



FINTECH NEWSLETTER: UNVEILING INDIA'S LATEST LEGAL SHIFTS AND MARKET WAVES

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INTRODUCTION

The year 2023 continued to be arduous for fintech entities in India with a downward trend in funding in comparison to 2022. In 2023, the fintech sector received funding worth USD 2 (two) billion, which is 63% (sixty three per cent) lesser than what the industry had received in 2022.¹ While the numbers in terms of funding saw a decline, globally, India ranked third in terms of fintech startup funding in 2023.² With industry players having expressed their confidence in 2024 witnessing a moderate growth in terms of funding, this is a positive start to the year.³

Separately, on the regulatory side, the Reserve Bank of India ("RBI") has kicked off the year with a forward-looking draft framework for self-regulation of fintech entities, marking a significant step towards achieving a balance between governance and independence of entities in the fintech sector in India. Further, the

Securities and Exchange Board of India ("SEBI") has brought about several key changes in its framework for alternative investment funds ("AIFs"), along with introduction of a consultation paper proposing a relaxed framework for AIFs and venture capital funds to deal with their unliquidated investments after expiration of the fund tenure. That said, the industry also witnessed regulatory actions being taken by the RBI against Paytm, one of the key players in India, causing significant hindrance to its operations.

This edition of the newsletter highlights significant shifts in regulations, prevailing industry hurdles, and noteworthy market dynamics within the realm of Indian FinTech, spanning the period from January 01, 2024 to January 31, 2024.

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INDUSTRY DEVELOPMENTS

RBI imposes extensive restrictions on Paytm Payments Bank Ltd.

The RBI vide a press release issued on January 31, 2024 imposed a slew of restrictions on Paytm Payments Bank Ltd. ("PPBL") in exercise of RBI's powers under Section 35A of the Banking Regulation Act, 1949 for "*persistent non-compliances and continued material supervisory concerns*".⁴ Earlier in January, in a separate action, the Indian Highways Management Company (the toll collection arm of the National Highways Authority of India) had barred PPBL from issuing fresh FASTags after an audit found that PPBL was not complying with the parameters prescribed in the service level agreement.⁵

As on January 31, 2024, the RBI action barred deposits or credit transactions or top-ups after February 29, 2024 in any PPBL customer accounts, prepaid instruments, wallets, FASTags, National Common Mobility Cards ("NCMC"), etc. However, interest, cashbacks, or refunds can be credited. Withdrawal or utilisation of funds by customers from any of their PPBL accounts including savings bank accounts, current accounts, prepaid instruments, FASTags, NCMCs, etc. are permitted without any restrictions, up to their available balance. No other banking services, other than the aforesaid can be provided by PPBL after February 29, 2024 (as on January 31, 2024). The RBI has also directed that the nodal accounts of One97 Communications Ltd. (the parent entity of PPBL) and Paytm Payments Services Ltd. (the payments arm of PPBL) are to be terminated at the earliest, in any case not later than February 29, 2024. Settlement of all pipeline transactions and nodal accounts (in respect of all transactions initiated on or before February 29, 2024) have to be completed by March 15, 2024, and no further transactions are to be permitted thereafter.

On March 11, 2022, RBI had prohibited PPBL from onboarding new customers with immediate effect. The relevant official press release⁶ at the time had stated that the prohibition was based on "*certain material supervisory concerns observed in the bank.*" PPBL was directed to appoint an IT audit firm to conduct a comprehensive system audit. The lifting of the prohibition was to be dependent on RBI's specific permission and the report of the IT auditors. The RBI has now said that the 'comprehensive system audit' report and subsequent compliance validation report of the external auditors revealed persistent non-compliances and continued material supervisory concerns at PPBL, warranting further supervisory action.

Several stakeholders in the fintech startup ecosystem viewed the RBI's action as "*excessively stringent*" with the potential to result in far-reaching adverse consequences for the sector as a whole. Another startup founder expressed discontent with the regulator's decision, calling the act an "*overreach*" that could kill the fintech ecosystem altogether.⁷ While many industry players viewed the decision as disproportionate, some stakeholders deemed the RBI's action as a step towards ensuring that fintech startups focus on compliance and institutional accountability. A director of a fintech startup indicated that the decision would prompt other players in the ecosystem to remain vigilant regarding directives from the regulator.⁸ Some investors in the industry also expressed faith in the RBI's decision-making process and the regulator's commitment to promoting systematic growth.⁹

The RBI's decision has led to renewed emphasis by investors in the fintech space on examining the impact of regulations on a business model from a long-term perspective. Now, investors will be looking towards individuals with expertise on regulatory matters prior to making investment decisions. Many industry stakeholders have expressed that the decision will increase investor scrutiny of regulatory matters in the fintech ecosystem. Some investment entities believe that the RBI's decision is merely going to push investors to exercise greater caution where "*regulatory clarity is less*" and will not significantly reduce investor interest in the fintech space.¹⁰ Overall, the decision appears to have shaken investor confidence, and many industry players expect an increased risk premium on future investments in the fintech space.

RBI Governor says 'whitelist' of digital lending apps shared with MeitY

Speaking at a public event, RBI Governor Shaktikanta Das stated¹¹ that RBI has already given a 'whitelist' of legitimate digital lending apps to the Ministry of Electronics and Information Technology ("MeitY"). However, at this stage, it is unclear¹² whether MeitY will make the list public.

As per news reports, the list consists of the names of digital lending apps that are seen as being operated in compliance with the applicable laws including the Guidelines on Digital Lending, 2022. This 'whitelist' is in pursuance of a decision that was taken in September 2022 at a high-level meeting chaired by Union Finance

Minister Nirmala Sitharaman specifically on the issue of 'illegal loan apps' which was also attended by RBI representatives.¹³

In response to a question asked in Parliament in the Budget Session 2024, the Union Ministry of Finance confirmed that RBI *vide* letter dated October 09, 2022 and e-mail dated January 19, 2023 had, in fact, shared with MeitY a list of 442 (four hundred and forty-two) unique digital lending apps used by the regulated entities, for the purpose of whitelisting and the same has been shared with prominent application stores.

Updates on digital payment products

NPCI commences pilot for UPI for Secondary Market:

In December 2022, the RBI had announced¹⁴ the 'single block and multiple debits' functionality for Unified Payments Interface ("UPI") payments. Now, based on SEBI's approval, the National Payments Corporation of India ("NPCI") has launched¹⁵ the pilot for 'UPI for Secondary Market' from January 01, 2024, with the collaborative support of key stakeholders including clearing corporations, stock exchanges, depositories, stockbrokers, banks, and UPI app providers. Initially, this functionality will be available for a limited set of pilot customers of HDFC Bank and ICICI Bank. During this pilot, investors can block funds in their bank accounts, which will only be debited by the clearing corporations upon trade confirmation during settlement.

IMPS transfers will no longer require bank account number:

In October 2023, it was reported¹⁶ that NPCI was contemplating an easier user flow for the Immediate Payment Service ("IMPS") whereby the payment could be completed with only the beneficiary's mobile number and name of the bank. This new feature will now go live February 01, 2024 onwards.

Cross-border payments using UPI: The NPCI eased making cross border payments with Singapore, by allowing Indians to transfer money from Singapore using major UPI applications such as Paytm, PhonePe as well as applications of banks including ICICI Bank and Axis Bank.¹⁷ Following a Memorandum of Understanding signed between Google India Digital Services Pvt. Ltd. ("Google Pay")ⁱ and NPCI International Payments Ltd,¹⁸ a wholly-owned subsidiary of NPCI, Google Pay has recently joined PhonePe and Paytm in offering its UPI services to those travelling abroad.¹⁹

Paytm investment into GIFT City

Recently, One97 Communications Limited, the parent entity of the fintech giant Paytm, announced that it would invest approximately USD 12.04 (twelve point zero four) million in Gujarat International Finance Tec-City ("GIFT City"). Among other things, Paytm plans to utilise the investment towards setting up a development centre in GIFT City in order to build cross-border solutions and to build various financial products and services.²⁰

Action against virtual digital assets service providers

On the side of virtual digital assets ("VDAs"), January 2024 continued to witness an increase in action against VDA service providers servicing customers in India. Following the action by the Financial Intelligence Unit – India, the MeitY ordered a takedown of applications of several popular entities following which their applications were taken off the Google Play Store and the Apple App Store.²¹

Action against Chinese loan applications

It is also relevant to note that in light of the continued action being taken against illegal lending platforms, the Ministry of Corporate Affairs ("MCA") is contemplating cancelling the registration of Chinese loan app operators and freezing their accounts, in the event the ongoing probe conducted against them indicates that they have committed fraud. The MCA's investigation teams have been conducting raids on such operators, who have been accused of engaging in fraudulent and extortive practices against borrowers.²²

Proposed law on anti-competitive practices in the digital economy

With a view of ensuring that large players such as Facebook, Amazon and Google ensure that their operations are conducted in a competitive manner, the MCA has set up an expert panel, which is all set to submit its report and propose a new bill. The MCA will invite stakeholder feedback on the report, upon its submission. Further, the proposed bill will aim to ensure that search engines, marketplaces and social media platforms do not engage in anti-competitive practises and ensure that they are operating in a fair manner.²³

i. Google Pay is a client of IndusLaw.

REGULATORY UPDATES

RBI invites comments on draft framework for recognising self-regulatory organisations for the fintech sector

The RBI on January 15, 2024, issued²⁴ a draft framework²⁵ which is proposed to serve as the basis for recognising self-regulatory organisations ("SROs") for entities in the fintech sector ("SRO-FT"). The SRO-FT recognition framework (as may be finalised by the RBI after receiving public comments on this draft) will prescribe the broad objectives, functions, eligibility criteria, governance standards, application process and other basic conditions for grant of recognition as SRO-FT.

The draft framework envisages SRO-FTs to strive towards a healthy and sustainable development of the fintech sector. The draft has adopted a principles-based approach on most aspects and does not prescribe a set mechanism. The draft states that the SRO-FT should motivate its members to align with regulatory priorities and develop a culture of compliance. The draft framework states that to maintain credibility, the SRO-FT should operate independently, free from the influence of any single member or group of members.

The draft framework also proposes that the SRO-FT should be empowered to investigate and take disciplinary action against its members for non-adherence to codes/standards/rules. It also requires that an SRO-FT applicant should be set up as a not-for-profit company registered under Section 8 of the Companies Act, 2013 but it will be allowed to have fintech members domiciled anywhere.

This is the second attempt by the RBI to create an SRO for the fintech industry. In 2020, the RBI had released guidelines for a payments SRO. While a few entities have applied for recognition under previous guidelines, final approval from the RBI is still awaited.

SEBI amends Alternative Investment Funds Regulations

On January 05, 2024, the SEBI issued the Securities and Exchange Board of India (Alternative Investment Funds) (Amendment) Regulations, 2024²⁶. These amendments introduce certain changes to improve the regulatory framework governing AIFs by introducing amendments to the Securities and Exchange Board of India (Alternative Investment Funds) Regulations, 2012 ("AIF Regulations"). Regulation 15 of the AIF Regulations has been amended, now requiring AIFs to hold their investments in dematerialised form. However, the

amendments also provide certain exceptions to allow flexibility for investments not eligible for dematerialisation or those held by liquidation schemes. In Regulation 20 (*Custodian Appointment and Reporting*), sub-regulation (11) of the AIF Regulations has been substituted with new text whereby (i) the requirement to appoint a custodian has been extended to all AIFs irrespective of the corpus size, subject to conditions as may be prescribed by SEBI (earlier, the corpus size had to be more than INR 500 (five hundred) crore for this requirement to apply); and (ii) custodians are required to report or disclose information regarding investments of the AIF to SEBI in such manner as may be specified.

SEBI issues circular on voluntary freezing/blocking facility for trading accounts

Vide a circular²⁷ issued on January 12, 2024, SEBI has proposed that the trading members provide a facility of voluntary freezing/blocking of the online access of the trading account to their clients in the case of any suspicious activities. SEBI has stated in the aforesaid circular that sometimes even though suspicious activities are noticed by investors, the facility of freezing/blocking of accounts is not available with a majority of trading members. Consequently, SEBI is of the view that there is an urgent need to address the situation and have a facility for blocking of trading accounts as is available for blocking of ATM cards and credit cards.

The circular states that the framework for this shall be laid down by the Brokers' Industry Standards Forum on or before April 01, 2024, and the stock exchanges shall ensure that the guidelines so issued are implemented by trading members with effect from July 01, 2024. Stock exchanges will be required to put in place an appropriate reporting requirement by trading members to enforce the framework. Stock exchanges will have to submit a compliance report to SEBI by August 31, 2024.

SEBI amends Master Circular on AIFs pursuant to amendments to the Prevention of Money Laundering (Maintenance of Records) Rules, 2005

In exercise of its powers under Section 11(1) of the Securities and Exchange Board of India Act, 1992 and vide a circular²⁸ issued on January 11, 2024, SEBI has amended the Master Circular on AIFs dated July 31, 2023.²⁹ This is pursuant to the amendments made to the Prevention of Money Laundering (Maintenance of

Records) Rules, 2005 ("**PML Rules 2005**") on March 07, 2023, and September 04, 2023. These changes to the PML Rules 2005, which revise thresholds for determining beneficial ownership, necessitated amendments to the SEBI Master Circular on AIFs.

Consequently, para 4.1.2 under Chapter 4 (Investment in AIFs) of the SEBI Master Circular on AIFs dated July 31, 2023 stipulates that the investor or the beneficial owner as determined under the PML Rules 2005 should not be person(s) mentioned in the 'Sanctions List' notified from time to time by the United Nations Security Council (UNSC) and should not be resident in a country identified by the Financial Action Task Force ("FATF") as either a jurisdiction having deficiencies in relation to 'Anti-Money Laundering or Combating the Financing of Terrorism' measures and has not made sufficient progress in either addressing them nor is it committed to an action plan with the FATF in that regard.

The amendment circular also states that in case an investor who has been already on-boarded to the scheme of an AIF, does not meet the revised condition, the manager of the AIF shall not drawdown any further capital contribution from such investor for making investment, until the investor meets the said condition. This amendment has come into force with immediate effect.

SEBI consultation paper proposes relaxation in norms for AIFs to deal with unliquidated investments

SEBI, in a consultation paper issued on January 12, 2024, has proposed a relaxed framework³⁰ for AIFs and venture capital funds ("**VCFs**") to deal with their unliquidated investments after the fund tenure expires. SEBI has proposed allowing AIFs a dissolution period even after their scheme's tenure to manage unliquidated investments, eliminating the mandatory launch of a liquidation scheme for this purpose. Moreover, the consultation paper proposes a one-time flexibility extension for AIF schemes with expired liquidation periods to address unliquidated investments. Additionally, SEBI has also proposed that VCFs can migrate to the AIF regime to avail the longer window for liquidating their investments. Currently, VCFs have to liquidate their investments within 3 (three) months of the fund expiring, while AIFs have a 12 (twelve) month

window.³¹ SEBI will finalise the framework after taking into consideration the comments and feedback received.

Indian companies can now list directly on GIFT City's international exchanges

On January 24, 2024, the Union Ministry of Finance announced³² that Indian companies can now directly list their shares on international stock exchanges located in the GIFT City. This has been done through an amendment to the Foreign Exchange Management (Non-debt Instruments) Rules, 2019³³ including the insertion of the 'Direct Listing of Equity Shares of Companies Incorporated in India on International Exchanges Scheme'. Simultaneously, the MCA has issued the Companies (Listing of Equity Shares in Permissible Jurisdictions) Rules, 2024.³⁴

This move is expected to enable startups and unlisted companies to access global capital and raise funds from foreign entities. However, currently, only unlisted public Indian companies can list their shares on international exchanges. SEBI is in the process of issuing the operational guidelines for listed public Indian companies. Private companies, which are mostly startups, are ineligible to list on international exchanges. Additionally, the MCA has issued rules for governing the listing of equity shares in permissible jurisdictions, where it has specified that Nidhi companies, companies with negative net worth, and those with outstanding deposits from the public will not be eligible for listing.³⁵

RBI amends the Master Direction on KYC

Vide a notification³⁶ issued³⁷ on January 04, 2024, the RBI has amended the Master Direction on KYC ("**KYC MD**").³⁸ In the existing KYC MD, the definition of "Politically Exposed Persons" ("**PEPs**") was provided in sub-clause (xvii) of clause (a) of Section 3 of the KYC MD. However, in order to provide better clarity, the RBI has decided to include the definition of PEPs as an explanation to Section 41 of the KYC MD as follows: "*Explanation: For the purpose of this Section, "Politically Exposed Persons" (PEPs) are individuals who are or have been entrusted with prominent public functions **by a foreign country**, including the Heads of States/Governments, senior politicians, senior government or judicial or military officers, senior executives of state-owned corporations and important political party officials.*"

MAJOR DEALS IN INDIAⁱⁱ

78% (seventy-eight per cent) startup founders are optimistic about 2024 being a lucrative year in terms of fundraising for the startup ecosystem.³⁹ January 2024 has already witnessed a surge in market activities in the fintech space. 5 (five) companies including Zomato and Digio received their payment aggregator license from the RBI.⁴⁰

MAJOR FUNDING DEALS

SalarySe, a fintech startup building a platform to offer credit to employees of mid-tier companies, has raised USD 5.25 (five point twenty-five) million in its first institutional funding round. The round saw participation from Peak XV's seed fund Surge and Pravega Ventures. The startup intends to use the funds for the purpose of building its platform and ramp up its technology stack, which will offer credit that can be utilised through UPI payments.⁴¹

Mobikwik, a fintech start-up, has recently filed its draft red herring prospectus with the SEBI in relation to its proposed initial public offering of up to USD 84 (eighty four) million (approx.).⁴² ⁱⁱⁱ It has also raised a term loan of approximately USD 1.2 (one point two) million from Equentia Financial Services Private Limited, which it intends to use for its working capital needs.⁴³

BharatPe, a fintech unicorn has recently marked the final close of its USD 100 (one hundred) million debt round led by InnoVen Capital in the range of USD 60 (sixty) million – USD 70 (seventy) million. With an aim to avoid dilution at a juncture where the unicorn is approaching break-even, the company has chosen to raise funds through debt over equity.⁴⁴

FinnAGG Technologies, a fintech startup that offers credit solutions to distributors, retailers and micro, small and medium enterprises, has raised USD 11 (eleven) million as a part of its Series A funding round. This round was co-led by BlueOrchard and Tata Capital Limited, and also saw participation from Small Industries Development Bank of India and existing investor Prime Venture Partners. The startup aims to utilise the fresh infusion of funds for expanding its offline and online presence, enhancing global outreach and driving product innovation.⁴⁵

Softbank, the Japanese conglomerate, has recently scored returns of USD 650 (six hundred and fifty) million from its exit from PB Fintech, the parent entity of PolicyBazaar, which is an insurance aggregator. Softbank had initially invested around USD 200 (two hundred) million in the early days of PB Fintech.⁴⁶ SoftBank has also off-loaded 2% (two per cent) of its stake in One97 Communications, the parent company of Paytm, for USD 114 (one hundred and fourteen) million.⁴⁷

Zestmoney, a buy-now-pay-later ("BNPL") startup, has been acquired by the DMI Group, in a distressed sale. The deal amount has currently not been reported by the entities. As a result of this acquisition, the DMI Group will have exclusive right to the use of all Zest brands and DMI Finance will be the preferred lender on the BNPL platform of Zestmoney. The DMI Group also intends to deploy ZestMoney's checkout financing platform to its product suite to widen its engagement with customers.⁴⁸

Upswing Financial Technologies, a startup which provides banking-as-a-service platform, has raised USD 4.2 (four point two) million, in its pre-series A funding round. The round was led by venture capital firm Quona Capital, and witnessed participation from existing investor, QED Investors. The startup intends to utilise the fresh infusion of funds towards expanding the footprint of its multi-bank deposit product as well for building new products in deposits and lending.⁴⁹

FPL Technologies, the parent-entity of OneCard, has raised USD 14.4 (fourteen point four) million, from venture debt fund, Alteria Capital. OneCard aims to utilise the funding towards innovation of products and enhancement of customer experience.⁵⁰

Varthana, an education-focussed fintech startup, has raised USD 14 (fourteen) million from its existing investor Blue Earth Capital. The fintech startup intends to deploy the funds towards expanding financial support to a wider network of affordable private schools in India.⁵¹

Riskcovry, an insure-tech startup which facilitates insurance infrastructure for platforms and vendors seeking to offer insurance products, has raised around USD 4.5 (four point five) million in a bridge funding round. The round was led by Morphosis Venture Capital

ii. To the extent any transactions involve clients of IndusLaw, the information herein is based on statements in the media and not our professional knowledge of the relevant transaction.

iii. IndusLaw advised Mobikwik in this proposed IPO.

and saw participation from IIFL. The startup plans to use the funds to push towards profitability and eventually towards a Series B round of funding.⁵²

Vivifi India Finance Pvt Ltd, a non-banking financial company ("NBFC"), has raised USD 75 (seventy-five) million in its Series B funding round. The NBFC has raised these funds in a mix of debt and equity, from an investor based in the United States of America (USA). The NBFC has intentions of channelling the fresh infusion of capital towards expansion of its reach to more consumers and expansion of its workforce.⁵³

Namdev Finvest Private Limited, an NBFC which offers financial solutions in rural India, has raised USD

15 (fifteen) million in its Series B funding round. The round witnessed participation from British International Investment and LC Nueva AIF, and existing backer Incofin India Progress Fund. The NBFC intends to utilise the capital for expanding its reach, enhancing product diversification, technology enhancement and for contributing to the economic empowerment of the underserved segment in India.⁵⁴

Ecofy, an NBFC focussed on green energy, has raised USD 10.8 (ten point eight) million in an equity round from Dutch entrepreneurial development bank FMO. The NBFC plans to use the fresh infusion of funds to grow its loan book, enable product diversification and expansion across the country.⁵⁵



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