

Comments to the Draft Omnibus Framework for recognising Self-Regulatory Organisations (SROs) for Regulated Entities (REs) of the Reserve Bank of India dated 21 December 2023

[Also considers the Draft Framework for recognising Self-Regulatory Organisations for FinTech Sector dated 15 January 2024, subsequently released by the RBI]

On 21st December 2023, the Reserve Bank of India (RBI) released the *Draft Omnibus Framework for recognising Self-Regulatory Organisations (SROs) for Regulated Entities (REs)* (hereafter "**the draft Omnibus Framework**") (Reserve Bank of India, 2023). The draft Omnibus framework lays out a) the characteristics, b) the objectives and responsibilities, and c) the licensing and governance framework for prospective SROs for the REs of the RBI. Soon after, on 15th January 2024, the RBI released the *Draft Framework for Recognising Self-Regulatory Organisations for FinTech Sector* (hereafter "**the draft FinTech Framework**") (Reserve Bank of India, 2024). The draft FinTech Framework also lays out similar guidelines for prospective SROs in the FinTech sector. In this response, we present our comments primarily to the former, but significantly implicating the latter. We begin by discussing our rationale behind considering the details of the latter in our response to the former and, at times, combining the two responses. Thereafter, we discuss the recommendations.

Rationale Behind a Combined Response:

Both frameworks, the draft Omnibus Framework and the draft FinTech Framework, cover similar subject matter – the creation of an SRO. However, one key difference exists. The Omnibus Framework targets a collection of regulated entities (REs), whereas the FinTech Framework targets a specific sector or an activity. The banking sector, or the Non-Banking Financial Companies (NBFC) sector, is exclusively populated by REs. In contrast, in the FinTech sector, non-regulated entities often partner with REs to offer services, and most often, the REs hold the principal risks originated. Thus, a combined response allows us to comment on the overlapping subject and, at the same time, address sectors that are not entirely captured by one framework. Further, since we do not discuss how sectors can be organised under the draft Omnibus Framework, as the framework itself is silent on the subject, the overlaps between the two draft frameworks become more apparent.

Comments on the two Draft Frameworks:

Our comments on the frameworks are across three key themes. Firstly, we discuss the need to introduce an explicit responsibility of the SRO towards the customers. Second, we discuss how some of the current responsibilities towards the members of the SROs are misplaced and should be subsumed under the new set of responsibilities towards the customers. Finally, we submit that the key precursor to the operationalisation of the frameworks is the identification of a sector to which such a framework must apply. Thus, in the third theme, we discuss the need for greater clarity regarding how such sectors will be identified. These themes are discussed below.

A. Introducing an explicit objective of responsibility of the SRO towards customers

The RBI's initiative to acknowledge SROs' role in enhancing regulatory functions for the industry and representing the interests of all stakeholders is appreciated. The draft Omnibus Framework indicates that "*the expected role and responsibilities of the SRO*" shall include "*steering the sector towards enhanced professionalism, compliance, innovation, and ethical conduct*". Similarly, the draft FinTech Framework suggests that "*by pivoting towards a culture of self-governance*", the sector will be able to "*demonstrate its commitment to responsible conduct and innovation*". Thus, both frameworks explicitly acknowledge the role of an SRO in ensuring the highest standards of conduct, suggesting an implicit responsibility towards the customers.

A reading of the frameworks reveals that two sets of responsibilities are placed on the SROs. These are the responsibilities of the SRO towards its members¹ and responsibilities towards the RBI². The second set of responsibilities (towards the regulator) distinguishes an SRO from an industry association since the latter is only a representative of the industry's interests and, as such, has no explicit responsibilities towards the regulator.

However, any explicit responsibility towards the customers is amiss. We posit that to ensure uniform standards of institutional conduct towards the recipients and purchasers of the services offered by the industry under question, an SRO must also have an explicit responsibility towards the customers of their member entities. This crucial design element is the other important feature that distinguishes an SRO from an industry body/association.

Currently, responsibilities towards the customers are subsumed under the responsibilities towards the members (of the SRO). For example, paragraph 8 (vi) of the draft Omnibus Framework reads, "*The SRO should educate public about operations of REs, grievance redress mechanisms available to them and spread awareness in general about the sector*". Such a framing may be inferred as "the SRO's responsibilities towards the customers are of a lower priority than the responsibilities towards its members". To mitigate such inferences, we recommend that a separate section be added to the frameworks that outlines the responsibilities of an SRO towards the customers of the sector. By prioritising improved customer outcomes, SROs can enhance the presence of member entities who are trustworthy actors and bolster the industry's reputation in delivering useful offerings for the customer.

Further, we propose four additional aspects of customer protection that must be added to the responsibilities of the SRO. The following four responsibilities present the minimum additional responsibilities that should be placed on the SROs:

1. *Reducing information asymmetry between members and customers* by enabling clear customer disclosures, assisting customers in comparing financial products and enhancing transparency and trust between the two parties.
2. *Encouraging product suitability for customers* that prevents adverse financial outcomes for customers by creating guidelines and standards for suitability assessments and identification of over-indebtedness (in case the members engage in lending activities).
3. *Focussing on improved and effective data protection practices* at an industry-level by encouraging research and formulating guidelines that safeguard customers against harm from the activities of member entities and allow them to practice effective consent during financial transactions.
4. *Providing grievance redress mechanisms for members' customers* that are independent, customer-centric, accessible and efficient.

We submit that protecting the customers' interests should take centre stage in any industry's SRO. The SRO must recognise the critical role of its customers as the primary users of its members' products and services and assume responsibility for ensuring favourable outcomes for them. Such protections need not be restricted to individuals alone and are also relevant to enterprise-customers and other wholesale customers. This is especially relevant for the financial sector, where the role of financial services is to maximise the welfare outcomes of the customer, while minimising the impact of adverse events (Reserve Bank of India, 2014). Additionally, when considering the FinTech sector, customers, especially those in low-income households, emerge as extremely vulnerable to dark patterns that

¹ Paragraph 8 of the draft Omnibus Framework, and Chapter IV of the draft FinTech Framework.

² Paragraphs 9 and 10 of the draft Omnibus Framework, and Paragraph 13 of the draft FinTech Framework.

confuse, coerce, or manipulate users into making decisions that do not reflect their underlying preferences (Chugh & Jain, 2023). Therefore, we submit that the draft frameworks should expand the responsibilities of the SROs towards the customers and integrate their financial well-being into the decision-making processes of its members. There is precedence for this already in India. Such a principle was adopted by the Securities and Exchange Board of India (SEBI) in the Self-Regulatory Organisations Regulations, 2004, which explicitly made SROs responsible for "*investor protection and education of investors*" (SEBI, 2004). Internationally, the Organisation for Economic Co-operation and Development (OECD) acknowledges that industry self-regulation must play a critical role in supporting consumer interests irrespective of the sector (OECD, 2015). In the following paragraphs, we discuss these responsibilities in detail.

1. Reducing information asymmetry between REs and customers:

Information asymmetries persist in the financial sector and often impede the welfare-enhancing function of financial services (Reserve Bank of India, 2014). Left unchecked, they may enable perverse incentives for mis-selling to materialise, thus diminishing or reversing the gains achieved in the wake of ever-increasing financial inclusion. We recommend that the draft Omnibus Framework place the onus of reducing such information asymmetry on the SRO. We posit that an SRO is uniquely situated to embody such a responsibility since they are necessitated to monitor their members and the sectors in which such members operate. Further, their greater familiarity with prevalent products and processes of their members, along with a mandate to influence such products and processes, make them a suitable candidate. Especially in the ever-evolving FinTech landscape, with non-universal regulatory coverage, an impetus on the SRO to minimise information asymmetry is critical. This is also implicitly acknowledged in the draft FinTech Framework, which calls for standard-setting functions of the SRO to "*set industry benchmarks and baseline technology standards, as could be applicable, for transparency, disclosure*" for their members (paragraph 12(i)(c) of the draft FinTech Framework). While such an articulation is greatly appreciated, providing lucid and user-friendly disclosure tools and standards must be applicable across all financial activities and categories. Accordingly, we recommend the responsibilities of potential SROs in the draft Omnibus Framework be expanded to include the following:

- i. Helping design customer-friendly pre-sale disclosure instruments that the industry may adopt. This would ensure that customers are fully informed and can make decisions based on clear and comprehensible information.
- ii. Assisting customers in comparing different financial products effectively, enabling them to choose products that best suit their needs and circumstances.
- iii. Continuing research initiatives aimed at improving the design and effectiveness of disclosure instruments.

2. Encouraging product suitability for customers:

The suitability of financial services and products is central to the customer protection mandate. It can be challenging to ascertain whether the reasons behind poor outcomes were primarily because of product mis-sale by the providers (or their distributors) or the consequence of random shocks. Given the complexity of financial services, identifying suitable products for customers can be a barrier. More recently, predatory lending and mis-selling concerns have proven to result in poor customer outcomes. For credit products, these may include distress and over-indebtedness (George, 2019). Thus, an SRO's capacity to mobilise sector-wide common resources makes them an ideal candidate to design and facilitate the adoption of existing approaches through which members of SROs may adjudicate product

suitability. It is therefore recommended that additional responsibility be placed on SROs to ensure the suitability of products offered to the customers, and accordingly, may be operationalised using the following:

- i. Providing comprehensive training for customer-facing staff. This would be achieved through guidance issued to SRO members, ensuring that these staff members are equipped to deal with customers ethically and effectively.
- ii. Maintaining an industry-wide database of sales and collection vendors known for unethical practices, thereby protecting customers from potential malpractices.
- iii. Continuing research initiatives aimed at identifying symptoms of negative customer outcomes (like overindebtedness).
- iv. For the FinTech SRO, it would be critical to proactively identify early signs of debt distress among borrowers through effective market monitoring. This would enable timely intervention and support for those at risk of financial hardship.

3. Focussing on improved and effective data protection practices at an industry-level:

In addition to promoting best practices amongst all its members, the FinTech Framework requires the SRO to carry out any work assigned to it, such as providing data/information as requested by the regulator. We acknowledge that this is a step in the right direction by mandating the SRO to act as a repository of information that collects, analyses, and disseminates relevant data pertaining to the activities of its members for the purpose of industry research, trend analysis and policy making. The framework also encourages establishing and enforcing guidelines for consumer protection, data security, data privacy, etc. We welcome this emphasis on personal data protection and the acknowledgement of customers' vulnerabilities to various data harms. To further enhance the protective net, we recommend that the draft Omnibus Framework expand the scope of the SRO's responsibilities to include effective data protection practices concerning customer data and any other data in the custody of its members, irrespective of the category of the entity or nature of the activity the members might undertake. We also recommend that potential SROs be required to take a more active and collaborative role in ensuring that members enhance the customers' experience with data sharing and consent-taking during their interactions while also protecting against misuse of such data by its members. Listed below are some aspects that the RBI may include as the responsibilities of the SRO towards customers for ensuring protection against misuse of personal data:

- i. Facilitate the design of consent forms, including those in audio/visual formats, to ensure comprehensibility for the customers.
- ii. Audit and certification of the member Regulated Entities' data protection practices and publishing their data trust scores based on their data use policy will facilitate transparency, and accountability.
- iii. Facilitate operationalising of key data protection principles such as lawfulness, legitimacy of purpose and necessity are key to building a secure data collection and processing architecture. This includes security safeguards for sensitive data processing and prevention against unwarranted use of personal data, with an emphasis on using automated means of data processing responsibly (Prasad & Chugh, 2022).
- iv. Routinely examining third-party providers' compliance with data protection principles through audits, analysis of grievance data, etc., to ensure their compatibility with evolving standards.

4. Providing grievance redress mechanisms for member entities' customers:

The draft Omnibus Framework entrusts the SRO to "establish a grievance redressal and dispute resolution/ arbitration framework for its members and offer counselling on restrictive, unhealthy and such other practices which may be detrimental to growth of the sector". We welcome the explicit focus on establishing an efficient, fair, and transparent grievance redressal and arbitration framework for its members. Further, as discussed earlier, entrusting the SRO to educate the public about the various grievance redress mechanisms available is also commendable. Similarly, the draft FinTech Framework also reinforces the establishment of grievance redressal and dispute resolution guidelines for its members, as well as customer education focused on products and services offered by the industry. However, there is no emphasis on establishing accessible and transparent customer-friendly redressal systems. Customers in the financial sector may face barriers in navigating grievance redress channels. Where they are able to overcome these, they may experience difficulty in identifying or articulating grievances such as mis-selling or collection agent harassment (Singh, Chugh, & Prasad, 2023).

It is noted that both frameworks are limited to customer awareness regarding redressal channels concerning their providers. In contrast, in the case of Non-Banking Financial Company – Micro Finance Institutions (NBFC-MFIs), the RBI states the establishment of a Grievance Redressal Mechanism (GRM) and the appointment of a Grievance Redressal Nodal Officer as a key criterion for the recognition of SROs (Reserve Bank of India, 2013). Given this precedent, we recommend that SROs contemplated under these frameworks must be assigned a responsibility to establish grievance redressal channels for the customers of their member entities. In particular, the regulator may consider expanding the scope of responsibilities of potential SROs to include the following:

- i. Advertising and educating the customers on the various pathways for reaching the GRM to improve the GRMs' accessibility. Such advertisements should clearly display GRM entry points and detailed instructions for easy navigation. Placing assistive bots along with human touchpoints at every step will allow even inexperienced customers to access the GRMs seamlessly.
- ii. Provision of an integrated redress forum (linked to members' GRMs) for customers to report grievances that functions independently and free from the influence of invested parties.
- iii. Customers should be educated and kept informed about acceptable service standards. This will enable them to identify and report transgressions accurately.
- iv. Develop a model Standard Operating Procedures (SOP) for SRO members to provide grievance redress to customers.
- v. Creating feedback loops to use customer complaints to inform the practices of SRO members as well as the regulator. Studying customer feedback can help decipher customer preferences and is thus critical for creating an environment where the members are able to grow with the industry.
- vi. Leveraging real-time market monitoring of the industry along with data on grievances will help tackle fraud at the customer as well as at the provider level. Routinely sharing such data with the regulator will inform key policy decisions that will be beneficial to all stakeholders within the industry.

To conclude, we appreciate the RBI's initiative to acknowledge a role for SROs in enhancing regulatory functions for the industry and representing the interests of all stakeholders. The draft frameworks contain several commendable objectives and outline clear pathways to achieve them. Though the framework implicitly places some objectives of ensuring customer protection and better customer outcomes onto the SROs, we propose making such a mandate explicit and more expansive. These can together form a new segment – "responsibility towards the customers".

Finally, to ensure the effective operationalisation of these responsibilities, it is important to be more ambitious about independence in the proposed governance structure of the SRO. The proposal to ensure that *"at least one-third of members in the Board of Directors including the chairperson shall be independent and without any active association with the category/ class of REs for which the SRO is established"* may not be enough. Since the restriction is on *"active association"*, retired senior personnel from the same industry are likely to find themselves as independent members of the SRO board. While such a situation may not result in a worst-case scenario of industry capture, it can certainly lead to a disproportionate disposition of the board towards its members instead of the customer. Thus, we propose that the board of the SRO must also comprise of representatives of the customers, and they can be drawn carefully from consumer organisations, other civil society actors and/or academia. We further propose that to ensure customer voices are well represented, at least 30% of board members ought to be representatives of the customer. Such a design has precedence - the Australian Securities & Investments Council (ASIC) requires industry associations to demonstrate *"a balance of industry representatives and consumer representatives and an independent chair"* while approving an industry code of conduct (Australian Securities & Investment Commission, 2013).

B. Subsuming certain current objectives under the "responsibilities towards the customers"

We propose that some of the mandates currently placed under *"responsibility towards members"* of the SRO be rearranged under the new section (discussed earlier) on *"responsibilities towards customers"*. Specifically, we propose that paragraph 8(vi) of the draft Omnibus Framework, which reads *"The SRO should educate public about operations of REs, grievance redress mechanisms available to them and spread awareness in general about the sector"*, should be subsumed under the new section on *"Responsibilities towards the Customer"*. Similarly, for the draft FinTech Framework, paragraph 12(iv)(b) – *"The SRO-FT should work towards customer education focused on products and services offered by the industry"* should be subsumed under the new section on *"Responsibilities towards the Customer"*. Thus, the objective of enhancing financial education of the customers, especially regarding the products the sector offers, should be a separate objective under the new *"responsibilities towards the customers"*.

C. Greater clarity is needed regarding how sectors for SROs will be defined

The draft Omnibus framework mentions that the RBI *"may prescribe sector-specific additional conditionalities, if warranted, at the time of calling for applications for recognising SROs for a category/ class of REs"*. This implicitly acknowledges that different categories/classes of REs may have different industry needs. While the argument is true in many cases, it is not universal.

There are several activities where both banks and regulated non-banking entities can participate. For example, banks and regulated non-banks can originate assets across several common asset classes. Moving beyond credit, in payments, we observe the presence of banks, regulated non-banks and unregulated FinTechs as participants. Though certain activities like accepting demand deposits or originating Kisan Credit Card (KCC) loans are within the strict purview of specific classes of REs, most activities are no longer the domain of REs alone. Thus, defining *"sectors"* for which an SRO must be created would be onerous when only specific classes of REs that constitute participants in a certain sector/ industry are considered.

Similarly, an activity (or asset class or product) based definition of a sector may make the SRO's membership too heterogeneous to manage when such an activity (or asset class or product) is very

broadly defined. For example, while defining the sector "FinTech" in the draft FinTech Framework, the RBI notes that "*FinTechs encompass diverse entities in terms of constitution, size, activities, domains, etc., all subject to constant flux and evolution*". Thus, what constitutes "FinTech" today may not constitute "FinTech" tomorrow. Further, FinTechs are increasingly carving out narrowly defined sectors from pre-existing broader sectors. For example, different categories of FinTechs together enable "digital lending". Some crowd-in leads, others provide underwriting services, some facilitate client servicing, and some facilitate loan recovery services, to name a few.

Finally, adopting both definitions, i.e., activity-based and a class of RE-based, may present challenges to "*voluntary membership*" as envisaged in both drafts. For example, if SROs are created for the FinTech sector, then would it be necessary for an NBFC-MFI engaged in digital lending to enrol for the same despite already being a member of either Microfinance India Network (MFIN) or Sa-Dhan (the two existing SROs for NBFC-MFIs)? If not, the FinTech SRO will be unable to provide "*a consultative platform for policy making*" as envisaged by the RBI in the Statement on Developmental and Regulatory Policies (Reserve Bank of India, 2023). Conversely, if the RBI expects such an NBFC-MFI (engaged in digital lending) to become a member of both sectors' SRO, the memberships cease to remain voluntary. Similar is the case with a small commercial bank that engages in digital lending and housing finance, and is a member of a Fintech SRO and a housing finance-SRO, but does not have a bank-SRO to become a member of.

Thus, we submit that the RBI should elucidate a set of principles that will guide how it will decide whether to issue additional sector-specific conditionalities. There would be many considerations for the RBI in this regard, including more tactical benefits such as handling many day-to-day complaints and industry issues by the SRO that the RBI would otherwise not have the capacity to deal with. Another area where clarity can help is whether or not the RBI envisages the role of the SRO's GRM as being a formal intermediate GRM (placed between the internal GRMs of member entities and the RBI's Ombuds) in serving aggrieved customers. Instilling formality to an SRO's GRM is most welcome, but when seen along with the 'voluntary' aspects of how SROs are to be brought into existence and to evolve, the system may be faced with a situation where the more traditional sectors or REs may continue to lack SROs, or they may choose not to take up membership in new SROs, and their customers lose out on the benefits that such SROs' oversight can bring for them.

An alternative to consider for the RBI, through inter-departmental coordination, is to lay out the details of expectations on the Omnibus framework but to not restrict the framework only to categories/classes of REs, and to let the participants in the economy decide whether they want to organise themselves into an SRO for their specific product-type, service or activity-type or not. While forming an SRO will entail additional costs for entities, not doing so will increase the risk of unchecked and unscrupulous activities by a few actors, necessitating heavier regulatory treatment and enforcement actions from the RBI that will apply also to good actors. This trade-off is best left to the industries and sectors to decide for themselves. This is especially so given that the RBI's steering of the microfinance sector towards a successful establishment of SROs that have as members both NBFC-MFIs but also others such as banks engaged in microfinance activities, provides valuable guidance to others in financial services to follow suit.

More clarity on these key design aspects would enable stakeholders to assess the potential outcomes, engage in the consultative process more effectively, and support the RBI in its endeavour to develop SROs as credible intermediaries that can serve the objectives outlined.

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