of transactions of the entity. Subsequently, they are required to partner with a larger and more established financial institution that is sufficiently capitalized, and further, have to comply with stricter financial regulations. This system gives certain leeway to the Fintech Companies, when they have limited potential to create systemic risks. Tougher licensing and controls are imposed to deter fraud, which becomes an increasingly serious issue as the business/industry grows. While increased regulatory scrutiny may stifle Fintech companies' free-wheeling approach, financial innovation should not be left unchecked indefinitely.

		becomes an increasingly serious issue as the business/industry grows. While increased regulatory scrutiny may stifle Fintech companies' free-wheeling approach, financial innovation should not be left unchecked indefinitely. In reference to the given recommendation of the WG Report, it is opined that India can adopt a similar approach of regulating DLAs through Self-Regulatory Organizations, until they attain sizable no. of assets and transactions. Subsequently, stricter regulations should be imposed on the larger DLAs. A similar 4 layered structure has been proposed by the RBI for NBFCs via its circular on 'Scale Based Regulation (SBR): A Revised Regulatory Framework for NBFCs' issued on October 22, 2021.	In reference to the given recommendation of the WG Report, it is opined that India can adopt a similar approach of regulating DLAs through Self-Regulatory Organizations, until they attain sizable no. of assets and transactions. Subsequently, stricter regulations should be imposed on the larger DLAs. A similar 4 layered structure has been proposed by the RBI for NBFCs via its circular on 'Scale Based Regulation (SBR): A Revised Regulatory Framework for NBFCs' issued on October 22, 2021. It is thus recommended that the same can be extended to all DLAs in the Digital lending ecosystem. It is crucially recommended that instead of constituting only a single SRO, two or more SROs must be constituted to keep a check on each other.
3.4.2.5	The given section proposes a Banning of Unregulated Lending Activities (BULA) Act, that will be analogous to the current 'the Banning of Unregulated	References: 1. Non-bank lending in the European Union, Allen and Overy, Alternative Credit Council, https://www.aima.org/stati	The given recommendation aims to analyse the feasibility of the Banning of Unregulated Lending Activities (BULA) Act, in the light of the regulations of other jurisdictions, as well as the Banning of Unregulated Deposit Scheme Act, 2019, to which the

	Deposit Scheme Act, 2019'. This act is said to cover all those lending entities unregulated and unauthorized by the RBI, or in other words, entities not registered under any other law for specifically undertaking public lending business.	c/uploaded/d3eb38cf-c998-4d5c-bbeb67502020f8a2.pdf 2. Banning of Unregulated Deposit Scheme Act, 2019	BULA is said to be analogous. Regulations in jurisdictions such as that of USA and the European Union reveal that the laws pertaining to unregulated, or in other words, non-banking lenders are regulatory and supervisory in nature, and **not** prohibitory. For example, in Europe, under the existing regulatory framework, non-banking lenders are authorized and supervised by the national competent authorities. Further, they are to undertake rigorous borrower due diligence and credit underwriting procedures on any loans they originate, and they are also mandated to provide detailed reporting to investors and national competent authorities. Further, on examining the Banning of Unregulated Deposit Scheme Act, 2019, the act prescribes strict penal provisions for unregulated deposit schemes. If the BULA is to adopt a similar approach, then it would entail penal provisions for unregulated/unauthorized lenders. It is recommended that instead of a prohibitory act, an act aimed at supervising the practices of unregulated lending entities in the digital lending ecosystem, be initiated. This will ensure the protection of

			consumer interests, and ensure compliance by unregulated NBFCs.

IV. Comments on Section 4 - Technology Standards of Digital Lending

4.3.1	Algorithms should remain outside the oversight of regulators.	The developer may not predict the functioning of algorithms. **Problem-1-**This keeps algorithms outside the scope of lenders, but such algorithms are in fact include confidential company information and may include proprietary technology that lenders may not want to disclose publicly. For long-term investment, the investor's interest needs to be balanced with that of the borrower. **Problem-2-** To determine negligence liability for a decision based on an algorithm, courts would need to know how the algorithm reached its decision, or where it may have been flawed. To make a negligence claim to prevail, three elements must normally be demonstrated: (i) the defendant had a duty of care; (ii) the defendant breached that duty; and	It would be more appropriate to coordinate with other stakeholders for the regulation of algorithms.

		(iii) that breach caused an injury to the plaintiff. Proving causation may be difficult when an algorithm is involved.[2] If these are outside the scope of the regulator, in case of any biasness, it would be difficult to determine the negligence liability. **Problem-3-** The use of Algorithms has unfair distributive effects because it manipulates the customer's choices, even without the awareness of customers.[3]	
4.4.1.4	A comprehensive framework is essential to ensure the protection of individuals' privacy and rights.	The provisions from Data Protection Bill, 2019 should be applied to protect the data collected by Digital Lending Applications (DLAs). Since DLAs collect personal data, they are under the purview of DPB.[4]	DLAs should be made to comply with DPB as soon as it comes into force.
4.4.3.1	As multiple players have access to sensitive consumer/ financial data, there must be clarity on	Personal data may be retained only until the purpose of collection is completed.[5] DLAs should consider	1. Personal Data should be collected with "explicit consent" of the customer and should be "deleted" if the customer says so. The Data should be "retained"

[2] Miriam C BUITEN, Towards Intelligent Regulation of Artificial Intelligence, European Journal of Risk Regulation, University of Cambridge, https://www.cambridge.org/core/journals/european-journal-of-risk-regulation/article/towards-intelligent-regulation-of-artificial-intelligence/AF1AD1940B70.
[3] Algorithm: How they can reduce competition and harm consumers, Competition and Market Authority, https://www.gov.uk/government/publications/algorithms-how-they-can-reduce-competition-and-harm-consumers/algorithms-how-they-can-reduce-com.
[4] Data Protection Bill, 2019, S. 2.
[5] Data Protection Bill, 2019, S. 9.

	issues like the type of data that can be held, the length of time data can be held, restrictions on the use of data, data destruction protocols etc.	developing data retention policies, outlining the length of time they will hold on to the personal information of their users, as there is a positive obligation to delete such data in certain situations. A lot of DLAs collect non-personal information too in order to improve customer experience on their website and to make the website user friendly.[6] They collect information about our browsing history, our buying behaviour, preferences, etc. According to California Consumer Protection Act, 2018[7], "inferences drawn from any of the information identified in this subdivision to create a profile about a consumer reflecting the consumer's preferences, characteristics, psychological trends, preferences, predispositions, behaviour, attitudes, intelligence, abilities and aptitudes" is also covered under the	only until the purpose of collection is completed. 2. Non-Personal Information like browsing history should also be protected as "Personal Data", just like under California Consumer Protection Act, 2018.

[6] Kredit Bee Privacy Policy, https://www.kreditbee.in/privacy-policy.
[7] California Consumer Protection Act, 2018, https://oag.ca.gov/privacy/ccpa.

		definition of "personal data" under the Act. DLAs check the previous history of the consumer and use AI to see whether and what kind of loan should be given to the customer. This previous history of the customer should be protected and the use of AI in deciding the type of loan should be regulated. The previous history of customers should be protected as "personal data" in India too, and should not be shared with third parties (be it any other DLA or NBFC) unless explicit consent is given by the customer. Customers should have the right to request the deletion of their personal data at any time. The idea of 'Consent Manager'[8] (identified as data fiduciaries who will enable Data Principals to gain, withdraw, review and manage consent through "accessible, transparent and interoperable" platforms) as given in DPB should be adopted. The idea of 'consent managers' is	3. Idea of "Consent Manger" should be adopted.

[8] Data Protection Bill, 2019, S. 23.

		innovative but relatively untested in practice for personal data, though to a certain extent, the “Account Aggregator” framework prescribed by the Reserve Bank of India (RBI), contemplates a similar role for Account Aggregators, requiring them to develop platforms that enable customers to manage consent and information across financial accounts and products. The underlying intention is to mitigate ‘consent fatigue and provide greater awareness to the uninitiated. This will ensure that customer information is not freely sent between different DLAs. Compliance with such requests, require the data fiduciary to confirm the removal of such personal data[9] from both its systems, and those of any other companies who were processing the same data (the data is shared between different DLAs to see customer history, so the data should be deleted from all the DLAs having that info) on its behalf. It must be noted that in a digital	4. Minimum Information of the borrowers could be kept on a common platform.

[9] Data Protection Bill, 2019, S. 20.

		ecosystem, the feasibility of accurately confirming the complete deletion of data to the exclusion of any digital footprints, remains questionable. The customers should have the right to withdraw their consent, and the procedure for such withdrawal, if the personal data is intended to be processed based on consent, should be outlined earlier only. A concept of Minimum Information Requirement' (MIR) could be derived. Under this, Minimum Information necessary for both lenders and borrowers can be kept on a common platform. Both parties need certain minimum information to guide their decisions, and hence the regulatory framework should ensure that they get that information. However, at the same time, DLAs are in a position of using that information to tailor products according to consumer preferences and patterns, giving rise to antitrust and conflict	

		of interest concerns (especially when the LSP/DLA is under the same entity as the partner NBFC). Hence, it is recommended that the MIR ensure full minimum information of the borrowers to all lenders on a common platform. Any other information would have to be deleted permanently. "Explicit Consent" should be taken of the borrower for keeping MIR on the platform and for sharing the information with another lender. The borrower should be informed of the sharing of the information with another lender. Information regarding any cross-border transfer of the personal data that the DLAs intends to carry out, if applicable, should be given to the customer. The data should be processed by the DLAs on the consent of customers. The Data Protection Bill (DPB) lays down the test for 'valid consent' for personal data, i.e., consent which is:	

		1. Free (as per the Indian Contract Act, 1872), 2. Informed (considering whether the information required under the notice provision has been provided), 3. Specific (considering whether the Data Principal can determine the scope of consent for the purpose), 4. Clear (indicated through affirmative action in a meaningful way) and 5. Capable of being withdrawn (considering the ease of withdrawal of such consent compared to the ease with which consent was granted). This should be done by DLAs while collecting the data of the customers. General Data Protection Regulation (GDPR)[10] also talks about "Informed Consent". Most users indiscriminately click "I agree" due to the sheer	

[10] General Data Protection Regulation, https://gdpr-info.eu/.

		verbosity, complexity and lengthy agreement text. Commonly known as “consent fatigue”, where consent form is treated as a point of friction, GDPR enforces meaningful consent by simplification of language and deters storage of any data that is not necessary for operations. This should be adopted by DLAs too. Explicit consent should be taken by DLAs.	
4.4.3.1 (d)	When data breaches occur, the pre-defined protocol should kick in to ensure customers are aware of the security issue and the steps being taken to contain the damage.	Under GDPR, a breach of data has to be reported within 72 hours. Similarly, DLAs should also be made to report a breach of data within a reasonable period of time. According to GDPR, the controller of the data is responsible for reporting the data breach.[11] Similarly, out of the DLAs or their partner NBFCs, whoever is handling the information should be held responsible for reporting the breach of the data.	Breach of data should be reported by the controller of data within 72 hours.

[11] GDPR, Art. 33, https://gdpr-info.eu/art-33-gdpr/.

V. Comments on Section 5 – Financial Consumer Protection

5.3	Parallels between digital lending today and microfinance industry in 2010	In comparison to the steady growth of MFIs across India, the state of Andhra Pradesh witnessed an explosive growth of MFIs. Due to several political motives, the then state government of AP systematically fostered and inculcated the SHG culture. The SHGs were further federated to Village Organizations and Mandal Organizations so microcredit could penetrate to remotest of areas. The presence of such, existing organised groups of the poor resulted in the largest concentration of MFIs in AP among all the states in India.[12] Thus, taking advantage of the strong SHG network set up by the state, the private MFIs flocked to AP as it was much easier to grow and survive in the MFI sector over there. Thus, many poor households in AP took advantage of the easy availability of credit and borrowed far	Looking at the present scenario of fintech companies and the digital lending sector as a whole, a similar pattern is noted. The DLAs/LSPs are trying to penetrate to low-credit penetrated markets. In fact, fintechs are even granting credit to new-to-credit consumers without a proper credit rating. The decision as to selection of borrowers is arbitrary. In interests of profitability and business, the fintech companies, similar to private MFIs may go on to oversupply the market with credit and owing to over indebtedness a similar cycle of defaults and debt traps may ensue.

[12] The Andhra Pradesh microfinance crisis in India: manifestation, causal analysis, and regulatory response, Anurag Priyadarshee, Asad K. Ghalib

		beyond their repayment capabilities from various microfinance sources. The MFIs, for their part, offered multiple loans to the same borrower household without following due diligence, as it served their business interests. Worse still, some MFIs collaborated with consumer goods companies to supply consumer goods such as televisions as part of their credit programmes. As the poor aspired to own such goods, they were happy to receive them. Possession of such goods only exacerbated their already worsening indebtedness as such investments did not generate any income. The poor borrowers therefore started defaulting in repayment and the MFIs resorted to coercive methods for loan recovery. Many borrowers were forced to approach moneylenders to borrow at exorbitant rates of interest to repay to MFIs. When the situation became impossible, some of these borrowers	

		committed suicide and the matter caught the attention of media.	
5.3.4.1	It is important for DLAs to be transparent about the total cost including interest and other charges borne by the customers. There is a tendency to mask the excessive interest rates by disclosing only weekly or monthly rates depending on the repayment schedule. It has also been observed that the entire costs associated with first loss default guarantee or any other such mechanism offered by the platforms to their lending partners are passed on to the borrowers resulting in higher interest rates. Though it is difficult to have the same benchmark for the level of interest rates for all borrowers across all segments, rates of interest beyond a certain level are indeed		Disclosure of yearly average interest rate percent charged on borrowers must be made compulsory.

	excessive and can neither be sustainable nor justifiable		
5.3.6.5	Ombudsman Scheme: The Ombudsman Scheme extended to NBFCs in 2018 is applicable to (a) those authorized to accept deposits, or (b) have customer interface with asset size of one billion rupees or above. The high threshold of asset size essentially exempts smaller NBFCs, which originate majority of the small-ticket digital loans, and hence, the deterrence effect is absent in majority of the digital lenders partnering with (smaller) NBFCs.	As of today, there are three "Ombudsman" schemes, i.e. (i) Banking Ombudsman Scheme (ii) Ombudsman Scheme for Non-Banking Financial Companies and (iii) Ombudsman Scheme for Digital Transactions are in operation from 22 ombudsman offices of RBI located across the country."13What is of relevance among these is the Ombudsman for Digital Transactions. Digital Transactions. Introduced in 2019, under the Section 18 of Payments and Settlements Act, 2007, it was supposed to be a free of cost expeditious mechanism for resolving conflicts arising out of digital transactions. This seem sought to adjudicate over all the entities that participated in the capacity of "System Participants". System Participants, under Section 3(11) of the scheme, have been	Therefore, a requirement for a better, i.e., more accessible and approachable grievance redressal mechanism is realized. For this, we may take some reference from IMF's working paper on Fintech in Europe: Promises and Threats[16]. With regards to consumer protection, there are several national regulations in the EU. There are no concerns as to financial stability however it does not leave the fintechs scot free. Conduct regulations and disclosure requirements are often applied to fintech companies. Furthermore, national legislations like Anti Money Laundering Rules and Combating Finance of Terrorism Rules often require the fintech companies to conduct customer due diligence.

[13] https://www.rbi.org.in/Scripts/BS_PressReleaseDisplay.aspx?prid=51078
* The number in the bracket shows no. of offices in the city marked against.
[16] Fintech in Europe: Promises and Threats, Chikako Baba et. al., International Monetary Fund

		defined as "any person other than a bank participating in a payment system". In my opinion, this term is wide enough to be able to include the Lending Service Providers/Digital Lending Authorities which may not be subject to direct supervision and/or regulation by the RBI. These three schemes have been integrated under the "One Nation One Ombudsman" approach to grievance redressal. In this regard, it is quintessential to take note of the fact that due to Modularization and subsequent outsourcing of several jobs in the digital lending process to multiple entities, it has already become a tedious task to identify a proper grievance redressal channel or authority. Multiple channels also lead to lack of clarity regarding fixation of responsibility and legal liability. The borrowers tend to be unaware of answers to several questions of material importance, such as where their data resides, which	

		entity to contact or hold liable in case of a grievance, or which forums to approach to seek redress.14 Especially owing to Modularization, i.e., outsourcing each process on the lending spectrum to a Third Party, generally fintech companies, or Lending Service Providers which may be referred to as non-risk holding entities as they are not regulated by the RBI, the situation of grievance redressal has become very miserable in this multi-layered setting. Due to the multitude of layers, often, customer care systems interacting with each other, which finally leads to failed redressal of issues. In a study conducted by Dvara Research Foundation in collaboration with the Consultative Group to Assist the Poor (CGAP)15, the risk holding entities (SCBs, NBFCs, other sources of lending under regulation by the RBI) have opined that the only available redressal	

[14] A Convening on 'Emerging Customer Risks in Digital Lending in India', Dvara Research.
[15] *Id.*

		option is either through a chatbot or a WhatsApp window. Most often, there is neither a contact number visible on the website or app of the customer-facing entity, nor there is a physical location that borrowers can approach to seek redressal. Another factor that further reduces the approachability of the redressal options is that any available information is in English and not provided in any vernacular languages.	
5.4.2.1 **5.3.2.1**	**Lenders to capture the economic profile of borrower and assess the consumer's creditworthiness in an auditable way** Over indebtedness starts before a default actually happens. Information about loans extended by money lenders or companies other than NBFCs is not	Lax pre-agreement borrower assessment policies of lenders, including but not limited to their failure to establish consumer credit worthiness, have both contributed to reckless lending in the digital domain.[17] As identified, there are, for sure, certain loopholes on the lender's side but then it also becomes necessary to state that borrowers must also submit correct and comprehensive information to lenders in	It is clear that ultimately the problem lies in inadequate credit assessments which increase the risk of losses from borrower's defaults for lenders and over-indebtedness for the borrowers.[23] Hence, imposing creditworthiness assessment requirements is something that is really needed. Moreover, there is a need to prevent discrimination in lending. To give an example, the MCD looks at the competition side of the market and it provides for the non-discriminatory access of creditors to the databases used in another Member State via the exchange of information among

[17] https://www.pwc.in/assets/pdfs/consulting/financial-services/fintech/publications/a-wider-circle-digital-lending-and-the-changing-landscape-of-financial-inclusion.pdf

[23]

5.3.2.2 5.3.2.4	submitted to credit information companies. This may lead to under-reporting of outstanding loans of the borrowers resulting in their over-indebtedness. Hence, suitable remedial measures need to be provided for the customer to service his debt and live his life with dignity. The focus needs to shift from a sales-oriented culture to an engagement-based culture What could be lacking currently in the regulatory sense are explicit guidelines in the Fair Practices Code to restrict reckless lending, and predatory practices like debt entrapment (ensuring that borrowers will be unable to repay loans and ultimately forcing them to default), debt	order for them to make an informed lending decision. They must not supply deceptive information or hide any essential information. What generally happens is, the borrower fails to identify their own repayment capacity and just borrow more due to the easy-looking, unregulated process. This might lead to losses on both sides of the spectrum, the borrower falls into the depths of over indebtedness, debt entrapments and whatnot, the lenders try to increase the interest rates to cover those losses. The borrower should also make an assessment of their income and repayment capacity considering their expenses and should carefully consider if availing credit is the only option left to meet the immediate needs/ wants. This becomes	the competing creditors, specifying that such databases comprise databases operated by private information providers as well as public registers.[24] A common platform maintained by the RBI regarding all information extracted for a particular consumer would be a suitable step in this regard. This can be in nature of the Consumer Financial Protection Bureau in the US.[25] With reference to data protection, the concept of consent can be duly made use of, and the idea of "consent manager" can be applied.[26]

[24] Directive 2014/17 of the European Parliament and of the Council, at art. 21. The focus on competition of the MCD is clear from Recital 60 MCD: "[T]o prevent any distortion of competition among creditors, it should be ensured that all creditors, including credit institutions or non credit institutions providing credit agreements relating to residential immovable property, have access to all public and private credit databases concerning consumers under non discriminatory conditions …."
[25] https://www.consumerfinance.gov/about-us/
[26] https://www.medianama.com/2020/01/223-pdp-bill-2019-consent-and-offences-views/

	treadmill (finding methods that will produce a constant [80] stream of fee payments from the borrower to the lender) and debt criminalization (making borrowers fear arrest if they fail to repay their loans).	more critical in case of loans availed for consumption/ life-style needs. A suitable reference here would be the buy-now, pay-later loans which are provided by many platforms. Such services somehow induce the customer to buy beyond their capacity and fall into the depths of indebtedness.[18] There are companies that use BNPL as payment product where credit reporting does not happen. This kind of an approach creates a gap when evaluating a consumer for other loans and often leads to misinterpretation of the customer's actual pay burden by other potential lenders, causing the customer to be over leveraged when approved. Last but not the least, the borrower is obliged to make timely repayments. He should realize that any laxity on this front is not in his self-interest and may	

[18] https://economictimes.indiatimes.com/industry/banking/finance/buy-now-pay-later-or-party-now-worry-later-decoding-the-latest-finance-fad/articleshow/86931186.cms?utm_source=contentofinterest&utm_medium=text&utm_campaign=cppst

		impact his credit history adversely thus making it difficult to avail credit on favourable terms in future. Borrowers often understate their indebtedness hence, a positive financial behaviour, so to say, needs to be developed. By operating in a legal vacuum, assessment methods escape or circumvent credit laws designed—at least in principle—to protect consumers from the old problems caused by unsuitable credit for their needs and the risk of over-indebtedness, as well as to allow them to borrow responsibly.[19] Real-time information sharing on borrowers can reduce information asymmetries, and better assess suitability. This will help in better risk management on the lender's side and can also help borrowers provide their information to more lenders at the same time and enable them to show a positive repayment history to receive better products	

[19] https://www.cambridge.org/core/journals/german-law-journal/article/peertopeer-lending-and-eu-credit-laws-a-creditworthiness-assessment-creditrisk-analysis-or-neither-of-the-two/5CE96E68947E0A9496E018D67FD5DD50

		and better interest rates on loans.[20] But, it is also important to note that at the moment, many digital lending platforms use AI to evaluate the same, and hence, collect non-financial private information as well, which comes with its own set of problems. Credit data is one of many possible sources of information for the creditworthiness assessment. These different data points (basically digital footprints[21]) include soft information on borrowers, transaction information such as invoices and GST data, transportation data such as E-Way bills. There are certain security risks associated with it including exploitation of the borrower and even credit discrimination. Hence, a proper mechanism is needed to be developed in this regard which must be water-tight and guarantee the borrower's privacy and	

[20] https://www.dvara.com/research/wp-content/uploads/2021/08/A-Convening-on-Emerging-Customer-Risks-in-Digital-Lending-in-India.pdf
[21] https://rady.ucsd.edu/docs/seminars/puri_manju-paper.pdf

		safety and fair treatment.[22]	
5.4.3.3	The proposed key facts statement (KFS)/ fact-sheet applicable also to all STCC/ micro borrowers would give customers a simple summary of the important terms and conditions (tenor/ fees/ interest rate/ reset dates) of the financial contract. Use of any techniques by digital lenders, where they use hidden fee structures or "teaser" rates, should invite appropriate regulatory/ supervisory action.	Consumer testing on disclosure for digital microcredit in Kenya found that simpler versions of T&C led to better comprehension and more searching for products from other providers.[27] A summary of key T&C in a streamlined format may strike a sufficient balance between the limitations of devices and the need to ensure that key information is highlighted for consumers up front.[28] A European Commission behavioural study on digital sales of retail financial services found that well-laid-out, ordered information had a substantial positive effect on consumers' choosing more optimal products in a test environment, and the positive impact actually proved greater on	Present format of the KFS as under Annexure F of the Report is the one that is standardized for SCBs and therefore, is not optimized enough to be readily put to use in the digital lending sphere. It must be tweaked and optimized according to the realized needs. Before rolling out a KFS, KFS testing is essential.

[22] https://internetfreedom.in/privacyofthepeople-small-borrowers-and-digital-lending-apps/
[27] Busara Center for Behavioral Economics, Pricing Transparency
[28] Consumer Risks in Fintech: New Manifestations of Consumer Risks and Emerging Regulatory Approaches

		mobile phones than desktop channels.[29] To incentivize consumers to engage with information delivered in a digital environment, including by layering information as a means to guide consumers through their journey in a way that enables them to digest each part easily, rather than including all information up front.282 For example, summary information can be included up front, with more detailed information included in secondary layers in a menu. Testing of user interfaces for the provision of digital microcredit via mobile channels would also be highly beneficial. The G20 Task Force suggests that policy makers encourage FSPs to test digital disclosure approaches to ensure their effectiveness, taking into account factors such as different screen sizes and	

[29] EC, Behavioral Study on Digitalisation.

		communication formats.[30]	

[30] G20/OECD Task Force on Financial Consumer Protection, Financial Consumer Protection Policy Approaches, World Bank

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