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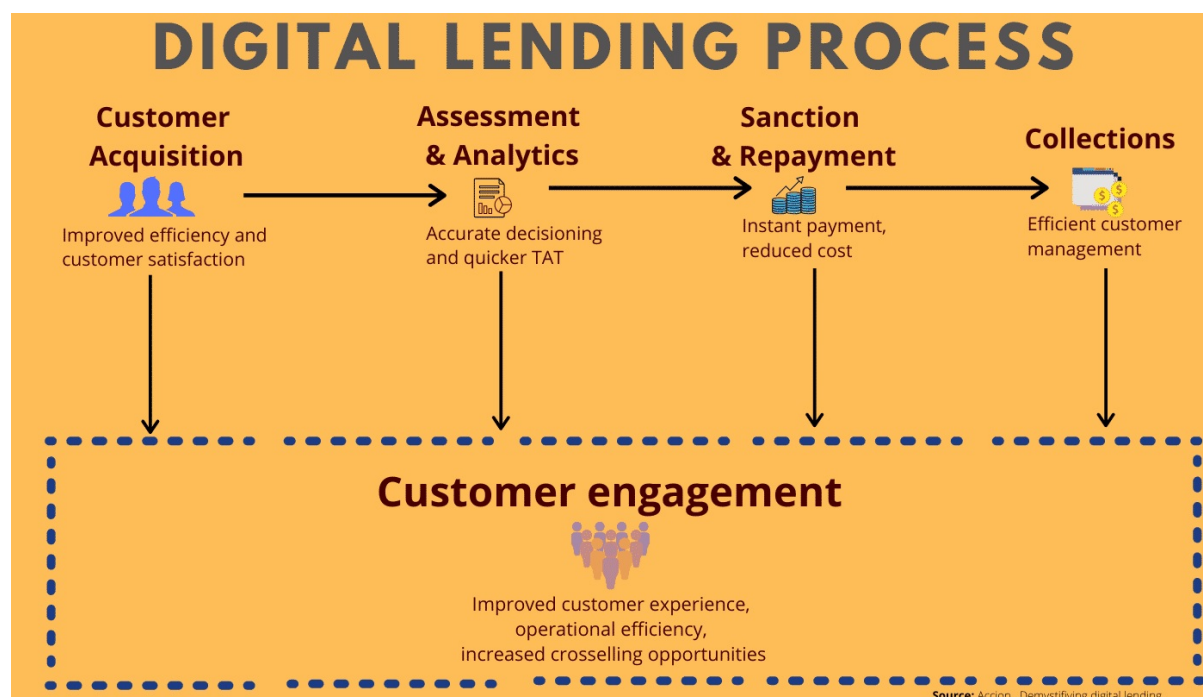
## Digital Lending Draft Rules

### Why in news?

The 'Report of the Working Group on Digital Lending including Lending through Online Platforms and Mobile Apps' has been released by the RBI.

### What is digital lending?

- Digital lending is the process of availing credit online
- Digital lending is mostly preferred by those who are generally not able to avail any credit through the formal sources of finance like banks.



### What digital lending models have been in place?

- Presently, there are three digital-lending models seen through the regulatory-approach lens.
- **Bank/NBFC-owned digital platforms** - They operate under the direct regulatory purview of RBI.
- **Fintech companies' proprietary digital platforms** - They work in

partnership with banks/NBFCs, typically under an outsourcing arrangement to support sourcing of borrowers, assess creditworthiness using alternative data and recover the dues.

- Being mere intermediaries, these platforms are not required to seek any registration with RBI and are only indirectly regulated through RBI's outsourcing guidelines applicable to Banks/NBFCs.
- **Peer-to-peer (P2P) lending platforms** - They usually involve the otherwise unregulated retail lenders.
- RBI has mandated such platforms to seek registration as NBFC-P2P and thus they are directly regulated by RBI.

### **What is the significance of digital lending?**

- Instant disbursal of funds
- Customer friendly application
- Paperless process
- Transparent and simplified process
- Reasonable interest rates
- Ensure swift payback
- Reduced credit gap
- Operating cost efficiency
- Financial inclusion - Example- JAM (Jan Dhan-Aadhaar-Mobile) trinity

### **What are the concerns of digital lending?**

- Unauthorised lenders
- Exorbitant rates of interest
- Use of coercive repayment methods
- Non consensual collection of user data

*RBI report finds 600 illegal loan apps operating in India which are available on several app stores for Android users.*

### **What are the key recommendations on digital lending?**

- The working group was set up on January 13, 2021 with Jayant Kumar Dash, Executive Director of RBI as the Chairman.
- **Loan servicing** - The balance-sheet lending through the apps should be restricted to RBI-regulated entities.
- All loan servicing should be executed directly in a bank account of the balance-sheet lender and disbursements should always be made into the

bank account of the borrower.

- **Nodal agencies** - Nodal agencies must be set up to run digital lending applications through stringent verification processes .
- **Legislative measures** - The group has recommended that in the medium term, the government may consider bringing in legislation to prevent illegal lending activities by introducing the 'Banning of Unregulated Lending Activities Act'.
- **Technology standards** - Certain baseline technology standards should be developed when it comes to digital lending apps and compliance with those standards as a pre-condition.
- Algorithmic features used in digital lending has to be documented to ensure transparency.
- The group recommends that auditable logs should be kept for every action that a user performs on the app and that every fintech app must be signed/ verified in a secured manner.
- **Data collection and usage** - Data should be collected from the borrower with prior information on the purpose, usage and implication of such data and with the explicit consent.
- All such data must be stored in servers located in India.
- **Reporting of lending activities** - Lending by regulated entities (REs) through lending apps must be reported to credit bureaus.
- And only regulated entities can access bureau data for the purpose of collecting or reporting data on behalf of borrowers.
- **Interest calculation** - Interest must be calculated on the basis of the actual number of days and no prepayment penal rate of interest for short-term consumer credit.
- **Shaping the Self- Regulatory Organisations (SRO)**- Standardised code of conduct for recovery to be framed by the proposed SRO in consultation with RBI.
- The group recommended the maintenance of a 'negative list' of Lending Service Providers by the proposed SRO.

### What does the draft rule imply?

- The panel wants to encourage more legitimate lenders while enhancing customer protection and making the digital lending ecosystem safe and innovative.
- The digital lending market in India is evolving fast, and with the Fourth Industrial Revolution it is a matter of time for a shift from digital-too to digital-first to digital-only.
- It is now up to digital apps to play by the rules and self-regulate

themselves.

- As the universe of fintech grows, RBI must arm itself with the necessary technology and technical expertise needed to track lending apps on a real-time basis.

## Reference

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