CENTER for FINANCIAL INCLUSION | ACCION

FACE

Fintech Lending Risk Barometer 2022-2023

Understanding the Perception of Risks in the Fintech Lending Sector in India

JANUARY 2023

Context

India has seen a rapid rise in fintech lending since 2014, and the industry continues to evolve with the launch of new models and approaches to lending. Much of this growth can be attributed to a combination of factors — an economy that is rapidly digitalizing, an increase in mobile and internet penetration, low cost of internet data, and investment by the government in digital public infrastructure in the form of India Stack. And all these factors are accompanied by a progressive regulatory and policy environment that encourages rapid innovation.

Yet, as the industry has scaled and diversified, so have the risks. Reports published by the Reserve Bank of India (RBI) warn about the imminent dangers posed by digital lenders to consumers and the financial sector.[i] However, although there is awareness of the multitude of risks the fintech lending industry faces, this risk barometer study, conducted by the Fintech Association for Consumer Empowerment (FACE) in collaboration with the Center for Financial Inclusion (CFI), is the first attempt at ranking these risks in terms of the urgency perceived by fintech lenders, investors, and other stakeholders who monitor the sector closely.

This risk barometer study aims to create a systematic baseline of emerging risks in order to help observe how risks change as the industry matures. The study is part of a market monitoring exercise to understand the range of risks and how they are perceived by multiple stakeholders in the Indian fintech lending sector.

Foreword

From this risk barometer study of the fintech lending sector in India, the key theme that emerged is the erosion of trust. Lack or erosion of trust stems from irresponsible and suboptimal market practices by regulated or unregulated players. It poses the threat of depleting consumer value, invoking regulatory backlash, and declining investor interest, all of which can prevent the sector from benefiting from the opportunities fintech lending presents to the Indian market.

The good news is that multiple stakeholders have a growing awareness and willingness to work together to address the risks that contribute to eroding trust. Delivering greater consumer value, ensuring that people are treated responsibly, adhering to regulations, and creating better channels for collaboration and communication all contribute to improved market practices, help lenders differentiate themselves, and create value for all stakeholders.

CFI and FACE are pleased to partner on this study and hope that this report will contribute to the fintech lending industry as it evolves to maturity, combining innovation, inclusion, and impact.

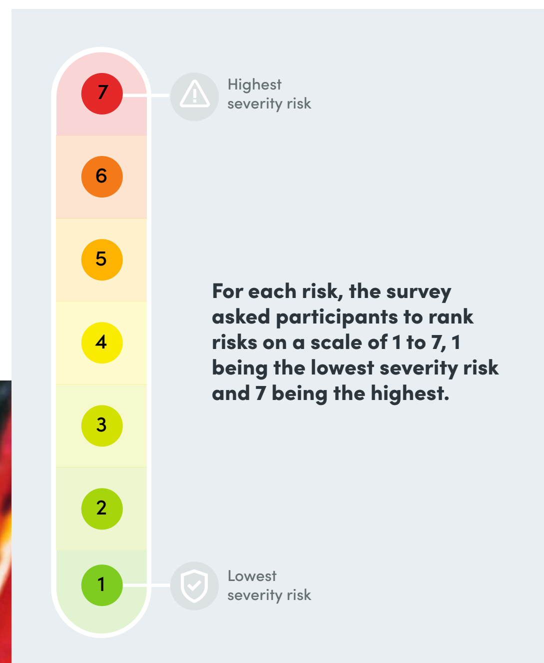
About This Study

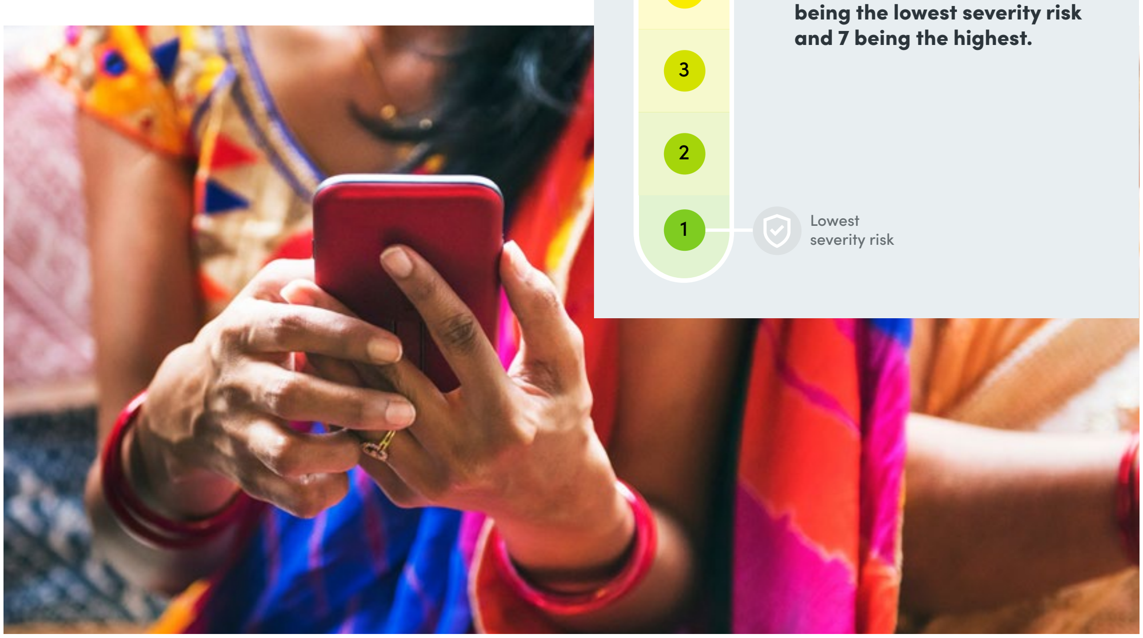
This fintech lending risk barometer study followed a mixed methods approach. First, an online survey was conducted from September to October 2022 to gather lenders' and non-lenders' initial perceptions of risks (see Annex 1 for the questions). The survey respondents all closely follow the fintech lending sector in India. Forty companies responded — 30 lenders and the remaining 10 from the non-lender community (see Annex 2). This was then followed by nine in-depth qualitative interviews with select respondents to further understand emerging risks and how they impact consumer lives.

For each risk, the survey asked participants to rank risks on a scale of 1 to 7, 1 being the lowest severity risk and 7 being the highest. The survey also captured comments and feedback on these risks and the top three opportunities.

Responses received were confidential, although respondents to the survey could choose to be identified. For the purposes of this report, the term "lenders" is used to refer to all entities regulated by the Reserve Bank of India (RBI), including banks and non-bank finance companies (NBFCs), as well as fintechs that have direct engagement with consumers throughout the credit journey and are not regulated by the RBI. The term "non-lenders" includes investors, think tanks, representatives of consumer associations, and other institutions that do not directly transact with consumers.

Of note, the survey responses were collected at the same time as the RBI issued its Digital Lending Guidelines.[ii] This context and background must be considered when reviewing the responses.





Digital Lending Regulations in India

Fintech digital lending in India has rapidly grown since 2014, attracting over USD $2.4 billion in venture capital investments and growing in terms of sophistication and market penetration.[iii] The growth of fintech startups was encouraged by the rapid rise in smartphone usage[iv], a significant population under the age of 64,[v] a rapidly digitalizing economy,[vi] a conducive policy environment,[vii] and deepening digital infrastructure.[viii] Fintech lending companies started curating digital journeys for consumers by innovating through products and distribution channels, and using data, technology, and partnerships.

Acceleration in digitalization in the last five years has created strong tailwinds for digital lending. Digital loans are largely unsecured, small, and short-term, and are provided to low- and middle-income customers and small businesses. As digitalization took root, incumbents (i.e., traditional banks and NBFCs) also warmed up to digital lending across asset classes. The rapid growth comes with risks in the form of stress on consumers and small business owners — the primary borrower segments. The sector has also seen a proliferation of unlawful digital lending apps, many with cross-border linkages, that can harm consumers by providing excessively priced credit, misusing consumer data, and employing harsh recovery practices.

Noting these developments, the Reserve Bank of India (RBI) formed a working group (WG) in January 2021 to study all aspects of digital lending activities.[ix] RBI released the WG report[x] in November 2021 and opened public consultations by December 2021. In August 2022, RBI released its implementation recommendations from the working group, which proposed a phased approach to implementation.[xi] The first phase was the release in September 2022 of the Digital Lending Guidelines for immediate execution.[xii]

"Digital lending can make access to financial products and services more fair, efficient, and inclusive. Fintech-led innovation is now at the core of the design, pricing, and delivery of financial products and services. RBI aims to take a balanced approach so that the regulatory framework supports innovation while ensuring data security, privacy, confidentiality, and consumer protection. The rapid growth and popularity of digital lending apps has been accompanied by risks which have wider systemic implications. Against this backdrop, a Working Group (WG) is being set up to study all aspects of digital lending activities in the regulated financial sector as well as by unregulated players so that an appropriate regulatory approach can be put in place."

Reserve Bank of India on the working group

Key features of the Digital Lending Guidelines are summarized below:

1. Digital lending is defined as "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."

2. The regulations are applicable to regulated entities of the RBI (i.e., banks and non-banks).

3. The core feature is consumer protection, including standards on disclosures including pricing, data usage and sharing, third parties, disbursement and repayment transactions, and customer grievances. Regulations also stipulate a detailed framework for transparency, privacy, and safety of customers' data with specific technical and data requirements.

4. Recognize the critical role of fintech companies (non-regulated players working with regulated entities) as loan service providers (LSPs) and set principles and rules for partnership arrangements between regulated entities and LSPs, with regulated entities taking accountability for their actions, regardless of the partnership arrangement. The Digital Lending Guidelines emphasized due diligence by regulated entities on LSPs, "taking into account its technical abilities, data privacy policies and storage systems, fairness in conduct with borrowers, and ability to comply with regulations and statutes."

RBI also articulates the gradual evolution of regulations for digital lending, including establishing self-regulatory organizations which cover regulated entities, digital lending apps, and LSPs in the digital lending ecosystem.[xiii]

The digital lending ecosystem in India is at a point of transformation and is likely to see several changes over the next few years, influenced partly by regulation. Because of this, a risk barometer study like this one is crucial to be able to track changes in risk perceptions as the industry continues to evolve.

Ranking Risks

Survey respondents were asked to score the severity of 23 identified risks on a scale of 1 to 7, with 1 being the lowest and 7 being the highest, and then to rank the risks. The results provide an understanding of how risks are perceived by those closely associated with the fintech lending sector in India.

Table 1 below presents the top 10 risks overall out of the 23 risks listed. Of these, the top four risks (unscrupulous fintech lenders, cyber fraud and cybercrime, data privacy, and compliance) fall in the severe category of risk, with a score greater than or equal to 5. The remaining six risks fall under moderate, with scores ranging between 3 and 5.

Lenders and non-lenders differed in their responses, not just in the overall risk ranking but also in the rating of a particular risk indicator. Non-lenders tended to score all risks, except funding risk, as more severe compared to lenders. Additionally, non-lenders ranked risks experienced by consumers, such as unfair practices, transparency, indebtedness, and exclusion, higher in severity compared to lenders. Lenders, on the other hand, seemed more concerned about business risks, such as funding, data, compliance, regulation, reputation, and business model-related issues. Table 2 highlights the different risk indicator ratings of lenders and non-lenders, and additional details on the difference in risk perceptions is provided in Annex 3.

Further, for each risk indicator, there is variation between lenders and non-lenders and between companies. This is to be expected given that companies provide responses based on their stage of maturity and individual context. Factors that drive differences in responses include business model, product or segment focus, scale, and regulatory status. We have captured these nuances in the commentary in the section on the top 10 risks.

TABLE 1: TOP 10 RISKS

Rank	Risk Indicator	Explanation	Average Rating (out of 7)
1	**Unscrupulous fintech lenders**	This term refers to fintech lenders who operate in the market in an unauthorized manner, and tend to use aggressive collection practices or engage in mis-sale and predatory lending practices, etc.	6.3
2	**Cyber fraud/crime**	Reputation risk and business loss to fintech lenders and consumers due to threats like cybercrime, fraud, and money laundering.	5.5
3	**Data privacy**	Risks of poor visibility on data ownership (who owns data) and compliance (what data can be collected), and inadequate mechanisms at the lender level to protect and appropriately use the consumer data they access.	5.1
4	**Compliance**	The risk of non-compliance due to unclear and rapidly changing rules.	5.0
5	**Unfair practices**	The risk of aggressive marketing and collection practices that harm consumers. (These are market practices followed by authorized lenders.)	4.9
6	**Regulation**	Inadequate or excessive regulation changing frequently for fintech lenders, creating an uncertain business environment, making compliance difficult and expensive, and slowing down the innovation.	4.8
7	**Data**	The current data ecosystem (insufficient and unusable data trails, non-standard data, ambiguity on privacy laws) leads to suboptimal risk assessments as well as rejecting viable customers.	4.8
8	**Funding**	The risk that fintech lenders do not have access to diversified sources of debt or equity funding at an affordable rate.	4.7
9	**Reputation**	The risk that the fintech lending sector suffers from poor reputation/lack of trust by regulators, government, customers, and other stakeholders.	4.7
10	**Business model**	Risks due to partnership agreements with regulated/non-regulated entities operating in a regulatory grey area.	4.7

TABLE 2: RANKING AND RATING OF RISKS BY LENDER AND NON-LENDER RESPONDENTS

By Lenders			By Non-Lenders		
Rank	Risk Indicator	Average Rating (out of 7)	Rank	Risk Indicator	Average Rating (out of 7)
1	Unscrupulous fintech lenders	6.1	1	Unscrupulous fintech lenders	6.7
2	Cyber fraud/crime	5.4	2	Data privacy	6.2
3	Funding	4.8	3	Cyber fraud/crime	6.0
4	Compliance	4.8	4	Unfair practices	5.9
5	Data privacy	4.7	5	Transparency	5.9
6	Regulation	4.7	6	High growth	5.8
7	Unfair practices	4.5	7	Indebtedness	5.7
8	Data	4.5	8	Exclusion	5.6
9	Reputation	4.5	9	Compliance	5.5
10	Business model	4.4	10	Data	5.5
11	Costs	4.4	11	Insolvencies	5.5
12	Transparency	4.2	12	Business model	5.4
13	High growth	4.1	13	Regulation	5.3
14	Outsourcing	4.1	14	Reputation	5.3
15	Indebtedness	4.0	15	Costs	4.8
16	Exclusion	3.9	16	Outsourcing	4.8

By Lenders			By Non-Lenders		
Rank	Risk Indicator	Average Rating (out of 7)	Rank	Risk Indicator	Average Rating (out of 7)
17	Insolvencies	3.9	17	Macroeconomy	4.7
18	Talent	3.9	18	Competition	4.7
19	Governance	3.9	19	Grievance redressal	4.7
20	Macroeconomy	3.8	20	Risk management	4.7
21	Competition	3.6	21	Talent	4.6
22	Grievance redressal	3.5	22	Governance	4.6
23	Risk management	3.1	23	Funding	4.3

Top 10 Risks

1. Unscrupulous Fintech Lenders

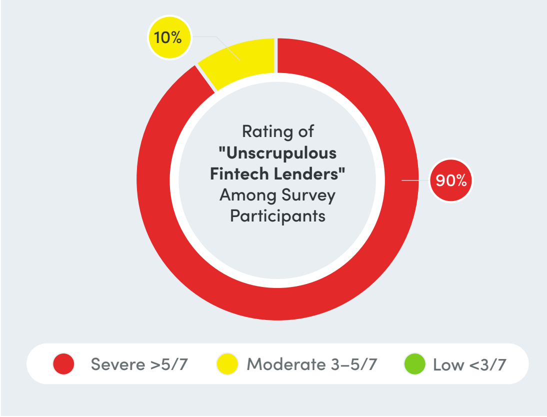
What does it mean?

This term refers to fintech lenders who operate in the market in an unauthorized manner, and tend to use aggressive collection practices or engage in mis-sale and predatory lending practices, etc.

"The challenge with unscrupulous fintech lenders is the reputation risk for the whole sector — everyone gets painted with the same brush. Unscrupulous lenders operate with a very different playbook but make everyone look bad."

Interview respondent

Risk Indicator	Average Rating (out of 7)	Rank of Concern Compared to All Risk Indicators
Overall	6.3	1
Lenders	6.1	1
Non-lenders	6.7	1



The existence of unscrupulous fintech lenders — those that are unauthorized, charge excessive processing fees, do not reveal terms and conditions, and follow aggressive collection practices — emerged as the top risk facing the industry today.

The COVID-19 pandemic saw a growth spurt in digital lending apps that promise access to quick cash. Unfortunately, many of these were not authorized or legal. The RBI Working Group on Digital Lending found almost 1,100 lending apps available to Indian Android users, of which nearly 600 were illegal.[xiv] The RBI has also observed a significant rise in complaints[xv] from consumers since December 2020 when they released a note cautioning the public against unauthorized lending apps.[xvi]

Respondents spoke about the risks presented by unauthorized fintech lenders to businesses and consumers alike. These lenders harm consumers, undermine trust in digital lending, and bring disrepute to the sector. Some respondents indicated that unscrupulous or unethical activities may not be limited to lenders outside of the regulated space and there is a need for strong and clear standards as well as monitoring and enforcement. Any irresponsible practice at the market level can pose a reputation risk to the sector.

Enforcement agencies and app stores have been working to remove apps reported for policy violation. The RBI is preparing a whitelist of legal lending apps,[xvii] and the Ministry of Electronics and Information Technology (MeitY) will ensure that only whitelisted apps are hosted on app stores.

There is, however, a need to establish a market monitoring mechanism and identify supervisory tools that can lead to real-time identification of risks caused by irresponsible lending practices as the sector matures. As one respondent said, “There is a need to differentiate between unscrupulous and illegal — the two may not always be the same.”

2. Cyber Fraud and Cybercrime

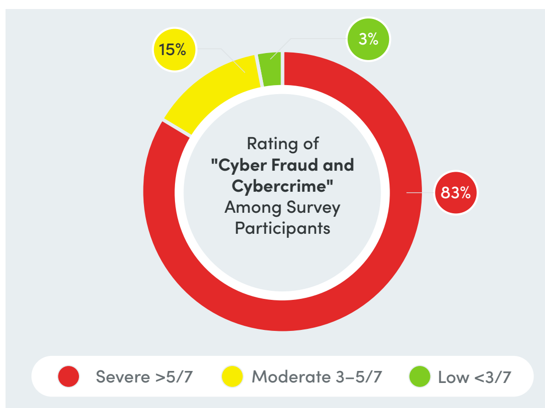
What does it mean?

Reputation risk and business loss to fintech lenders and their consumers due to threats like cyber fraud, cybercrime, and money laundering.

“Cyber fraud is a massive challenge — we have instances of people using our logo on pages set up on Instagram and claim they are collecting on behalf of us, promising consumers that if they pay through these pages, the consumers will get better rates, or discounts on loans. It is hard to monitor and when consumers report this to us, we escalate it as a cybercrime.”

Interview respondent

Risk Indicator	Average Rating (out of 7)	Rank of Concern Compared to All Risk Indicators
Overall	5.5	2
Lenders	5.4	2
Non-lenders	6.0	3



Eighty-three percent of the respondents ranked cyber fraud and cybercrime as a severe risk. This reflects concerns about the vulnerability of fintech lenders and consumers alike. The Global Findex 2021 revealed the pace of rapid digitalization, which was accelerated by the pandemic.[xviii] As digital lending expands to a larger consumer base and first-time borrowers, consumer protection risks from cyber fraud are likely to increase.

Lenders repeatedly highlighted the rise in cybercrime, experienced in the form of identity (ID) theft. Several lenders have instituted processes that help flag possible instances of ID theft by triangulating multiple data points and systems like facial recognition software, bank statement analysis, e-NACH/NPCI checks, device ID checks, and others. However, they acknowledged that these processes to flag ID theft could also create risks for the business. For one, there is a risk of adverse selection given that the borrowers who take loans are the most desperate and are willing to provide lenders permission to access their information.

There is also a risk of excluding good borrowers since the processes could blacklist genuine applicants for using IDs that have been stolen. This loss of business is a challenge that businesses will need to address as competition increases.

As the nature and frequency of cybercrime increase, and as the industry matures and increasingly uses open APIs, risks can emerge in the form of unauthorized transactions.[xix] There is a need to inform all market players about newer crimes so they can create adequate checks and balances. Easier reporting mechanisms also need to be developed so consumers can escalate complaints quickly. One of the challenges highlighted from the survey is that reporting cybercrime can be a time-consuming process; customers must file a First Information Report (FIR) which may take up to a day, often deterring people from acting.[xx] Finally, there is a need for cyber insurance that can help mitigate the impact of risks on lenders and consumers.

3. Data Privacy

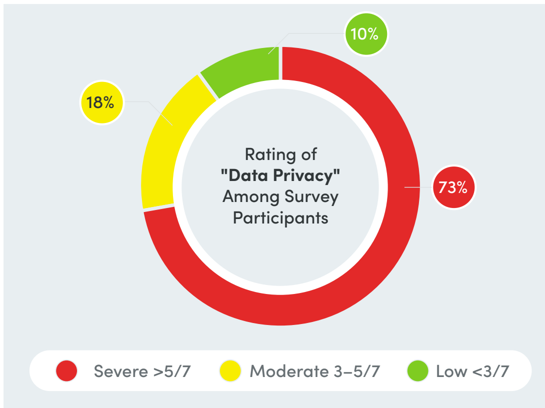
What does it mean?

Risks of poor visibility on data ownership (who owns data) and compliance (what data can be collected), and inadequate mechanisms at the lender level to protect and appropriately use the consumer data they access.

"The absence of a data protection law makes it hard to tell if collecting something will become unlawful in the future. From a lender standpoint, this creates a business continuity challenge — we might have to change something in the credit scoring algorithm in the future … it creates uncertainty."

Interview respondent

Risk Indicator	Average Rating (out of 7)	Rank of Concern Compared to All Risk Indicators
Overall	5.1	3
Lenders	4.7	5
Non-lenders	6.2	2



Many of the lender and non-lender respondents ranked data privacy as a severe risk. The absence of a clear data protection law, lack of standards, and the current distributed model of credit — where information is exchanged between multiple players — all contribute to create a risk of non-compliance for the fintech industry. For consumers, there is an inherent power imbalance between a lender and potential borrower that often leads them to submit information demanded by the potential lender. Studies reveal that over 90 percent of consumers do not read the terms and conditions, which can be a barrier even if lenders seek consent.[xxi]

Some of these challenges have been addressed in the Digital Lending Guidelines. For instance, the RBI clearly mandates that the data collected by digital lending apps should be need-based, have clear audit trails, and should be collected only after prior explicit consent from the borrower. Recognizing that borrowers may not read the terms and conditions, lenders have been asked to provide an option to borrowers to accept or deny consent for use of specific data — including the option to revoke previously granted consent, or to delete data collected from borrowers by the digital lending apps or loan service providers. The government recently has released a draft Digital Personal Data Protection Bill 2022 for public consultation which will provide an overarching framework.[xxii] This is a space that is continually evolving with implications for businesses and consumers.

4. Compliance

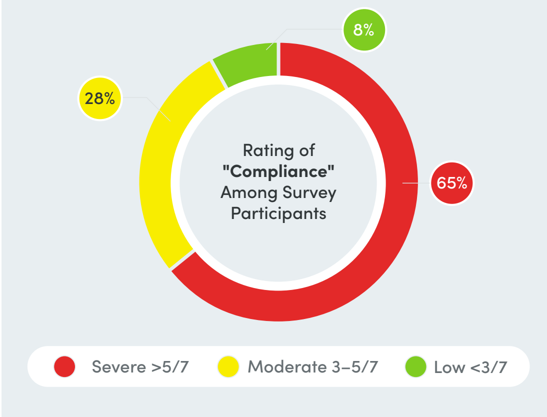
What does it mean?

Risk of non-compliance due to unclear and rapidly changing rules and regulations.

"Regulation is important, but the lack of clarity when trying to implement some of the guidelines is a challenge. In the absence of a clear channel of communication with the regulators, there is a danger that the guidelines are implemented in different ways, which will lead to fines and penalties, and erode consumer trust."

Interview respondent

Risk Indicator	Average Rating (out of 7)	Rank of Concern Compared to All Risk Indicators
Overall	5.0	4
Lenders	4.8	4
Non-lenders	5.5	9



Overall, compliance received a moderate to severe rating. Although non-lenders rated compliance higher in severity compared to lenders, more lenders than non-lenders ranked compliance as a higher risk compared to all the other risk indicators. In their responses, survey participants spoke about the need for greater clarity around regulatory expectations, and the current lack of channels for open interactions with the regulator to explain and discuss the new and evolving models. There was a fear that innovation by fintechs would be impacted, which would have a cascading effect on their ability to generate consumer value. Another challenge is the fear of penalties and fines in the case of non-compliance and possible erosion of consumer trust.

Industry associations play a crucial role in building robust market practices and can act as systematic communication channels between the stakeholder groups they represent and regulators. However, to ensure transparent and consultative framing of regulations, there should be systematic consultations and meeting minutes should be made available for public access.

5. Unfair Practices

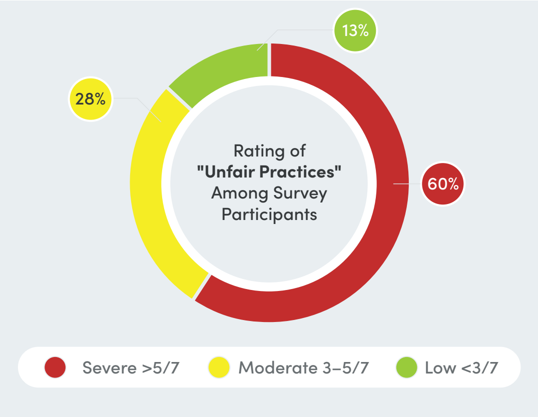
What does it mean?

The risk of aggressive marketing and collection practices that harm consumers.

"We need a systematic demand side study to assess how large the problem is. Analysis of complaints received shows that it is definitely widespread and not restricted to an urban [consumer] segment or specific geography. The challenge is that even a few bad experiences can have a ripple effect and erode trust in the industry."

Interview respondent

Risk Indicator	Average Rating (out of 7)	Rank of Concern Compared to All Risk Indicators
Overall	4.9	5
Lenders	4.5	7
Non-lenders	5.9	4



Non-lenders perceived the risk of unfair practices to be more concerning compared to lenders. However, respondents to the survey largely agreed that even a single publicly reported episode of unfair practice can precipitate rapidly and create reputational risks, invoke regulatory ire, and erode consumer trust. There is a need for systematic research to understand how many consumers experience unfair practices when applying for and using digital loans. Although consumer complaints on social media and media reporting about unfair collection practices and misuse of data permissions by apps led the RBI to institute the Working Group on Digital Lending, complaints on social media do not reveal the scale of the problem.

On the regulatory front, the RBI has issued stringent guidelines on recovery practices and indicated that strong regulatory action would be taken for lenders who do not comply. However, this is another area where self-regulatory organizations and consumer associations can play an important role in enabling responsible market conduct.

6. Regulation

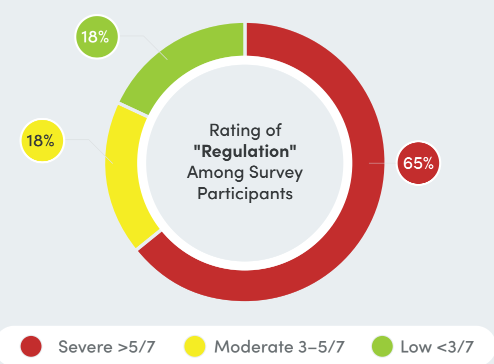
What does it mean?

Inadequate or excessive regulation changing frequently for fintech lenders, creating an uncertain business environment, making compliance difficult and expensive, and slowing down innovation.

"The impact of rapidly changing regulations is on investments. Investors are not sure how the sector is evolving, which will slow down access to capital. We need catalytic capital investors at this stage, not venture capital investors."

Interview respondent

Risk Indicator	Average Rating (out of 7)	Rank of Concern Compared to All Risk Indicators
Overall	4.8	6
Lenders	4.7	6
Non-lenders	5.3	13



Responses to regulatory risks were mixed, with approximately 65 percent of respondents ranking regulatory risks as severe, 18 percent as moderate, and 18 percent as low. Responses must be considered within the context of the fact that the RBI released the Digital Lending Guidelines just before this survey was issued. In general, regulations were viewed as positive and helpful in building trust in the ecosystem. Fintech lenders thought regulators should ensure a fair playing ground that would allow further innovation.

There was a sentiment that app stores and big techs hold a significant amount of power and information, which impacts the digital lending market in India in a multitude of ways. This is likely to become a larger challenge in the future with business models that use embedded financial services. For smaller lenders, there is a fear of misinterpreting regulations, which could translate into business risks. Smaller lenders also spoke about the costs involved with frequent changes in regulations, which affect both time and process- or system-level changes and could diminish attention to other issues.

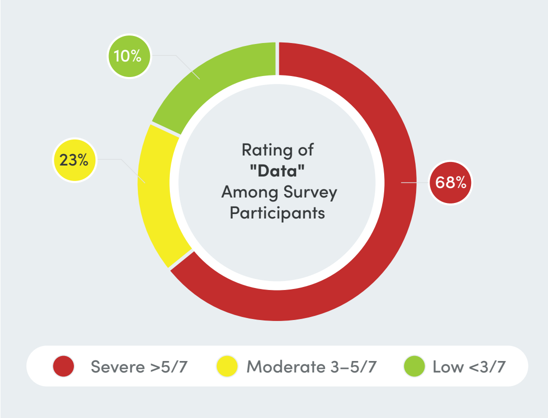
Regulators and market players need to interact on a timely basis. There is also a need to help consumers distinguish between regulated and authorized players and those that operate without authorization. As it is now, more regulations do not always translate into higher consumer trust.

7. Data

What does it mean?

The current data ecosystem (insufficient and unusable data trails, non-standard data, ambiguity on privacy laws) leads to suboptimal risk assessments as well as rejecting viable customers.

Risk Indicator	Average Rating (out of 7)	Rank of Concern Compared to All Risk Indicators
Overall	4.8	7
Lenders	4.5	7
Non-lenders	5.5	9



India's rapid digitalization has led to the inclusion of newer consumer segments. The Global Findex 2021 revealed that the share of adults making digital merchant payments increased after the outbreak of COVID-19.[xxiii] In India, 80 million adults made their first digital payment during the pandemic. This means that consumers who are new to digital financial services are now generating a data footprint and creating transaction trails.

Digital lenders can use these data trails to include consumers who have thus far been excluded from formal lending because they lack collateral and other documentation required to take out a loan. However, the use of alternate data to develop credit scores and the lack of clarity about data privacy laws create concerns for lenders. There is also the related issue of potentially losing consumer data to competitors as people change jobs in the fintech lending space and, in the absence of regulations or legal requirements, take consumer data with them or sell it to competitors.

Additionally, consumers' limited digital capabilities and the lack of understanding around how data is used also contribute to data protection risks. This is a risk that must be addressed urgently by fintech lenders.

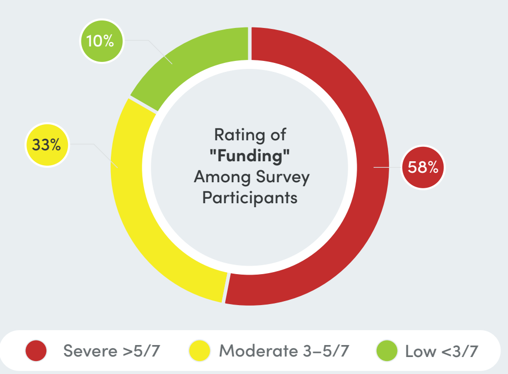
8. Funding

What does it mean?

The risk that fintech lenders do not have access to diversified sources of debt or equity funding at an affordable rate.

> "Large lenders are in a good spot with respect to debt and equity funding, but smaller lenders may face a challenge."
>
> **Interview respondent**

Risk Indicator	Average Rating (out of 7)	Rank of Concern Compared to All Risk Indicators
Overall	4.7	8
Lenders	4.8	3
Non-lenders	4.3	23



While the industry has grown rapidly and is projected to grow at a compound annual growth rate (CAGR) of over 20 percent,[xxiv] access to capital is not equitable. Smaller fintech lenders continue to face challenges in raising both debt and equity.

From the lenders' perspective, there are many uncertainties around equity, including a challenging global environment where investments are slowing down and development funding is being diverted to other priorities, along with rising interest rates, regulatory risks, and opacity about business models and profitability. There is also a paucity of longer-term, patient capital in the sector that can support innovation.

With debt funding, respondents expressed a need to diversify sources. Currently, debt funding is limited to a small pool of lenders, largely NBFCs, and there is a demand by fintech lenders to classify on-lending to fintechs as a priority sector to facilitate access to capital at affordable rates. Doing so would require a focus on lending to low-income consumers, ensure greater consumer protection measures, and would provide a clear measurement of positive consumer outcomes.

9. Reputation

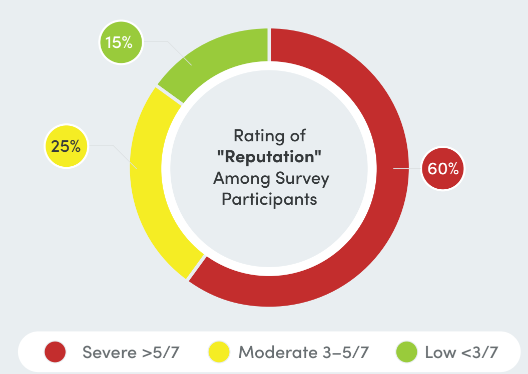
What does it mean?

The risk that the fintech lending sector suffers from poor reputation/ lack of trust by regulators, government, customers, and other stakeholders.

“Reputation risk is real — it can end business models with a single stroke if there is regulatory backlash.”

Survey respondent

Risk Indicator	Average Rating (out of 7)	Rank of Concern Compared to All Risk Indicators
Overall	4.7	9
Lenders	4.5	9
Non-lenders	5.3	13



Lenders, while excited about the opportunities presented by fintech lending, are painfully aware of reputation risks stemming from poor market practice or consumer complaints. Lenders are concerned today about an imbalanced industry narrative that tends to only focus on valuations and the potential of the sector. There is a perception that the lack of information and data about fintech lending in terms of model, scale, and impact creates a trust deficit for both consumers and regulators.

The absence of systematic complaint channels, which leads consumers to complain on social media or other media channels, also results in reputation risk for responsible lenders. This in turn can translate into regulatory backlash.

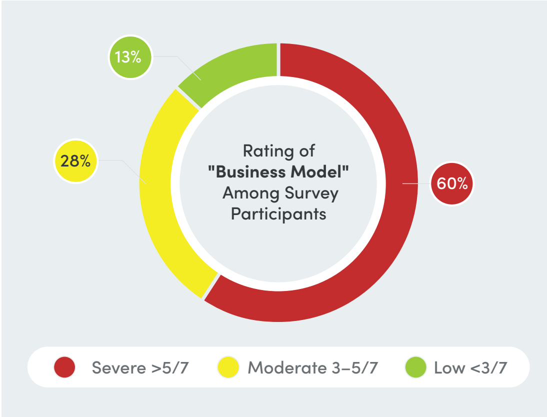
Respondents spoke about the need for self-regulatory organizations and better governance within companies. There is a need to build greater transparency, opportunities for dialogue, and a way to listen to consumers’ voices to build better products and services.

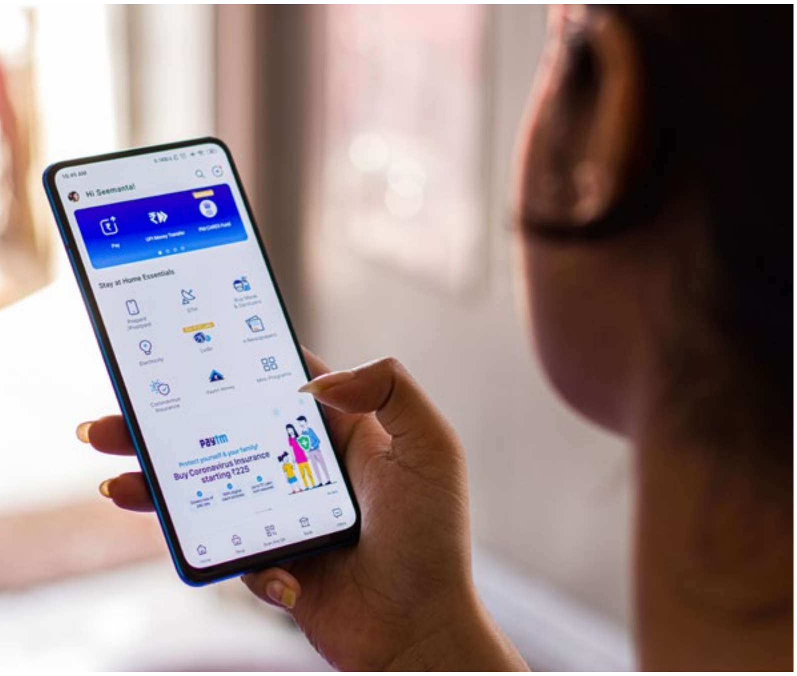
10. Business Model

What does it mean?

Risks due to partnership agreements with regulated/non-regulated entities operating in a regulatory grey area.

Risk Indicator	Average Rating (out of 7)	Rank of Concern Compared to All Risk Indicators
Overall	4.7	10
Lenders	4.4	10
Non-lenders	5.4	12





Fintech lending in India thrives on a partnership model and brings together many players — predominantly technology players and regulated entities. However, these lending models bring their own challenges and risks and have attracted regulatory attention around customer protection, risk sharing and transfer, and data safety and privacy. There is also concern about how newer business models that use embedded financial services would be treated.

Respondents spoke about the need for digital lending to receive fair and even regulatory treatment to promote innovation and competition.

Top Opportunities

Respondents unanimously agreed on the opportunities for the digital lending sector in India. The top three opportunities identified are:

1. **Strong customer demand:**

India continues to be underpenetrated when considering credit to gross domestic product (GDP) ratio, the adult population that accesses formal credit, and other metrics. A consumer survey conducted in 2022 by FACE revealed that approximately 16 percent of borrowers were small business owners who used a loan for business purposes. Most credit continues to be accessed by salaried individuals. Digital lending has the potential to meet the needs of micro and small business owners, women, individuals who lack collateral, and other consumer segments. Taking a nuanced approach to consumer segments can help develop relevant products and services for underserved consumers.

2. **Growing digital economy:**

The pandemic accelerated digitalization and changed consumer behavior. As more people connect via mobile phones, transact digitally on a daily basis, and digitally engage with the wider economy for purchases, business, and financial transactions, digital data trails are created. These data trails allow digital lenders to reach underserved consumer segments. New business models also will allow digital lenders to integrate credit and finance with non-financial services.

3. **Positive policy environment:**

The government of India's focus on creating digital public infrastructure and encouraging open APIs through a unified payment interface (UPI),[xxv] open digital ecosystems (ODEs),[xxvi] and open credit enablement network (OCEN)[xxvii] are seen as positive steps to transform the digital lending ecosystem in India and create a pathway to a mature, responsible lending ecosystem.

While the RBI has created a regulatory sandbox in the form of the RBI Innovation Hub[xxviii] that can encourage innovation and inclusion, there are several other areas that simultaneously need work. To enable responsible market practice and enforcement, there is a need to engage with civil society organizations and consumer associations that can be the eyes and ears of the regulator. Creating self-regulatory organizations can be an important step in enabling responsible market conduct. There is also an opportunity to learn from regulators as digital lending matures in other markets.

Although factors like grievance redressal mechanisms and governance were not ranked high in the survey, in the interviews with select respondents they were indicated as crucial to building responsible market practices. The responses to the survey were received at a time when other factors were top of mind, which could explain the lower ranking.

RBI's Digital Lending Guidelines highlight the importance of building grievance redressal systems and requiring regulated entities to ensure that all loan service providers have appointed a nodal grievance redressal officer to address complaints received against digital lenders. Consumer advocacy groups mentioned the importance of developing accessible, affordable, and easy-to-use complaint systems to ensure consumer protection.

Governance, while seen as an important criterion, is not top of mind for fintech lenders right now, as the industry is evolving and most companies are unlisted. However, it is considered an important factor and one that will contribute to better market practice in the long run.

Annex

Annex 1: Survey Questions

ABOUT THE RESPONDENT	
Name	
Email	
Designation	

ABOUT THE COMPANY	
Name	
Regulatory status	Bank/NBFC/Not regulated by RBI
The offering of retail loans	Digital only/Digital and physical/Not applicable
Type of company	Loan service provider/Balance sheet lender/Marketplace/Other (research, advisory, debt/equity to fintech, technology services to fintech, etc.)
Channels you use to offer digital loans (check multiple, if applicable)	Own lending platform/Marketplace/Other lending platforms/Ecommerce platforms/Merchants
Willing to be interviewed	Yes/No
Willing to be quoted	Yes/No
Willing to have company be disclosed in the list of survey participants	Yes/No

ASSESSMENT OF RISKS

Rate on a scale of 1 to 7 the extent to which you see this factor as a risk to consumers and/or the industry (1 = Highly negligible, 7 = Extremely severe). Comments may be provided if you choose to provide an explanation.

Rating Scale:

1	2	3	4	5	6	7
Highly negligible	Slightly negligible	Somewhat negligible	Neither negligible nor severe	Somewhat severe	Severe	Extremely severe

Risk	Definition	Rating	Comments, if any
Macroeconomy	The risk that fintech lenders/their customers will be damaged by trends in the wider macroeconomy such as inflation, slowing growth, high-interest rates, and unemployment.		
Regulation	Inadequate/excessive regulation changing frequently for fintech lenders creating an uncertain business environment, making compliance difficult and expensive, and slowing innovation.		
Funding	The risk that fintech lenders do not have access to diversified sources of debt or equity funding at an affordable rate.		
Data	The current data ecosystem (insufficient and unusable data trails, non-standard data, ambiguity on privacy laws) leads to sub-optimal risk assessment as well as rejecting viable customers.		
Insolvencies	Insolvency of fintech companies due to various factors (business model, compliance, regulatory/enforcement action, credit losses) impacting the overall environment for fintech lending companies.		
High growth	Focus on high business growth undermines other necessary imperatives like risk management, market conduct, compliance, and appropriate risk-based pricing framework.		
Reputation	The risk that the fintech lending sector suffers from poor reputation/lack of trust by regulators, government, customers, and other stakeholders.		
Competition	The risk of reduced or increased entry barriers to fintech lending can prevent healthy competition. For example, the entry of traditional NBFCs/banks, big techs, and other technology providers.		
Unscrupulous fintech lenders	This term refers to fintech lenders who operate in the market in an unau-thorized manner, and tend to use ag-gressive collection practices or engage in mis-sale and predatory lending prac-tices, etc.		
Costs	Increasing costs of funding, operations, technology, compliance, and HR im-pacting margin and affordable loans.		
Cyber Fraud/ Crime	Reputation risk and business loss to fintech lenders/their consumers due to threats like cybercrime, fraud, and money laundering.		
Outsourcing	The risk that fintech lenders/their cus-tomers face due to integration with multiple players like privacy/data se-curity and integrity, vulnerability due to APIs, and mis-selling by merchants.		
Business model	Risks due to partnership agreements with regulated/non-regulated entities operating in a regulatory grey area.		
Risk management	Challenge that fintech lenders do not have the ability to identify and man-age business risk.		

Risk	Definition	Rating	Comments, if any
Talent	Inability to hire or retain the right talent, particularly those with tech-nical expertise in IT, data science, cyber security, or risk management.		
Governance	Weakness at the board level leading to poor oversight and control.		
Compliance	The risk of non-compliance due to unclear and rapidly changing rules.		
Data privacy	Risks of poor visibility on ownership (who owns data) and compliance about data (what data can be collected) and inadequate mechanisms at the lender level to protect and appropriately use consumer data they access.		
Grievance redressal	The risk that consumers feel remote due to the digital nature of the busi-ness, and do not know about or are unable to use grievance redressal sys-tems.		
Transparency	The risk that consumers don't know their processing fees, change in inter-est rates, or interest rates they pay.		
Unfair practices	The risk of aggressive marketing and collection practices that harm cus-tomers.		
Indebtedness	The inability of lenders to assess consumers' credit repayment and absorp-tion abilities lead to the customer getting over-indebted.		
Exclusion	Inability to assess consumer creditworthiness due to incorrect/ inadequate data and algorithmic biases leads to the exclusion of customers.		

- Which of the above risks would you classify in your top three risks?
- What are the top three opportunities (customer demand/emerging technology/forthcoming regulation/ availability of talent/digital economy/innovation/government support)?

Annex 2: Survey Participants

The survey received responses from 40 companies, of which 30 (listed below) gave consent to publish their names as respondents:

Company
Ambition Services
Arogin Fintech
Arthimpact Digital
Buddy Loan
Consultative Group to Assist the Poor (CGAP)
Chqbook
Datasigns Technologies
Ekagrata Finance
FatakPay
Financepeer
Grant Thornton Bharat LLP
Indicus Foundation
JuicyScore
Kissht
KrazyBee

Company
Kreon Financial
LoanTap
MAS Financial
MicroSave Consulting
Monexo
Navadhan
Paisabazaar
PayU Finance
Phocket Infotech
SahiBandhu Fintech
SaveIN
Spice Money
Stashfin
Unitus Capital
Vaibhav Vyapaar

Annex 3: Rating and Ranking of Risks

	Average Rating (out of 7)			Ranking		
Risk	**Overall**	**Lenders**	**Non-Lenders**	**Overall**	**Lenders**	**Non-Lenders**
Unscrupulous fintech lenders	6.3	6.1	6.7	1	1	1
Cyber fraud/crime	5.5	5.4	6.0	2	2	3
Data privacy	5.1	4.7	6.2	3	5	2
Compliance	5.0	4.8	5.5	4	4	9
Unfair practices	4.9	4.5	5.9	5	7	4
Regulation	4.8	4.7	5.3	6	6	13
Data	4.8	4.5	5.5	7	7	9
Funding	4.7	4.8	4.3	8	3	23
Reputation	4.7	4.5	5.3	8	9	13
Business model	4.7	4.4	5.4	10	10	12
Transparency	4.6	4.2	5.9	11	12	4
High growth	4.5	4.1	5.8	12	13	6
Costs	4.5	4.4	4.8	13	11	15
Indebtedness	4.5	4.0	5.7	14	15	7
Exclusion	4.4	3.9	5.6	15	16	8

Risk	Average Rating (out of 7) Overall	Average Rating (out of 7) Lenders	Average Rating (out of 7) Non-Lenders	Ranking Overall	Ranking Lenders	Ranking Non-Lenders
Insolvencies	4.3	3.9	5.5	16	16	9
Outsourcing	4.3	4.1	4.8	17	14	15
Talent	4.1	3.9	4.6	18	18	21
Governance	4.1	3.9	4.6	18	18	21
Macroeconomy	4.0	3.8	4.7	20	20	17
Competition	3.9	3.6	4.7	21	21	17
Grievance redressal	3.8	3.5	4.7	22	22	17
Risk management	3.5	3.1	4.7	23	23	17

Resources

i Reserve Bank of India, "Report of the Working Group on Digital Lending Including Lending Through Online Platforms and Mobile Apps," Nov. 18, 2021. https://www.rbi.org.in/Scripts/PublicationReportDetails.aspx?UrlPage=&ID=1189; Reserve Bank of India, "Financial Stability Report," Jun. 30, 2022. https://www.rbi.org.in/Scripts/PublicationReportDetails.aspx?UrlPage=&ID=1203

ii Reserve Bank of India, "Guidelines on Digital Lending," Sep. 2, 2022. https://rbi.org.in/Scripts/NotificationUser.aspx/NotificationUser.aspx?Id=12382

iii Singh, Sandeep. "Decoding Digital Lending in India: The Rise of Consumer Lending, Report 2020." Inc42, Dec. 21, 2020. https://inc42.com/datalab/digital-lending-in-india-the-rise-of-consumer-lending-report-2020/

iv GSMA, "The Mobile Economy Asia Pacific 2022," Jul. 2022. https://www.gsma.com/mobileeconomy/wp-content/uploads/2022/07/GSMA_APAC_ME_2022_R_Web_Final.pdf

v United Nations Population Fund, "World Population Dashboard: India," accessed Dec. 2022. https://www.unfpa.org/data/world-population/IN

vi Kemp, Simon. "Digital 2022: India." Kepios, Feb. 15, 2022. https://datareportal.com/reports/digital-2022-india

vii Digital India, "Agencies Enabling DI Initiatives," accessed Dec. 2022. https://digitalindia.gov.in/agencies-enabling-di-initiatives/

viii Digital India, "Infrastructure," accessed Dec. 2022. https://digitalindia.gov.in/infrastructure/

ix Reserve Bank of India, "Reserve Bank Constitutes a Working Group on Digital Lending Including Lending Through Online Platforms and Mobile Apps," Jan. 13, 2021. https://www.rbi.org.in/Scripts/BS_PressReleaseDisplay.aspx?prid=50961

x RBI, "Report of the Working Group."

xi Reserve Bank of India, "Recommendations of the Working Group on Digital Lending – Implementation," Aug. 10, 2022. https://www.rbi.org.in/Scripts/BS_PressReleaseDisplay.aspx?prid=54187

xii RBI, "Guidelines on Digital Lending."

xiii Reserve Bank of India, "Recommendations of the Working Group on Digital Lending – Implementation: Annex 2," Aug. 10, 2022. https://rbidocs.rbi.org.in/rdocs/content/pdfs/PR689DL10082022_AN2.pdf; Reserve Bank of India, "Recommendations of the Working Group on Digital Lending – Implementation: Annex 3," Aug. 10, 2022. https://rbidocs.rbi.org.in/rdocs/content/pdfs/PR689DL10082022_AN3.pdf

xiv RBI, "Report of the Working Group."

xv Ibid.

xvi Reserve Bank of India, "RBI Cautions Against Unauthorised Digital Lending Platforms/Mobile Apps," Dec. 23, 2020. https://www.rbi.org.in/Scripts/BS_PressReleaseDisplay.aspx?prid=50846

xvii Ministry of Finance, Government of India, "Finance Minister Smt. Nirmala Sitharaman chairs meeting on 'illegal loan apps,'" Sep. 9, 2022. https://www.pib.gov.in/PressReleaseIframePage.aspx?PRID=1857998

xviii Demirgüc-Kunt, Asli, Leora Klapper, Dorothe Singer, and Saniya Ansar. "The Global Findex Database: Financial Inclusion, Digital Payments, and Resilience in the Age of COVID-19." World Bank, 2022. https://www.worldbank.org/en/publication/globalfindex/Report

xix Boyd, Mark. "Digital Finance APIs Come With Risks – Here's One Way to Manage Them." CGAP, Jan. 30, 2020. https://www.cgap.org/blog/digital-finance-apis-come-risks-heres-one-way-manage-them

xx Ghosh, Soumik. "What's wrong with cybercrime reporting in India and how to fix it." CSO Online, Jul. 17, 2020. https://

www.csoonline.com/article/3567106/whats-wrong-with-cybercrime-reporting-in-india-and-how-to-fix-it.html

xxi Cakebread, Caroline. "You're not alone; no one reads terms of service agreements." Business Insider, Nov. 15, 2017. https://www.businessinsider.com/deloitte-study-91-percent-agree-terms-of-service-without-reading-2017-11?r=US&IR=T

xxii Ministry of Electronics and Information Technology, Government of India, "The Digital Personal Data Protection Bill," 2022. https://www.meity.gov.in/content/digital-personal-data-protection-bill-2022

xxiii Demirgüc-Kunt et al., "The Global Findex Database."

xxiv RBI, "Report of the Working Group."

xxv NPCI, "Unified Payments Interface (UPI) Product Overview," accessed Dec. 2022. https://www.npci.org.in/what-we-do/upi/product-overview

xxvi Kumar, Ashutosh. "India's open digital infrastructure could generate an economic value of over $500 billion: Study." ET Telecom, Oct. 27, 2021. https://telecom.economictimes.indiatimes.com/news/indias-open-digital-infrastructure-could-generate-an-economic-value-of-over-500-billion-study/87311276?redirect=1

xxvii Dhanwani, Robin. "OCEN (Open Credit Enablement Network): What Will it Look Like?" Parallel, Aug. 16, 2021. https://www.parallelhq.com/blog/ocen-open-credit-enablement-network

xxviii Reserve Bank of India, "Reserve Bank Innovation Hub," accessed Dec. 2022. https://rbihub.in/

FACE

CENTER *for* FINANCIAL INCLUSION | ACCION

About Fintech Association for Consumer Empowerment (FACE)

Fintech Association for Consumer Empowerment (FACE) is a non-profit industry body set up in September 2020, convening fintech lenders to collectively advance fair and responsible digital lending practices through self-regulation and customer empowerment.

The growing membership of fintech lenders in FACE account for an estimated 50 percent of the retail digital lending by non-banks. FACE pursues an ecosystem-building approach that creates value for all stakeholders while contributing to prosperity and resilience for the customers. Core functions for FACE are self-regulation, policy, knowledge and market development using the customer-first lens.

www.faceofindia.org

@FACEOfIndiaOrg

About the Center for Financial Inclusion at Accion

The Center for Financial Inclusion (CFI) works to advance inclusive financial services for the billions of people who currently lack the financial tools needed to improve their lives and prosper. We leverage partnerships to conduct rigorous research and test promising solutions, and then advocate for evidence- based change. CFI was founded by Accion in 2008 to serve as an independent think tank on inclusive finance.

www.centerforfinancialinclusion.org

@CFI_Accion