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Recommendations of the Working group on Digital Lending - Implementation

On November 18, 2021, the Reserve Bank of India ("RBI") published the 'Report of Working Group on digital lending including lending through online platforms and mobile apps' ("Report") laying down recommendations on digital lending. Further to the Report, the RBI on August 10, 2022, has issued a press release titled 'Recommendations of the Working group on Digital Lending - Implementation' ("Press Release") and introduced the first set of recommendations to be implemented by regulated entities ("REs") and lending service providers ("LSPs")² with immediate effect.

The Press Release addresses recommendations under the following three heads:

- Recommendations to be complied with immediate effect;
- Recommendations accepted in-principle which require further examination; and
- Recommendations for consideration of the Government of India.

Part A: Recommendations which take effect immediately for implementation

Sr. No.	Key Recommendations
1	<p>Disbursement and repayment of loan: All loan disbursements and repayments are required to be executed only between the bank accounts of borrower and the RE. Any passthrough/ pool account of the LSP or any third party is not permitted, except few exceptions, where disbursements have to be made pursuant to (i) statutory mandate, (ii) flow of money between REs for co-lending transactions, (iii) disbursement where loans are mandated by RBI as per specific guidelines.</p> <p><i>SAM & Co. Note:</i> This requirement will affect existing digital lending models where the loans are disbursed, and repayments collected through the LSP's nodal bank accounts. Further, this will impact payment aggregators who provide payout/ collection services to REs as funds are routed through their respective nodal/escrow accounts. The impact will also be felt by 'buy now pay later' business models where the loans are disbursed directly into the bank account of the end merchant/ service provider and may require change in existing arrangements unless specific clarity is proffered by RBI.</p>
2	<p>Charges to borrowers:</p> <ul style="list-style-type: none"> • Fees and charges payable to LSPs cannot be charged to the borrower and are instead required to be paid directly by REs. • All-inclusive cost of digital loans as an 'Annual Percentage Rate' ("APR") is required to be disclosed upfront by the RE. • A standardized 'Key Fact Statement' (KFS) is required to be provided to the borrower before executing the loan contract, which should provide details of loan, fees, grievance officers etc. Any fees or charge which is not mentioned in the KFS cannot be charged to the borrower at any stage during the term of the loan. <p><i>SAM & Co. Note:</i> It will be crucial for REs and LSPs to disclose all charges in KFS to the borrower in the KFS- as any other fees/charge cannot be charged to the borrower. This requirement has been brought to address the issue of levy of undisclosed processing fees, default interest and late payment fees to borrowers by LSPs in certain instances.</p>

1 **Note:** REs are entities regulated by the RBI and for the purposes of the Press Release will include banks and NBFCs.

2 **Note:** LSPs are lending service providers which assist REs in customer acquisition, underwriting support, pricing support, disbursement, servicing, monitoring, collection, liquidation of specific loan or loan portfolio for compensation from the balance sheet lender.



3	<p>Customer protection:</p> <ul style="list-style-type: none"> REs have to ensure that digitally signed documents³ supporting important transactions through digital lending applications (“DLA”)⁴ automatically flow from the RE to the registered/ verified email/ SMS of the borrower. REs have to publish the list of LSPs (and DLAs, if any) engaged by them along with the details of the activities for which they have been engaged, on their website. At onboarding stage, DLAs have to prominently display information relating to the product features, loan limit and cost, etc. REs have to ensure that DLAs have links to REs’ website where borrowers can access information about the loan products, the lender, the LSP, particulars of customer care, link to ‘Sachet Portal’ and privacy policies. REs have to communicate to the borrower the details of the LSP, at the time of sanctioning of the loan and also at the time of passing on the recovery responsibilities to an LSP or change in the LSP.
4	<p>Customer grievance redressal:</p> <ul style="list-style-type: none"> REs and LSPs have to appoint a nodal grievance redressal officer and details of such nodal officer have to be displayed on the website of RE and LSPs and also in the KFS. Information on the mode of lodging complaint has to be made available on the DLA and on the website of LSP and RE. A borrower can lodge a complaint over the Complaint Management System portal or other prescribed modes under the Reserve Bank Integrated Ombudsman Scheme, if any complaint is not resolved by the RE within 30 days.
5	<p>Sanctioned credit limits: Automatic increases in credit limits are prohibited unless explicit consent of borrower is taken on record for each such increase.</p>
6	<p>Cooling off period: A cooling off period, determined by the board of RE, has to be given to borrowers for exiting digital loans if borrower decides to not continue with the loan during that period, by paying the principal and proportionate APR without any penalty.</p>
7	<p>LSP onboarding:</p> <ul style="list-style-type: none"> Enhanced due diligence of LSPs has to be undertaken REs to assess their technical abilities, data privacy policies and storage systems, fairness in conduct with borrowers and ability to comply with regulations and statutes. Periodic review of conduct of LSPs has to be conducted by REs. Compliance with various technology standards/ requirements on cybersecurity stipulated by RBI or other agencies, will be treated as a precondition to offer digital lending by the REs and LSPs.
8	<p>Customer consent of data collection and processing</p> <ul style="list-style-type: none"> Any collection of data by DLAs is permitted only on a need basis and with prior and explicit consent of the borrower which can be audited, if required. The borrower has to be provided with an option to give or deny consent for use of specific data, restrict disclosure to third parties, data retention, revoke consent already granted to collect his personal data and if required, make the app delete/ forget the data. Explicit consent of the borrower has to be taken before sharing personal information with any third party, except for cases where such sharing is required as per statutory or regulatory requirement. The purpose of obtaining borrowers’ consent needs to be disclosed at each stage of interface with the borrowers.
9	<p>Storage of customer data by LSPs:</p> <ul style="list-style-type: none"> REs have to ensure that all data is stored in servers located within India. LSPs are not permitted to store personal information of borrowers except for some basic minimal data (viz. name, address, contact details of the customer, etc.) required to carry out their operations. <p><i>SAM & Co. Note: Till date LSPs used to store and access customer data with customer consent pursuant to provisions of the Information Technology Act, 2000 and Information Technology (Reasonable security practices and procedures and sensitive personal data or information) Rules, 2011. Now, the RBI has imposed further stringent requirements where customer personal data, except to the extent permitted, cannot be stored by LSPs even with explicit customer consent. It appears that RBI is gradually moving towards localisation of all data in India. While the previous data localisation requirements were limited to payment system data and payment system operators, the Press Release requires REs to ensure that all data is stored in servers located in India. Now all REs and LSPs will have to store all data (both payments and non-payments data) in servers located in India and this will result in further cost implications for REs and LSPs.</i></p>

3 **Note:** Such documents may include KFS, summary of product, sanction letter, terms and conditions, account statements, privacy policies of the LSPs with respect to borrowers’ data, etc.

4 **Note:** DLAs are mobile and web-based applications with user interface that facilitate borrowing by a financial consumer from a digital lender.



10	<p>DLAs' access to customer data:</p> <ul style="list-style-type: none"> DLAs are not permitted to store or collect biometric data unless allowed under extant statutory guidelines. A one-time access is permitted to be taken by DLAs for camera, microphone, location or any other facility necessary for the purpose of on-boarding/ KYC requirements with the explicit consent of the borrower. DLAs are recommended to desist from accessing mobile phone resources such as file and media, contact list, call logs, telephony functions, etc. <p><i>SAM & Co. Note: These restrictions may be applicable to DLAs of both REs and LSPs. RBI has ensured that customer information and data security is paramount aspect which needs to be adhered to and has kept its approach on this consistent with its ongoing position on this issue in other matters as well. One important aspect to be noted is that RBI has specifically discouraged DLAs to have access to mobile phones for accessing media files, contact list, other resources etc., and this may affect the manner in which credit assessment were being carried out and other functionalities/product offerings were being made to customers.</i></p>
11	<p>Privacy policy: DLAs have to publish on its website and app:</p> <ul style="list-style-type: none"> A comprehensive privacy policy compliant with applicable laws, associated regulations and RBI guidelines. Policy guidelines regarding storage of customer data, type of data that can be held, the length of time data can be held, restrictions on the use of data, data destruction protocol, standards for handling security breach, etc. <p><i>SAM & Co. Note: These requirements may be applicable to DLAs of both REs and LSPs.</i></p>
12	<p>Reporting of loans to CIC: REs have to report to CICs:</p> <ul style="list-style-type: none"> All lending done through DLAs irrespective of its nature/ tenor. Extension of new digital lending products by REs over a merchant platform involving short term, unsecured/ secured credits or deferred payments.

Part B: Recommendations accepted in-principle requiring further examination

Sr. No.	Key Recommendations
1	<p>First Loss Default Guarantee (FLDG): The recommendation pertaining to FLDG in Report are under examination with the RBI. RBI has stated that till specific instructions are issued on, for FLDGs, REs have to adhere to the guidelines laid down in Master Direction – Reserve Bank of India (Securitisation of Standard Assets) Directions, 2021 (Securitisation Directions) dated September 24, 2021.</p> <p><i>SAM & Co. Note: The interim recommendation from RBI for REs to comply with provisions of Securitisation Directions appears to be a shift from the Report which recommended an outright ban of FLDG arrangements. It appears at this stage, that RBI has not taken a final position whether there will be an outright ban on FLDG arrangements; however, it will be a wait and watch approach to see if the RBI has accepted the recommendation of the Report in FLDG in principal or will RBI continue to permit FLDG arrangements and the specific parameters that it may legislate on these issues.</i></p> <p><i>The REs are presently expected to adhere to the provisions of Securitisation Directions including guidelines on credit enhancement facilities, first loss facilities and second loss facilities till final position on this formed by the RBI.</i></p>
2	<p>Baseline technology standards: RBI will issue baseline technology standards for DLAs addressing following:</p> <ul style="list-style-type: none"> Security of applications running on mobile phones; Proper authentication, input validation, clear access rules, measures to ensure protection of sensitive data, etc; Maintaining auditable log of every action of the user performs; Monitoring of transactions being undertaken through DLA; Multi-step approval for critical activities undertaken on the DLA; Specific technological safeguards to prevent frauds like sanction of loans on stolen identity, data breaches.
3	<p>Customer Protection: Each access/ enquiry of credit information by any RE or LSP from CIC will be required to be conveyed to the borrower through email/ SMS.</p>



4	Technology and data requirements: <ul style="list-style-type: none"> Banks will be required to monitor accounts regularly operated from a different/ overseas IP address which is not consistent with the KYC profile of the account holder. REs will be required to ensure that the algorithm used for underwriting is based on extensive, accurate and diverse data to rule out any prejudices. Further such algorithm should be auditable to point out minimum underwriting standards and potential discrimination factors used in determining credit availability and pricing. REs will be required to adopt ethical AI which focuses on protecting customer interest, promotes transparency, inclusion, impartiality, responsibility, reliability, security and privacy. REs will be required to ensure measures related to data privacy and security at the end of SMS gateways/ SMS service providers before onboarding them.
5	Regulatory framework: <ul style="list-style-type: none"> Self-Regulatory Organisation covering REs and DLAs/LSPs in the digital lending ecosystem will be set up which will address the issue of framing a code of conduct for recovery, model standardised LSP agreement for balance sheet lenders, Code of Conduct for responsible advertising and marketing standards, institutional mechanism for training and accreditation of recovery agents in consultation with RBI, maintaining 'negative list' of LSPs which are non-compliant with regulatory and statutory provisions, engaged in unfair practices. REs will be required to report LSPs engaged in unfair practices or in breach of regulatory norms to SRO for inclusion in negative list. REs will be required to file periodical returns including data on digital lending and (attempted) frauds in digital lending space. Regulatory framework for web-aggregator of loan products will be framed. <p><i>SAM & Co. Note: On the lines of web aggregators for insurance (regulated by IRDAI), web aggregators for banking products may be brought under the regulatory purview of RBI.</i></p>

Part C: Recommendations for consideration of the Government of India

For entities lending outside the purview of any statutory/ regulatory provisions, the Press Release records the following recommendations for the Government of India to consider:

Sr. No.	Key Recommendations
1	Balance sheet lending using DLAs to be restricted to REs.
2	Government to consider framing a legislation for banning of unregulated lending activities.
3	Digital India Trust Agency to be set up, which will discharge the functions of verifying DLAs before such apps can be publicly distributed through app store.
4	Steps for early identification of shell finance companies and finance companies with proxy directors or opaque beneficial owners.

Concluding Remarks

The Press Release is certainly a welcome step by the RBI where RBI has tried to balance fintech innovation and customer protection. The Press Release will result in indirect regulation of LSPs and DLAs by putting the onus on the REs to ensure that the LSPs implement the applicable recommendations. This paves the way for RBI to gain control over REs and LSPs to ensure customer protection and curb unscrupulous lending practices.

The Press Release clarifies that while REs and LSPs should be guided by the regulatory stance taken by the RBI, detailed instructions will be issued separately by the RBI. A lot of aspects covered in the Press Release will get ironed out and enforced once the SRO is set up and additional guidelines are prescribed, which could entail changes or modifications to existing models/arrangements for REs and DLAs/LSPs.

Please feel free to address any further questions or request for advice to:

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