

January 2024

Draft Framework for Self-Regulatory Organisation(s) in the FinTech Sector

On January 15, 2024, the Reserve Bank of India (“RBI”) issued the ‘Draft Framework for Self – Regulatory Organisation(s) in the FinTech Sector’ (“Draft Framework”) and has invited comments on the Draft Framework until the end of February 2024.

With the aim to promote responsible practices and ethical standards across the industry, the RBI has reiterated the role of the proposed FinTech self-regulatory organisations (“SRO-FT”) in achieving a delicate balance between the potential of change brought by FinTechs and the idiosyncratic risks FinTechs pose to the financial system. Notably, the Draft Framework comes soon after the ‘Draft Framework for comments Omnibus Framework for recognising Self-Regulatory Organisations (SROs) for Regulated Entities of the Reserve Bank of India’, which was issued by the RBI on December 21, 2023.

The RBI notes that the Draft Framework is not comprehensive in its approach to regulate the sector and some important aspects are yet to be determined, such as:

1. If the membership to the SRO-FT will be available only to regulated entities, unregulated entities, or a combination of both?
2. If there be one SRO-FT for the entire FinTech sector, or several given the diverse nature of the sector?

While the above points will be subject to discussions, the broad features of the Draft Framework are as set out below:

Characteristics and Operations

The SRO-FT is envisaged as an entity that is truly representative of the sector it seeks to regulate, and should:

1. strive to achieve legitimacy and credibility to not only frame widely acceptable baseline standards and rules of conduct codes, but also to effectively monitor and enforce them;
2. foster learning and development of the sector, with a focus on assisting upcoming entities;
3. maintain the body’s independence and ensure decision making without the influence of one particular member or a group of members;
4. build transparent and fair dispute resolution mechanisms to efficiently handle disputes and build a stable environment for the FinTech industry;
5. facilitate communication between the regulator and the industry players;
6. be empowered to investigate and take disciplinary action against its members for non-adherence to codes / standards / rules; and

7. serve as a repository of information in connection with its members' activities, to assist with research and policy making.

Eligibility and Membership

The entity applying for registration as an SRO-FT, should:

1. be set up as a company under Section 8 of the Companies Act, 2013, and the constitutional documents must categorically state as one of its aims as acting as an SRO-FT;
2. demonstrate sufficient net-worth and capability to act an SRO-FT and compliance with the 'fit and proper' criteria for the board of directors; and
3. possess a robust IT infrastructure and the ability to deploy technological solutions within a reasonable timeframe and can manage 'user harm' instances that are referred to it.

The Draft Framework also prescribes guidelines for the membership structure that the SRO-FTs can adopt. Membership should be voluntary and should represent the FinTech sector with membership across entities of all size, stage, and activities. In the event, the representation is not adequate at the time of application, a roadmap has to be included for achieving this. The fee structure for the membership should be reasonable, and non-discriminatory. The membership agreements should provide the SRO-FT authority to set rules, standards, codes of conduct, etc., for the members. It is important to note that SRO-FTs are not permitted to set up entities / offices overseas without the prior approval of the RBI.

Application Requirements

1. The RBI will invite applications for the SRO-FT either for the entire sector or for specific sub-sectors, as and when required.
2. The manner in which an application can be made to the RBI to act as an SRO-FT and the documents required have been provided in detail in the Draft Framework.
3. If the applicant is deemed suitable, the RBI would issue a "*Letter of Recognition*" to the SRO-FT, subject to validity of certain conditions.
4. The recognition granted to the SRO-FT by the RBI would be subject to periodic review.

Functions and Responsibilities

1. The Draft Framework prescribes the additional functions and responsibilities that the SRO-FTs are supposed to discharge. These are in accordance with the requirements and goals listed in 'characteristics and operations' as set out earlier.
2. Broadly the functions can be divided into two categories: (a) towards the members of the SRO-FT; and (b) towards the RBI.
 - a) The functions towards the members, *inter alia* include:
 - (i) setting standards, framing code of conduct, setting applicable industry benchmarks and baseline technology standards;
 - (ii) drafting standard agreements which may be used by the FinTech companies;
 - (iii) deploying suitable surveillance mechanisms for effective monitoring of the FinTech sector;
 - (iv) actively promoting understanding of statutory and regulatory requirements and promoting a culture of compliance;

- (v) encouraging a culture of research and development within the FinTech sector to encourage responsible innovation; and
 - (vi) establishing a grievance redressal as well as dispute resolution framework for its members.
- b) The functions towards the RBI , *inter alia*, include:
- (i) to provide update regarding the developments in the sector, including updated sectoral information, addressing regulatory concerns, and collaboratively working towards the overall development of the FinTech sector; and
 - (ii) to act as the collective voice of its members in engagements with the RBI.
- c) The RBI may audit the books of the SRO-FTs and require the SRO-FTs to provide additional information about the entities' operations.

Governance and Management

The Draft Framework obliges SRO-FTs to uphold transparency, accountability, integrity, fairness, responsiveness, and compliance with applicable law, and requires the SRO-FTs, to:

1. be professionally managed, where at least one-third members of the board (including the chairperson) should not be actively associated with a FinTech entity;
2. have a framework for the ongoing monitoring of 'fit and proper' status of its director and providing updates about any changes in the directorship or adverse change in its 'fit and proper' status; and
3. possess adequately skilled human resources, and robust technical capability to monitor the sector.

While self-regulation is the over-arching aim of the Draft Framework, the RBI has provided for the possibility of the appointment of an observer by it, to the board of the SRO-FT.

JSA Comment:

Regulatory support and encouragement to establish self-regulatory organisations for Fintech may be traced back to November 2017, when in the RBI Report of the Working Group on '*Fintech and Digital Banking one of the key recommendations*', was to encourage a self-regulatory body for FinTech companies. At the recent Global FinTech Festival (held in Mumbai in September 2023), the RBI Governor and Deputy Governor highlighted the need for FinTechs to establish an effective self-regulatory structure to adopt the best industry practices and ensure good governance. They shed light upon need for FinTechs to establish this self-regulatory structure themselves.

The regulatory approach followed by the RBI towards FinTech started with the '*wait and watch*' mode and slowly moved to passive and active regulations with opportunities to the industry to provide comments through consultations and discussion papers. The formation of the SRO-FT will be in line with the regulatory approach followed by the RBI and will enable FinTechs to convey and discuss their requirements in an organised manner. The RBI has stated that the SRO-FT would be able to derive its strength from its membership – ensuring a true representation of the FinTech sector. For the SRO-FT to be effective, the roles of the regulators, relevant industry associations and FinTechs will need to be harmonious.

The SRO-FT would be able to set standards and rules for its members which will foster a perpetually developing FinTech environment. The responsibilities furnished to SRO-FT will allow it to act as the chamberlain, ensuring transparency and aiding growth and stability in the industry. There are clarifications required from the Draft Framework in relation to understanding the relationship between the SRO-FT and the RBI and the segregation of their powers. This is a welcome initiative by the RBI, in keeping up with the ever-evolving industry and envisions to provide an impetus to the FinTech ecosystem as to promote a competitive, accountable, and responsible FinTech industry.

FinTech Practice

JSA is one of India's pioneering law firms in the FinTech space. JSA's FinTech group brings together an integrated multi-practice team to support clients with transactions, disputes and regulatory matters at the intersection of financial services and technology. Our practice leverages the experience and in-depth technology expertise of attorneys across practice areas and allows us to offer clients access to time-tested strategies and holistic advice. Our experienced attorneys are well positioned to assist clients navigate through the complex legal, regulatory and compliance landscape within which these businesses and their technologies operate. Our strong relationships with regulators, banks, insurers, funds, large technology companies and infrastructure and service providers mean that we understand the issues that affect every area of the financial technology ecosystem. This enables us to deliver incisive, informed and innovative advice across the FinTech spectrum. We work with financial institutions, as they adapt and transform, FinTech start-ups, from inception through to all rounds of funding, to IPO and beyond, large technology companies diversifying into FinTech and Investors and strategic acquirers as they identify and secure strategic opportunities in the FinTech space.

Our areas of expertise inter alia include: (a) Prepaid payment instruments and variations thereof, (b) Remittance (person-to-person and person-to-merchant) models and services, (c) Central treasury arrangements and collection agency models, (d) Artificial Intelligence (AI) and Machine Learning (ML) enabled payment systems, (e) Alternative lending and payment platforms, (f) blockchain enabled service offerings, including smart contracts, (g) crowdfunding and crowdsourced investments, (h) Cryptocurrencies, including initial coin offerings, (i) InsurTech products and business models, (j) investments, including PE/VC financing into fintech and financial services companies, (k) Invoice trading and receivable discounting platforms, (l) Payment services and solutions (both cross-border and domestic).

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