

## Comments to the Draft Framework for recognising Self-Regulatory Organisations for FinTech Sector dated 15 January 2024.

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On 15<sup>th</sup> January, the Reserve Bank of India (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 lays out the guidelines for prospective SROs in the FinTech sector. It sets out the roles, responsibilities, powers and governance structure of a prospective FinTech SRO, intending to create a culture of self-governance and regulatory compliance in the sector. In this response, we present our comments to the draft FinTech framework.

We would also like to highlight that earlier in January, Dvara Research submitted a *combined* response to both the draft Omnibus Framework and the draft FinTech Framework ([available here](#)). In this response, we summarise aspects from the combined response that are of relevance to the draft FinTech SRO framework in this document.

### **Summary of Comments**

We welcome the RBI's vision of instituting the SRO to achieve the twin objectives of greater innovation and ethical business even in the absence of formal regulation (Reserve Bank of India, 2024). The emphasis on melding customer protection concerns with the routine operations of the FinTech industry is very welcome at a time when new customer segments are getting included in the fold of formal credit owing to the declining ticket sizes and loan tenures made available by FinTech lenders (FACE, 2023).

Our response focuses on two themes. First, leading from a customer protection perspective, our comments focus on further entrenching customer protection in the responsibilities of the FinTech SRO. Therefore, we discuss the need to introduce an explicit responsibility of the SRO towards the customers. Second, reflecting on the implications of the creation of this SRO on the system as a whole, this response highlights the need for greater clarity and nuance in the treatment of those entities that may belong to more than one SRO (such as NBFCs). These two 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 welcome. 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*". This desired vision explicitly acknowledges the role of an SRO in ensuring the highest standards of conduct, suggesting an implicit responsibility towards the customers.

A reading of the framework reveals that two sets of responsibilities are placed on the SRO. First, the functions that the SRO must discharge, primarily focusing on shepherding its members<sup>1</sup> and second, the responsibilities towards the RBI<sup>2</sup>. The second set of responsibilities (towards the regulator)

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<sup>1</sup> Chapter IV of the draft FinTech Framework.

<sup>2</sup> Paragraph 13 of the draft FinTech Framework.

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.

We submit that a similar responsibility of the SRO **towards the customers and their protection** will put the customer on an even keel in this dynamically evolving sector. Such an explicit responsibility of the SRO towards the customers of its members (and customers at large) will help ensure minimum uniform standards of institutional conduct towards the recipients and purchasers of the services offered by the FinTech industry. This crucial design element is the other important feature (in addition to the responsibility to the regulator) that distinguishes an SRO from an industry body/association.

Currently, responsibilities towards the customers are subsumed under the various **Functions** set out in Chapter IV of the Draft FinTech Framework. For instance, paragraph 12 (iv) (b) reads, "*The SRO-FT should work towards customer education focused on products and services offered by the industry.*" Similarly, paragraph 12 (i) (c) emphasises the need for baselining technology to ensure data privacy etc. While customer protection appears at the heart of these functions, the current framing falls short of giving the theme of customer protection the salience that it deserves.

If the theme of customer protection were promoted to a responsibility per se (at par with paragraph 13, for instance), it would have significant implications for *all* other functions that the SRO must discharge. For instance, the responsibility of customer protection, will interface with the function of **Standard Settings**, causing these functions to also internalise the goal of customer protection. This would ensure, for instance, that the codes of conduct instituted by the FinTech SRO for its members<sup>3</sup>, or the standardised agreements between the lending service partner (LSP) and the regulated entity (RE)<sup>4</sup> are in the service of customer protection. For example, in this case, this would have the effect of the codes of conduct urging the members to actively pursue customer protection, and the standardised agreements between LSPs and REs codifying customer protection safeguards by default. A standalone responsibility of customer protection would have similar implications for the functions of **Oversight and Enforcement**, wherein, for instance, the surveillance operations to detect violations<sup>5</sup> would be bound to look out for egregious violations of customer protection.

By adding a separate section that outlines the responsibilities of an SRO towards the customers of the sector, the proposed SRO may be better placed to manage the risks around customer protection<sup>6</sup> and strengthen its developmental<sup>7</sup> role. 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 submit that protecting the customers' interests at par with protecting the interests of other stakeholders is crucial to the foundation of a healthy industry. 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

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<sup>3</sup> Paragraph 12 (i) (b) of the draft FinTech Framework.

<sup>4</sup> Paragraph 12 (i) (c) of the draft FinTech Framework.

<sup>5</sup> Paragraph 12 (ii) (b) of the draft FinTech Framework.

<sup>6</sup> Chapter 1 of the draft FinTech Framework.

<sup>7</sup> Paragraph 4 (ii) the draft FinTech Framework.

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 in a digital environment to forces such as dark patterns that confuse, coerce, or manipulate users into making decisions that do not reflect their underlying preferences (Chugh & Jain, 2023). Therefore, we propose that the draft framework 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).

Further, in line with the combined response (Dvara Research, 2023), we propose four dimensions of customer protection to consider adding to the responsibilities of the SRO:

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 (when 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. Upholding data protection principles as set out in Indian legislation, including but not limited to practising effective consent during financial transactions.
4. *Ensuring that grievance redress mechanisms for members' customers* are independent, customer-centric, accessible and efficient.
5. *Aligning all other functions of the SRO with the responsibility of customer protection*, to ensure that all functions of the SRO are sensitive to and organically internalise the concerns of the customer. This would help make customer protection a ***second nature of the SRO***.

We discuss these aspects of customer protection in detail, below.

#### 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 encourage mis-selling, thus diminishing or reversing the gains achieved in the wake of ever-increasing financial inclusion. We recommend that the draft FinTech Framework place the onus of reducing such information asymmetry on the SRO. 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 (Dvara Research, 2023). 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*"<sup>8</sup> for their members. This articulation is greatly appreciated, and, the following activities may do it justice:

- 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 gauge product suitability (Dvara Research, 2023). Therefore, the prospective SRO can be entrusted the function to ensure the suitability of products offered to the customers. This function 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 and sharing with members (and other relevant partners) 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. Proactively identify early signs of debt distress among borrowers through effective market monitoring and surveillance<sup>9</sup>. This would enable timely intervention and support for those at risk of financial hardship.

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<sup>8</sup> Paragraph 12(i)(c) of the draft FinTech Framework.

<sup>9</sup> Paragraph 12(ii)(b) of the draft FinTech Framework.

### 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 about the activities of its members for 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. We also recommend that prospective SRO 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 (Dvara Research, 2023):

- 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:

We welcome the explicit focus on establishing an efficient, fair, and transparent grievance redressal and arbitration framework for its members. Similarly, the draft FinTech Framework also reinforces the need for customer education focused on products and services offered by the industry. This vision can further be strengthened by emphasising that these grievance redress forums be accessible, transparent, inclusive and customer-friendly. Customers in the financial sector may face barriers in navigating grievance redress channels. Where they can overcome these, they may experience difficulty in identifying or articulating grievances such as mis-selling or collection agent harassment (Singh, Chugh, & Prasad, 2023). Therefore, designing a simple-to-access-and-use grievance redress system is essential to safeguarding customers and earning their trust.

The guidelines around grievance redress in the draft FinTech Framework will also benefit from the grievance redress template set out in the case of Non-Banking Financial Company – Micro Finance Institutions (NBFC-MFIs) for instance. In the SRO Guidelines for the NBFC-MFI sector, the establishment of a Grievance Redressal Mechanism (GRM) and the appointment of a Grievance Redressal Nodal Officer are key criteria for the recognition of SROs by the RBI (Reserve Bank of India, 2013). Given this

precedent, we recommend that SRO contemplated under the draft FinTech framework consider expanding the scope of responsibilities of the prospective SRO to include the following (Singh, Chugh, & Prasad, 2023) (Dvara Research, 2023):

- 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.

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 FinTech entity"*<sup>10</sup> 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) (Dvara Research, 2023).

#### 5. Aligning all other functions of the SRO with the function of customer protection:

In the absence of a distinct, stated function of responsibility towards customers, it is tempting to infer that the functions of the SRO need only account for regulatory and member expectations. For instance, paragraph 12 (iii) (a) reads, *"The SRO-FT should actively promote understanding of statutory and regulatory requirements and promote a culture of compliance. It should facilitate exchange of expertise and experience, as well as organise training*

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<sup>10</sup> Paragraph 14(iv) of the draft FinTech Framework.

*programs for the benefit of its members.” Similarly, Paragraph 12 (i) (b) reads, “The SRO-FT should frame a code of conduct for its members, customised to the nature of various set of activities undertaken by them”. However, many of these commitments must also account for the customer, minimising the risks to them and bolstering safeguards to achieve the envisioned objective of “maximising the creative potential of FinTechs, while minimising the idiosyncratic risks they pose to the financial system”. Most functions set out in Chapter 4 can aid the aforementioned four dimensions of customer protection and distinguish the SRO from being an industry body.*

**B. Greater clarity is needed regarding the treatment of entities that may be a part of more than one SRO**

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. Some of these entities may already be regulated by the RBI, and, by extension be members of other SROs.

For example, should an NBFC-MFI engaged in digital lending enrol for the FinTech SRO 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 and there may be a duplicitous reporting burden on the entities. 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 the treatment of regulated entities that engage in digital lending and may already be members of other SROs.

The institution of an SRO for the FinTech sector is a very welcome step. Leading from a customer protection perspective, we submit that calling out customer protection as a distinct responsibility of the SRO will help in the pro-customer growth of the sector. Similarly, attending to nuances around subscription to more than one SRO can reduce the cost of regulation for entities while enabling the achievement of regulatory objectives.

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