



## Digital lending guidelines applicable to banks and NBFCs

30 September 2022

First Notes on
<ul style="list-style-type: none"> <li>Financial reporting</li> <li>Corporate law updates</li> <li><b>Regulatory and other information</b></li> <li>Disclosures</li> </ul>
Sector
<ul style="list-style-type: none"> <li>All</li> <li><b>Banking and insurance</b></li> <li>Information, communication, entertainment</li> <li>Consumer and industrial markets</li> <li>Infrastructure and government</li> </ul>
Relevant to
<ul style="list-style-type: none"> <li>All</li> <li>Audit committee</li> <li>CFO</li> <li>Others</li> </ul>
Transition
<ul style="list-style-type: none"> <li><b>Immediately</b></li> <li>Within the next three months</li> <li>Post three months but within six months</li> <li>Post six months</li> <li>Forthcoming requirement</li> </ul>

### Background

The digital lending<sup>1</sup> landscape in India has sharply risen, especially during the COVID-19 pandemic. Banks and NBFCs are increasingly lending either directly through their own digital platforms<sup>2</sup> or through a digital lending platform under an outsourcing arrangement. Such outsourcing arrangements are generally entered into with Lending Service Providers (LSP)<sup>3</sup>/ Digital Lending Applications<sup>4</sup> (DLAs).

With the expansion of digital lending, various concerns have also emerged. These primarily relate to the unbridled engagement of third parties (or LSPs), mis-selling, breach of data privacy, unfair business conduct, exorbitant interest rates, and unethical recovery practices. While the current share of digital lending in the overall credit of the financial sector is not significant to affect financial stability, its growth momentum has compelling stability implications.

With a view to strike a balance between the need for an innovative and inclusive system of lending (i.e. digital lending) while at the same time protecting the customer's interest, the Reserve Bank of India (RBI) undertook certain measures as given in Figure 1 below:

**Figure 1: Measures undertaken by RBI for regulating digital lending**

June 2020	Circular on digital lending*	<ul style="list-style-type: none"> <li>RBI advised the following through the circular: <ul style="list-style-type: none"> <li>Digital lending platforms to disclose name of bank/NBFC on whose behalf they provide credit</li> <li>Sanction letter should be on the letterhead of concerned bank/NBFC</li> <li>Banks/NBFCs to ensure oversight over digital lending platforms engaged by them</li> </ul> </li> </ul>
January 2021	Working group on Digital Lending	<ul style="list-style-type: none"> <li>RBI constituted a working group on 'digital lending including lending through online platforms and mobile apps' (WGDL)</li> <li>WGDL was required to study all aspects of digital lending activities and suggest regulatory changes</li> </ul>
November 2021	Report of WGDL submitted	<ul style="list-style-type: none"> <li>WGDL submitted its report</li> <li>WGDL report was placed on the RBI website for comments from stakeholders and members of the public</li> </ul>
August 2022	Circular on implementation of WGDL recommendations	<ul style="list-style-type: none"> <li>In its circular, RBI issued the following <ul style="list-style-type: none"> <li>Recommendations accepted for immediate implementation</li> <li>Recommendations accepted in-principle which require further examination</li> <li>Recommendations for consideration of the Government of India</li> </ul> </li> </ul>
September 2022	Guidelines on Digital Lending	<ul style="list-style-type: none"> <li>On 2 September 2022, RBI issued guidelines on digital lending (the guidelines)</li> <li>These guidelines are applicable to banks (all commercial banks and certain co-operative banks<sup>#</sup>) and NBFCs (including Housing Finance Companies) (Regulated entities)</li> </ul>

\* Loans sourced by banks and NBFCs over digital lending platforms: adherence to fair practices code and outsourcing guidelines  
# Primary (Urban) Co-operative banks, State co-operative banks and District Central Co-operative Banks

(Source: KPMG in India's analysis, 2022)

<sup>1</sup> 'Digital lending' is a remote and automated lending process, largely by use of seamless digital technologies for customer acquisition, credit assessment, loan approval, disbursement, recovery, and associated customer service.  
<sup>2</sup> Various NBFCs have registered with the Reserve Bank of India (RBI) as 'digital only' lending entities, and certain NBFCs have also registered to work both on digital and brick-mortar channels for credit delivery.  
<sup>3</sup> An LSP is an agent of a regulated entity (banks and NBFCs) who carries out one or more of its' functions or part thereof in customer acquisition, underwriting support, pricing support, servicing, monitoring, recovery of specific loan or loan portfolio on behalf of regulated entities in conformity with extant outsourcing guidelines issued by RBI.  
<sup>4</sup> DLAs are mobile and web-based applications with user interface that facilitate digital lending services. DLAs will include applications of the regulated entities as well as those operated by LSPs engaged by regulated entities for extending any credit facilitation services in conformity with extant outsourcing guidelines issued by RBI.

As per figure 1, the guidelines on digital lending (the guidelines) are applicable to all Regulated Entities (REs). The REs would also need to ensure that the LSPs engaged by them, the DLAs of the REs and the DLAs of the LSPs engaged by the REs comply with the guidelines.

**Effective date :** The effective date from which the guidelines are applicable is given below:

- **New Loans :** The guidelines are applicable on an immediate basis (i.e. from 2 September 2022) to the existing customers availing fresh loans and to new customers getting onboarded.
- **Existing Loans :** REs would be given time till 30 November 2022 to put in place adequate systems and processes to ensure that existing digital loans comply with the guidelines.

In this issue of the First Notes, we aim to provide an overview of the digital lending lifecycle and the guidelines issued by RBI.

### Overview of the digital lending lifecycle

A digital lending lifecycle begins with a user discovering the DLA and ends with the repayment of a loan. A generic lending process goes through the following stages:

**Figure 2: Digital Lending Lifecycle**



(Source: KPMG in India's analysis, 2022 read with Report of the Working Group on Digital Lending including Lending through Online Platforms and Mobile Apps, issued by WGDL on 18 November 2021)

**Lending app discovery and registration:** Users find DLAs (the DLAs may belong to the REs or to the LSPs) primarily through online searches on search engines, app stores, marketing material- such as SMS, email, online advertisements, etc. The user downloads the DLA from the app stores and registers using the mobile number/e-mail id, or any other unique ID. The user also gives the DLA necessary permissions, based on which the DLA can access various other apps and services on a user's mobile phone.

**Loan application processing:** The user provides information about himself/herself on the DLA, based on which the DLA pulls his/her credit score, historical banking information, mobile recharge history, etc. from the mobile phone. Based on the DLA's proprietary algorithm a credit score of a user is generated, based on which the DLA chooses to underwrite the loan.

**User verification:** Based on the user's credit score<sup>5</sup>, a DLA displays the loan options that the user could be eligible to. When a user chooses an appropriate loan option, the user would need to verify his/her identity and e-sign the loan.

**Loan disbursement:** The loan amount is either credited to the customer's account, or credited to the end user of the facility.

**Loan repayment:** The user pays back the interest and principal amount as per the repayment plan. In case of a delay, the RE or the LSPs appointed by the RE, which are in the business of collection/recovery step in.



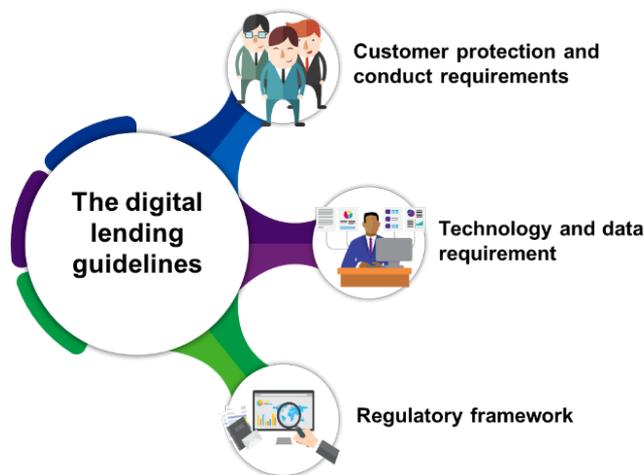
<sup>5</sup> In some cases, the REs provide the credit underwriting logic to the DLAs which run the algorithm for determining credit score of the borrower based on the same.

## Overview of the digital lending guidelines issued by RBI

Considering the lack of a comprehensive regulatory framework in consumer lending through DLAs from origination to debt collection and its administration, RBI vide its circular dated 2 September 2022 has issued the digital lending guidelines. The guidelines reiterate that outsourcing arrangements entered by REs with an LSP/DLA do not diminish a RE’s obligations, and it should continue to conform to the extant guidelines on outsourcing prescribed by RBI<sup>6</sup>. Additionally, it would be the RE’s responsibility to ensure that the guidelines are conformed with by the LSPs and the DLAs.

The guidelines focus on three main areas, as given in figure 3 below, each of these areas is discussed in the subsequent paragraphs:

**Figure 3: Areas of focus of the digital lending guidelines**



(Source: KPMG in India’s analysis, 2022, read with the circular on Guidelines on Digital Lending issued by RBI on 2 September 2022)

## A. Customer Protection and Conduct Requirements

To enhance customer awareness and protect the interests of customers, RBI has issued guidelines on customer protection and conduct requirements. Key aspects of the guidelines are as follows:

Areas covered in the guideline	Detailed guidance
<b>Loan disbursement, servicing and repayment directly through RE account</b>	To enhance transparency in a digital lending transaction, REs need to ensure that all disbursements are made to a bank account of the borrower without any pass-through account/pool account of any third party (including LSPs/DLAs) <sup>7</sup> . Similarly, all repayments, etc. should be executed by a borrower directly in a RE’s bank account.
<b>Collection of fees, charges, etc.</b>	<p><b>Fees/charges:</b> The REs should directly pay the fees, charges, etc. that are payable to LSPs, and these should not be charged by the LSP to the borrower directly.</p> <p><b>Penal interest/charges:</b> The penal interest/charges levied on the borrower should be based on the outstanding amount of the loan. Further, the rate of the penal charge should be disclosed on an annualised basis to the borrower in the Key Fact Statement.</p>

<sup>6</sup> Para 2.6 of the Master Circular on “Loans and Advances – Statutory and Other restrictions” dated July 01, 2015, Guidelines on Managing Risks and Code of Conduct in Outsourcing of Financial Services by Banks issued vide Circular dated November 03, 2006 as amended from time to time, Para 120 and 120 A of “Master Direction - Non-Banking Financial Company - Systemically Important Non-Deposit taking Company and Deposit taking Company (Reserve Bank) Directions, 2016” dated September 01, 2016, Para 106 and 106A of the ‘Master Direction - Non-Banking Financial Company – Non-Systemically Important Non-Deposit taking Company (Reserve Bank) Directions, 2016’ both dated September 01, 2016, ‘Guidelines for Managing Risk in Outsourcing of Financial Services by Co-operative Banks’, dated June 28, 2021 and other related instructions issued by the Reserve Bank from time to time.

<sup>7</sup> Certain exceptions to this include disbursements covered exclusively under statutory or regulatory mandate (of RBI or of any other regulator), flow of money between REs for co-lending transactions and disbursements for specific end use, provided the loans is disbursed directly into the bank.

Areas covered in the guideline	Detailed guidance						
<p><b>Enhanced disclosures to the borrowers</b></p>	<p>REs need to ensure that the following information is available to the borrowers:</p> <ul style="list-style-type: none"> <li>• <b>Key fact statement:</b> Before execution of the contract for any digital lending product, REs should provide the borrower a Key Fact Statement (KFS)<sup>8</sup> in a format prescribed by the guidelines. [See annexure for more detailed guidance on KFS]</li> </ul> <p>It is to be noted that any fees, charges, etc. which are not mentioned in the KFS cannot be charged by the REs to the borrower at any stage during the term of the loan.</p> <ul style="list-style-type: none"> <li>• <b>Digitally signed documents:</b> Upon execution of the loan contract, all documents (on the letterhead of the RE)<sup>9</sup> signed by the borrower using digital signature should automatically flow to the borrower on his/her verified email/phone number.</li> <li>• <b>List of LSPs:</b> REs are required to prominently publish on their website their DLAs, LSPs engaged by them and the DLAs of such LSPs, with the details of activities for which they have been engaged<sup>10</sup>.</li> <li>• <b>Product information:</b> The DLAs of the REs and/or of the LSPs engaged by the REs should prominently display information relating to the product features, loan limit and cost, etc. at the on-boarding/sign-up stage.</li> <li>• <b>Link to website:</b> The DLAs of the REs and of the LSPs engaged by the REs should have links to the REs' website where detailed information about the loan products, the LSPs, customer care, link to Sachet Portal, privacy policies, etc. is provided. Such information should be placed at a prominent single place on the website of the RE for ease of accessibility.</li> </ul>						
<p><b>Grievance redressal</b></p>	<p>The responsibility of grievance redressal would remain with the RE. The guidelines have prescribed the following:</p> <ul style="list-style-type: none"> <li>• <b>Nodal grievance redressal officer:</b> LSPs of the REs should have a suitable nodal grievance redressal officer to deal with digital lending related complaints/issues raised by the borrowers against their DLAs. Contact details of the grievance redressal officer should be displayed<sup>11</sup> and facility for lodging complaint should be made available on the DLA and websites of the RE and LSPs.</li> <li>• <b>Reserve Bank-Integrated Ombudsman Scheme (RB-IOS):</b> If any complaint lodged by a borrower against an RE or an LSP engaged by the RE is not resolved within the stipulated period (currently 30 days), he/she can lodge a complaint under the RB-IOS or as per any other grievance redressal mechanism prescribed by RBI.</li> </ul>						
<p><b>Cooling-off/look-up period</b></p>	<p>The guidelines now require borrowers to be given an explicit option to exit digital loans by paying the principal and proportionate Annual Percentage Rate (APR), without any penalty during this period- this is referred to as the cooling-off/look-up period. The period should be determined by the Board of Directors (Board) of the RE. The minimum cooling off period for digital loans is prescribed hereunder:</p> <table border="1" data-bbox="427 1644 1407 1765"> <thead> <tr> <th data-bbox="427 1644 919 1693">Tenure of loans</th> <th data-bbox="919 1644 1407 1693">Minimum cooling-off period</th> </tr> </thead> <tbody> <tr> <td data-bbox="427 1693 919 1727">Less than seven days</td> <td data-bbox="919 1693 1407 1727">One day</td> </tr> <tr> <td data-bbox="427 1727 919 1765">Seven days or more</td> <td data-bbox="919 1727 1407 1765">Three days</td> </tr> </tbody> </table> <p>Borrowers that continue with the loan even after the cooling-off period, prepayment would continue as per the current RBI guidelines<sup>12</sup>.</p>	Tenure of loans	Minimum cooling-off period	Less than seven days	One day	Seven days or more	Three days
Tenure of loans	Minimum cooling-off period						
Less than seven days	One day						
Seven days or more	Three days						

<sup>8</sup> This requirement is in line with the Master Circular on Customer Service in Banks, which requires scheduled commercial banks to provide a KFS to their customers.

<sup>9</sup> Such documents include KFS, summary of loan product sanction letter, terms and conditions, account statements, privacy policies of the LSPs/DLAs with respect to borrower data, etc.

<sup>10</sup> The RBI, vide its circular issued in June 2020 required all REs to disclose on their website the names of digital lending platforms engaged as agents.

<sup>11</sup> Contact of the nodal grievance redressal officer would also be available in the KFS.

<sup>12</sup> As per the current RBI guidelines, banks and NBFCs are not permitted to charge foreclosure charges/ pre-payment penalties on any floating rate term loan sanctioned, for purposes other than business, to individual borrowers with or without co-obligant(s).

Areas covered in the guideline	Detailed guidance
<b>Assessing borrower's creditworthiness</b>	<p>With a view to restrict reckless lending and prevent over-indebtedness of the borrowers, the guidelines now require REs to:</p> <ul style="list-style-type: none"> <li>• Capture the economic profile of the borrowers (covering age, occupation, income, etc.) to assess the borrower's creditworthiness in an auditable way, before digital loans can be extended to him/her through the DLA of the RE or of the LSP.</li> <li>• Ensure there is no automatic increase in credit limit unless explicit consent of the borrower is taken on record for such increase.</li> </ul>
<b>Due diligence and other requirements with respect to LSPs</b>	<p>The guidelines require REs to conduct enhanced due diligence before entering into a partnership with an LSP for digital lending, taking into account its technical abilities, data privacy policies, storage systems, fairness in conduct with borrowers and ability to comply with regulations and statutes. A periodic review of the conduct of the LSPs should be carried out by the REs.</p> <p>With regard to LSPs acting as recovery agents, REs should impart necessary guidance to such LSPs so that they discharge their duties responsibly and comply with the existing instructions in this regard<sup>13</sup>.</p>

## B. Technology and Data requirement

In order to safeguard against the concerns relating technology and data requirement, the guidelines specifically provide following guidance:

Area covered in the guideline	Detailed guidance
<b>Collection, usage and sharing of data with third parties</b>	<p>With regard to personal information of borrowers, the REs should ensure the following:</p> <ul style="list-style-type: none"> <li>• <b>Need-based data:</b> The collection of data by the DLAs of the REs and of the LSPs engaged by the REs should be need-based and with prior and explicit consent of the borrower having audit trail.</li> <li>• <b>Access to apps:</b> DLAs should desist from accessing mobile phone resources like file and media, contact list, call logs, etc. A one-time access can be taken with the consent of the borrower for camera, microphone, location or any other facility necessary for the purpose of e-KYC requirements.</li> <li>• <b>Borrower to manage data:</b> Borrower should be provided with an option to give or deny consent for use of specific data, restrict disclosure to third parties, data retention, revoke consent already granted to collect personal data and if required, make the app delete/forget the data.</li> <li>• <b>Purpose of obtaining consent:</b> The purpose of obtaining borrower's consent needs to be disclosed at each stage of interface with the borrowers.</li> <li>• <b>Sharing personal information:</b> Explicit consent of the borrower should be taken before sharing personal information with any third party, except where such sharing is as per statutory/regulatory requirement.</li> </ul>

<sup>13</sup> As per the existing instructions issued by RBI vide the notification 'Outsourcing of Financial Services-Responsibilities of regulated entities employing recovery agents' issued on 12 August 2022, in addition to the existing requirements, REs should strictly ensure that they or their agents do not resort to intimidation or harassment of any kind, either verbal or physical, against any person in their debt collection efforts, including acts intended to humiliate publicly or intrude upon the privacy of the debtors' family members, references and friends, sending inappropriate messages either on mobile or through social media, making threatening and/ or anonymous calls, persistently calling the borrower and/ or calling the borrower before 8:00 a.m. and after 7:00 p.m. for recovery of overdue loans, making false and misleading representations, etc.

Areas covered in the guideline	Detailed guidance
<p><b>Storage of data</b></p>	<p>With regard to storage of customer data, REs should ensure the following:</p> <p><b>Storage of minimal data:</b> The LSPs/DLAs engaged by the REs should store only the basic minimal data<sup>14</sup> that may be required to carry out their operations. The ultimate responsibility of customer’s personal information and security will be that of the RE.</p> <p><b>Biometric data:</b> No biometric data should be collected/stored in the systems associated with the DLA of REs/their LSPs unless allowed under existing statutory guidelines.</p> <p><b>Policy guidelines for storage of data:</b> As multiple players have access to sensitive consumer/ financial data, clear policy guidelines regarding storage of customer data, such as type of data that can be stored, length of time it can be stored, etc. should be put in place and disclosed on the apps and website of the DLAs of the REs and of the LSPs engaged by the REs.</p> <p><b>Servers in India:</b> All data should be stored in servers located within India.</p>
<p><b>Comprehensive privacy policy</b></p>	<p>The REs should ensure that their DLAs and LSPs engaged by them have a comprehensive privacy policy, which is compliant with applicable laws, associated regulations and RBI guidelines. It should also include details of third parties allowed to collect personal information through the DLA. This privacy policy should be made available publicly. These privacy policies should be disclosed at the time of access and collection of personal information of borrowers.</p>
<p><b>Technology standards</b></p>	<p>The REs should ensure that the REs and the LSPs engaged by them comply with various technology standards/requirements on cybersecurity stipulated by RBI and other agencies as specified from time to time. This will help to weed out non-serious players and push the sector towards maturity.</p>



<sup>14</sup> Such as name, address, contact details, etc.

## C. Regulatory Framework

From a regulatory perspective, RBI has prescribed the following requirements for digital lending:

Area covered in the guideline	Detailed guidance
<p><b>Reporting to CICs</b></p>	<p>The REs should ensure that any lending done through their DLAs and/or DLAs of LSPs engaged by them is reported to Credit Information Companies (CICs) irrespective of its nature/tenure. Reporting would also be done for structured digital lending products extended by REs or LSPs engaged by REs over a merchant platform involving short-term, unsecured/secured credits or deferred payments (such as Buy Now Pay Later). Reporting should be done in accordance with the existing regulations<sup>15</sup>. Submission of such information will break the perpetuation of data marginalisation of certain vulnerable groups. This will ensure less dependence on alternative data for financial consumers as more and more of them would develop formal credit history for themselves. Further, it will offer wider choices/competitive pricing for consumers.</p>
<p><b>Loss sharing arrangement in case of default</b></p>	<p>Various LSPs provide certain credit enhancement features such as first loss guarantee up to a pre-decided percentage of loans generated by it. From the LSP's perspective, offering First Loss Default Guarantee (FLDG) acts as a demonstration of its under-writing skills whereas from the RE's perspective, it ensures the LSP's skin in the business. For all practical purposes, credit risk is borne by the LSP without having to maintain any regulatory capital. The loan portfolio backed by FLDG is akin to off-balance sheet portfolio of the LSP wherein the nominal loans sit in the books of the lender without having to partake in any lending process. With increasing share of digital lending in retail/personal space, there is a potential for risk build-up because of these platforms.</p> <p>In this view, the RBI press release issued in August 2022 has stated that the recommendation pertaining to FLDG is under examination. Meanwhile, the guidelines require the REs entering into financial contracts including a clause on FLDG to comply with the Securitisation Guidelines, especially the provision relating to synthetic securitisation<sup>16</sup>. The Securitisation Guidelines impose certain restrictions on synthetic securitisation transactions. While lenders are not permitted to enter into such transactions in the normal course, any such transactions entered into by lenders must be subject to 100 per cent capital charge, and will be subject to RBI's supervisory scrutiny and action. Further clarifications on this are expected.</p>



<sup>15</sup> As per provisions of the Credit Information Companies (CIC) (Regulation) Act, 2005; CIC Rules, 2006; CIC Regulations, 2006 and related guidelines issued by RBI from time to time.

<sup>16</sup> Synthetic securitisation is an arrangement where the credit risk of an underlying pool of loan exposures is hedged by the originator through credit derivatives or credit guarantee arrangements.

## Our Comments

The digital lending guidelines encapsulate RBI's approach i.e. customer-first regulations. While they aim to protect customers, these guidelines have a significant impact on the digital lending companies and REs. The digital guidelines reiterate that the ultimate responsibility of customer protection, data protection, lending policies, etc. would lie with the RE. Some of the key points to consider include:

**Greater onus on REs:** Through the guidelines, the RBI has reiterated that REs should follow the outsourcing guidelines that RBI has laid down, which essentially states that outsourcing of any activity does not diminish an RE's obligations and those of their Board and senior management as the onus of compliance rests solely with them. Thus the REs would be responsible for the actions of the LSPs. In this regard, the REs would need to ensure that the LSPs and the DLAs of the REs and of the LSPs comply with all provisions of the guidelines. REs would also need to have effective oversight over the LSPs and DLAs activities. This would entail significant effort on the part of the RE and senior management involvement. The Board and senior management of an RE would need to be involved in setting the policies and procedures for compliance with these guidelines and would need to monitor these transactions on a frequent basis.

**LSPs to reassess certain business models:** Some of requirements prescribed in the guidelines, such as the requirement of direct disbursements to customers by REs would impact the business models of certain LSPs e.g. payment aggregators<sup>17</sup>, etc. Even the business model for financial products involving contractual arrangements such as First Loss Default Guarantee (FLDG) would need to be reassessed.

**Data privacy:** In the absence of an enforceable data protection law, borrowers are still vulnerable about their personal and financial data. The guidelines are protective and trying to ensure that minimum data is taken from users, and explicit confirmations are taken where additional data is required, adequate disclosures are made regarding who is collecting the data, how it would be used, and the RE is now obliged to oversee the third party collecting the data. However, this area and rules in this area are emerging and sector needs empowered legal and regulatory framework aimed at privacy policy of mobile apps.

**Challenges on transition:** The guidelines are applicable from 2 September 2022 for all new loans, RBI has provided time till 30 November 2022 to the REs to comply with these guidelines for the existing loans. Some of the challenges that are expected to arise on transition are with respect to:

- **Operational Challenges and technological investment:** With regard to digital lending, many of the REs are largely dependent on the business sourced from the LSPs, they may not be geared with the technology tools and processes for conducting digital lending themselves. The guidelines now require the REs to directly disburse loans to borrowers (except in case of co-lending) and receive interest and principal payments directly from the borrowers, including fees, charges (such as penal charges, overdue charges, etc.). Therefore, significant investment in technology, processes and people will have to be made to transition to the new guidelines. For example, investment would be required.

Additionally, REs would now be required to modify or enhance their systems to handle the additional volume of transactions, differentiate between the recovery of principal, interest and charges, etc.

Another area where investment would be required is in storage of customer data in India. RBI requires entire customer data to be stored in servers located within India. Therefore, if any data is on servers present outside India, or where cloud technology is being leveraged, the data will now have to be migrated to servers within India.

- **Impact on customer experience:** Given the guidelines on the collection, usage and sharing of data with third parties for the DLAs, the REs will have to revamp their customer experience journey to make it a seamless process. They will have to ensure minimal/no impact on business simultaneously while complying with regulatory requirements.



<sup>17</sup> Payment aggregators collect amounts on behalf of various merchants from different means, such as credit cards, etc.

- **LSPs not meeting the due diligence requirements:** As per the guidelines, the REs need to perform a due diligence of the LSPs before they enter into agreements with them. Certain digital loans with a maturity post 30 November 2022 may have been issued through the LSPs that may not meet the new requirements of the due diligence requirements of the RE). REs would need to establish processes to meet due diligence requirements with respect to the digital loans issued by such LSPs on the date of transition.
- **Contractual arrangements:** The existing contracts between the LSPs and the REs would need to be reevaluated under the new guidelines. The LSPs and REs would need to ensure that the amended contracts meet the outsourcing framework guidelines of RBI for REs.
- **Assessing creditworthiness of customers:** The guidelines require REs to ensure that the credit worthiness of customers is assessed in an auditable manner. REs will need to work towards providing an audit trail for loans that have already been disbursed before the date of issue of the circular (i.e. prior to 2 September 2022) and which would mature post 30 November 2022 (date of transition for existing loans). This process would not be an easy task. Further clarification on this from the regulator would be helpful.

**Analysing creditworthiness of customers and provide transparency in the process:** Before the issuance of the guidelines, DLAs had access to a lot of information on a user's mobile phone such as text messages (to determine salary amounts credited, frequency and quantum of such credits, etc.), location of the user (to determine travel history - i.e. whether the user has a regular job), etc. Basis this information, the DLAs analysed various parameters to determine the creditworthiness of the user.

Additionally, LSPs and DLAs have been using certain technology driven operating models to assess customers' creditworthiness. However, such tools lacked transparency. However, the guidelines now require the assessment of a customer's creditworthiness to be done in an auditable way.

Due to data security concerns, the guidelines have now restricted access to information on a user's mobile phone. Therefore, LSPs and DLAs would need to develop different processes to analyse a customer's creditworthiness with the same level of granularity. Moreover, the provision of additional information such as KFS (which includes the APR, details of recovery agents, etc.), digitally signed documents, and other information would result in enhanced information being provided to the customer.

**Cybersecurity and data leakages:** While the guidelines have reduced the amount of personal information of the user that can be accessed by the LSPs and DLAs, they still have access to certain information for e-KYC requirements and for assessing creditworthiness of the customers. Considering this, REs should ensure that robust systems, similar to those required to be adopted by REs, are put in place to ensure that the LSPs and DLAs are protected from potential ransomware and cyber-attacks and data leakages. LSPs and DLAs would need to increase their investments in technological advancements.

**Applicability:** The universe of digital lenders is classified into three groups:

- Entities regulated by the RBI and permitted to carry out lending business (i.e. REs)
- Entities authorised to carry out lending as per other statutory/regulatory provisions<sup>18</sup> but not regulated by RBI
- Entities lending outside the purview of any statutory/regulatory provisions (unregulated entities).

The guidelines are applicable to entities in category (a) above (i.e. REs and LSPs engaged by the REs). For entities in category (b), RBI has recommended that the respective regulator/controlling authority should consider formulating or enacting appropriate rules/regulations on digital lending based on the recommendations of the WGD. Companies in category (b) should watch out for amendments in the digital lending space.



**Further regulations awaited:** While the RBI has provided detailed guidelines applicable to the REs, LSPs and their DLAs. There are certain recommendations of the WGDL that require further examination. Therefore, some of the key recommendations on which RBI is yet to issue guidelines include:

- Expand the scope of financial literacy centres and certain training programmes<sup>19</sup> to include digital lending
- Refine travel rules (narration of payment transactions through digital mode, i.e. information collected, retained and involved in fund transfer transactions initiated on behalf of the customer) for better comprehension
- Laying down baseline technology standards for DLAs
- Supervisory follow-up and review of NBFCs with certificate of registration with the provision of digital lending, but who have not been carrying out this activity for a reasonably long period
- Laying down a regulatory framework for web-aggregators
- To have a regular agenda in the State Level Coordination Committees (SLCC) meetings covering reports on unauthorised apps in the market involved in digital lending/illegal recovery and such other types of activities
- Include reporting of digital lending data and frauds in digital lending space in periodical returns
- Establishment of a self regulatory organisation covering REs and DLAs/LSPs, to perform stipulated functions.

Additionally, RBI has forwarded certain recommendations of the WGDL for the consideration of the Government of India. Some of the key recommendations to the Government of India include:

- Restricting balance sheet lending using digital lending apps to REs
- Setting up a framework to ban unregulated entities
- Setting up of Digital India Trust Agency (DIGITA<sup>20</sup>)
- Setting up of certain entities (such as a National Financial Crime Record Bureau<sup>21</sup>) or leveraging on existing entities (such as the channel of Financial Intelligence Network (FINnet)<sup>22</sup> of the Financial Intelligence Unit – India or the local law enforcement agencies) for sharing information on unscrupulous DLAs and lenders.
- Strengthening KYC rigor for issuance of new/replacement SIM cards, and holding mobile network operators accountable for any violations and shortcomings

## The bottom line

While growth of digital lending is an important aspect forming part of RBI's inclusive growth agenda, it is imperative that the sources of credit are regulated to enhance customer confidence and prevent entry of unscrupulous entities in the digital lending ecosystem.

The role of financial intermediaries such as account aggregators, payment aggregators, marketplace lenders and LSPs is likely to undergo a significant change with regards to their business models and strategies. These guidelines are likely to lead to reassessment of the terms of the agreements between RE and LSP, consolidation of LSPs/DLAs with their partner REs or could also require an evaluation of going concern assessment of certain FinTechs which do not have capital support.

REs will now have to transform themselves and invest in technology, data driven analytics, develop strategy to enhance customer experience and robust framework to address financial crime while meeting the market demand and regulatory requirements.

This is an emerging area and REs and LSPs would need to work with the regulators and seek more guidance and support.

## Upcoming publication



### **KPMG's Point of View: Reserve Bank of India- Digital Lending Guidelines**

Watch out for KPMG in India's upcoming publication highlighting the key impact of the RBI's digital lending guidelines on the products offered, processes undertaken, and technology adopted by banks, NBFCs and their partner FinTech entities.

<sup>18</sup> Such as the Companies Act, 2013, State Money Lenders Act, Chit Funds Act, 1982 and others

<sup>19</sup> Financial Literacy Centres, Centre for Financial Literacy and Electronic Banking Awareness and Training Programmes

<sup>20</sup> DIGITA would discharge the functions of verifying DLAs before such apps can be publicly distributed through the app stores.

<sup>21</sup> The National Financial Crime Record Bureau would have a data registry similar to crime and criminal tracking network and systems which would be accessible to REs.

<sup>22</sup> FINnet channel was established to adopt industry best practices and appropriate technology to collect, analyze and disseminate valuable financial information for combating money laundering and related crimes

## Annexure

REs need to ensure that the following information is available to the borrowers:

- **Key fact statement:** Before execution of the contract for any digital lending product, REs should provide the borrower a Key Fact Statement (KFS)<sup>23</sup> in a format prescribed by the guidelines. Before the issuance of these guidelines, a KFS was not required to be issued to borrowers in case of digital loans.

The KFS should include the following matters:

- **Details of the loan:** Details of the loan amount, tenure, repayment frequency, number and amount of instalments, total interest during the tenure, charges - such as up-front charges, processing fees, insurance charges, etc.
- **Details of contingent charges:** Rates of annualised penal charges in case of delayed payments and details of other annualised penal charges.
- **Annual Per centage Rate (APR):** An effective annualised rate is charged to a borrower of a digital loan. It represents the all-inclusive cost- including cost of funds, credit cost, operating cost processing fee, verification charges, maintenance charges, etc. Before the issuance of these guidelines, such a rate was not required to be communicated to the borrowers of the digital loans.
- **Cooling off/look-up period:** The guidelines now require the cooling-off/look-up period determined for the loan to be disclosed in the KFS.
- **Details regarding a recovery agent:** REs may authorise an LSP to act its recovery agent , and who will thus approach the borrower for recovery. The REs are required to communicate to the borrower details of the LSP acting as a recovery agent at the time of sanctioning of the loan (i.e. as part of KFS) or/and when the RE appoints/changes a recovery agent.
- **Nodal grievance officer:** The KFS should include details of the nodal grievance officer designated to deal with digital lending/FinTech related matters.

It is to be noted that any fees, charges, etc. which are not mentioned in the KFS cannot be charged by the REs to the borrower at any stage during the term of the loan.

<sup>23</sup> This requirement is in line with the Master Circular on Customer Service in Banks, which requires scheduled commercial banks to provide a KFS to their customers.

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## Missed an issue of Accounting and Auditing Update or First Notes?



### Issue no. 74 – September 2022

The topics covered in this issue are:

- Greenhouse gas statements
- Assessment of material misstatement in the financial statements
- Regulatory updates



### MCA amends rules relating to maintaining of books by companies

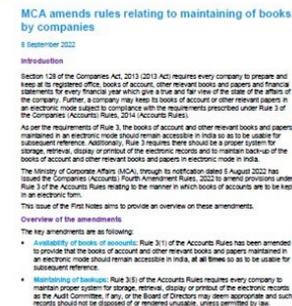
#### 8 September 2022

Section 128 of the Companies Act, 2013 (2013 Act) requires every company to prepare and keep at its registered office, books of account, other relevant books and papers and financial statements for every financial year which give a true and fair view of the state of the affairs of the company. Further, a company may keep its books of account or other relevant papers in an electronic mode subject to compliance with the requirements prescribed under Rule 3 of the Companies (Accounts) Rules, 2014 (Accounts Rules).

The Ministry of Corporate Affairs (MCA), through its notification dated 5 August 2022 has issued the Companies (Accounts) Fourth Amendment Rules, 2022 to amend provisions under Rule 3 of the Accounts Rules relating to the manner in which books of accounts are to be kept in an electronic form.

This issue of First Notes aims to provide an overview of these amendments.

To access the First Notes, please click [here](#)



## Voices on Reporting

### KPMG in India is pleased to present Voices on reporting (VOR) – a series of knowledge sharing calls to discuss current and emerging issues relating to financial reporting.

On 21 July 2022, KPMG in India released its VOR - Quarterly updates publication. The publication provides a summary of key updates from the Securities and Exchange Board of India (SEBI), the Ministry of Corporate Affairs (MCA), the Institute of Chartered Accountants of India (ICAI) and the Reserve Bank of India (RBI) for the quarter ended 30 June 2022.

To access the publication, please click [here](#).



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