Fintech Round-up
2024-25

Foreword

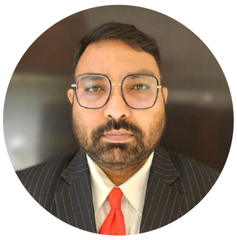
The year 2024-25 has been significant for the Indian Fintech industry, with transformative regulatory measures aimed at promoting responsible market behaviour, client protection, and market stability. This report, "Fintech Round-up 2024-25", produced by the Digital Lenders Association of India (DLAI) and Khaitan & Co, provides an in-depth analysis of important regulatory milestones that have shaped the sector throughout this time.

India's Fintech sector is quickly evolving, fuelled by innovation and collaboration. To assist this expansion, regulatory agencies have offered timely guidance in a variety of fields, including digital lending, payments, wealth technology, cybersecurity, and fraud prevention. These steps demonstrate the commitment to finding a balance between encouraging innovation and protecting consumers.

This work provides a comprehensive overview of the regulatory landscape and its consequences for Fintech players. It provides clarity on regulatory frameworks and highlights issued instructions, allowing industry actors to handle problems and capture opportunities.

I believe that this report will be a helpful resource for Fintech companies, governments, and stakeholders seeking to build a responsible and sustainable financial environment in India. As we move forward, collaboration among regulators, industry actors, and legal experts will be critical in addressing obstacles and fostering Fintech innovation while protecting consumer interests.

We appreciate Khaitan & Co's collaboration in developing this report and their commitment to aiding the Indian Fintech industry.



Jatinder Handoo

CEO, Digital Lenders Association of India (DLAI)

Fintech dealmaking in 2024: A difficult year navigated with sheer grit and resilience

Sanjay Khan Nagra
Partner, Khaitan & Co

In many aspects, 2024 was the year of paradigm shift from a dealmaking perspective in the Indian Fintech ecosystem.

While Fintechs continued to attract investors' attention, and there were many notable funding transactions across various classes of Fintechs (early stage to unicorns / post-unicorns), overall deal volumes as well as values did witness a decline from the highs of previous years.

This resulted from the overhang of the global funding winter compounded by diminished investor confidence on account of various regulatory actions in the Indian Fintech space involving revocation of licenses, imposition of penalties, and impeding businesses continuity in some cases.

As a result, the market saw a critical shift in dealmaking, where emphasis on deal timelines was replaced by thorough regulatory diligence and long-term evaluation / stress-testing of businesses in light of the evolving regulatory environment.

Regulated businesses (as well as businesses which had a roadmap to getting regulated) started emerging as preferred choices for investors. A fundamental shift was also seen in the mindset that investing in a regulated business is perhaps not as restrictive as perceived earlier (particularly by new-to-India investors).

The above factors also resulted in consolidation in the Fintech space and significant changes to existing business models of Fintechs across various stages of their life-cycles.

On the positives, Fintechs continued to show resilience amidst regulatory changes impacting their established businesses and lack of funding, with as many as eight of them filing for public listing.

Last quarter of 2024 has already seen a surge in dealmaking and the (positive) impact of it is also expected throughout 2025.

The learnings of 2024 have certainly resulted in a more mature and resilient Fintech ecosystem with largely serious and long-term Fintechs remaining active with good runway. That makes the Indian Fintech ecosystem much better prepared for the future (as compared to the beginning of 2024) and certainly a bright spot for investors to make long-term bets given the sheer depth of the Indian market.

Artificial Intelligence and Financial Services: What the Future Holds

Smita Jha
Partner, Khaitan & Co

2024 emerged as a landmark year in reshaping financial sector regulators' approach to the regulation of Fintechs. From barring new or unauthorised businesses to imposing penalties and revoking licenses, the Fintechs witnessed it all. Many examples and expectations for Fintechs were set, underscoring the need for adopting an 'innovate with care' approach. This encouraged businesses to incorporate sufficient guardrails taking risk management and compliance into account as a dominant perspective. While the regulators continue to maintain a hawk-eye over the sector, 2025 is also likely to see extensive regulatory action in respect of deployment of AI in financial services.

The RBI and SEBI have already taken steps in their respective domains by setting up of a committee to develop a "Framework for Responsible and Ethical Enablement of Artificial Intelligence (FREE-AI) in the financial sector", and releasing the consultation paper on "Proposed amendments with respect to assigning responsibility for the use of artificial intelligence tools by Market Infrastructure Institutions, Registered Intermediaries and other persons regulated by SEBI" for public consultation, respectively in December 2024.

From these steps it is evident that both the regulators recognise the transformative impact AI can have on financial services. AI's utility ranges from handling of enormous volumes of data, automation of complex processes, enhancement of decision-making and incorporation of unprecedented efficiencies, resulting in an imminent and wide-spread adoption. For the regulators there is also an awareness that they cannot turn a blind eye to inherent risks of AI like algorithmic bias, explainability of decisions, data privacy, inaccuracy of data sets, systemic risks, lack of understanding of differences and use cases of predictive AI, generative AI and neural networks etc. and their need for regulation. Therefore, it would be imperative for the respective regulators to adopt a balancing stance on innovation proportionate to the risks identified.

For the industry, some of the key areas to watch out would be outsourcing norms for technology service providers, data analytics services, technical standards for cyber security, data protection and adoption of AI, impact on employment and skilled workforces, customer services, grievance redressal, avoidance of biased outcomes, accuracy of representative data sets and attribution of ultimate responsibility to the regulated entities. As keen industry observers and contributors, we hope that along with regulation, the regulators also promote responsible adoption of AI by stakeholders.

Prashanth Ramdas
Partner, Khaitan & Co

Gearing up for a new era of Data Protection compliances

Earlier this month, the MeitY released the much-awaited draft of the rules to be notified under India's landmark legislation on data privacy and protection, the Digital Personal Data Protection Act, 2023. While the new law was passed by both houses of the Parliament and assented by the President of India in August 2023, the administrative infrastructure to enforce the new law is yet to be established. The rules will pave the way for setting up the Data Protection Board of India which will play a pivotal role in enforcing data protection laws in the country.

Market players in the Fintech and financial services segment collect and process various types of data as part of their business operations. Such data is utilised for various purposes including for providing curated Fintech products, behavioural monitoring of customers, KYC / AML and fraud prevention purposes, etc. The new law is a sector neutral legislation, and must be adhered to in addition to sector specific data related compliances prescribed by sectoral regulators such as the RBI, SEBI, IRDAI, etc.

It is a common practice for multiple entities to collaborate and partner together to ensure delivery of financial services in the Indian ecosystem. One of the key lookouts for all businesses would be to understand whether they would fall within the bucket of a data fiduciary (who determines the purpose and means of processing data) or a data processor (who merely processes data on behalf of a fiduciary). This categorisation is crucial in devising compliance with the new law, especially from the perspective of defining contractual rights and obligations between parties involved in a commercial arrangement.

Fintech players will also need to plan and structure customer consents both for data sets which are presently residing in their systems, as well as fresh data which may be obtained after the new law comes into force. The draft rules prescribe strict requirements in connection with the notice to be issued to customers to enable them to provide specific and informed consent for usage of their personal data. Businesses will need to identify and list out various types of personal data required by them, the specific purposes for which such data will be processed by them, as well as the list of products or services to be provided pursuant to processing of such data.

The new law also introduces various customer-centric rights which businesses must facilitate including the right to correction and erasure, grievance redressal and information access. Adoption of suitable technology tools to ensure compliance with these requirements will be inevitable.

Table of Contents

01.
LENDING

Keeping up with global trends, the Indian lending sector has witnessed increased growth over the last year, especially in the digital lending sector, powered by post-pandemic economic growth and driven by consumer spending. The NBFC sector has continued its upwards trajectory with net advances growing 21% year-on-year and NBFCs leveraging digital services to increase their outreach, including increased disbursals of personal loans through mobile and web applications, utilising digital modes for collection of EMIs, and enabling frictionless onboarding journeys through web and mobile applications.[1] However, a worrying trend that has been permeating the digital lending and payment ecosystem has been the steady growth of fraudulent transactions.[2]

In 2024, RBI slightly shifted its focus on consolidation of the digital lending ecosystem by placing emphasis on curbing practices it deemed to be going against the intent and spirit of the prescribed regulatory framework or harming consumer interests, while also proposing measures to create a stronger foundation for the sector. The vulnerability of the digital lending ecosystem to fraud has led to RBI prescribing measures to improve fraud detection, prevention, and reporting amongst different categories of REs to enable the creation of harmonised standards for dealing with fraud. RBI has also taken note of technological innovations in the lending sector and has sought to leverage the same to create a more secure ecosystem while improving customer experience and providing greater impetus to REs to continue to innovate and promote the growth of the digital lending ecosystem.

[1]*Boston Consulting Group – India NBFC Sector Roundup – FY24*
[2]*Reserve Bank of India - Payment System Indicators (rbi.org.in)*

Some of the measures adopted by RBI range from:

1. Issuing FAQs clarifying the manner of application of the 5% cap for DLGs on loan portfolios generated by LSPs
2. Curbing non-standard practices adopted by NBFCs in calculation and charging of interest
3. Prescribing the framework to be adopted by NBFCs for prevention, detection and reporting of frauds
4. Reviewing practices in the P2P lending ecosystem, barring characterisation of P2P loans as investment products as well as clarifying the limited role of NBFC - P2Ps as mere facilitators in the ecosystem
5. Introducing a new set of harmonised fraud risk management directions

In addition to the above, the Central Government has ended the year by offering a preview of the legislation-driven tidying up of the credit products market to come, by way of the Draft Lending Bill which shall ensure that the business of lending remains safely guarded against any systemic risks and regulatory loopholes.

We have briefly summarised the key regulatory changes impacting the digital lending ecosystem below:

FREQUENTLY ASKED QUESTIONS ON DLG GUIDELINES

Background

The DLG Guidelines permitted DLGs subject to a threshold of 5% of the amount of the loan portfolio. The DLG FAQs were subsequently released by RBI to provide certain clarifications on operational aspects relating to creation and utilisation of DLG covers.

Analysis

Identification of DLG Set: The DLG Guidelines prescribe that the total amount of DLG cover on any outstanding portfolio specified upfront should not exceed 5% of the amount of that loan portfolio. The DLG FAQs clarify that DLG cover has to be provided vis-à-vis a pre-identified and measurable set of loan assets that have been sanctioned by an RE, i.e. the 'DLG Set'. Once identified, the DLG Set shall be frozen, and there cannot be any addition or removal of loans from it except removal of loans upon such loans being repaid or written off. This essentially curbs the practice of rolling portfolios which would lead to diluting the guidelines around the DLG cover being capped at 5% of a portfolio.

Utilisation of DLG Cover: While the DLG cover is computed based on the sanctioned loan amounts constituting the DLG Set, the active DLG cover on such DLG Set adjusts proportionally to the loans actually disbursed. For instance, if a loan portfolio of INR 1 billion is sanctioned, the DLG cover shall not exceed INR 50 million. However, if only INR 100 million have been disbursed, the DLG cover that can be utilised by the RE should not be more than INR 5 million (i.e., 5% of the disbursed loan amounts). If the RE disburses an additional INR 100 million (increase the total disbursed amount to INR 200 million), then the active DLG cover would proportionally increase to INR 10 million.

The DLG FAQs also clarify that once the DLG cover on a DLG Set is invoked, such invoked amounts cannot be replenished, including using any amounts recovered subsequently from the defaulting borrowers.

Restriction on Loan types: The DLG FAQs further clarify that DLG is not permitted for the following:

- Revolving credit facilities
- Loans arranged through peer-to-peer lending platforms
- Loans sourced outside the Digital Lending Guidelines
- Financing availed through credit cards

KEY TAKEAWAYS

The DLG Guidelines provide clarity on the practical implementation of DLG Guidelines and provide illustrations to REs and LSPs on the manner in which the threshold of DLG arrangements must be reckoned. It provides clear guidance to ensure that the spirit of the DLG Guidelines is upheld in such default loss guarantee arrangement and ensures there is no scope for misinterpretation.

RBI CIRCULAR ON FAIR PRACTICES CODE FOR LENDERS – CHARGING OF INTEREST

Background

The Interest Circular was issued on 29 April 2024 to curb various unfair and predatory practices in relation to charging of interest on loans by REs, various instances of which were noted during onsite visits by RBI. The underlying intent behind the Interest Circular is to create fairness and transparency in the manner interest is charged to borrowers by REs.

Analysis

The Interest Circular has highlighted several instances of non-standard practices such as interest being charged from the date of sanction of a loan or date of execution of a loan agreement rather than date of actual disbursement. RBI has directed all REs to review their practices regarding application of interest and to desist from unfair practices. Some of the key instructions issued by RBI in relation to charging of interest are as follows:

1. Interest to be charged only from the date of disbursement of a loan.

2. Interest may only be charged for the actual period during which the loan remains outstanding.

3. The interest shall be charged on the outstanding loan amount after deducting the repaid instalments, especially in cases where part repayment has been done in advance.

4. In cases of disbursement by cheque, an RE must ensure that interest is only charged from date of delivery of the cheque provided that such cheque may be utilised for banking immediately.

5. RBI has also urged REs to adopt online modes of disbursement in lieu of issuance of cheques to ensure that there are clear trails for date of disbursement.

KEY TAKEAWAYS

The Interest Circular is the latest in a long line of circulars issued by RBI to curb unfair and predatory practices in the lending sector and proves to be a significant move towards promoting fairness and transparency in lending practices and demonstrating the commitment of RBI towards creating trust in the lending ecosystem amongst borrowers. RBI has also indicated that it will be monitoring REs for compliance with the Interest Circular and other regulatory mandates and would initiate strict action in case of any non-standard practices being noted, which has been seen in practice through a press release issued on 17 October 2024 directing certain NBFCs to cease and desist from sanction and disbursal of loans due to breaches of regulatory requirements.

RBI has, however, granted REs some breathing room by providing REs with the freedom to formulate and determine the manner of execution of regulatory principles set out in the Interest Circular and other similar policy documents.

RESERVE BANK OF INDIA (FRAUD RISK MANAGEMENT IN NBFC) DIRECTIONS, 2024

Background

On 15 July 2024, RBI released the FRM Directions to enhance fraud detection and prevention mechanisms for Applicable NBFCs, superseding the Erstwhile Circular.

Analysis

Expansion of Definition of Fraud: The FRM Directions expand the definition of fraud to cover new instances of fraud such as wilful falsification, destruction, alteration, mutilation of any book, electronic record, paper, writing, valuable security, account with intent to defraud, and fraudulent electronic banking / digital payment related transactions.

Governance: Applicable NBFCs must adopt a board approved policy on fraud risk management, reviewed at least once every 3 years. This must, *inter alia*, cover procedures for addressing fraud allegations in compliance with the natural justice principles, due diligence of auditors, time limits for completion of audit and submission of audit reports and setting up the organisational structure for institutionalising fraud detection amongst departments. Senior management would be responsible for policy implementation and fraud reporting.

1. **SCBMF and COE**: Upper layer NBFCs must establish a SCBMF while middle and base layer NBFCs must create a COE to implement the FRM Directions.

2. **EWS:** Upper and middle layer NBFCs must implement EWS frameworks by 15 January 2025 which involves continuous monitoring of credit facilities / loan accounts and other transactions using qualitative and quantitative indicators to identify suspicious accounts and conduct investigations to prevent potential fraud.

3. **Additional Fraud Detection Measures:** Applicable NBFCs must ensure a transparent whistleblower

policy is put in place to address and investigate complaints of possible fraudulent activities. Loan agreements and service provider agreements should include language enabling audits for fraud detection and prevention.

4. **Penal Measures:** Fraudulent persons are barred from raising funds or seeking credit for five years from the date of full repayment of the defrauded / settlement amount agreed upon in case of a compromise settlement.

Reporting of Fraud: The FRM Directions prescribe reporting incidents of fraud to RBI either through filing FMR online or communications to relevant RBI departments and law enforcement agencies, and specify timelines, practices and procedures for reporting fraud, ensuring coordination with the law enforcement agencies.

KEY TAKEAWAYS

Similar instructions have been issued by the RBI to other REs as well. RBI's simultaneous issuance of these instructions to various REs demonstrates their intent to instil greater risk management practices and create a uniform fraud detection, prevention and reporting framework.

REVIEW OF MASTER DIRECTION - NON-BANKING FINANCIAL COMPANY – PEER TO PEER LENDING PLATFORM (RESERVE BANK) DIRECTIONS, 2017

Background

The P2P Master Directions classified NBFCs undertaking business as an intermediary providing the services of loan facilitation via online medium or otherwise as NBFC – P2Ps, and laid down clear guidelines regarding the functioning of NBFC – P2Ps.

However, varied interpretation of the intent of the P2P Master Directions by NBFC – P2Ps as well as Fintechs led to many P2P-NBFCs acting as intermediaries offering investment returns and liquidity options, as well as taking up credit risk to ensure fixed returns to lender participants on their platforms. RBI viewed these practices as contravening the spirit and intent of the P2P Master Directions and therefore issued the P2P Amendments, with a view to clarify the role of NBFC – P2Ps in the financial ecosystem.

Analysis

Reestablishing NBFC – P2Ps as Facilitators of Credit: The P2P Amendments seek to expressly limit the role of NBFC – P2Ps as an intermediary platform. Therefore, they have been prohibited from the following:

- Assuming any credit risk or bearing any losses arising out of lending transactions carried out on its platform
- Endorsing peer to peer lending as an investment product
- Managing the lenders' and borrowers' funds opaquely, including using lenders' funds to repay any loans whether by utilising one lender's funds to replace another lender or otherwise and using any borrower's funds for disbursement of loans to other borrowers

Transparent Mapping Policy: To ensure accountability, transparency, and adherence to fairness as an intermediary in facilitation of credit, NBFC – P2Ps have been instructed to map borrowers and lenders only as per their board approved policy and stop the practice of matching participants within a closed user group. In order to further curb the exercise of any undue indiscretion by NBFC – P2Ps, they are mandatorily required to disclose: 1. the details of borrowers to their relevant lenders; 2. all fees (actual or contingent) at the time of lending itself; and 3. portfolio performance on its website.

KEY TAKEAWAYS

By re-affirming the regulatory intention of the P2P ecosystem and imposing clearer procedures, RBI seeks to re-establish NBFC – P2Ps as facilitators of an alternate avenue for credit rather than an investment product.

THE BANNING OF UNREGULATED LENDING ACTIVITIES (DRAFT) BILL

Background

RBI had published a press release titled 'Recommendations of the Working group on Digital Lending – Implementation' on 10 August 2022 suggesting legislative and institutional interventions by the Central Government to curb illegitimate lending activities being undertaken by entities lending outside the purview of statutory / regulatory provisions as unregulated lenders posed a threat to consumer welfare and the lending ecosystem. This was a precursor to the digital lending regime in India.

In continuation of the same line of regulatory oversight, the Ministry of Finance under the Draft Lending Bill has sought to prohibit any entity or individual from engaging in public lending activities unless they are authorised by a regulator and registered under any applicable law. The comments and suggestions have been requested on the Draft Lending Bill by 13 February 2025.

Analysis

Restriction on Unregulated Lending Activities: The term 'unregulated lending activities' is defined to mean all lending activities which do not fall within the ambit of 'regulated lending activities'. Regulated lending activities are linked to specific legislations as provided in Schedule I to the Draft Lending Bill including Banking Regulation Act 1949, Reserve Bank of Indian Act 1934, State Money Lenders Acts, Chit Funds Act 1982, Factoring Regulation Act, 2011, among others.

Section 3 of the Draft Lending Bill seeks to expressly prohibit undertaking, promoting, operating, or issuing any advertisement in relation to unregulated lending activities or howsoever inducing another person to borrow from lenders engaged in unregulated lending activities, including those conducted through digital platforms.

Creation of a Central Database of Lenders: The Draft Lending Bill also proposes the creation of an authority empowered by the Central Government which will create, maintain, and operate an online database for information on lenders operating in India. All lenders are required to provide information about their business to the proposed authority.

Stringent Punishments for Unregulated Lending Activities: The Draft Lending Bill proposes severe penalties including imprisonment for up to 10 years and fines up to INR 100 million depending on the nature of contravention. The Draft Lending Bill also proposes to designate government servants as 'Competent Authorities' and empower them to attach the bank accounts, money, and property of any lender who is suspected of contravening the restrictions imposed under the Draft Lending Bill.

KEY TAKEAWAYS

The Indian Fintech sector has seen unprecedented growth in recent times. The Draft Lending Bill is another testament to the government motto of following innovation with regulation. In light of the sheer variety of financial products floating in the market, the Central Government has reaffirmed that the lending business is to stay firmly regulated. The broad and all-encompassing definition of 'unregulated lending activities' has clearly communicated that the legislative stance on the business of lending stays focused on consumer protection and mitigation of systemic risks.

CHANGES TO CREDIT INFORMATION REPORTING TIMELINES

RBI has shortened the timelines for credit information reporting and updating by credit institutions and CICs through the CIC Master Directions. Acknowledging the rapid growth of short-term credit and digital underwriting, RBI emphasised the need for CIRs to reflect current data.

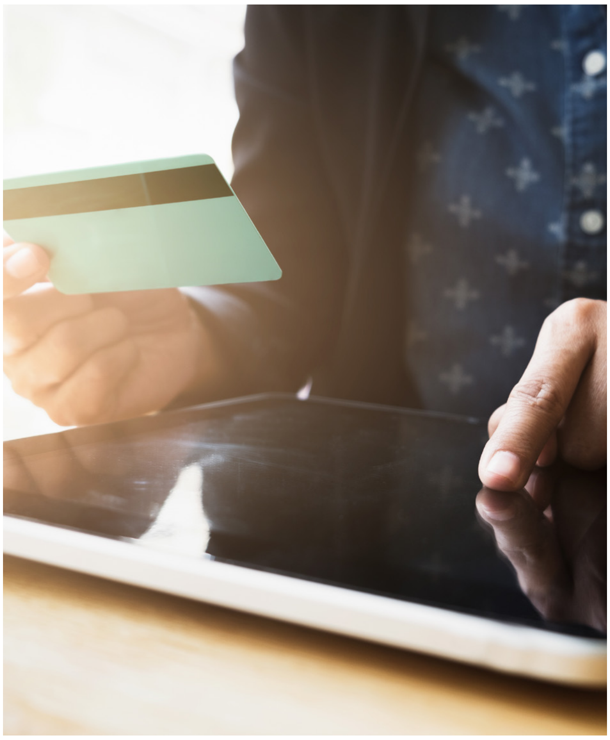
Previously, credit information was reported on a monthly basis, leading to 30 - 60 days old data. Now, credit institutions must report credit information within seven days after the 15th and last day of each month, and CICs must update this information fortnightly and ingest received data within five days. Non-compliant institutions will be reported biannually to RBI.

KEY FACT STATEMENT FOR LOANS & ADVANCES

Background

RBI issued the KFS Circular with a view to enhance transparency and reduce information asymmetry on financial products being offered by different REs, empowering borrowers to make informed financial decisions.

The KFS outlines key loan details in a simplified format, including the APR, processing fees, penalties, and other charges. The KFS Circular is applicable to all lenders regulated by RBI. The KFS Circular is not applicable to credit card receivables but is applicable to loans provided on credit cards. Provisions of the KFS Circular become applicable in respect of all new retail and MSME loans sanctioned on or after 1 October 2024.



Analysis

Broader Definitions to Enhance Understanding: The KFS Circular aims to harmonise borrower disclosures, thereby facilitating informed loan decisions. By defining key terms like APR and EPI in a broader and more generalised manner, it ensures applicability across diverse lending scenarios.

Standardised KFS Format: A uniform KFS format is prescribed, including a summary box and loan amortisation schedule, ensuring clarity for borrowers. To enhance accessibility, the KFS must be provided in the borrower's preferred language. Further, an acknowledgement must be obtained from the customer confirming their understanding of the terms of the loan.

Transparency in Fees and Validity of KFS: The KFS Circular mandates full disclosure of all fees, including third-party charges, prohibiting any additional charges without explicit borrower consent. The KFS must also be included as part of the loan agreement in the form of a summary box. To allow sufficient review time, the KFS remains valid for three days for loans with tenures of seven days or more, and at least one day for shorter loans.

KEY TAKEAWAYS

KFS has been made a mandatory requirement under the Digital Lending Guidelines as well as the circular titled 'Display of information by banks' dated 22 January 2015. By providing a clear standardised format and providing generic definitions of terms often used in loan agreements, the KFS Circular provides clarity and consistency to REs on the manner in which disclosures in the KFS are to be made to customers.

The obligations placed on REs, on the other hand, enable customers to understand and compare loan terms, thereby enhancing transparency in financial products offered by REs. The KFS Circular also reiterates that hidden charges cannot be imposed on customers and all chargeable amounts must be disclosed to enable customers to make well-informed choices, thereby promoting fair and transparent lending practices.

DRAFT GUIDELINES ON DIGITAL LENDING – TRANSPARENCY IN AGGREGATION OF LOAN PRODUCTS FROM MULTIPLE LENDERS

Background

The focus of RBI, through the Draft DL Guidelines, is on regulating loan aggregation by LSPs and establishing a framework for WALPs.

Analysis

The Draft DL Guidelines contemplate the following:

Digital view of Loan Offers: LSPs must provide digital views of all available loan offers from willing lender partners as per the requirements of the borrower.

Consistency and Disclosure of Approach to Ascertain Willingness to Offer Loan: While the LSP may adopt any reasonable mechanism to ascertain willingness of lenders to offer loans, it must disclose this approach on its website.

Promotion and Dark Patterns: The content displayed by the LSP must neither be biased nor promoted directly or indirectly so as to push the product of a particular RE. This includes a caution against use of dark patterns and deceptive means designed to mislead borrowers into choosing a particular loan offer.

By seeking to enforce these guidelines, RBI aims to foster a more transparent, fair, and accountable digital lending environment that benefits both consumers and lenders alike.

KEY TAKEAWAYS

RBI has addressed the current practices in the industry that show that LSPs often offer aggregation services through multiple lender arrangements without upfront disclosure of the potential lenders involved. This lack of transparency can create confusion and hinder a clear understanding of the full scope of available lending options for consumers. In response to these concerns, RBI has emphasised the importance of maintaining a safe distance between parties involved in connected lending arrangements. Without such a separation, there is a risk of compromising product pricing, leading to unfair financial terms, and undermining effective credit control.

The Draft DL Guidelines aim to enforce greater transparency in the process of digital credit intermediation, ensuring that consumers are well-informed about the lenders they are engaging with, as well as the terms and conditions of the credit products being offered. These measures are designed to promote fair lending practices, protect the interests of consumers, and create a more reliable and accountable lending ecosystem in the digital space.

02. PAYMENTS

In line with its overall outlook towards the Fintech ecosystem, in 2024 RBI focused its attention towards making payments in India safe, trustworthy and secure. This year witnessed various notable regulatory initiatives in the payment ecosystem such as rehauling the bill payment business, providing explicit clarity in role of co-branding partners, recognising payment system operators, offline payment aggregation and mandating tough cybersecurity and authentication measures to combat frauds. Such measures will instil transparency, security and inclusivity within the ecosystem.

India's tryst with digital payments began a decade ago and gained traction amongst different focus groups YoY. In the first half of 2024, UPI saw a remarkable 52% rise in transaction volume compared to the same period in 2023. The launch of UPI Circle this year will instil confidence amongst non-tech savvy population to use UPI under supervision of their trusted individuals. The growth in credit card transactions saw a YoY increase of 37% due to addition of Rupay credit cards and credit lines on UPI. UPI on credit lines introduced by RBI last year has become a great example of collaboration between banks and Fintechs in increasing the payment volumes of UPI.

The surge in digital payments has also paved the way for the recent uptick in digital fraud incidents. Digital payment frauds in India witnessed more than a fivefold jump to INR 14.57 billion in the year 2023-24 as compared to the previous year. Fraud in digital payments comprised of 10.4% of the total fraud amount in fiscal 2023 as compared to 1.1% in the previous year. The introduction of the Cyber Resilience Master Directions and the Draft AFA Guidelines are key measures taken to address rise in payment frauds. Lastly, RBI's focus towards ensuring robust safeguards to be adopted by SCBs in respect of their touchpoint operators for AePS is also aimed at mitigating frauds, particularly in areas with vulnerable customers such as rural or underserved areas.

RBI has now mandated that operating a system for payment of bills would require a payment system authorisation. The Amended Credit Card Master Directions have also paved the way for secured credit cards and restricted the sharing of card transaction details to third parties. The succeeding sections below will touch upon the yearly round up in the payment regulatory space.

AMENDED CREDIT CARD MASTER DIRECTIONS

Background

RBI issued the Amended Credit Card Master Directions along with corresponding FAQs to provide explicit clarity on various operationalities involved in credit card transactions.

Key Amendments

1. Co – branded partners are completely restricted from accessing cardholder's data but can display the cardholder's information on their platform through encrypted flow of such information from the credit card issuer to the co-branded partner.
2. Customers are now allowed to modify their billing cycle at least once.
3. The requirement for a seven-day advance notification to cardholders before notifying the CIC of a payment default has been removed.
4. On delay of repayment by the cardholder, interest can be levied only on outstanding amounts.
5. Card issuers to address any complaint within 30 days. If a satisfactory response is not received, the complainant may escalate the issue to RBI ombudsman.
6. Secured Credit Cards:

1 The Amended Credit Card Master Directions allow the issuance of secured credit cards linked to overdraft or cash credit, which can be secured against assets like fixed deposits, securities, and insurance policy surrender values, etc.

2 In India, as unsecured lending slows, REs are focusing on secured credit cards, to enhance customer engagement and retention, while adhering to the guidelines prescribed under the Master Circular- Loans and Advances – Statutory and Other Restrictions, 2015.

3 Additionally, given that most credit cards were unsecured, REs faced difficulties in ensuring that defaulted amounts were repaid. The introduction of secured credit cards provides card issuers with an avenue to ensure that unpaid dues can be reclaimed by enforcing the security provided.

4 If a credit card is linked to a loan product which not classified as an overdraft or cash credit facility and not covered under the Amended Credit Card Master Directions and the customers are onboarded digitally, then the Digital Lending Guidelines will apply instead.

KEY TAKEAWAYS

The Amended Credit Card Master Directions prioritise fostering transparency and trust between cardholders and issuers. In light of the same, the following must be taken note of:

1. RBI has allowed NBFCs to participate in co-branding partnerships, thereby acknowledging the Fintech sector's rapid digitisation. By streamlining entry requirements and encouraging collaboration, RBI aims to harmonise digital growth with financial stability, driving economic progress and expanding financial inclusion.
2. With respect to credit card default reporting, the mandatory seven-day notice period for cardholders has been eliminated. By striking a balance between regulatory oversight and industry flexibility, the Amended Credit Card Master Directions mark a significant step forward in fostering a secure financial landscape. Empowering businesses and consumers to make informed decisions, the Amended Credit Card Master Directions safeguard financial interests and encourages sustainable growth.

DRAFT OFFLINE PA DIRECTIONS

Background

With its intent to regulate PAs undertaking proximity / face-to-face transactions, RBI issued the Draft Offline PA Directions to:

- Regulate the activities of PA-P
- Have a consolidated and harmonised legal framework for regulating the activities of both PA-Os and PA-Ps

Analysis

PA-Ps brought Under Regulatory Ambit: Currently, entities providing offline payment aggregation services are not subject to a specific regulatory framework. This is in stark contrast to PA-Os, who are required to ensure compliance with the PA-PG Guidelines. With the Draft Offline PA Directions, RBI has attempted to harmonise regulatory obligations on all entities engaged in payment aggregation and settlement services irrespective of the domain they operate in.

Authorisation by RBI: While bank PA-Ps will not require separate authorisation, non-bank PA-Ps would need to intimate RBI within 60 days of the enforcement of the Draft Offline PA Directions about their intention to seek authorisation and apply for such authorisation by 31 May 2025. PA-Ps already providing physical PoS aggregation services would be allowed to continue their operations until RBI rejects their application for authorisation.

Compliance with Existing Guidelines: Existing PA-Ps intending to obtain authorisation and continue their operations will be required to ensure compliance with the PA-PG Guidelines within 3 months of the Draft Offline PA Directions coming into force. Thereafter, PA-Ps will be obligated to ensure continuous compliance of PA-PG Guidelines.

Consequence of Default: Existing non-bank PA-Ps that are not able to submit their application for authorisation within the stipulated time or achieve the prescribed net-worth criterion are mandatorily required to wind-up their activities by 31 July 2025. SCBs have been mandated to close accounts of existing PA-Ps by 31 October 2025, unless such entities receive authorisation.

KEY TAKEAWAYS

RBI has noticed a surge in transactions through PoS machines, necessitating apposite regulatory oversight to mitigate systemic risks. The Draft Offline PA Directions intends to bring entities involved in processing of payments, other than collection agents under the PSS Act and CoD transactions, within its regulatory ambit and thereby create parity in the regulatory framework for PA-Os and PA-Ps. Such a mandate would potentially require PA-Ps to revamp their operational frameworks in compliance with the amended PA-PG Guidelines when the Draft Offline PA Directions come into force.

DRAFT PA-PG AMENDMENT

Background

Along with the Draft Offline PA Directions to regulate PA-Ps, RBI also issued Draft PA-PG Amendment to the existing PA-PG Guidelines to standardise the regulatory framework and further strengthen regulatory oversight in the payments space.

Analysis

The Draft PA-PG Amendment proposes to modify the definition of 'payment aggregator', such that it includes within its ambit both PA-Os, as well as PA-Ps. The Draft PA-PG Amendment further proposes an overhaul of some crucial operational guidelines as set out below.

Classification of 'Merchant': The Draft Amendment proposes to classify merchants into 'Small Merchants', and 'Medium Merchants', based on certain objective determinants.

Small Merchants are those that

1. Undertake only proximity / face-to-face (offline) transactions
2. Have a business turnover of less than INR 500 thousand per annum
3. Are not registered under GST

Medium Merchants are those that

1. May undertake both online and offline transactions
2. Have turnover of more than INR 500 thousand but less than INR 4 million per annum
3. Are not registered under GST

KYC and Due Diligence Requirements: The extant PA-PG Guidelines does not require PA-Os to carry out the entire process of KYC in cases where the merchant already has a KYC-compliant bank account which is being used for transaction settlement purpose. However, the Draft PA-PG Amendment proposes varying CDD requirements depending on the kind of merchant being onboarded. The PA will be required to undertake CPV of business establishment in case of both Small and Medium Merchants.

However, for Medium Merchants, the PA will be required to additionally obtain OVDs of the business. In respect of other merchants, the PA will be required to undertake KYC as per the KYC Master Directions.

Changes to the use of Escrow Accounts by PA-Ps: The escrow account opened by the PA can be used for both PA-O and PA-P activities. The Draft PA-PG Amendment mandates routing all payments for DvP transactions through the escrow account. It is unclear whether this requirement also applies to online DvP transactions by PA-Os, which is unregulated under the extant PA-PG Guidelines. However, it has been clarified that CoD transactions shall be outside the scope of PA-PG Guidelines. Further, the hitherto permitted debit to escrow account for 'payment to other accounts on specific directions of the merchant' has also been proposed to be deleted. This proposed removal may impact merchants' ability to avail immediate commitment-based products / services.

Other Key Changes: The Draft PA-PG Amendment would allow PAs to appoint agents, aiding in onboarding offline DvP merchants, particularly in rural areas. This move enhances financial inclusion and technology reach. In view of safeguarding customer privacy and confidentiality, the prohibition on storing customer card credentials would apply to PA-Ps as well under the Draft PA-PG Amendment. The Draft PA-PG Amendment also requires compliance with the PA-PG Guidelines by all PAs involved in a chain of transaction, thereby requiring smaller PAs relying on escrow accounts operated by larger PAs in facilitating a transaction to also undertake KYC and other regulatory obligations.

KEY TAKEAWAYS

The Draft PA-PG Amendment is aimed at primarily ensuring robust KYC practices in the payments sector, and consequently mitigating ML / TF risks. However, such KYC obligations along with consequent FIU-IND registration requirement and compliances would inevitably increase regulatory costs for the PAs. Further, RBI also intends to curb systemic risks in the payments segment with the proposed restrictions, such as

1. Removal of the specified permitted debits by PAs upon merchant's instructions,
2. Prohibition on card data storage by PA-Ps, and
3. Mandatory compliance by all PAs involved in a transaction etc.

CYBER RESILIENCE MASTER DIRECTIONS

Background

On 30 July 2024, RBI introduced the Cyber Resilience Master Directions to strengthen governance mechanisms for identifying, assessing, and managing cyber resilience and payment security risks. The Cyber Resilience Master Directions build on existing frameworks applied to SCBs and NBFCs, tailored for non-bank PSOs. Non-bank PSOs are categorised into small, medium, and large entities based on operational scale and systemic risk, which determines their compliance timelines. All non-bank PSOs must develop a board-approved policy on information security and cyber resilience, extending to service providers.

Analysis

The Cyber Resilience Master Directions necessitate significant changes in how non-bank PSOs operate, particularly concerning governance, security measures, and compliance protocols.

Governance Controls: The Cyber Resilience Master Directions emphasise the board of directors' critical role in managing cybersecurity risks. Non-bank PSOs must form a dedicated sub-committee on information security, meeting quarterly to review policies and practices. This shift to top-management-driven governance highlights the growing regulatory focus on leadership's role in cybersecurity oversight.

Operational Adjustments: Non-bank PSOs must adopt baseline security measures, including asset inventory management, access controls, network security, and regular risk assessments for new products or changes. The non-bank PSOs will also be required to appoint a CISO who will be responsible for implementing the policy on information security and the cyber resilience framework.

Financial Implications: Compliance will require significant investment in technology upgrades and security infrastructure, including systems capable of managing enhanced security protocols, including S-SDLC and multi-factor authentication. These investments are crucial for both regulatory compliance and maintaining customer trust in thedigitalecosystem.

Impact on Business Models: The Cyber Resilience Master Directions will require non-bank PSOs to reassess business models, renegotiate third-party partnerships for compliance, and invest in resources or technology for enhanced customer communication, such as multilingual transaction alerts.

KEY TAKEAWAYS

The Cyber Resilience Master Directions are a major step in regulating digital payment systems in India, posing both challenges and opportunities for non-bank PSOs. While the compliance cost may be high initially, it aims to build customer trust by creating a safer environment for digital payments, leading to better customer loyalty. In the long run, the Cyber Resilience Master Directions will make digital payments more secure, benefiting customers and helping the Fintech sector grow.

INTRODUCTION OF DELEGATED PAYMENTS IN UPI

Background

The NPCI published the Delegated Payments Circular on 13 August 2024 for launching UPI Circle. Under UPI Circle, an existing UPI Primary User can link their UPI account with a Secondary User for making payments and approving any payment requests from the Secondary User. Potential use cases include parents delegating payments to children, senior citizens to house-help, or employers to employees.

Analysis

Product Features: UPI Circle will enable a Primary User to delegate payments to the Secondary User in either of the two following modes:

Full Delegation

Secondary User will be able to make transactions as per spend limits defined by the Primary User subject to a maximum monthly limit of INR 15,000 and a maximum per transaction limit of INR 5,000.

Partial Delegation

Secondary User is allowed to initiate UPI payments, but the Primary User will complete the transaction by authenticating such delegated payment for every transaction. Existing UPI limits shall apply on transactions initiated by Secondary Users through partial delegation.

Procedure for Delegation: Primary User may delegate payments to a Secondary User by scanning their QR code or entering their UPI ID and verifying their contact number from their contact list. In the future, NPCI plans to simplify the process by enabling delegation through contact selection alone. The Primary User may delegate up to 5 Secondary Users at a time, but a Secondary User may be linked to only 1 Primary User at a time.

Key Compliance Obligations for Member Banks: Member banks of NPCI are required to ensure the following with respect to implementing UPI Circle:

1. The Primary User and Secondary User would be required to undergo authentication on their UPI app through app passcode / biometrics, etc.
2. The first 24 hours post delegation would be treated as a 'cooling off' period, during which a daily transaction limit of INR 5,000 shall apply.
3. Primary User will have visibility over the transactions performed by their Secondary Users on their UPI app and bank account statement which gives them sufficient control over their account management.

KEY TAKEAWAYS

UPI Circle is poised to broaden UPI access, enabling

1. Individuals without bank accounts to make payments, and
2. Primary Users to authorise payments by Secondary Users while retaining oversight.

The feature introduces safeguards such as defined limits, visibility, and a structured hierarchy to mitigate misuse. UPI Circle points to the next stage of innovative Fintech products in India, with a focus on solving for diverse use cases relevant to various categories of users.

e-KYC SETU FRAMEWORK

Background

Undertaking KYC verification of potential customers has been a key component of customer acquisition costs for REs operating through digital mediums. This has been a significant obstacle in making financial products accessible to underserved population in India. The e-KYC Setu framework was envisioned as a solution to enable REs to undertake KYC verification of potential customers securely under the Aadhaar Act.

On 6 December 2022, the Ministry of Finance, in consultation with UIDAI and financial sector regulators like RBI, issued a notification outlining the e-KYC Setu framework under Aadhaar Act and PMLA. Being tasked by RBI to operationalise this framework, NPCI announced the launch of the e-KYC Setu system on 29 August 2024 at the Global Fintech Fest, 2024.

Analysis

The e-KYC Setu framework introduces significant operational changes and benefits for REs while ensuring compliance with regulatory requirements.

Onboarding Process: REs are required to onboard themselves as members of NPCI's e-KYC Setu system. During onboarding, NPCI would verify that the REs meet all prerequisites for Aadhaar-based e-KYC authentication and have the necessary regulatory approvals. Once onboarded, REs can conduct client KYC through 1. a web-based URL directed to an NPCI webpage or 2. an SDK for e-KYC authentication.

Operational Oversight: NPCI governs system access, ensuring that entities comply with UIDAI requirements. If an RE breaches compliance, discontinues use, loses authorisation, or remains inactive for six months, NPCI may revoke access and notify UIDAI and the relevant regulators. UIDAI ensures the system aligns with Aadhaar related regulations and is empowered to issue directives for additional security and compliance measures.

KEY TAKEAWAYS

The e-KYC Setu framework simplifies the KYC process for REs, making it more efficient and cost-effective. It reduces the operational challenges typically associated with KYC, helping businesses save time and resources. This centralisation also enhances transparency, giving customers confidence that only authorised REs will have access to their data. Overall, the e-KYC Setu framework plays a key role in promoting financial inclusion and improving operational efficiency, making it an important development in India's Fintech sector.

DRAFT AFA GUIDELINES

Background

Digital payments have grown annually, along with related frauds like phishing and brute force attacks. To address this, RBI released the Draft AFA Guidelines on 31 July 2024 for public comments. The Draft AFA Guidelines mandate robust multi-factor authentication for all PSOs and PSPs, including banks and non-banks. It sets clear guidelines for authenticating digital transactions, enhancing security and user confidence in the digital payments ecosystem.

Analysis

Factors of Authentication: RBI recognises the need for alternatives to SMS-based OTP. The Draft AFA Guidelines provides guidelines for PSOs and PSPs to create authentication frameworks, categorising factors into:

- Knowledge-based (e.g., PIN, password)
- Possession-based (e.g., card hardware, software tokens)
- Inherent factors (e.g., biometrics)

Dynamic Creation: PSOs and PSPs must implement AFA mechanisms involving one dynamically created factor post-transaction initiation, specific to the transaction. The factors used must come from two distinct categories. The Draft AFA Guideline allows risk-based use of AFA mechanisms and offers customers the flexibility to de-register from certain modes.

Authentication: For non-exempt digital payment transactions, users must authenticate payments by inputting a unique dynamic credential and either a possession-based or inherent factor.

Exempted Transactions: Certain transactions are exempt, including e-mandates for recurring transactions, small value offline payments, and small value contactless card payments.

Other Guidelines: PSOs and PSPs must conduct comprehensive risk assessments, set up near real-time customer alerts, obtain explicit customer consent, and avoid exclusivity arrangements with third parties.

KEY TAKEAWAYS

Baseline Safeguards: The Draft Framework sets baseline safeguards, requiring PSOs and PSPs to implement risk-based authentication without a standard threshold.

Technological Savviness: PSOs and PSPs must consider customer technological savviness. Consent-based frameworks are user-centric but may lead to service denial if biometric consent is refused. Further, devices without advanced features will limit the AFA modes available to the customer.

DRAFT AePS DIRECTIONS

Background

On 31 July 2024, RBI released the Draft AePS Directions to improve due diligence of AePS touchpoint operators due to the rise in digital transactions, particularly in rural and smaller cities. Operated by NPCI, AePS enables users to conduct financial transactions using biometric authentication linked to Aadhaar numbers and facilitates interoperable transactions at PoS through business correspondents.

Analysis

The Draft AePS Directions stipulate several measures aimed at enhancing the security and integrity of AePS transactions:

Onboarding Procedures: SCBs must conduct due diligence on AePS touchpoint operators as per the KYC Master Directions. If an operator has not performed transactions for six months, the SCBs must update their KYC records before re-enabling them.

Exclusive Onboarding: Each AePS touchpoint operator can only be onboarded by one SCB, ensuring streamlined oversight and reduced fraud risk through better monitoring.

Ongoing Due Diligence: SCBs must continuously monitor AePS touchpoint operators, setting transaction limits based on risk profiles and ensuring that transactions align with operators' locations and risk profiles to pre-emptively mitigate risks.

Adherence to NPCI Guidelines: All AePS participants must comply with NPCI regulations, promoting a unified approach to security and operational standards across the system.

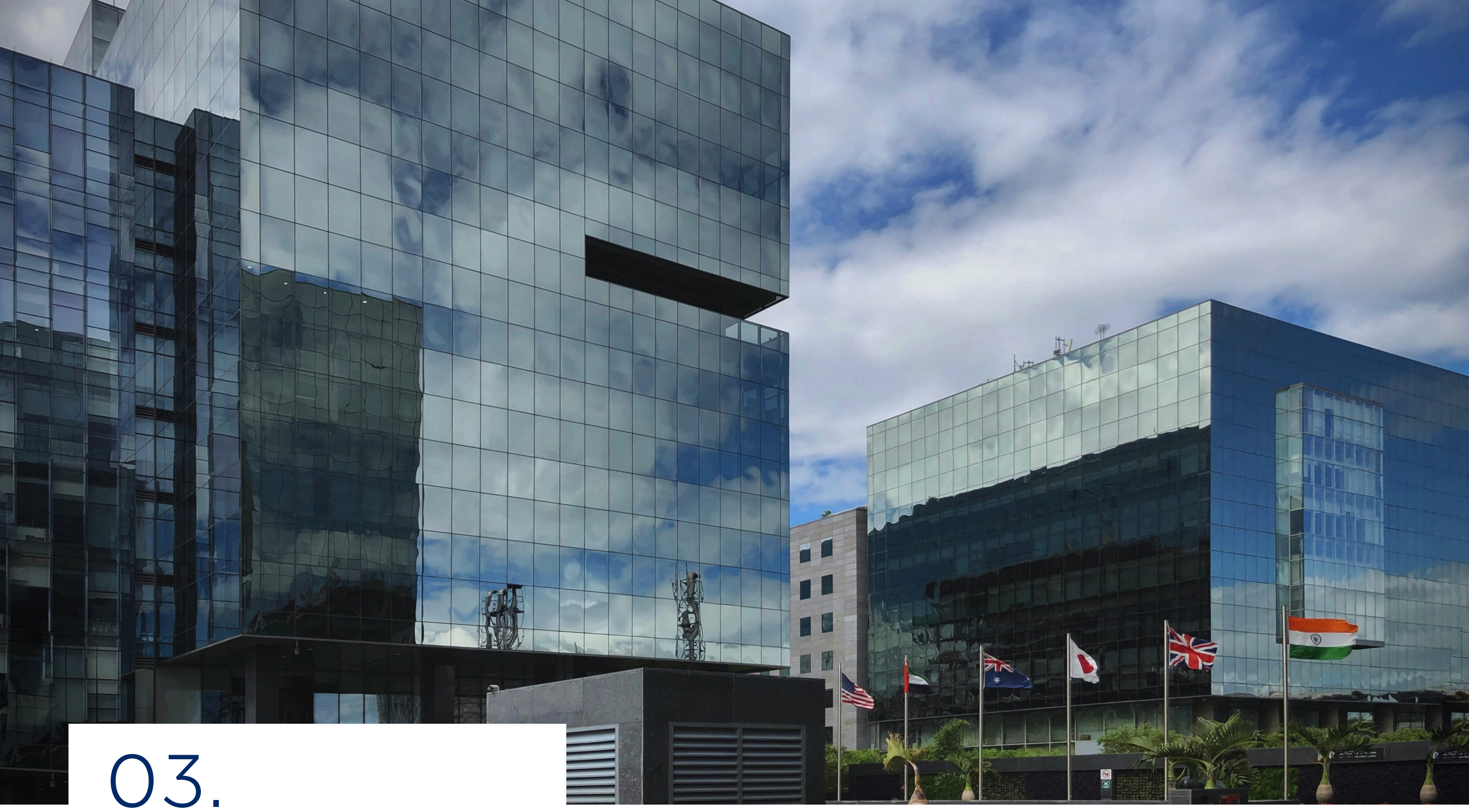
KEY TAKEAWAYS

Consumer Confidence: The Draft AePS Directions aim to mitigate digital payment risks, especially in biometric-reliant systems. By enhancing onboarding processes and enforcing ongoing due diligence, RBI seeks to boost consumer trust in AePS, promoting broader financial inclusion, particularly in underserved rural areas.

Security and Efficiency: As digital payments grow, stronger security frameworks are essential. Emphasising fraud prevention and identity verification can reduce financial crimes, enhancing the digital payments ecosystem's integrity. SCBs may use advanced technologies like AI and machine learning for KYC processes to improve accuracy and efficiency in identifying fraudulent activities.

Operational Framework: Implementing the Draft AePS Directions may face challenges, such as uniform compliance from all SCBs. RBI can encourage SCBs to share best practices and intelligence to create a robust operational framework. Public awareness campaigns can also empower consumers to be vigilant.

The Draft AePS Directions indicate a crucial step in securing digital transactions and protecting consumer interests, relying on collaboration among SCBs, technology providers, and informed consumers for successful implementation if formalised by RBI.



03.

IFSCA

The IFSC Gift City represents India's ambitious vision of emerging as a global hub for financial services, catering to international markets with a state-of-the-art ecosystem. The IFSC, located in Gandhinagar, Gujarat has seen rapid evolution as a nucleus for global banking, insurance, asset management and other financial services. Within this ecosystem, the payments sector has emerged as the next frontier of innovation and opportunity.

As global trade, e-commerce and digital transactions increasingly transcend borders, the demand for seamless, efficient and compliant payment solutions has never been greater. The recently introduced IFSCA Payment Regulations by the IFSCA is a testament to this forward-looking approach. They, *inter alia*, address the regulatory considerations involved in aspects of payments, including cross-border transactions, payment services and integration with banks within the IFSC Gift City. The introduction of the IFSCA Payment Regulations highlights the recognition that payments are not merely ancillary to other financial services but are, in fact, a cornerstone of the modern financial ecosystem.

We have provided a brief update on the IFSCA Payment Regulations below:

NAVIGATING PAYMENTS IN THE IFSCA: FRAMEWORK GOVERNING PAYMENT SERVICES

Background

The IFSCA issued the IFSCA Payment Regulations laying down the regulatory framework for entities seeking to provide payment services in the IFSC Gift City. Currently in India, the aspects related to payment system providers and payment systems are governed under the PSS Act, wherein the PSS Act confers powers on RBI to regulate payments systems, and substantive obligations for specific categories of payment systems flow from the delegated legislations enacted by RBI. The IFSCA Payment

Regulations, on the contrary, itself provide a comprehensive set of guidelines for setting up various payment services in the IFSC GIFT City. Key highlights of the IFSFC Payment Regulations are elaborated in the ensuing paragraphs.

Key Highlights

Applicable Payment Services: The IFSCA Payment Regulations provide an exhaustive list of Payment Services including account issuance service, e-money issuance service, escrow service, cross border money transfer service, and merchant acquisition service.

Application for Authorisation for Providing Payment Services: Entities exploring to undertake the above mentioned Payment Services in IFSC are required to obtain a certificate of authorisation from IFSC. Currently, an IFSC banking company or an IFSC banking unit and a person licensed to carry on the business of issuing cards in IFSC are exempted from the authorisation requirements.

An entity seeking to operate as PSP in IFSC GIFT City must

1	2	3	4	5
Be incorporated as a company with its registered office located in the IFSC GIFT City	Have a minimum net-worth of USD 100,000 on the date of commencement of operations	Achieve a minimum net-worth of USD 200,000 by the end of its third financial year	Adhere to the exhaustive 'fit and proper' criterion provided	Designate an IFSC banking unit or an IFSC banking company as its nodal bank

Duties and Obligations of PSPs: A PSP is, *inter alia*, required to comply with the following major duties and obligations:

1. The funds received by the PSPs while providing Payments Services must be segregated from other funds and must be safeguarded by depositing the same with a safeguarding institution.
2. PSPs must submit audited financial statements, along with the auditor's report, to the IFSCA within 3 months from the date of finalisation.
3. PSPs are also required to develop comprehensive risk management policies, procedures, and systems to effectively identify, measure, monitor, and manage various risks associated with delivering Payment Services.

KEY TAKEAWAYS

The IFSCA Payment Regulations offer a more streamlined regulatory approach to the Payment Services in IFSC GIFT City. This would facilitate Indian payments entities to provide tailor made solutions for the global market. At the same time with reduced entry barriers in IFSC GIFT City combined with a single window mechanism for authorisation would also encourage and attract more foreign participation in the payments ecosystem leading to a healthy competition.

04.
WEALTHTECH

SEBI has demonstrated significant proactivity last year, spearheading critical reforms and regulatory interventions across the securities market ecosystem. In keeping with its mandate to safeguard investor interests and ensure market integrity, SEBI has addressed a wide spectrum of issues, ranging from unregulated activities and emerging asset classes to the evolving dynamics of financial influencers and their role in shaping retail participation.

One of the notable areas of focus has been the review of the regulatory frameworks governing IAs and RAs. The updated regulatory framework will be fundamental in ensuring an increase in the number of registered IAs and RAs in India, thereby ensuring the overall growth of the securities market at large. Additionally, SEBI's decisive actions against unregistered bond platforms highlights the regulator's vigilance towards investor protection and ensuring that entities operate within the ambit of the regulatory framework.

A landmark development this year is the introduction of a new asset class – SIF which is aimed at catering to niche investment strategies and innovative financial products. SEBI has also taken significant strides in addressing the challenges posed by the growing influence of financial influencers, or "finfluencers," and their association with registered intermediaries via specified digital platforms.

As we navigate this transformative regulatory landscape, SEBI's initiatives reaffirm its role as a vigilant and progressive regulator which has helped in ensuring a more robust and inclusive securities market in India.

We have provided a brief analysis on the abovementioned updates below:

AMENDMENTS TO THE REGULATORY FRAMEWORK GOVERNING INVESTMENT ADVISERS AND RESEARCH ANALYSTS

Background

By way of IA / RA Amendments dated 16 December 2024, SEBI significantly modified the regulatory framework applicable to IAs and RAs with a view to enhance, simplify and reduce the compliance requirements applicable under the current framework. These IA / RA Amendments were introduced in response to the growing disparity between the limited number of registered IAs and RAs and the increasing investor base. Given that these IA / RA Amendments ease compliance requirements and reduce entry barriers for IAs / RAs, we may see more professionals obtaining registration with SEBI and providing their services within the prescribed regulatory framework.

Analysis

We have set out key highlights of the IA / RA Amendments below:

Eligibility Criteria: The IA / RA Amendments have relaxed the eligibility criteria for an individual IA / RA or a principal officer of a non-individual IA / RA by reducing the minimum qualification from a post graduate degree to a graduate degree and removing the need for prior experience in the securities market. Further, the current net worth requirement (INR 2.5 million and 5 million for an RA and IA respectively) has been replaced with a deposit requirement commensurate with the number of clients which will be lien marked to the supervisory body of IAs and RAs.

Part-time IA / RA: SEBI has allowed individuals and partnership firms engaged in other business activities and employment (not related to securities) to seek registration as a part-time IA / RA if the said applicant – (1) obtains a no-objection certificate from its employer and (2) provides a declaration that it shall maintain an arms-length relationship between its business activity as an IA / RA and its other activities.

Recognition of Model Portfolios: SEBI has specifically recognised 'model portfolios' as a permissible research service for an RA and detailed guidelines in relation to the same are expected to come out soon. A model portfolio is defined to mean a basket of securities, with relevant weightage for each security which has been issued by an RA by way of a research report.

Scope of Investment Advice: An IA may now provide investment advice in respect of products or services which are not regulated by SEBI, subject to appropriate disclosures being made to the clients that such advice is outside the regulatory purview of SEBI and no recourse from SEBI would be available for any grievance arising therefrom.

Use of AI: The IA / RA Amendments have clarified that the responsibility of providing investment advice / research services lies solely with the respective IA / RA, irrespective of the scale and scenario of IA using AI tools. Additionally, an IA / RA will also be required to disclose to their clients the extent of AI tools used in providing investment advice.

Compliance by Independent Professionals: Non-individual IAs / RAs have been allowed to appoint independent professionals such as member of Institute of Chartered Accountants of India or Institute of Company Secretaries of India or Institute of Cost Accountants of India or member of any other professional body as may be specified by SEBI, as compliance officer in place of a full-time compliance officer.

KEY TAKEAWAYS

The IA / RA Amendments are a welcome measure that provide much needed relaxations and clarity in the regulatory framework applicable to IAs and RAs. The updated regulatory framework not only reduces compliance burden but also open the doors for more professionals to enter the field with the objective of ensuring quality research and advisory services for investors. However, clarity on certain provisions of the IA / RA Amendments and proposals outlined in the IA / RA Consultation Paper will be obtained only upon the issuance of detailed circulars by SEBI on the subject. The IA / RA Amendments, along with the proposals highlighted in the IA / RA Consultation Paper are likely to improve access to investment advice and research services for retail investors whilst ensuring that such services are aligned with regulatory expectations.

SEBI CRACKS DOWN ON UNREGISTERED BOND PLATFORMS

Background

During routine surveillance by SEBI, it was observed that certain UBPs, namely altGraaf, Tap Invest and Stable Investments, engaged in acquiring unlisted NCDs, issued by various private limited companies on a private placement basis, either directly or through associated entities, and subsequently, down sold (offered for sale) the NCDs 'warehoused' by them to the public at large through their website / application. With the objective of curbing such unregistered platforms, SEBI issued an Interim Ex Parte Order against these UBPs, *inter alia*, directing them to immediately cease and desist from offering securities (unlisted NCDs) for public subscription or for arranging for their offer for sale to the public.

SEBI observed that these UBPs were facilitating the sale of privately placed, unlisted NCDs to retail investors in violation of the Companies Act. The offerings on the UBPs were structured in manner to falsely portray compliance with the regulatory framework, which SEBI prima facie found to fall within the ambit of 'fraud' under the SEBI Act and PFUTP Regulations.

Analysis

As per Section 42(2) of the Companies Act read with Rule 14(2) of the the Share Capital Rules, securities offered through private placement cannot exceed two hundred investors in a financial year and must be limited to pre-identified individuals. Upon exceeding the threshold of two hundred investors, it shall be deemed to be a public issue and a number of additional requirements, including compliance with NCS Regulations would get attracted. Given that the UBPs had no checks in place to limit the number of investors or ensure that the securities (unlisted NCDs) were offered only to pre-identified individuals, SEBI found that these offerings effectively transformed private placements into public issues without adhering to the stricter disclosure, compliance, and regulatory requirements mandated for public issues.

SEBI also referred to Section 25(2)(a) of the Companies Act which provides that if securities issued via private placement are offered to the public within six months of their allotment, such offerings are deemed public issues. SEBI held that determining liability under Section 25(2)(a) of the Companies Act would require a detailed investigation, particularly to assess of whether the issuers of NCDs connived with the UBPs to structure these transactions as public offerings under the guise of secondary sales. Further, in the case of altGraaf, SEBI prima facie observed violation of Section 42(7) of the Companies Act, which provides that issuers are prohibited from utilising distribution channels / platforms in aid of making their private placements.

As a result of the above, SEBI concluded that the platforms' disclosures asserting that their products adhered to regulatory requirements were misleading and tantamount to mis-selling of securities thereby violating Regulation 4(2)(s) of the PFUTP Regulations.

Separately, SEBI also issued a press release subsequently on 5 December 2024, *inter alia,* cautioning investors from undertaking transactions on similar UBPs, emphasising that these platforms lack investor protection or grievance redressal mechanisms since they are largely unregulated.

KEY TAKEAWAYS

The Interim Ex Parte Order is likely to have a significant impact on other unregulated platforms who are providing similar services in the bond market space, encouraging them to obtain registration as an OBPP and function within the regulatory framework prescribed by SEBI for such OBPPs which, *inter alia,* includes offering of only listed debt securities. An increase in the number of OBPPs in the market would also result in the expansion of the listed debt capital markets in India.

BRIDGING THE GAP: THE INTRODUCTION OF SIFs IN INDIA

Background

SEBI, vide its amendment to the MF Regulations dated 16 December 2024, has introduced a new asset class within the mutual fund industry called the 'Specialised Investment Fund'. SIF aims to offer a more tailored investment option for investors who are willing to take on higher risks in search of better returns. With a minimum investment amount of INR 1 million, the SIF is designed to bridge the gap between PMS and mutual funds, enabling high risk-taking investors to invest in a regulated investment product. Under the SIF, the investment manager may introduce distinct investment strategies, each tailored to different objectives and risk profiles, offering investors a diverse range of options.

Analysis

We have set out below the key highlights of the framework governing SIFs:

Targeted for Experienced Investors: The minimum investment amount for an investor to invest in an SIF shall be INR 1 million across all investment strategies. This threshold may deter retail investors from investing in this product, while attracting other experiences investors who are more comfortable with risk.

Permissible Investments: SIFs allow asset managers to invest up to 10% of the NAV of the fund in equity and equity related instruments of any company. However, the SIF cannot invest in more than 15% of a company's paid up capital. For debt instruments, asset managers can invest up to 20% of the NAV of the

fund, with possibility of extending to 25% with prior approval from the Board of Trustees. Lastly, SIFs have also been allowed to invest in REITS and InvITs, subject to a limit of up to 20% of its NAV in units of REITs and InvITs and up to 10% of the NAV in units of REITs and InvITs issued by a single issuer.

NISM Certification: The fund manager of the SIF will be required to obtain the relevant NISM certification as may be prescribed from SEBI from to time. As of now, this requirement has not been notified by SEBI, but it is expected to be similar to the certification requirement for Portfolio Managers or Investment Managers of an AIF.

Clear Differentiation from Mutual Funds: AMCs shall clearly distinguish SIFs from mutual funds through through branding, advertising, disclaimers, and by maintaining separate websites for the two investment options.

KEY TAKEAWAYS

Mutual funds have generally been a popular choice for retail investors seeking diversified investment options, while PMS appeal to those sophisticated investors who are willing to invest larger amounts with personalised strategies. However, a gap has existed between these two offerings, and the introduction of the SIF seeks to address this very gap. The introduction of SIFs as an additional investment product will further promote domestic participation in the mutual fund industry. That being said, SEBI may consider allowing Portfolio Managers to offer these investment strategies as well, perhaps after they comply with certain additional requirements as may be specified.

Lastly, it is relevant to note that the NAC Consultation Paper which had proposed the SIF framework also suggested allowing SIFs to invest in derivatives, enabling strategies such as long-short equity funds and inverse ETFs. While these aspects do not form part of the current amendments, it remains to be seen whether they will be incorporated through subsequent amendments or circulars.

REGULATING THE FINFLUENCER LANDSCAPE: RECOGNITION OF SPECIFIED DIGITAL PLATFORMS

Background

The finfluencer industry has gained significant traction in recent years with finfluencers simplifying complex financial concepts for consumers. Taking note of such unregulated growth of the industry, SEBI had, by way of SEBI Amendments, barred SEBI REs from directly / indirectly associating with unregistered individuals (including finfluencers) engaged in Regulated Activities. With the aim to further, streamline the interactions of SEBI REs with finfluencers, SEBI issued the SDP Consultation Paper, *inter alia*, providing for recognition of SDPs through which SEBI REs may associate with finfluencers who provide genuine investor education or hold relevant SEBI registration. SEBI has also released the Draft Finfluencer FAQs and SDP Clarification to further shed light on the proposed regulatory framework.

Analysis

We have set out below key highlights of the proposed regulatory framework governing finfluencers and their associations with SEBI REs:

Recognition of SDPs: SDPs are digital platforms which would be responsible to employ certain preventative and curative measures to ensure that the financial content offered by finfluencers is within the purview of SEBI's regulatory framework. The SDP Clarification further clarifies that not every digital platform that may host content from finfluencers is within the regulatory purview of SEBI, and such platforms may choose at their discretion to be recognised as an SDP. Only such platforms seeking recognition would be required to adhere to the measures set out under the SDP Consultation Paper.

Regulated Activities: In terms of the SDP Consultation Paper, SDPs may onboard finfluencers undertaking Regulated Activities, if they are registered with SEBI, whereas unregistered finfluencers shall only be permitted to provide investor education. The Draft Finfluencer FAQs draws a distinction between 'education' and 'advice' / 'recommendation,' clarifying that those engaged in investor education cannot be said to be involved in Regulated Activities, however, they must avoid using market price data from the past three months to suggest investment in specific securities. The SDP Clarification allows SEBI REs to directly (or through other digital platforms) associate with finfluencers, provided that such SEBI REs ensure compliance with relevant SEBI norms and that no unregistered finfluencer partakes in any Regulated Activities.

Preventative Measures: The SDP Consultation Paper outlines several key preventative measures required to be adopted for SDPs with an aim to enhance investor protection and ensure proper oversight of financial content shared on SDPs. These include robust data-sharing policies with SEBI and mechanisms for monitoring content, such as deployment of AI and machine learning tools to identify unregistered entities engaging in

Regulated Activities and requires a verification system to distinguish SEBI REs from unregistered finfluencers. Additionally, SDPs are expected to implement measures against impersonation and fraud and periodically report compliance actions to SEBI.

Curative Measures: The SDP Consultation Paper also outlines certain curative measures required to be adopted by SDPs, including the establishment of an escalation mechanism to allow SEBI, SEBI REs, or platform users to report unauthorised content, which the SDP must act upon. With an objective of maintaining platform integrity, SDPs may also, depending on the severity of the violation, undertake corrective actions including removal of content, access restrictions, profile deactivation, and blacklisting of repeat offenders.

KEY TAKEAWAYS

The recognition of SDPs by SEBI would be a welcome move for both the finfluencer industry and SEBI REs since it enables finfluencers to be onboarded on SDPs and associate with SEBI REs. While the proposed measures in the SDP Consultation Paper place a clear responsibility on SDPs to ensure compliance, it remains unclear if any liability will be imposed on SEBI REs in the event the SDP's measures prove insufficient in allowing an unregistered finfluencer to engage in Regulated Activities. Additionally, the SDP Consultation Paper is silent on several key operational aspects, such as the fee structure for services offered by SDPs, whether any limits will be placed on such fees, and whether the fees will be charged to the finfluencer, the SEBI RE, or both.

Glossary

Aadhaar Act	Aadhaar (Targeted Delivery of Financial and Other Subsidies, Benefits and Services) Act, 2016
AePS	Aadhaar Enabled Payment System
AFA	Additional Factor Authentication
AI	Artificial intelligence
AIF	Alternate Investment Fund
AMC	Asset Management Company
Amended Credit Card Master Directions	Amendment to the Reserve Bank of India (Credit Card and Debit Card – Issuance and Conduct) Directions 2022 dated 7 March 2024
Applicable NBFCs	The NBFCs to which FRM Directions apply, i.e., all NBFCs in the upper layer, middle layer and in the base layer (with asset size of INR 500 crore and above)
APR	Annual Percentage Rate
CDD	Customer Due Diligence
CIC	Credit Information Company
CIC Master Directions	Reserve Bank of India (Credit Information Reporting) Directions, 2025
CIR	Credit Information Report
CISO	Chief Information Security Officer
CoD	Cash on Delivery
COE	Committee of Executives
Companies Act	Companies Act, 2013
Consultation Paper	Consultation Paper on Review of Regulatory Framework for Investment Advisers and Research Analysts dated 6 August 2024
CPV	Contact Point Verification
Cyber Resilience Master Directions	Master Directions on Cyber Resilience and Digital Payment Security Controls for Non-Bank Payment System Operators dated 30 July 2024
Delegated Payments Circular	Introduction of "UPI Circle" – Delegated Payments for secondary users' issued by NPCI dated 13 August 2024
Digital Lending Guidelines	RBI Guidelines on Digital Lending dated 2 September 2022
DLG	Default Loss Guarantee
DLG FAQs	FAQs on the DLG Guidelines dated 5 November 2024
DLG Guidelines	Delivery versus Payment
	Guidelines on Default Loss Guarantee in Digital Lending dated 8 June 2023
DLG Set	Measurable set of loan assets that have been sanctioned by REs
Draft AePS Directions	RBI Direction on 'Aadhaar Enabled Payment System – Due Diligence of AePS Touchpoint Operators' dated 31 July 2024
Draft AFA Guidelines	Framework on Alternative Authentication Mechanisms for Digital Payment Transactions issued by RBI on 31 July 2024
Draft DL Guidelines	Draft guidelines on digital lending transparency titled, "Digital Lending – Transparency in Aggregation of Loan Products from Multiple Lenders" dated 26 April 2024
Draft Finfluencer FAQs	Consultation paper on draft circular to provide clarity on provisions related to association of persons regulated by the SEBI, MIIs and their agents with persons carrying on prohibited activities dated 6 December 2024 issued by SEBI

Draft Lending Bill	The Banning of Unregulated Lending Activities (Draft) Bill, 20__" presented on 13 December 2024
Draft Offline PA Directions	Draft Directions on Regulation of PA – Physical Point of Sale (PA-P / Offline PA) dated 16 April 2024
Draft PA-PG Amendment	Regulation of Payment Aggregators (PAs) – Draft dated 16 April 2024
DvP	Delivery versus Payment
e-KYC Setu	e-KYC Setu framework enabled via the NPCI circular 'e-KYC Setu System' dated 29 August 2024
EMI	Equated Monthly Instalment
EPI	Equated Periodic Instalment
Erstwhile Circular	Circular on Monitoring of frauds in NBFCs (Reserve Bank) Directions, 2016 dated 29 September 2016
ETF	Exchange Traded Fund
EWS	Early Warning Signals
FAQs	Frequently Asked Questions
FIU-IND	Financial Intelligence Unit - India
FMR	Fraud Monitoring Returns
FRM Directions	Reserve Bank of India (Fraud Risk Management in NBFCs) Directions, 2024 dated 15 July 2024
GIFT City	Gujarat International Finance Tec-City
GST	Goods and Services Tax
IA	Investment Advisors
IA / RA Amendments	SEBI amendments dated 16 December 2024 comprising of – (a) the Securities and Exchange Board of India (Investment Advisers) (Second Amendment) Regulations, 2024; and (b) the Securities and Exchange Board of India (Research Analysts) (Third Amendment) Regulations, 2024
IA / RA Consultation Paper	Consultation Paper on Review of Regulatory Framework for Investment Advisers and Research Analysts
IFSC	International Financial Services Centre
IFSCA	International Financial Services Centres Authority
IFSCA Payment Regulations	The International Financial Services Centre's Authority issued the IFSCA (Payment Services) Regulations, 2024
Interest Circular	Fair Lending Practices – Charging of Interest dated 29 April 2024
Interim Ex Parte Order	Interim Ex Parte Order in the matter of Unregistered Online Bond Platforms dated 18 November 2024
IT	Information Technology
InvIT	Infrastructure Investment Trust
KFS Circular	RBI Circular on Key Facts Statement (KFS) for Loans & Advances dated 15 April 2024
KYC	Know Your Customer
KYC Master Directions	Reserve Bank of India (Know Your Customer (KYC)) Directions 2016
LSP	Lending Service Provider as defined under the Digital Lending Guidelines
Medium Merchants	Medium Merchants shall have the meaning ascribed to it under Draft PA-PG Amendment
MF Regulations	Securities and Exchange Board of India (Mutual Funds) Regulations, 1996
ML	Money Laundering

MSME	Micro, Small and Medium Enterprise
NAC Consultation Paper	Consultation Paper on Introduction of New Asset Class/ Product Category dated 16 July 2024
NAV	Net Asset Value
NBFC	Non-Banking Financial Company
NBFC – P2P	A class of NBFCs carrying on business of P2P lending.
NCDs	Non-Convertible Debentures
NCS Regulations	SEBI (Issue and Listing of Non-Convertible Securities) Regulations, 2021
NISM	National Institute of Securities Markets
NPCI	National Payments Corporation of India
OBPP	Online Bond Provider Platform
Online PAs	PA - Online Point of Sale
Order against UBPs	Interim Ex Parte Order in the matter of Unregistered Bond Platforms dated 19 November 2024
OTP	One Time Password
OVD	Officially Valid Documents
P2P	Peer to Peer
P2P Amendments	Review of Master Direction - Non-Banking Financial Company – Peer to Peer Lending Platform (Reserve Bank) Directions, 2017 dated 16 August 2024 along with the update to the Non-Banking Financial Company – Peer to Peer Lending Platform (Reserve Bank) Directions, 2017 dated 9 September 2024
P2P Master Direction	Non-Banking Finance Company – Peer to Peer Lending Platform (Reserve Bank) Directions, 2017 dated 4 October 2017
PA	Payment Aggregator
PA - O	Online Payment Aggregator
PA - P	PA - Physical Point of Sale
PA-PG Guidelines	Guidelines on Regulation of Payment Aggregators and Payment Gateways dated 17 March 2020
Payment Services	Account issuance service, e-money service, escrow service, cross border money transfer service and merchant acquisition service
PFUTP Regulations	SEBI (Prohibition of Fraudulent and Unfair Trade Practices Related to the Securities Market) Regulations, 2003
PIN	Personal Identification Number
PMLA	Prevention of Money Laundering Act 2002
PMS	Portfolio Management Services
PoS	Point of Sale
Primary User	A UPI user
PSO	Payment System Operator
PSP	Payment System Provider
PSS Act	Payment and Settlement Systems Act 2007
RA	Research Analyst
RBI	Reserve Bank of India
RE	Regulated Entity

Regulated Activities	Activities that may only be undertaken by SEBI RE such as offering of investment advice / recommendation or making a claim of return or performance in relation to a security
REIT	Real-Estate Investment Trust
REs	Regulated Entities
S-SDLC	Secure Software Development Life Cycle
SCB	Scheduled Commercial Bank
SCBMF	Special Committee of the Board for Monitoring and Follow-up of cases of Frauds
SDK	Software Development Kit
SDP	Specified digital platform
SDP Clarification	Press release issued by SEBI titled 'Clarification' dated 4 December 2024 issued by SEBI
SDP Consultation Paper	Consultation paper on recognition as specified digital platform dated 22 October 2024 issued by SEBI
SEBI	Securities and Exchange Board of India
SEBI Act	Securities and Exchange Board of India Act 1992
SEBI Amendments	The SEBI amendments dated 29 August 2024 consisting of: (a) the SEBI (Intermediaries) (Amendment) Regulations, 2024; (b) the Securities Contracts (Regulation) (Stock Exchanges and Clearing Corporations) (Fourth Amendment) Regulations, 2024; and (c) the SEBI (Depositories and Participants) (Second Amendment) Regulations, 2024
SEBI RE	Entities regulated by SEBI such as stock exchanges, depositories, brokers, asset management companies, etc
Secondary User	Another UPI User who is authorised by Primary User to undertake delegated UPI payments from the Primary User's bank account
Share Capital Rules	Companies (Share Capital and Debentures) Rules, 2014
SIF	Specialised Investment Fund
Small Merchants	Small Merchants shall have the meaning ascribed to it under Draft PA-PG Amendment
TF	Terrorist Financing
UBP	Unregistered Bond Platform
UIDAI	Unique Identification Authority of India
UPI	Unified Payments Interface
UPI Circle	Delegated Payments feature introduced through the circular 'Introduction of "UPI Circle" – Delegated Payments for secondary users' issued by NPCI dated 13 August 2024
URL	Uniform Resource Locator
WALPs	Web Aggregators of Loan Products
YoY	Year-Over-Year

About Khaitan & Co

Khaitan & Co is a top tier and full-service law firm with over 1200 legal professionals, including 270+ leaders and presence in India and Singapore. With more than a century of experience in practicing law, we offer end-to-end legal solutions in diverse practice areas to our clients across the world. We have a team of highly motivated and dynamic professionals delivering outstanding client service and expert legal advice across a wide gamut of sectors and industries.

The Fintech practice of the firm envisions to emulate the firm's ambition of being the trusted advisor to its clients on all aspects of Fintech offerings, including regulatory, compliances, product advisory, disputes, investments, partnerships, and licensing / approvals.

To know more about us, please visit www.khaitanco.com

Sanjay Khan Nagra
Partner
sanjay.khan@khaitanco.com

Smita Jha
Partner
smita.jha@khaitanco.com

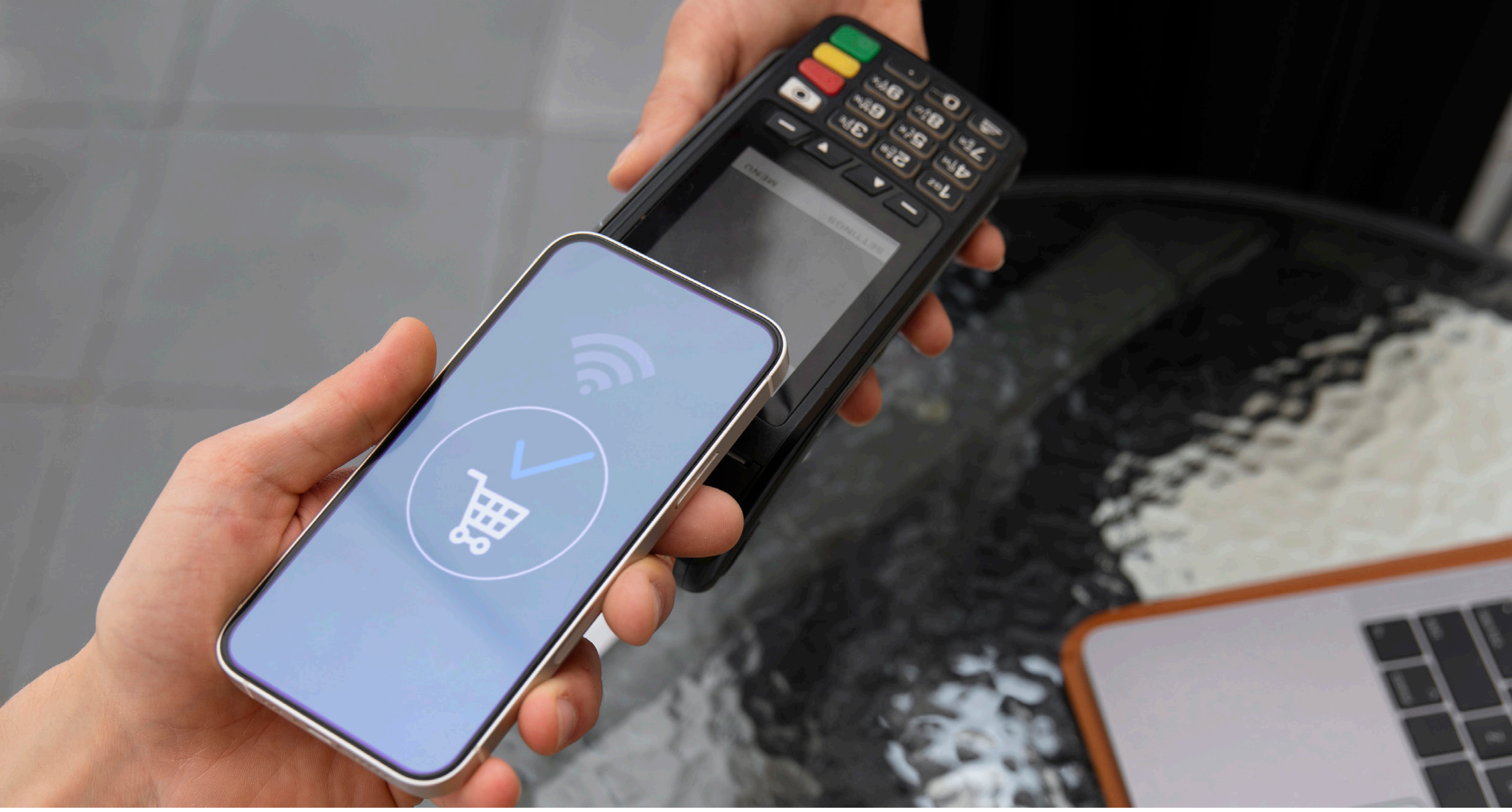
Prashanth Ramdas
Partner
prashanth.ramdas@khaitanco.com

About Digital Lenders Association of India

Digital Lenders Association of India (DLAI) was formed in November 2016 with the objective of bringing together digital lenders and their associated players under one roof to form an association that would help the ecosystem grow and flourish. Its primary objective is to unite digital lenders (MSME and consumer), marketplace platforms, and industry members to create a platform for sharing best practices, conduct research on innovative business models, and work with regulators, industry experts, and other government bodies to set broad contours on policy matters beneficial to the entire digital credit industry.

To know more about us, please visit www.dlai.in

For queries, please write to us at **contact@dlai.in**



Ahmedabad ▪ Bengaluru ▪ Chennai ▪ Delhi-NCR ▪ Kolkata ▪ Mumbai ▪ Pune ▪ Singapore