Perspective - RBI: Digital Lending Rules

For Prelims: Reserve Bank of India, Digital Lending, Integrated Ombudsman Scheme of RBI

For Mains: Concerns related to Digital Lending and Steps Taken by the Government to Tackle the Situations

Why in News?

Recently, the **Reserve Bank of India (RBI)** has issued detailed guidelines for digital lending according to which digital loans must be credited directly to the bank accounts of borrowers and **not through any third party.**

- It is the **first set of guidelines for** digital lending, to crack down on illegal activities by certain players. This follows the recommendation of a **Working Group on Digital Lending (WGDL)** that had submitted its report recently.

What is Digital Lending?

- **About:**
  - It consists of **lending through web platforms or mobile apps,** by taking advantage of technology for authentication and credit assessment.
  - Banks have launched their **own independent digital lending platforms** to tap into the digital lending market by leveraging existing capabilities in traditional lending.
- **Significance:**
  - **Financial Inclusion:** It helps in meeting the huge unmet credit need, particularly in the microenterprise and low-income consumer segment in India.
  - **Reduce Borrowing from Informal Channels:** It helps in reducing informal borrowings as it simplifies the process of borrowing.
  - **Time Saving:** It decreases time spent on working loan applications in-branch. Digital lending platforms have also been known to cut overhead costs by 30-50%.
- **Challenges:**
  - A growing number of unauthorised digital lending platforms and mobile applications as:
    - They charge excessive rates of interest and additional hidden charges.
    - They adopt unacceptable and high-handed recovery methods.
    - They misuse agreements to access data on mobile phones of borrowers.

Who comes under these New Guidelines?

- The banking regulator has categorically specified that the lending business **can only be carried out by entities regulated by the RBI** or those permitted under the law.
- The central bank has **divided the universe of digital lenders into three groups namely:**
  - Entities regulated by the RBI and permitted to carry out lending business.
  - Entities authorised to carry out lending according to other statutory/ regulatory provisions

but not regulated by the RBI.
  - Entities lending outside the purview of any statutory/ regulatory provision.
- The central bank's regulatory framework is **focused on the digital lending ecosystem of regulated entities** and the Lending Service Provider (LSPs) engaged by them to extend various permissible credit facilitation services.
  - However, the lenders in the other **categories do not come under the new guidelines** and can consider formulating appropriate rules and regulations on digital lending based on the recommendations of the working group.

What are the Guidelines About?

- **Third-Party Inclusion:** The central bank said that for RBI-Regulated Entities (RE), their LSPs, and Digital Lending Apps (DLAs) of REs, all loan disbursals and repayments are required to be executed only between the bank account of the borrower and the RE, without any pass-through/ pool account of the LSP or any third party.
- **Fees Charges**: It also specified that digital lending entities and not the borrowers should pay fees or charges payable to LSPs in the credit intermediation process.
- **Loan Disclosure:** All-inclusive cost of digital loans in the form of Annual Percentage Rate (APR) is required to be disclosed to the borrower by REs.
  - REs must also provide a **Key Fact Statement (KFS)** to the borrower before the execution of the contract in a standardised format for all digital lending products.
  - Any fees, charge, etc., which is not mentioned in the KFS cannot be charged by the REs to the borrower at any stage during the term of the loan.
- **Credit Limit & Publishment of Lists:** There cannot be an automatic increase in credit limits without the borrower's on-record explicit consent.
  - These regulated entities also have to publish the list of LSPs and DLAs engaged by them, besides details of the activities for which they have been engaged, on their website.
- **Withdrawal of Loan:** A cooling-off period shall be provided within the loan contract during which the borrower shall have the option to exit the digital loans by paying the principal and proportionate APR without any penalty.
- **Grievance Redressal Mechanism:** Banks will have to ensure that they, and the LSPs engaged by them, must have a suitable nodal grievance redressal officer to deal with **fintech- or digital lending**-related complaints.
  - This officer will also deal with complaints against their respective Digital Lending Apps (DLAs).
  - Current guidelines allow for the borrower to complain to the **Integrated Ombudsman Scheme** of the RBI if their grievance was not resolved by the bank within 30 days.
- **Regarding Data Protection & Privacy:** In order to ensure data protection/ privacy of the borrower, the Framework provides that the DLAs shall be allowed to collect only need-based data with the prior explicit consent of the borrower.
  - In addition to this, the borrower shall also have the **option to either accept, deny or revoke its consent for use of any specific data** along with the option to delete any data collected by the DLAs/ LSPs.
  - REs to ensure that LSPs engaged by them **do not store personal information** of borrowers except for some basic minimal data (such as name, address, contact details of the customer, etc.) that may be required to carry out their operations.
- **Mandated Access:** The central bank has also mandated that DLAs should not access mobile phone resources, such as files and media, contact list, call logs, and telephony functions.
  - However, one-time access can be taken to camera, microphone, location, or any other facility necessary for onboarding/ KYC requirements only with the explicit consent of the borrower.
- **Reporting Requirement:** REs are required to ensure that any lending done through DLAs has to be reported to **Credit Information Companies (CICs)**, irrespective of its nature or tenor. More importantly, lending through the Buy Now Pay Later (BNPL) model also needs to be reported to CICs.

What is an Ombudsman?

- A government official who deals with complaints made by ordinary people against public

organizations. This concept of Ombudsman arrived from Sweden.
- It means an officer appointed by the Legislature to handle complaints against a service or administrative authority.
- In India an Ombudsman is appointed to resolve grievances in the following sectors.
    - Insurance Ombudsman
    - Income Tax Ombudsman
    - Banking Ombudsman

What is an Integrated Ombudsman Scheme?

- It amalgamates three ombudsman schemes of RBI - banking ombudsman scheme of 2006, **ombudsman scheme for NBFCs of 2018** and ombudsman scheme of digital transactions of 2019.
- The unified ombudsman scheme will provide redress of customer complaints involving deficiency in services rendered by RBI regulated entities viz. banks, **NBFCs (Non banking Financial Companies)** and pre-paid instrument players if the grievance is not resolved to the satisfaction of the customers or not replied within a period of 30 days by the regulated entity.
- It also includes non-scheduled primary **co-operative banks** with a deposit size of Rs 50 crore and above. The integrated scheme makes it a "One Nation One Ombudsman' approach and jurisdiction neutral.

Why are these Guidelines Being Framed?

- **Extension of Credit Services:** With the advent of technological innovation, there has been immense development in the digital lending ecosystem, which has resulted in several fintech firms extending credit services.
    - However, this growth has led to misselling to unsuspecting customers, unethical business conduct by digital lenders and excessive engagement of third parties, and **concerns over the data privacy of the borrower.**
- **Unreasonable Interest Rates:** There have been also been several complaints by consumers that digital lending apps are charging exorbitant interest rates or they were committing fraud, among others.

What can be the Way Forward?

- India is on the verge of a digital lending revolution and making sure that this lending is done responsibly can ensure the fruits of this revolution are realized.
- Digital lenders should proactively develop and commit to a code of conduct that outlines the principles of integrity, transparency and consumer protection, with clear standards of disclosure and grievance redressal.
- Apart from establishing technological safeguards, educating and training customers to spread awareness about digital lending is also important.