JSA Newsletter
FinTech

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JSA Fintech Newsletter – Thirteenth Edition

Introduction

This edition of the Fintech Newsletter focuses on the (a) Payments Framework for Facilitating Small Value Digital Payments in Offline Mode launcher by the Reserve Bank of India ("**RBI**"), (b) Six month extension of applicability of its prohibition on storage of Card-on-File, (c) Digital Lending Report, (d) NITI Aayog proposal for a digital bank licensing & regulatory regime, (e) Cryptocurrency Bill in India. (f) Integrated Ombudsman Scheme, (g) Eligibility criteria for 'specified user' under the Credit Information Companies (Amendment) Regulations, 2021, and (h) New regulations for Aadhaar authentication and verification.

Offline Payments Framework

RBI launches Offline Payments Framework for small value

On January 3, 2022, the RBI launched the Payments Framework for Facilitating Small Value Digital Payments in Offline Mode ("**Offline Payments Framework**"). The Offline Payments Framework is largely similar to the RBI's earlier Pilot Scheme for Offline Retail Payments ("**Pilot Scheme**") (where bank and non-bank payment system operators ("**PSOs**") were permitted to offer digital payments without internet or telecom connectivity between September, 2020 to March, 2021). Bank and non-bank PSOs and payment system participants are permitted to offer offline digital payments, using any channel or instruments such as cards, wallets, mobile devices, etc. However, unlike the Pilot Scheme which permitted proximity (face-to-face) and remote offline payments – the Offline Payments Framework only permits proximity offline payments.

Explicit customer consent is required for enablement of offline payments, with a per-transaction limit of INR 200 subject to an overall cap of INR 2,000. Notably, offline payments transactions do not require additional factor of authentication ("**AFA**"), which is only required when online to reset the INR 2,000 limit. Further, real-time transaction alerts are not required under the Offline Payments Framework – issuers may send alerts for transactions in a consolidated manner, once the transaction details are received.

The Offline Payments Framework is covered under RBI's limited customer liability circulars and customers will have recourse for grievances under the RBI Integrated Ombudsman Scheme. Notably, RBI has also retained the right to stop or modify the operations of any payment solution offering offline payments.

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Extension of time on storage of Card-on-File Deadline

RBI extends deadline for prohibition on storage of Card-on-File data by six months

RBI, through its Guidelines on Regulation of Payment Aggregators and Payment Gateways, intends to prohibit merchants and payment aggregators from storing Card-on-File ("**CoF**") data. This was reiterated in a circular issued by the RBI dated September 7, 2021 on CoF tokenization, which made it clear that no entity in the card transaction / payment chain, other than token service providers (card networks and card issuing banks), will be permitted to store any CoF data.

The RBI's initial deadline for compliance with its restriction on the storage of CoF data was June 30, 2021, which was later extended to December 31, 2021. However, on December 23, 2021, the RBI, based on inputs and representations from industry stakeholders, published a notification extending the deadline by another six months – until June 30, 2022.

The RBI has also suggested that in addition to tokenization, stakeholders may devise alternate methods for transaction and post-transaction activities, such as e-mandates and EMI options.

The extension of the deadline is a welcome move from the RBI, as many stakeholders, such as banks, had warned RBI that their tokenisation infrastructure was not ready for the shift, which would cause disruptions in online payments.

Digital Lending Report

RBI's Digital Lending Report examines digital lending applications and proposes restrictions on FLDG and unregulated balance sheet lending

On November 18, 2021, the RBI published the report on digital lending including lending through online platforms and mobile apps ("**Digital Lending Report**") which was submitted to it by the Working Group on digital lending. The Digital Lending Report has been placed on RBI's website for comments, and stakeholders had been given time until December 31, 2021 to submit feedback.

The Digital Lending Report includes near-term (up to one year) and medium-term (above one year) legal/regulatory recommendations, technology recommendations and consumer protection recommendations in relation to digital lending. Notably, the Digital Lending Report distinguishes between balance sheet lenders ("**BSLs**") (i.e., lenders who retain the loan and credit risk of the loan on their own balance sheets) and lending service providers ("**LSPs**") (i.e., agents of BSLs who undertake customer acquisition, underwriting support, pricing support, disbursement, etc.), and recommends that only entities regulated and authorised by RBI be permitted to act as BSLs. It also recommends that the Government pass appropriate laws to prohibit all unregulated lending in India.

We have summarized below some of the notable recommendations of the Digital Lending Report:

1. **DIGITA and SRO** – A nodal agency called the Digital India Trust Agency (DIGITA) should be set up to verify the technological credentials of digital lending applications ("**DLAs**") and maintain a public register of verified DLAs on its website. Applications which do not carry a 'verified' signature by DIGITA should be considered unauthorized

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for the purpose of law enforcement. Further, all participants in the digital lending ecosystem should be regulated by a self-regulatory organization ("**SRO**"). Anti-predatory lending policies should be framed by each BSL based on the characteristics defined by the RBI and SRO. DLAs must also adopt responsible advertising and marketing standards in line with the code of conduct to be put in place by the SRO.

2. **Disbursements to Bank Accounts/Full KYC PPIs** – All loan servicing, repayments, etc. should be executed directly in the BSL's bank account, and disbursements should always be made directly into the bank account of the borrower. Notably, only borrowers who do not have a bank account but have a PPI account may receive loans to their fully KYC compliant PPI account. General use of PPIs in addition to bank accounts may be permitted when full interoperability among PPIs is implemented.

3. **Data Protection and Localisation** – Data should only be collected from borrowers/prospective borrowers who have granted explicit consent for the same, and have been provided with information on the purpose, usage and implications of such data. Further, DLAs should comply with RBI standards for data and network security, monitoring, data breaches etc. in addition to storing all data in servers located in India, similar to P2P lending and account aggregation companies. DLAs should have publicly available policies regarding data storage, usage and privacy. If functionalities of any government/regulated utilities like the Aadhaar infrastructure, e-KYC, UPI, etc. are used to conduct customer due diligence, no biometric data should be stored or collected in the systems associated with the DLAs of BSLs. In the future, the 'Data Protection Authority', proposed in the Personal Data Protection Bill, could serve as the regulatory body to oversee DLAs.

4. **Algorithms and Technology**: As a near-term recommendation, BSLs should document the rationale for algorithmic features which aid lending decisions and ensure transparency in relation to such algorithms. As a medium-term recommendation, BSLs should also ensure that outputs of algorithms used for underwriting are auditable and knitted in ethical AI design. Baseline technology standards for DLAs of BSLs should be defined, keeping an auditable log of every action that users perform – including geolocation, IP address and device information. Further, there should be a multi-step approval process for critical activities, and transactions passing through the DLA must be monitored in an auditable manner.

5. **BNPL Products**: The Digital Lending Report recognizes that buy-now-pay-later (**BNPL**) products are not currently categorized as 'credit' and as a result, BNPL related advances are not reported to credit bureaus. Therefore, as a medium-term recommendation, the Digital Lending Report has recommended that the Indian Government issue suitable notifications to regulate BNPL as balance sheet lending.

6. **CIC Reporting**: The Digital Lending Report recommends that the submission of information to credit information companies (**CICs**) in respect of all lending carried out through DLAs be made mandatory. It also recommends that such reporting be ensured at shorter intervals compared to conventional reporting.

7. **Matching Advances in FinTech Aided Financial Services:** As a medium-term recommendation, the Digital Lending Report proposes that rules written in natural legal language be replaced with computer codes, and that artificial intelligence may be used for regulatory purposes. The purpose of this recommendation is to ensure a 'seamless digital' approach, which would exploit RegTech and SupTech tools. The Digital Lending Report also recommends the formulation of a blueprint for a forward-looking framework to regulate BigTech and DeFi.

8. **Regulation of Neobanks:** The Digital Lending Report suggests that RBI regulations should cover 'guidance' on bank-fintech partnerships. The Digital Lending Report also noted stakeholder feedback, which recommended that banks should have a code of conduct and set out standards and practices for their neobank partners. While the RBI seems to look at neobanks positively, it will likely prohibit 'front-end only' banks from using the term 'bank' to describe their activities in any form.

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NITI Aayog Proposed Neobank Framework

NITI Aayog released a proposal for a digital bank licensing & regulatory regime

Shortly after RBI's Digital Lending Report was published, NITI Aayog released its Discussion Paper on Digital Banks – A Proposal for Licensing & Regulatory Regime for India ("**NITI Aayog Proposal**"). The NITI Aayog Proposal has criticized 'front-end only' neobanks i.e., neobanks which partner with licensed banks to offer OTT services to customers, 'renting' the balance sheet of the bank.

The 'challenges' of the 'front-end only' neo-bank model, cited by the NITI Aayog Proposal include the following:

1. **Limited Revenue Potential** –Neobanks earn a fee-based revenue wherever they act as channel partners, and potentially earn a fraction of interchange on payments processed through cards; but lack any other revenue sources.
2. **Potential Obsolescence of the Partner Bank Core Banking System** – Neobanks are constrained by the product buckets their partner banks can offer. Without the ability to leverage their balance sheets and their own technological stack to create 'ground up' credit products and user experiences, the potential of such neobanks will never be unlocked.
3. **High Cost of Capital & No Entry Barrier** –Neobanks rely on equity capital to fund innovation, as they cannot issue low-cost deposits.

   That said, NITI Aayog also observed that entry barriers are low, which creates two negative externalities:

   a. Actors that are not fit-and-proper may enter the market creating consumer protection risks; and

   b. Herd mentality in terms of business model replication may occur, rather than genuine innovation.

   The NITI Aayog Proposal proposes the implementation of a licensing and regulatory regime for neobanks in a phased manner, which would result in neobanks becoming 'full-stack digital banks', i.e., entities which are fully functional banks, regulated by the banking regulator and issue deposits and make loans on their own balance sheet.

   The sequence for introduction of the regulatory framework is as follows:

   (a) Introduction of a restricted Digital Business ("**DB**") bank license.

   (b) Applicants acquiring the *restricted* DB bank license to enlist in a regulatory sandbox and be monitored by an identified set of metrics. The regulatory sandbox should recognize the need to offer relaxations to such applicants (in relation to financial soundness, track record, etc.) to facilitate experimentation.

   Contingent on satisfactory performance in the regulatory sandbox, the licensee will be advanced to a less restricted, 'Full Stack DB bank license'.

Progress of the Cryptocurrency Bill in India and other developments

Government likely to introduce a new Cryptocurrency Bill in February, 2022

In 2017, a high-level Inter-ministerial Committee ("**IMC**") was constituted to study issues relating to cryptocurrencies and recommend regulatory action. In 2019, the IMC proposed the 'Banning of Cryptocurrency & Regulation of Official Digital Currency Bill, 2019' ("**2019 Crypto Bill**") and such bill prohibited mining, generation, holding, selling, dealing

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in, issuing, transferring, disposing, or using of cryptocurrency in India. However, this 2019 Crypto Bill was never enacted as law.

With the rapid ascent of virtual currencies across the world, the Central Government's rigid approach to impose a blanket ban on all cryptocurrencies and related transactions has undergone a transformation. The Finance Minister of the country clarified that the 2019 Crypto Bill was re-worked entirely, and a new bill (**2021 Crypto Bill**) would be introduced. While the revamped 2021 Crypto Bill was slated to be introduced in the winter session of the Parliament in 2021, it did not get tabled in time. In all likelihood, the 2021 Crypto Bill will be introduced in the upcoming session of the Parliament in February.

While it has been said that the Central Government wishes to regulate cryptocurrencies, as opposed to banning them, there is a lack of clarity on how the government intends to regulate private cryptocurrencies in India. As per the bulletin published on the Lok Sabha website, the purport of the bill appears to create a facilitative framework for the creation of official digital currency to be issued by the RBI, and also prohibit all private cryptocurrencies in India.

Although the text of the 2021 Crypto Bill has not been made available to the public yet, media houses have been able to receive access to a cabinet note (pertaining to such bill) that suggests the following:

1. Cryptocurrency will not be recognized as legal tender/currency in India. Rather, it would be classified as an asset.
2. Crypto assets would fall under the regulatory scope of the Securities and Exchange Board of India ("**SEBI**") and existing crypto exchanges would come under the supervision of SEBI.
3. For persons owning crypto assets, a definite cut-off date will be prescribed. Within such prescribed timeline, all such persons would be required to declare their crypto assets and bring such assets under crypto exchange platforms operating in India (under the supervision of SEBI). Any failure to comply with such direction would attract hefty penalties in the range of INR 5 crore to INR 20 crore. Hence, storing of cryptocurrencies on foreign crypto exchanges or in private wallets would no longer be permitted.
4. RBI will introduce its own central bank digital currency (CBDC). However, provisions for such central digital currency will not be included under this 2021 Crypto Bill and a separate framework and regulations will be published at a later stage.

Further, media reports also indicate that the Government of India is planning to implement a uniform KYC mechanism that all crypto exchange platforms would be required to implement prior to onboarding investors onto their platforms. Such platforms would also need to disclose KYC details of their investors to the concerned regulatory authority as determined by the Government.

India's First Crypto Index: In January, 2022, CryptoWire, a global crypto application and a special business unit of TickerPlant has launched India's first index of cryptocurrencies, named IC15. IC15 will measure the performance of the 15 most widely traded cryptocurrencies listed on top crypto exchanges by market capitalisation. This index will help crypto enthusiasts and participants to monitor the performance of cryptocurrencies in the global markets.

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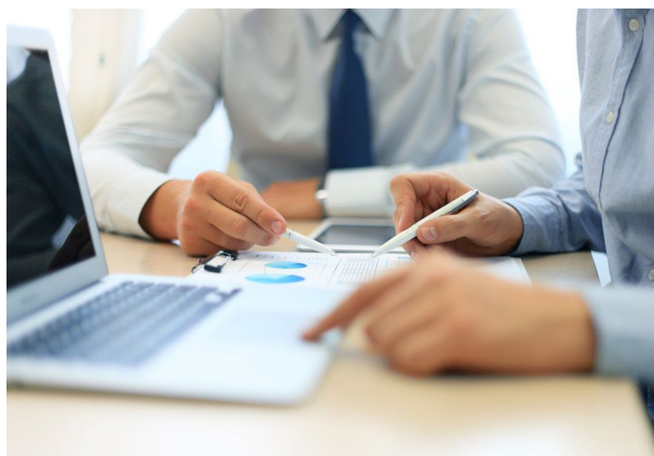
Integrated Ombudsman Scheme

RBI introduced the Reserve Bank - Integrated Ombudsman Scheme, 2021 as a consolidated grievance redressal framework for customers

On November 12, 2021, RBI introduced the Reserve Bank - Integrated Ombudsman Scheme, 2021 ("**Ombudsman Scheme**"), thereby subsuming three existing schemes, namely, (i) the Banking Ombudsman Scheme, 2006; (ii) the Ombudsman Scheme for Non-Banking Financial Companies, 2018; and (iii) the Ombudsman Scheme for Digital Transactions, 2019. This integrated scheme has been introduced to ensure speedier resolution of grievances of customers who stand to benefit from a single platform.



The Ombudsman Scheme has proposed the establishment of a Centralised Receipt and Processing Centre ("**Complaint Centre**") which will receive complaints from customers, doing away with the need to set up ombudsman offices in each jurisdiction. Complainants can register their complaints with respect to (i) deficiency in services provided by any entity regulated by RBI; and (ii) if such grievance/complaint is not resolved to the satisfaction of the customers or not replied to within a period of thirty (30) days by such Regulated Entity (as defined under the Ombudsman Scheme). Subject to specific exclusions, the Ombudsman Scheme defines a 'deficiency in service' as a shortcoming or an inadequacy in any financial service, which the Regulated Entity is required to provide statutorily or otherwise, which may or may not result in financial loss or damage to the customer in all cases. Complaints and grievances can be raised on the ground of such deficient services. Provision has been made for the submission of complaints and grievances both through online and offline modes.

Pursuant to this Ombudsman Scheme, every Regulated Entity would be required to appoint a Principal Nodal Officer and such personnel would be responsible for representing the Regulated Entity in respect of complaints filed against it and furnishing information on its behalf. The Principal Nodal Officer appointed should either be equivalent to the rank of a General Manager or at least not below the rank of such General Manager. Also, a Regulated Entity may, at its discretion choose to appoint other nodal officers to assist the Principal Nodal Officer for operational efficiency.

Every Regulated Entity must prominently display at all of its branches and on the websites information such as (a) name and contact details of the Principal Nodal Officer; (b) details of the complaint lodging portal of the Ombudsman (https://cms.rbi.org.in) and (c) salient features of the Ombudsman Scheme in English, Hindi and the regional language. It will also make available copies of the Ombudsman Scheme to customers upon request.

Every Regulated Entity must comply with an award rendered by the Ombudsman body and/or pay to the complainant, any compensation, as may be determined by the Ombudsman. The amount of compensation that may be ordered by the Ombudsman will, in no case, be higher than the consequential loss suffered by the complainant or INR 20 lakh whichever is lower. Such compensation will be exclusive of the amount involved in the dispute. Further, the Ombudsman may also award to the complainant, compensation not exceeding INR 1 lakh taking into account the loss of the complainant's time, expenses incurred, harassment and mental anguish suffered by the complainant. Every Regulated Entity is entitled to appeal against an award; however, no appeal should be instituted if an adverse award has been passed against a Regulated Entity on account of non-furnishing of documents/information. RBI's Executive Director in-charge of the Consumer Education and Protection Department has been designated as the Appellate Authority under the Ombudsman Scheme.

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Eligibility Criteria for 'Specified User' under the Credit Information Companies Regulations

RBI issued the eligibility criteria for entities to be categorised as a 'Specified User' under the Credit Information Companies (Amendment) Regulations, 2021

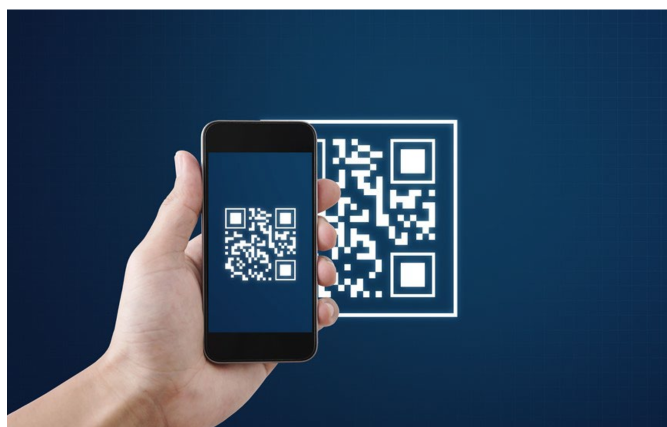
RBI has prescribed the following eligibility criteria for entities to be classified as 'Specified User' under clause (j) of Regulation 3 of the Credit Information Companies (Amendment) Regulations, 2021 ("**CIC Regulations**"):

1. It should be a company incorporated in India or a Statutory Corporation established in India.
2. The governing statute of the Statutory Corporation or Memorandum of Association of the Company (as the case may be) should allow the business/activity of processing of information for the support or benefit of credit institutions.
3. In case of a company, its net worth must at least be INR 2 crore as per the latest audited balance sheet, and it must meet such criterion on a continuous basis.
4. Also, the company must be owned and controlled by resident Indian citizens/an Indian company owned and controlled by resident Indian citizens in the case of a company. The ownership of the company shall be well diversified.
5. The company must have at least three years of experience in the business/activity of processing information for the assistance or benefit of credit institutions, as well as a clean track record.
6. The company, its promoters, or any of its directors should not have been convicted of a crime involving moral turpitude or a financial crime at any time in the past.
7. In addition, the entity should have a certification from CISA certified auditor that it has a robust and secure information technology system in place for preserving and protecting the data relating to the credit information in accordance with the Credit Information Companies (Regulation) Act, 2005 (including rules and regulations framed thereunder) and any other applicable regulations and guidelines in this regard.

New Regulations for Aadhaar authentication and verification

Unique Identification Authority of India ("UIDAI") has introduced QR Code Verification, Aadhaar Paperless offline e-KYC verification, e-Aadhaar verification and offline paper-based verification as modes of offline Aadhaar authentication and verification

UIDAI has notified the Aadhaar (Authentication and Offline Verification) Regulations, 2021 ("**Aadhaar Regulations**") vide notification dated November 8, 2021, in furtherance of the Aadhaar (Authentication) Regulations, 2016. The Aadhaar Regulations provide for a detailed process to enable offline verification of the Aadhaar for e-KYC process. UIDAI has added QR Code Verification, Aadhaar Paperless offline e-KYC verification, e-Aadhaar verification and offline paper-based verification as modes of offline verification. The existing modes of verifications such as OTP and biometric-based authentication will continue to be in effect along with offline options. Agencies authorised to verify Aadhaar data may choose any suitable mode of authentication and even opt for multiple-factor authentication for enhancing security.



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Some of the key highlights of the Aadhaar Regulations are as follows:

1. UIDAI provides two types of authentication facilities, i.e., yes/no authentication facility and e-KYC authentication facility.
2. The 'Aadhaar paperless offline e-KYC' means a digitally signed document generated by the UIDAI containing the last four digits of the Aadhaar number, demographic data like name, gender, address, date of birth and photograph of the Aadhaar number holder, etc. The Aadhaar Regulations give an Aadhaar holder a choice to share as a digitally signed document, the 'Aadhaar Paperless Offline e-KYC' with authorised agency for conducting e-KYC.

The Aadhaar Regulations also allow Aadhaar holders to revoke the consent given to any verification agency for storing their e-KYC data at any time. Upon revocation, the verification agency will need to delete the e-KYC data and provide the Aadhaar number holder with an acknowledgement of the revocation.

Quick Snapshots

RBI sets up a new Fintech Department to facilitate innovation in the Fintech sector

RBI has set up a Fintech Department with effect from January 4, 2022. This Fintech Department has subsumed the fintech division of the Department of Payment and Settlement Systems. This newly formed Fintech Department aims to promote innovation in the fintech sector; identify challenges and opportunities associated with it and address them in a timely manner. According to an administrative circular issued by RBI dated January 7, 2022, the Fintech Department established by it will provide a framework for further research on the subject to aid policy interventions by RBI. All matters related to the facilitation of constructive innovations and incubations in the fintech sector, which may have wider implications for the financial sector/markets and falling under the purview of the RBI will be dealt with by the Fintech Department, including any inter-regulatory coordination and internal coordination.

NPCI equates dishonour of UPI AutoPay transactions with dishonour of cheques

On November 25, 2021, through circular NPCI/UPI/OC No. – 125/2021-22, NPCI has stated that if any AutoPay transactions done through UPI fail due to insufficient funds, it will be treated as an offence committed by the payer. The payee will have recourse to the same rights and remedies against such defaulting payer as is available in case of dishonour of cheques under the Negotiable Instruments Act, 1881.

RBI discussion paper on digital payment charges

On December 8, 2021, the RBI released its Statement on Development and Regulatory Policies. Notably, the RBI plans to issue a discussion paper to examine aspects relating to costs and charges involved in digital payments such as credit cards, debit cards, prepaid payment instruments, UPI, etc. The discussion paper aims to seek feedback on issues relating to convenience fee, surcharge, etc. The RBI wants such charges to be reasonable, to ensure that users are not deterred from digital payments.

RBI lifts ban on Diners Club

The RBI has allowed Diners Club International Ltd. (Diners Club) to resume onboarding of new customers. The RBI had earlier restricted Diners Club from onboarding new domestic customers onto its card network due to non-compliance with the RBI's data localisation norms.

UPI limits increase for specified transactions

The NPCI, through circular NPCI/UPI/OC No. – 127/2021-22, has increased the per transaction limit for Retail Direct Scheme and UPI based ASBA IPO from INR 2 lakh to INR 5 lakh. This followed the RBI Statement on Development and Regulatory Policies, wherein the RBI discussed its efforts to facilitate greater participation of retail customers in financial markets, including investment in government securities through the Retail Direct Scheme and IPO applications.

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Investments in Fintech Sector

- Uni, a fintech startup that provides pay-later options via its cards, has raised $70 million (approx. INR 530 crore) in one of India's largest series A fundraising rounds. General Catalyst led a fresh round of fundraising for the company. New investors include venture capital firms such as Eight Roads Ventures, Elevation Capital, and Arbor Ventures. This round saw investments from existing investors Lightspeed and Accel India as well.
- CRED, a members-only bill payment platform, has announced that it would acquire Happay, a homegrown corporate expense management platform. The acquisition of Happay will give CRED access to a new customer segment. The deal values Happay at $180 million (approx. INR 1,362 crore) and the acquisition is likely to be a combination of cash and stock. Post-acquisition, Happay will operate as a separate entity with guidance from Cred's leadership team to expand their product offerings and scale up operations.
- Kaleidofin Pvt Ltd, a neobank platform focused on the informal sector, has raised $10 million (approx. INR 75 crore) in a Series B funding round led by the Michael & Susan Dell Foundation. The company has raised a total of $18 million (approx. INR 136 crore) so far and is looking to scale up.
- Muvin has raised $3 million (approx. INR 22 crore) in a pre-series A round led by WaterBridge Ventures. Muvin is a neobank startup based in Bangalore and focuses on digital financial inclusion and financial literacy of India's youth.
- Another neobank, Jupiter, has raised $86 million (approx. INR 651 crore), valuing the company at $711 million (approx. INR 5,382 crore). Jupiter is a market-leading 100% neobank with almost half a million users.
- Lendingkart, a fintech startup that provides short-term working capital loans to small and medium businesses, has raised $5.95 million (approx. INR 45 crore) in debt from BlueOrchard Finance Ltd.
- BharatPe is reportedly in talks to raise $150 million (approx. INR 1,135 crore) in a Series F transaction, which could value the company at $3.8 billion (approx. INR 28,766 crore). However, no official statement has been released by the company.

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