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Fintech: Regulatory Framework in India

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ABSTRACT

Fintech refers to businesses that enhance or automate financial services and operations through the use of technology. The words "finance" and "technology" are combined. The expression alludes to a swiftly developing industry that offers numerous advantages to both businesses and consumers. Fintech has a wide range of uses, including bitcoin, investing, insurance, and mobile banking apps. Currently, a wide range of industries and professions are referred to as "fintech," including nonprofit fundraising, retail banking, investment management, and education. Modern fintech is primarily driven by AI, big data, and blockchain technology, which have profoundly altered how organizations move, store, and protect the digital currency. FinTech's introduction of crowdfunding platforms has enhanced consumer interactions. It makes it possible for small businesses, entrepreneurs, charities, and artists to raise money without the aid of traditional investors. Social transformation is a key goal shared by many Fintech companies, particularly those operating in poor nations. Government support has been crucial in providing both necessary enabling support and regulation. Numerous government initiatives have fueled the growth of the Fintech industry in India, whether they be broadband infrastructure to promote internet access in rural areas or digital literacy and financial programs. The primary regulator of the fintech sector is the RBI, which is responsible for regulating payments and settlement procedures in India. The RBI is in charge of regulating international and foreign exchange transactions. In addition, the RBI regulates banks, NBFCs, and other financial participants in the ecosystem, including credit reporting agencies. ("CICS"). Given the nature of fintech offerings, additional regulators including SEBI, IRDA, the Ministry of Electronics and Information Technology ("Meity"), and the Ministry of Finance may also be pertinent.

Keywords: *Fintech, SEBI, IRDA.*

I. INTRODUCTION

Financial technology (better known as Fintech) is used to define cutting-edge technology that aims to enhance and automate the provision of financial services. The financial industry is changing drastically. The COVID-19 epidemic has expedited the transformation of payments, loans, insurance, and wealth management brought about by digital technologies. Fintech, at its

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core, helps organizations, business owners, and individuals better manage their financial operations, processes, and lives by using specialized software and algorithms that are used on computers and, increasingly, smartphones. The term "financial technology" is combined with the word "fintech." Fintech refers to companies that utilize technology to improve or automate financial services and operations. It is a mix of the terms "financial" and "technology." The phrase refers to a quickly expanding sector that benefits both consumers and companies in various ways. Fintech has a wide range of applications, including mobile banking, insurance, and investment apps as well as cryptocurrency. Currently, the term "fintech" is used to describe a wide range of professions and businesses, including investment management, retail banking, education, and nonprofit fundraising, to name a few. The creation and application of cryptocurrencies like Bitcoin are also a part of fintech. Today, the fintech industry is huge. And if recent venture capital investments in fintech startups — which reached an all-time high in 2021[2] can be considered a vote of confidence, the industry will continue to expand for years to come. The fintech sector has evolved and experienced exponential expansion over time.

Fintech, often known as financial technology, seeks to modernize and automate the usage of financial services. It makes it possible for enterprises, corporations, and individuals to efficiently manage their financial operations and payments. By implementing fintech laws and regulations, financial institutions, service providers, and customers are all protected from harm. One motivating aspect is the fact that many conventional banks actively assist and adopt cutting-edge fintech, buying or partnering with fintech businesses. Those are strategies that established banking institutions can use to satisfy the demands of customers who are tech-savvy while also advancing the sector and remaining current. The traditional international banking sector, with its multi-trillion dollar market capitalization, continues to be where the big money is, even though that fintech sector may garner the majority of headlines.

Regulators are finding it challenging to stay up with the most recent technological advancements to tailor the fintech rules appropriately as a result of the rapid advancement of technology. Regulators and policymakers must be aware of the most recent advancements in fintech to adopt policies that will improve service without jeopardizing security. Potential hazards like fraud, breaches, and cybersecurity risks are on the rise as fintech expands. Security and market integrity may be compromised by new payment systems and models. Customers who are unaware of the hazards or unable to accept them may be sold new products and services. The risks of fraud and hacking are growing for distributed ledger technology (DLT), blockchain,

[2] Sam Daley, Fintech- What is Fintech? Financial Technology Definition, Builtin, (Aug. 18, 2022) https://builtin.com/fintech

and crowdfunding. Financial services are the most strictly regulated industry in the world as a result of these hazards that are inherent in the finance industry. The internal workings of various financial technology products and services vary. Some of the most recent innovations use machine learning algorithms, blockchain technology, and data science to handle credit risks, manage hedge funds, and do other things. Concerns concerning cybersecurity have grown along with the finance industry. The tremendous growth of fintech enterprises and marketplaces on a global scale has made fintech infrastructure increasingly exposed and a target for cybercriminals. Thankfully, technology is always developing to lower current fraud risks and neutralize new threats.AI, big data, and blockchain technology are the main forces behind modern fintech, and they have all fundamentally changed how businesses move, store, and safeguard digital currency. In particular, AI may help firms better understand their clients by giving them insightful data on consumer behavior and purchasing patterns. Big data analytics can assist businesses in forecasting changes in the market and developing fresh, data-driven business plans. Blockchain, a more recent financial technology, enables decentralized transactions without the involvement of a third party by using a network of users to monitor prospective additions or modifications to encrypted data. Consumers trust fintech businesses generally; according to Forbes, 68% [3]of individuals are eager to use financial instruments created by non-traditional (e.g., non-finance, non-banking) institutions. However, because many fintech applications are still in their infancy, they are not currently governed by the same safety standards as banks. This is not to say that customers shouldn't put their trust in fintech companies; it just means that exercising caution can be advantageous. The advantages of cooperating with a fintech company outweigh the perceived risks for the majority of consumers.

In addition to facilitating faster and easier banking, technological advancements have a wide range of effects. FinTech has improved customer relationships by introducing crowdfunding platforms. Without the help of traditional investors, it enables small enterprises, entrepreneurs, charities, and artists to gain funding. Another major objective that many Fintech companies, particularly those in the developing world, strive to achieve is social transformation. People in underdeveloped countries increasingly have access to digital lending platforms including microlending. Payment services can now be used in parts like Africa, Asia, and India which had a huge population of people who were underserved by conventional banks. The insurance sector was also affected by fintech (sometimes known as "InsureTech"), which included everything from online. Up until recently, financial services organizations provided a range of services

[3] What is Financial Technology (FinTech)? A Beginner’s Guide for 2022,Columbia Engineering Boot Camps, (2022), https://bootcamp.cvn.columbia.edu/blog/what-is-fintech/

under one roof. These services covered a wide range of things, from conventional banking operations to mortgage and trading services. Fintech unbundles these services into separate offerings in its most basic form. Fintech companies can be more effective and reduce transaction costs by combining technology with solutions that are simplified. The word "disruption" best captures how many fintech innovations have changed traditional trading, banking, financial advice, and products. Financial services and products that were previously only available through branches, salespeople, and desktop computers are now available through mobile devices or simply move away from powerful, entrenched institutions. Many people believe fintech to be a relatively recent invention, however, this is not true. Although it has changed a lot in the previous ten years, most of that can be attributed to advances in technology that are now being used in the banking industry. Since the introduction of the first automated teller machine (ATM) in the 1960s, financial institutions have used technology to streamline service delivery and reduce costs. Even in comparison to cash and checks, credit cards—which exist before ATMs—was a revolutionary technological development in the payments industry. Many different technologies are supporting different fintech, business models. They consist of robotic processing automation, AI, machine learning, and blockchain technology, among other big data applications (RPA).

In general, India offers a large variety of fintech products. Based on these offerings, the sector has seen the growth of several sub-sectors, including online payments, digital lending, wealth management (invest-tech), personal finance management, insurance technology (InsurTech), etc. The regulatory focus of the RBI in the fintech ecosystem can be focused on the following fintech entities in the ecosystem, even though these are broad categories that tend to change with innovation in the industry: payment system operators ("PSOS"), which include PPIs, and National Payments Corporation of India ("NPCI"), a payment system that runs several well-known payment systems. In India, such as payment aggregators, RuPay (a card payment network), and Unified Payment Interface ("UPI"). There are over 2100 Fintech companies in India, out of which more than 67 percent have been set up in the last five years.

India’s Fintech segment has also seen exponential growth in funding; investments worth more than US$8 billion were received across various stages of investment in 2021.[4] Some of the main forces influencing the Fintech revolution in India are supply-side enablers like exponentially growing computing power, widespread internet penetration, and increased internet speed and coverage, combined with demand-side stimulants like the need for inclusive financial services,

[4] Naina Bhardwaj, What Trends are Driving the Fintech Revolution in India?, India Briefing,(June. 9, 2022), https://www.india-briefing.com/news/what-trends-are-driving-the-fintech-revolution-in-india-23809.html/

customer expectations, and the business need to reduce costs while providing faster, safer, and more reliable services. Super applications have also emerged as a result of the increased prospects for income diversification that have been identified as Fintech platforms and services developed with a strong user base and product-market fit. Super applications combine a variety of services under one roof to enable numerous daily use cases. Super applications are gaining ground on the Indian market thanks to rising levels of digitization, cheaper cellphones, and a COVID-induced demand for digital services. It's also important to note that BigTech companies like Google, Amazon, and WhatsApp have adjusted their offerings to offer customized services in India, such as Google Pay, Amazon Pay, and WhatsApp Payments, respectively.[5] payment app Paytm is also expected to develop into a Super app. On the same platform that also integrated e-commerce, value-added services for merchants, and consumer internet services (such as gaming and entertainment), Paytm has included financial service products and services, including payment, lending, investment, and insurance. There are currently 187 unicorns in the fintech sector worldwide, 21 of which are located in India. The names of these companies are Acko, BharatPe, BillDesk, Chargebee, Paytm, Oxyzo, PhonePe, Pine Labs, Coin DCX, Coinswitch Kuber, CRED, Slice, Razorpay, Cred Avenue, DIGIT, Groww, Policy Bazaar, Zerodha, Zeta, and Open. The newest members of the unicorn club in 2022 were Open (a fintech neo bank) and Oxyzo (a fintech marketplace and SME loan platform).[6] To monetize the data and user base, the majority of these platforms have now adopted financial services re-bundling by combining several services under one roof. These businesses cross-sell various financial services and products.

For instance, Pine Labs, formerly a POS/Payment gateway company, has expanded into merchant lending, rewards and loyalty programs, consumer finance, net banking, and value-added services for retailers. Similar to Yono, which was originally primarily a digital banking platform, the business today also offers pre-approved consumer loans, insurance, and online shopping. The first consumer-focused fintech product in India was internet-based banking. While Internet banking developed over time to become a classic fintech product, client adoption of fintech solutions in India did not pick up steam until demonetization in 2016.[7] Due to this disruption, fintech businesses were able to expand and provide customers digitally first financial goods like digital lending, digital insurance, discount brokerage, wallets, and payments.

[5] Ibid

[6] Emmanuel Christi Das, Spotlights, with Fintechs Leading the Pack, Silicon India Starup City, https://startup.siliconindia.com/editorial/spotlights-with-fintechs-leading-the-pack-nwid-33610.html

[7] Jaikrishnan G, Fintech Regulations: A No Man's Land, Financial Express, (July. 5, 2022, 6:33pm) https://www.financialexpress.com/money/fintech-regulations-a-no-mans-land/2583873/

Additionally, important factors in boosting consumer adoption of these digital-first business models were the India stack and the Pandemic. This modern fintech serves its consumers through strategic partnerships with banks, NBFCs, and insurance firms. They were not and still are not licensed by India's Central Bank. The RBI Governor's denial of the requirement for such a license framework further lessens their last remaining chance of eventually transitioning to a fully digital bank under a different license regime. The fintech industry in India has brought about a wide range of changes in how the general public transacts and how financial service institutions operate. Fintechs were able to reduce the inherent friction in the India Financial Services ecosystem by using cutting-edge technology and new people. To expand credit, banks and NBFCs have teamed with digital lending-focused fintech startup distribution across the various strata’s population by leveraging technology to create smoother customer journeys and shorter turnaround times.

Government support has been essential, both in terms of regulation and in terms of offering vital enabling support. Whether it is digital literacy and financial programs or broadband infrastructure to improve internet access in rural regions, numerous government initiatives have propelled the expansion of the Fintech business in India. These include the National Common Mobility Card (NCMC), Startup India, Digital India program, India Stack, E-RUPI, licenses for payments banks, Jan Dhan Yojana, recognition of peer-to-peer lenders as NBFCs, regulatory sandboxes by the RBI, and IRDAI for Fintech. Additionally, a strong public digital infrastructure supported by Aadhar, UPI, account aggregation, etc. as well as a favorable regulatory environment have facilitated and accelerated India's technological revolution. Numerous actions have been taken by regulators (RBI, IRDAI, and SEBI) to guarantee improved accountability and the constant accessibility of low-cost, secure digital financial systems.

India's Unified Payments Interface (UPI) had 261 banks participating as of October 2021, and it had recorded 4.21 billion monthly transactions totaling more than US$100 billion.[8] As part of the second cohort under its regulatory sandbox framework, the Reserve Bank of India recently chose Open Financial Technologies Pvt Ltd to develop a blockchain-based cross-border payment system. The start-up would employ Hyperledger Fabric, a Linux-based open-source blockchain, for the cross-border payment system covered by the RBI's regulatory sandbox. Cross-border payments currently come in two flavors: Rupee Drawing Arrangement (RDA), which is used for individual remittances, and Online Payment Gateway Service

[8] Supra note 4

Providers (OPGSP), which is utilized for exporters' financial transfers. In 2020, the International Financial Services Centre Authority (IFSCA) was also founded. India's International Financial Services Centre serves as a single authority for the development and supervision of financial products, financial services, and financial institutions in India’s International Financial Services Centre (IFSC). According to data from the Telecom Regulatory Authority of India, the total number of internet users in India climbed from 795.18 million at the end of December 2020 to 825.30 million at the end of March 2021, registering a quarterly growth rate of 3.79 percent (TRAI). India's active internet user base is anticipated to grow even further, mostly due to the high rate of rural adoption. According to other projections, India will gain 140 million middle-class and 21 million high-income families by the year 2030, fueling demand and expansion in the country's Fintech sector.[9] The development of the fintech department at India's Reserve Bank of India is another stark indication of the sector's significance (RBI). A fintech division was established by the RBI in 2018 under its regulation department. In 2020, this division was transferred to the department of payments and settlement systems, where the majority of fintech-related operations were regulated. The RBI established a specialized fintech department in early 2022 with an emphasis on supporting innovation, recognizing potential and difficulties, inter-regulatory coordination, and so forth. Additionally, it manages projects for the Reserve Bank Innovation Hub's secretariat, the Central Bank Digital Currency ("CBDC"), and the Regulatory Sandbox. The RBI has been attempting to stay up with fintech advancements in India, and its declared approach to regulation has always been centered on the needs of the client. The majority of Indian "regulated entities," such as banks and non-banking financial companies (or "NBFCs"), are typically tech-focused organizations that are subject to distinct regulations. Over several years, the RBI has developed several rules and directives that control the product offerings of fintech companies. The financial regulators in India are dispersed. The RBI, which oversees payments and settlement activities in India, is the major regulator of the fintech industry. The RBI also oversees the regulation of cross-border and foreign exchange operations. Additionally, the RBI oversees credit reporting agencies as well as other financial players in the ecosystem, including banks, NBFCs, and others. ("CICS"). Other authorities, such as SEBI, IRDA, the Ministry of Electronics and Information Technology ("Meity"), and the Ministry of Finance, may also be relevant given the nature of fintech offerings. Separately, NPCI, a not-for-profit organization that the RBI has authorized as a PSO for numerous well-known payment systems, is not a governmental body.[10] Separately, while

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[9] *Ibid*

[10] Vaibhav Kakkar, Sahil Arora, Gangesh Varma, Keshav Pareek, Fintech Laws and Regulations 2022 India, Global Legal Insights, https://www.globallegalinsights.com/practice-areas/fintech-laws-and-

though NPCI is a not-for-profit organization that is not a statutory authority and has been approved by the RBI as a PSO for several well-known payment systems, including RuPay (a card payment network) and UPI, its function is now equivalent to that of a quasi-regulatory body. There are numerous system participants and third-party technology app providers in the aforementioned payment systems run by NPCI. (TPAPS), which are controlled by NPCI's procedural directives, circulars, and instructions. Cross-border payments are a priority of the RBI Payments Vision 2025, which was released by the central bank in June 2022. NPCI International Payments Limited ("NIPL"), a wholly owned subsidiary of NPCI, was founded to deploy Rupay and UPI outside of India to increase its worldwide influence.[11] Agreements with France, Singapore, the UAE, and the UK have developed from bilateral cooperation to promote UP in other nations. The NPCI is also aggressively working to connect UPI to other nations and hopes to give ex-pats a convenient and affordable way to send money home. To control the processing of payments for cross-border transactions of goods and services, the RBI published Guidelines for Online Payment Gateway Service Providers in 2015. ("OPGSP Guidelines"). Recently, in April 2022, the RBI decided to review the aforementioned OPGSP Guidelines and issued proposed guidelines titled "Processing and Settlement of Small Value Export and Import Related Payments" facilitated by Online Export-Import Facilitators ("OEIF Guidelines"), which aim to update the legal framework governing online cross-border payments for the purchase of goods and services. The OPGSP Guidelines are still in effect because the OEIF Guidelines are still only in draught form and have not yet been officially announced by the RBI. Furthermore, the provisions of Indian exchange control regulations apply to cross-border transactions and notifications and directions issued by the RBI also assume relevance. The Framework for Recognition of Self-Regulatory Organizations for PSOs, developed by the Reserve Bank of India, is projected to play a significant role in ensuring the safety and caliber of PSO services in India. The implementation of NUEs in the retail industry is also expected to have an impact on how FinTech is implemented in the retail industry.

The Government established a committee to develop a framework for controlling non-personal data, and it just released its Report on Governance of Non-Personal Data, which suggests legislation for controlling non-personal data as well as the establishment of a new statutory authority. It is intriguing to learn that one of the report's main recommendations is to require the sharing of non-personal data for political, societal, and commercial objectives. Additionally,

regulations/india#:~:text=Regulatory%20bodies,-Back%20to%20top&text=India's%20financial%20regulators%20are%20fragmented,exchange%20and%20cross%2Dborder%20transactions.

[11] *Ibid*

the Digital Personal Data Protection Act, 2023—India's comprehensive data protection framework—is now being passed by legislators. Since financial information is now covered by the Act, once it becomes law, FinTech companies and financial institutions will likely face stricter duties for data protection.

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