# MARKET UPDATES AND RECENT LEGAL DEVELOPMENTS IN INDIA

The fin-tech sector has rapidly expanded out of the back-end technology used by large financial institutions, to cover all emerging technological innovations having a bearing on financial services. The fin-tech industry has been witnessing a continuous expansion. It is now no longer made up of only start-ups, but also includes seasoned companies and traditional financial institutions that have started offering a broad array of customer focussed, increasingly integrated and innovation driven service and product offerings.

## MARKET UPDATES AND MAJOR DEALS IN INDIA

The Indian fin-tech market has scaled new heights, both in terms of funding received and increasing consumer adoption of fin-tech solutions. We have witnessed several innovations related to digital banking, block chain technology and artificial intelligence, which have brought opportunities for both, the existing market participants and start-ups, by driving efficiency improvements and greater financial inclusion.

India saw 23 fin-tech deals during the second quarter of 2019, compared to 15 investments in China during the same period[1], according to 'The Global FinTech Report' from CB Insights. Some recent large Indian fin-tech deals include payments firm **RazorPay**[2], which raised $75 million in June led by Sequoia and Ribbit Capital, and digital insurance start-up **Acko**[3], which raised $65 million from investors such as Flipkart co-founder Binny Bansal.

Fin-tech start-up **BharatPe** has raised $15.5 million in funding from global venture capital and private equity firm Insight Partners and existing investors, Sequoia and Beenext[4]. The company stated that the investment proceeds would be deployed towards scaling its operations and equipping millions of merchants with a Unified Payment Interface (UPI) within the next 2 years.

**oCap Management**, a Singapore-grown business financing provider, announced its entry to India through a partnership with local non-banking financial company and short-term loan provider to micro, small and medium enterprises, **GoCapital Finance**. The partnership deal involved a 25% stake in GoCapital, which is still subject to regulatory approvals.[5]

Flipkart co-founder Sachin Bansal has picked up a majority 94% stake in a Bengaluru-based microfinance company, **Chaitanya Rural Intermediation Development Services**, in what is probably a stepping stone into the broader financial services space for the internet billionaire[6].

China's **Xiaomi** is poised to launch its Mi Credit service in India, offering loans of up to Rs 100,000 to consumers in the coming weeks.[7] India is Xiaomi's largest market outside China. **Revolut,** the London based branch-less banking unicorn, is also looking to enter India next year[8]. Being one of the fastest growing fin-tech firms in the European market, it is currently exploring options for licensing in the Indian banking system and is actively hiring people for a broad range of roles.

**RECENT LEGAL DEVELOPMENTS**

Regulators in India have been working towards effectively dealing with/ regulating the dynamically evolving fin-tech industry. The regulatory response to fin-tech seems to range from mimicking the traditional regulations to re-aligning regulation to match the changing environment. Following is an account of major regulatory actions/ developments in India:

**Enabling framework for Regulatory Sandbox**

A Regulatory Sandbox ("**RS**") allows the regulator, innovators, financial service providers and customers to conduct live testing of new products or services in a controlled/ test regulatory environment to collect evidence on the benefits and risks of new financial innovations, subject to certain relaxations for the limited purpose of the testing.

In the last few months, three draft regulations for governance of the procedure to set up an RS were issued by the three key regulators - the Reserve Bank of India (the "**RBI**"), the Insurance Regulatory and Development Authority (the "**IRDAI**") and the Securities and Exchange Board of India (the "**SEBI**") with respect to the banking, insurance and securities market sector, respectively.

The enabling framework issued by the RBI permits start-ups, banks and financial institutions to set up an RS for live testing of innovative products in areas like retail payments, digital Know Your Customer (KYC) and wealth management.[9]

The IRDAI has notified the IRDAI (Regulatory Sandbox) Regulations, 2019 (the "**IRDAI RS Regulations**"), and also issued the guidelines on operational issues pertaining to the IRDAI RS Regulations, which outline the procedure to be followed for implementing the RS programme.[10]

In a circular issued in May, 2019, SEBI too released its RS framework, proposing an 'Innovation Sandbox'. In this context, even fin-tech firms, individuals and entities not regulated by SEBI, can test their proposed solutions offline, isolated from the live market, subject to fulfilment of the eligibility criteria.[11]

**Recommendations by the Steering Committee on FinTech related issues in its final report**

The Steering Committee on FinTech related issues constituted by the Ministry of Finance, Department of Economic Affairs (the "**Committee**") submitted its final report in September, 2019.[12] The report outlines the current landscape in the fin-tech space globally and in India and makes recommendations focusing on how fin-tech can be leveraged to enhance financial inclusion of MSMEs with a view to making fin-tech related regulations more flexible and generate enhanced entrepreneurship.

The Committee's report recommends development of a marketplace model for peer-to-peer lending, virtual banking to allow lenders to operate without branches, use of drones for field assessments and artificial intelligence to reduce frauds. The Committee made wide ranging recommendations in its report, including a review of the existing regulatory framework in the financial sector with respect to data protection and privacy concerns, in keeping with emerging data privacy legislation in India.

**Discussion Paper on 'Guidelines for Payment Gateways and Payment Aggregators'**

In another initiative to review the extant regulatory framework, the discussion paper put forward by the RBI[13] covers various facets of the activities of payment gateways and payment aggregators and presents different options/approaches to regulating them. One of the critical options suggesting full and direct regulation will cover among others, the activities of payment gateways and payment aggregators in online transactions, their capital adequacy requirements, governance, safeguards (KYC /Anti-Money Laundering (AML) and Countering Financing of Terrorism (CFT)), merchant on-boarding and settlement and escrow account management, etc.

For instance, under the full and direct regulation approach, capital adequacy norms shall require a minimum net worth of Rs 100 Crores to be maintained at all times, which requirement will be required to be complied with within 1 year from issuance of the proposed guidelines for existing players. Entities which are not able to comply with the net-worth requirement within the stipulated time frame will be required to wind-up their payment aggregation business. Banks presently maintaining nodal accounts of such entities will be required to report compliance in this regard.

Other options/ approaches considered were either to continue with the extant instructions issued to regulated entities in respect of intermediaries, or adopt a limited regulatory regulation approach.

**INDUSTRY CHALLENGES**

While the fin-tech sector is growing at a rapid scale in India, it is faced with certain challenges that have the potential of thwarting the industry's growth.

**Sharing of credit information to non-regulated entities not allowed**

Recently, a Public Interest Litigation ("**PIL**")[14] was filed by a financial economist named Abhijit Mishra seeking to stop banks from sharing the Permanent Account Number (PAN) and financial transaction data of clients with credit rating agencies without the customers' formal consent to them.

As a consequence of the above, the RBI directed commercial banks and non-banking financial companies (NBFC) to stop granting unregulated entities access to consumer data held by credit information companies citing such actions to be in violation of the Credit Information Companies (Regulation) Act, 2005. The RBI has further warned the regulated entities that it may penalise them in case of a breach. A window of 15 days was provided to inform the RBI of the measures taken to curb this practice.

**CryptoCurrency matter before Supreme Court**

The Internet and Mobile Association of India ("**IAMAI**") challenged an RBI notification prohibiting banks and financial institutions from providing services in relation to cryptocurrencies, before the Supreme Court of India[15]. IAMAI's stand is that the RBI did not have the authority to place a ban when there was no legislative policy in place for virtual currencies or without analysing their effect on the economy, citing that the RBI had banned cryptocurrencies on "moral grounds". ***The matter is listed for admission on November 19, 2019.***

The government has separately clarified that despite banking restrictions put in place by the RBI, it is not a blanket ban on trading in cryptocurrencies. A draft bill for banning cryptocurrency has been in the works for some time with the Economic Affairs Secretary leading the exercise. According to the draft "Banning of Cryptocurrency and Regulation of

Official Digital Currency Bill 2019", holding, selling or dealing in cryptocurrencies such as Bitcoin coin may lead to imprisonment for 10 years. Besides making it illegal, the bill makes holding of cryptocurrencies a non-bailable offence.

**PayTM lending matter**

Another public interest litigation was filed earlier this year by the aforementioned petitioner Abhijit Mishra before the Hon'ble High Court of Delhi[16] claiming that Payments Bank Limited ("**PayTM**") has a license to operate as a *payments bank*, and it cannot offer a credit product or disburse loan facilities to customers. The PIL was filed on the ground that PayTM's 'post-paid' credit facility was operating contrary to the existing law and guidelines i.e. Guidelines for Licensing of Payments Banks and the Operating Guidelines for Payments Banks, as issued by the RBI ("**Licensing and Operating Guidelines**"). It also claimed that PayTM, by means of its post-paid service has provided un-monitored and unauthorized access to the personal information such as Aadhaar, Permanent Account Number (PAN), transactions, etc. of its customers to unauthorized third-party vendors.

PayTM's position is that the post-paid facility is a service and not a wallet, which is being provided by Clix Finance India Private limited ("**Clix**"), a non-banking financial company (NBFC) which offers various products in commercial and retail lending. Accordingly, PayTM was not required to notify/ inform the RBI and that there is no violation of the Licensing and Operating Guidelines.

On the privacy issue, PayTM is relying on its data sharing arrangement with Clix regarding the KYC ID data of the customer (available in the central records owned by the government, in relation to which sharing of data for KYC purposes is permitted by the RBI[17] for verification purposes), while asserting that no other personal or sensitive information is being shared with Clix in an unauthorised manner.[18] ***The matter is now listed for November 6, 2019.***

The judgment of the Delhi High Court is likely to impact unregulated companies partnering with regulated entities to offer innovative lending and payment solutions to customers.

**Authors:** Suneeth Katarki | Avimukt Dar | Namita Viswanath | Shreya Suri | Anuradha Singh

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**DISCLAIMER**



[1]https://www.livemint.com/companies/start-ups/india-beats-china-in-fintech-deals-for-the-first-time-ever-1565836175002.html

[2]https://www.livemint.com/companies/start-ups/razorpay-raises-75-mln-from-sequoia-capital-ribbit-capital-1560836308474.html
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[4]https://www.business-standard.com/article/pti-stories/bharatpe-raises-usd-15-5-mn-funding-from-insight-partners-sequoia-and-beenext-119040400497_1.html
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[12] https://dea.gov.in/sites/default/files/Report%20of%20the%20Steering%20Committee%20on%20Fintech.pdf
[13] https://www.rbi.org.in/Scripts/PublicationReportDetails.aspx?UrlPage=&ID=943
[14]W.P. (C) 732/2019 & CM APPL. 3227-3228/2019 before the High Court of Delhi
[15] W.P.(C) No. 000528 of 2018
[16] W.P.(C) 7007/ 2019
[17] Section 14, Chapter V (Customer Identification Procedure) of the Master Direction – Know Your Customer (KYC) Direction, 2016 (https://rbidocs.rbi.org.in/rdocs/notification/PDFs/MD18KYCF6E92C82E1E1419D87323E3869BC9F13.PDF)
[18] Information Technology Act, 2000 read with the Information Technology (Reasonable Security Practices and Procedures and Sensitive Personal Data or Information) Rules, 2011