IGAP Primer

RBI Framework for Self-Regulatory Organisations in the Fintech Sector

Background

On 30 May, 2024, the Reserve Bank of India (***RBI***) published a new self-regulatory framework for the Fintech sector (titled '**Framework for Self-Regulatory Organisation(s) in the FinTech Sector')** which allows for entities classified as 'Fintechs' to set up, and be a part, of a self-regulatory organisations (***SROs***).[1] The RBI views these SROs as mechanisms for greater regulatory compliances and standardization across the sector. The publication of this framework also divulges key aspects of the RBI's perspective on technological innovation in the financial space and expectations from regulators on appropriate governance standards. Crucially, it also acknowledges the complex challenges involved in creating new direct regulations to bind different kinds of Fintech entities which are expected to proliferate within Digital India over the next decade.

The following primer elaborates on key aspects of the RBI's framework, which may also inform self-regulation standards more broadly within India. At the outset, it should be noted that framework is distinct from the 'Omnibus Framework for recognising SROs for Regulated Entities (*REs*)' which was notified by the by Department of Regulation, RBI in March, 2024,[2] although some commonalities between the two frameworks remain.

What is a 'Fintech' under the SRO Framework?

For this framework, the RBI defines Fintechs as:

> *Entities that provide technological solutions for delivery of financial products and services to businesses and consumers or encompass regulatory and supervisory compliance in partnership with traditional financial institutions or otherwise.*

This definition may be construed as broad guidance to the SROs while determining their membership. The Fintechs referred to above are essentially innovative entities within the financial space, which may not be under direct regulation by a financial regulator. Hence, a public interest need arises to ensure that concerns surrounding customer protection, data

[1] Available at https://rbi.org.in/Scripts/PublicationReportDetails.aspx?UrlPage=&ID=1263#C1
[2] Available at https://www.rbi.org.in/Scripts/NotificationUser.aspx?Id=12636&Mode=0

privacy, cyber security, grievance handling, internal governance, and financial system integrity are adequately addressed within the operations of these entities.

The RBI framework acknowledges multiple benefits of SROs as a mechanism for this sector:

1. Dynamic nature of the sector requires bodies which keep abreast of technology and the regulatory environment
2. SROs carry the potential to be imaginative, adaptive, flexible, and proportionate to the perceived risks
3. Provide a balance between maximizing the creative potential of Fintechs, while minimizing their idiosyncratic operational risks
4. Encourage a culture of self-governance which increases proactivity
5. Reliance upon the collective expertise of its members on regulation

Crucially, the RBI also notes that the Fintech SROs will be ‘industry-led entities’. At the same time, the SRO framwork is sector-agnostic enabling new kinds of Fintechs to participate in the future. However, the framework makes it overtly clear that banks are to be strictly excluded for membership of these Fintech SROs.

Membership

1. The RBI’s framework allows for entities that are currently regulated by the RBI (e.g., NBFC-Account Aggregators, NBFC-Peer to Peer Lending Platforms), excluding banks to become members of the SROs. However, it is expected that membership in the SROs should be primarily from Fintech entities that are currently not regulated by any financial sector regulator.
2. ‘Regtech’ providers (i.e. entities which develop compliance solutions for a range of financial institutions) may also take up membership.
3. Importantly, entities domiciled or registered outside India can also become members of SROs despite their foreign origins.
4. The SRO must prescribe minimum eligibility criteria for its members, although membership in such SROs shall remain voluntary.
5. The framework requires that the membership fee-structure should be reasonable and non-discriminatory towards members, and should not impact their rights and representation. However, it should be noted that the RBI does not specify any restriction on the revenue model for the SRO to merely membership fees derived from Fintechs.

6. For entities taking membership in an SRO, entering into a comprehensive membership agreement will be necessary, and will entail adherence to a code of conduct and responsibilities of members.
7. Fintechs are also provided by the RBI with the option for taking membership in more than 1 SRO, acknowledging the dynamic and diverse nature of entities in the sector. While this provides scope for 'forum shopping', it may also enable entities to address regulatory concerns across multiple verticals.
8. The RBI requires that membership must be diverse across entity size and type. In case an applicant SRO lacks the requisite membership diversity at the time of application, scope is provided for a 'diversification roadmap' to be prepared to gain RBI approval.

Structure of SRO

1. The SRO must operate free from the influence of any single member or a group of members. This includes avoiding 'conflict of interest' within the organisation. Functional autonomy and impartiality should be explicitly articulated within the SRO's Articles of Association (***AoA***).
2. The SRO must be a not-for-profit company registered under Section 8 of the Companies Act, 2013, and no entity should hold 10%, or more, of its paid-up share capital, either singly or acting in concert.
3. Memorandum of Association (***MoA***) of the SRO should explicitly state the entity's 'operation as an SRO' as its primary objective.
4. AoA must stipulate measures for 'professional management' of the SRO. The AoA should explicitly outline the functioning of the board / governing body / management of the SRO. The AoA should also clearly and explicitly lay down the criteria for the admission, expulsion, suspension, and re-admission of its members to enhance transparency.
5. The SRO must have a net worth exceeding INR 2 crore before operations commencement of operations or within 1 year of recognition by the RBI, which earlier.
6. It must also have in place systems for managing 'user harm'[3] instances that come to its notice or are referred to it by the RBI or any other stakeholder.
7. Capability of establishing the necessary infrastructure to fulfil the responsibilities must also be demonstrated by the SRO applicant to the RBI.

[3] Under this framework, user harm may include fraud, mis-selling, unfair practices, unauthorised transactions, or any other form of misconduct that harm consumers of financial services.

8. The Board of Directors and Key Managerial Personnel of the SRO should possess professional competence and a reputation for fairness and integrity. The Board should put in place a framework for the ongoing monitoring of 'fit and proper' status of its directors. Any change in the directorship or adverse change in its fit and proper status, should be immediately reported to RBI.
9. To ensure unbiased decision-making and adherence to ethical standards, 1/3rd of members on board must be independent, and without any active association with a Fintech entity. Of the remainder board members, the majority should represent Fintechs that are not directly regulated by the RBI.

Responsibilities of the SRO

1. The SRO is expected to adhere to the highest governance standards and incorporate in its functioning the principles of: **transparency, accountability, integrity, fairness, responsiveness, and compliance with all relevant laws and regulations.**
2. Standardization: SROs are expected to develop baseline standards and rules of conduct for their members. However, the codes / standards / rules set for adoption are not intended as a substitute to any direct prescribed regulatory or legal requirements for Fintechs. For developing these standards, the SRO should incorporate objective, well-defined and consultative processes, and should also set up a mechanism for accreditation in the Fintech ecosystem.
3. Dispute resolution: The SRO is also expected to be a legitimate and transparent arbiter of disputes between its members with a transparent and fair resolution mechanism. A grievance redressal framework for members should also be established.
4. Monitoring and enforcement: Regular and proactive monitoring of member activities is expected of the SRO to ensure adherence to established standards. Proactive approach to maintaining integrity and compliance is required, which include effective surveillance mechanisms that maintaining strict confidentiality of information collected. It should be noted that this requirement places significant legal responsibility and potential liability on recognised SROs

   As its duty towards ensuring compliance, SROs should have adequate powers to investigate and take disciplinary action against members for non-adherence to codes / standards / rules (actions may include counselling, cautioning, reprimanding/ expelling members, and non-prohibitive monetary penalties). However, the SRO nature of intervention for breaches of statutory law are not clarified. The SRO are also be obligated to regularly update the RBI on any major violation by its members.

5. Capacity building: Interestingly, RBI envisions an SRO as an entity to provide training, guidance, specialized knowledge and expertise to its members as well, recognising that some members may have limited capacities on regulatory compliance activity.
6. Conduit between Regulators and Members: SRO must facilitate communication between industry players and the RBI, advocating for necessary changes, and promoting a culture of compliance, to help align members with regulatory priorities.
7. Repository of Information: As a repository of information, the Fintech SROs should collect, analyze, and disseminate relevant data pertaining to the activities of its members, for the purposes of both the industry, as well as the RBI.

Powers of RBI

1. While granting recognition as SRO, the RBI may prescribe additional conditions to ensure its functioning does not become detrimental to public interest. RBI may also de-recognise SROs in public interest.
2. The RBI may also, if it deems necessary, nominate / depute observer(s) on the Board of an SRO.
3. The RBI is also empowered to remove any member of the board and / or management of the SRO if necessary, as a mechanism for oversight.

How and when the SROs for Fintechs are practically implemented by the RBI will be understood only once SRO applications for the same are accepted. However, the driving principles and elements of the Fintech SRO framework have the potential to inform self-regulatory best practices outside of the financial space in the near future.