Guidelines to Regulate Digital Lending

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

For Mains: Concerns related to Digital Lending and steps taken by government in this direction

Why in News?

Recently, the **Reserve Bank of India (RBI)** issued the first set of guidelines for digital lending, to crack down on illegal activities by certain players.

- Towards addressing concerns that had sprung up, the RBI had constituted a Working Group on 'digital lending **including lending through online platforms and mobile apps' (WGDL)** in January, 2021.
- The group has **proposed stricter norms for digital lenders in November 2021**, some of which have been accepted and included in the new norms while others are under examination.

What do we Know about 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%.

What are the Highlights of the Guidelines?

- **For Loan Disbursals and Repayments:**
  - **All loan disbursals and repayments** will be required **to be executed only between the bank accounts of the borrower and the Regulated Entities (RE)** without any pass-through or pool account of the Lending Service Providers (LSP) or any third party.
    - **Regulated Entities include** a bank or a non-banking financial company.
- **Regarding Payment:**
  - The new rules mandate that **fees or charges payable to LSPs in the credit intermediation process** will be paid directly **by the bank** or Non-Banking Financial

Companies **(NBFCs)** and not by the borrower.

- **Regarding Loan Disclosure:**
  - All-inclusive cost of digital loans in the form of Annual Percentage Rate (APR) is required to be disclosed to the borrowers.
- **Regarding increase in Credit Limit:**
  - The new norm **prohibits any automatic increase in credit limit** without the explicit consent of the borrower.
- **Regarding Exiting Digital Loans:**
  - It also **provides, as part of the loan contract, a cooling-off/ look-up period** during which the borrowers can exit digital loans by paying the principal and the proportionate annual percentage rate without any penalty.
- **To Protect Data Privacy:**
  - To protect data privacy, the **data collected by digital lending apps has to be need-based**, with the customer's prior consent, and can be audited, if required.
- **Grievance Redressal Officer:**
  - 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.
- **Reporting of Loans:**
  - 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.

Who comes under RBI's New Purview?

- While announcing the norms, **RBI classified digital lenders into three categories.**
  - **Entities regulated by the RBI** and permitted to carry out lending business.
  - Entities **authorized to carry out lending** as per other statutory or regulatory provisions but not regulated by RBI.
  - Entities **lending outside the purview of any statutory** or regulatory provisions.
- The central bank's regulatory framework is focused on the **digital lending ecosystem of regulated entities** and the 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 is the Need for Such Guidelines?

- 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 **mis selling to unsuspecting customers**, unethical business conduct by digital lenders and excessive engagement of third parties, and concerns over data privacy of the borrower.
- There have also been several complaints by consumers that **digital lending apps are charging exorbitant interest rates** or they were committing fraud, among others.

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.

Source: TH