

CHRONICLES OF REGULATORY RESPONSES IN DIGITAL LENDING INDUSTRIES

Abstract

Customers' preferences have shifted in response to the swift pace of transformation in the lending industry, which has been sparked by new developments such as inventive technology and the entrance of non-traditional lending providers into popular markets. As financial organisations throughout the digital lending value chain attempt to adjust to these changes, they face increased rivalry and changing alliances with FinTech, non-banks, and some of the world's biggest merchants. In response, authorities are keeping customer safety at the forefront of their minds as they weigh ways to encourage transparent innovation while also maintaining a tight rein on it. The authors of the article contemplate the vast possibilities that lie within the realm of digital lending, but envision the transformative impact it could have on the accessibility and calibre of financial services for the broader populace. Yet, amidst the promise of this transformative technology, we find ourselves confronted with profound contemplations. Authors have acknowledged the inherent risks that accompany its advancement - the shadowy realm of unethical recovery practices, the looming spectre of exorbitant interest rates, the vulnerability of data privacy breaches, and the disconcerting reality of mis-selling. These contemplations compel us to tread cautiously, to ponder the delicate balance between progress and responsibility. The implications of such practices are worth pondering, as they have the potential to erode the public's trust in the digital loan industry. In light of these perils, regulatory authorities in India, most notably the esteemed Reserve Bank of India (RBI), have embarked on a journey to confront these obstacles by establishing a specialized task force.

Keywords: *Regulatory Regimes, Digital Lending, Exorbitant Interest Rates, Aggressive Recovery Practises, Data Privacy Breaches*

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I. INTRODUCTION

The realm of transformative financial services possesses substantial potential to fundamentally alter the manner in which credit is accessed and enhance the quality of life for a multitude of individuals. In light of technological advancements, it is evident that the financial landscape is subject to significant transformations, thereby giving rise to a plethora of prospects and obstacles. In the present expository composition, we shall undertake an examination of the pervasive assimilation of digital lending and its consequential ramifications on the accessibility and calibre of financial services for the populace at large. Amidst the realm of digital lending, one encounters a plethora of inherent risks that demand our meticulous examination. These risks encompass a spectrum of concerns, including but not limited to unscrupulous methods employed in the process of debt recovery, exorbitant rates of interest, surreptitious entanglements with third parties, and violations of data privacy. The matters give rise to apprehensions regarding the confidence of the general public in the digital loan sector and emphasize the necessity for comprehensive regulatory measures aimed at safeguarding consumers against deceitful commercial conduct.

In the course the analysis, authors shall scrutinize the endeavours undertaken by regulatory bodies in order to tackle these aforementioned challenges. In January 2021, the Reserve Bank of India (RBI) undertook a momentous measure by establishing a specialized working group with the purpose of conducting a comprehensive examination of digital lending activities. The report, duly submitted on the 18th day of November in the year 2021 by the aforementioned group, encompasses pivotal recommendations with the objective of attenuating risks and instituting a robust framework conducive to the facilitation of lending operations. As we advance, it is imperative to expand our purview beyond the borders of India, thereby seeking enlightenment from regulatory frameworks prevalent in other autonomous jurisdictions, including but not limited to the United States, and the European Union. Through a comprehensive analysis of their respective methodologies, our objective is to acquire a profound understanding of the means by which ethical lending can be nurtured, all the while facilitating the advancement of innovation within the realm of digital lending. The present introductory essay establishes the foundation for our comprehensive examination of the ever-evolving realm of digital lending, wherein the realms of technology and financial services converge, and wherein the pursuit of inclusivity and safeguarding the interests of consumers must harmoniously coalesce. In unison, let us commence upon a voyage to comprehend the obstacles, the remedies, and the path that lies ahead in the domain of digital lending practices in India and other jurisdictions.¹⁸⁷

II. REGULATORY STRATEGIES FOR ADAPTING TO DISRUPTIVE TECHNOLOGIES

The current frameworks for legislation were mainly established before the emergence of FinTech. However, the concerned authorities are attempting to adapt to the new conditions, and the applicable laws have been amended or redone. These legislations are intended to protect customers from fraud and other lending-related issues, strengthen online lending

¹⁸⁷PWC, 'A Wider Circle Digital Lending and the Changing Landscape of Financial Inclusion' (November 2019) <<https://www.pwc.in/>>

security, and promote innovative lending procedures.¹⁸⁸ The entry of FinTech firms can have a positive or negative impact on banks' earnings in digital lending, and in response, banks may take on vulnerable risk. As a consequence, regulatory tightening may encourage the growth of underground banking. One-time password (OTP) systems, mandatory password changes, tracking, brief log-in sessions, and flexible verification are just some of the important security measures that newcomers and veterans of digital lending must adhere to in order to safeguard themselves from unencrypted data, ransomware, third-party services, fraud, and scams.¹⁸⁹ Since thieves can easily use unencrypted data, encryption is a crucial instrument for security.¹⁹⁰ Most financial services are now outsourced to third parties, raising concerns about data breaches and the possible impact on the provider relationship.

III. A HOLISTIC OVERVIEW OF RBI'S REGULATORY FRAMEWORK FOR DIGITAL LENDING AND ITS IMPLICATIONS FOR THE INDUSTRY

The widespread adoption of digital lending has the potential to improve the availability and quality of financial services for the general population. The intrinsic risks concomitant with the fiasco of digital lending include unethical and aggressive recovery practises, extortionate rates of interest, concealed engagement of third parties, unsolicited breach of data concealment, and mis-selling.¹⁹¹ The public's trust in the digital loan industry could be damaged by unscrupulous business practises like charging high interest rates and using questionable collection methods.¹⁹² Recognising these dangers, we must take precautions to guarantee the steady growth of digital loans while also protecting the interests of our clients and investors. In Jan 2021, the Reserve Bank of India (RBI) confirmed the formation of a working group (WG) with a news statement. To ensure proper regulation of digital lending through online platforms and customer safety, the RBI established a WG to investigate all facets of digital lending operations in the regulated financial sector and by illegal actors.¹⁹³

The WG delivered its report to the RBI on November 18, 2021, and included several recommendations for tackling the current and potential hazards (such as consumer protection from illicit conduct, security of data breaches, regulation of untamed entities, implementation of an equitable practises code for digital lending entities, and data oversight in the digital lending realm without stifling innovation).¹⁹⁴ On the same day, November 18, 2021, the RBI made public the report in an effort to collect feedback from interested parties. In addition, on

¹⁸⁸Shilpa Mankar Ahluwalia, 'How Will the New Digital Lending Guidelines by the RBI Affect the Industry and Curb Fraud? - Shardul Amarchand Mangaldas & Co' (*Shardul Amarchand Mangaldas & Co*) <<https://www.amsshardul.com/insight/how-will-the-new-digital-lending-guidelines-by-the-rbi-affect-the-industry-and-curb-fraud/>>

¹⁸⁹'Managing the Risks of Digital Lending' (*Business Today*, 2 March 2022) <<https://www.businesstoday.in/magazine/columns/story/managing-the-risks-of-digital-lending-323086-2022-03-02>>

¹⁹⁰Team Finserv, 'FAQs on Digital Lending Regulations – Vinod Kothari Consultants' (*FAQs on Digital Lending Regulations – Vinod Kothari Consultants*) <<https://vinodkothari.com/2022/08/faqs-on-digital-lending-regulations/#scope-and-applicability>>

¹⁹¹Shilpa Mankar Ahluwalia, 'How to Correct 'bad Practices' in Digital Lending? - Shardul Amarchand Mangaldas & Co' (*Shardul Amarchand Mangaldas & Co*) <<https://www.amsshardul.com/insight/how-to-correct-bad-practices-in-digital-lending/>>

¹⁹²'Formal Credit Gap Driving Fintech Credit Growth' (*mint*, 15 September 2020) <<https://www.livemint.com/news/india/formal-credit-gap-driving-fintech-credit-growth-11600141041110.html>>

¹⁹³'RBI Issues Guidelines For Digital Lending Sector - Dodd-Frank, Consumer Protection Act – India' (*RBI Issues Guidelines For Digital Lending Sector - Dodd-Frank, Consumer Protection Act - India*, 13 March 2001) <<https://www.mondaq.com/india/dodd-frank-consumer-protection-act/1223966/rbi-issues-guidelines-for-digital-lending-sector/>>

¹⁹⁴GlobalData Thematic Research, 'Digital Lending: Regulatory Trends' (*Retail Banker International*, 14 March 2022) <<https://www.retailbankerinternational.com/comment/digital-lending-regulatory-trends/>>.

August 10, 2022, the RBI released a news statement implementing the Working Group's suggestions by outlining the basic regulatory structure for the affected companies.¹⁹⁵

The modus operandi of digital lending typically unfolds as follows. The loan applicant proceeds to download the mobile application of the digital lender and subsequently completes a concise application form on their mobile device. The lender employs an automated mechanism to undertake the processing of the applicant's information and proceeds to evaluate the creditworthiness of said applicant primarily by relying upon the data obtained from their mobile devices. Upon the approval of the loan application, it is duly mandated that the loan shall be disbursed expeditiously into the designated mobile wallet of the applicant, with due regard to the temporal proximity of the submission of said application.¹⁹⁶ Digital loans, commonly characterized by their brevity ranging from less than one month to several months, are typically of modest sums, ranging from a couple to a few hundred US dollars. Moreover, these loans are subject to an exorbitant annualized interest rate exceeding 100%.¹⁹⁷ In developing economies, it is evident that digital lenders are subject to significantly less regulatory oversight compared to their counterparts in developed economies within the fintech lending sector. In these respective economies, it is customary for digital loans to exhibit relatively diminutive magnitudes and briefer temporal spans, while concurrently manifesting significantly elevated rates of interest. Moreover, it is worth noting that individuals seeking digital loans in developing economies generally encounter limited availability of conventional financial services. Conversely, a substantial proportion of borrowers procuring credit from fintech lenders in developed economies enjoy access to an extensive array of financial products. The borrowers, who were previously engaged in financial transactions involving the borrowing of funds, exhibit a notable decrease in their overall financial status and experience a substantial increase in the volatility of their income.¹⁹⁸

Digital loans exhibit significant distinctions when compared to payday loans within developed economies. Payday loans are exclusively extended to individuals who are gainfully employed, meaning they receive regular compensation in the form of a pay check. Additionally, eligibility for such loans necessitates the possession of a functioning account with a financial company. Conversely, digital loans primarily cater to borrowers who lack official employment and lack access to a conventional financial system.¹⁹⁹

¹⁹⁵ 'The Curious Case Of Digital Lending Norms: Decoding RBI's FAQs - Securitization & Structured Finance – India' (*The Curious Case Of Digital Lending Norms: Decoding RBI's FAQs - Securitization & Structured Finance - India*, 3 March 2023) <<https://www.mondaq.com/india/securitization-amp-structured-finance/1289060/the-curious-case-of-digital-lending-norms-decoding-rbis-faqs/>>

¹⁹⁶ Shilpa Mankar Ahluwalia, 'Digital Lending Regulations: Impact on Businesses, Buy Now Pay Later Products, more; Key Things to Know - Shardul Amarchand Mangaldas & Co' (*Shardul Amarchand Mangaldas & Co*) <<https://www.amsshardul.com/insight/digital-lending-regulations-impact-on-businesses-buy-now-pay-later-products-more-key-things-to-know/>>

¹⁹⁷ 'Digital Lending Platforms To Face Stricter Norms - Financial Services – India' (*Digital Lending Platforms To Face Stricter Norms - Financial Services - India*, 11 August 2020) <<https://www.mondaq.com/india/financial-services/973790/digital-lending-platforms-to-face-stricter-norms>>

¹⁹⁸ 'RBI Working Group Report on Digital Lending – Trilegal' (*Trilegal*, 15 July 2022) <https://trilegal.com/knowledge_repository/rbi-working-group-report-on-digital-lending/>

¹⁹⁹ 'Guidelines On Digital Lending In India - Digital Lending Trends - Fin Tech – India' (*Guidelines On Digital Lending In India - Digital Lending Trends - Fin Tech - India*, 4 January 2023) <<https://mondaq.com/india/fin-tech/1267274/guidelines-on-digital-lending-in-india---digital-lending-trends>>

The provision of payday loans is not contingent upon the utilization of intricate credit scoring models. Similar to the evidence presented regarding fintech lending in developed economies, the vast body of literature pertaining to payday lending remains inconclusive in determining whether or not such lending practices worsen or mitigate the economic difficulties faced by borrowers.²⁰⁰

IV. PREDATORY LENDING PRACTICES IN DIGITAL FINANCIAL SERVICES: AN EXAMINATION OF INDIAN REGULATORY ENVIRONMENT

In the year of the pandemic, the administration gave financial aid to the poor, and this came in handy. Indians were setting up accounts, and a battering fraction of the population was making use of these new financial tools. That's the way the finance technology business and smartphone commerce evolved. Access to loans, in particular, is now within reach for India's unbanked people. Thanks to digital platforms aimed at achieving financial inclusion.²⁰¹ There is already substantial consumer momentum in favour of digital payments and online banking, propelled by a highly developed ecosystem. Micro, small, and medium-sized businesses (SMEs) are also eligible to apply for and receive digital loans. However, not all customers can accurately assess the precedence and drawbacks of various digital payment systems and their offerings, indicating supply-and-demand information mismatch.²⁰²

Concerns over disproportionate lending, repayments, and extortionate collection practises have emerged as lockdowns and a virtual halt to economic activity upshot followed the pandemic strike.²⁰³ Although the underlying causes and problems came to the face of it when the harassment activities came up in the recovery settlement of Chinese lending applications, they led several individuals to a suicide phase. This comes after a string of similar instances that have exposed the unscrupulous lending practises of many unlicensed loan apps. These applications primarily target the poorer classes of society, who frequently just need small-ticket loans to get through a financial emergency. Plenty of these applications reportedly request access to files and pictures after being launched. These apps would then reportedly alter the victims' images to demand high interest rates and additional payments from users.²⁰⁴

While the news articles cited here make allusions to the role played by Chinese carriers' in-house apps, the onus of responsibility must ultimately fall on other nodes in the network, most notably India's non-banking financial institutions. The reason for this is that out of over 12,000 NBFCs listed in the nation, only a few hundred are considered "systemically important." The most common path taken by Chinese applications was to "partner" with any

²⁰⁰RBI Introduces Norms to Curb Digital Lending Malpractices -SignDesk' (*SignDesk*, 2 July 2020) <<https://signdesk.com/in/regulations/rbi-introduces-norms-to-curb-digital-lending-malpractices>>

²⁰¹Shilpa Mankar Ahluwalia, 'Digital Lending a Game-Changer for Small Value Business Loans - Shardul Amarchand Mangaldas & Co' (*Shardul Amarchand Mangaldas & Co*) <<https://www.amsshardul.com/insight/digital-lending-a-game-changer-for-small-value-business-loans/>>

²⁰²Shilpa Mankar Ahluwalia, 'What Has COVID-19 Meant for Digital Lending in India? - Shardul Amarchand Mangaldas & Co' (*Shardul Amarchand Mangaldas & Co*) <<https://www.amsshardul.com/insight/what-has-covid-19-meant-for-digital-lending-in-india/>>

²⁰³Shilpa Mankar Ahluwalia, 'What Has COVID-19 Meant for Digital Lending in India? - Shardul Amarchand Mangaldas & Co' (*Shardul Amarchand Mangaldas & Co*) <<https://www.amsshardul.com/insight/what-has-covid-19-meant-for-digital-lending-in-india/>>

²⁰⁴Jan, 'Lending Apps under RBI Scrutiny' (*Law.asia*, 9 November 2022) <<https://law.asia/lending-apps-under-rbi-scrutiny/>>

NBFC that would have them in exchange for a permit.²⁰⁵ As a result, the Reserve Bank of India said on February 5 that it would explore a uniform edifice for all microfinance providers as part of its statement on economic and regulation policies. In the in the Indian context the safeguards provided includes credit information companies (regulation) act 2005 and 2006 which regulates credit information companies is to promote the effective and streamlined dissemination of credit. It is mandated that the borrower shall be provided with a precise and explicit rationale for the denial of credit in the event that such denial is predicated upon information contained within the credit report.

In the matter of *Dharanidhar Karimojji vs. Union of India*²⁰⁶ the plea requests the implementation of regulatory measures and oversight over online digital lenders operating via mobile applications, with the objective of establishing a prescribed cap on the permissible interest rates they may levy. The Honourable Court has proffered a suggestion to the regulatory body overseeing banking operations, wherein it is proposed that said body may proceed to ascertain and establish the applicable interest rate for online lending activities, duly classified and differentiated according to the quantum of funds borrowed. Financial equality is important, but so is assuring responsible practises that safeguard customers, and this is an equilibrium that the digital loan sector in India must find.²⁰⁷

V. COMPARATIVE ANALYSIS: A ROADMAP TO ETHICAL LENDING

1. United States of America

The burgeoning prevalence of digital payments within the United States and other jurisdictions has engendered a substantial transformation in consumer predilections and conduct. The McKinsey Digital Payments Customer Survey pertains to the continuous progression and profound transformations in the manner in which consumers engage digital payment solutions. The comprehension of these usage patterns may serve carriers in their endeavour to enhance the provision of services to their store partners and ameliorate the experiences of their customers.²⁰⁸ The regulatory framework governing digital lending applications in the United States is delineated by a confluence of federal statutes and state laws. The regulations are designed with the primary objective of safeguarding consumers who actively pursue credit through alternative means, specifically digital lending platforms.

- The Truth in Lending Act (TILA), is a federal statute that serves the purpose of safeguarding borrowers by mandating the provision of crucial loan particulars, including but not limited to the Annual Percentage Rate (APR), costs, and repayment schedules.²⁰⁹ The underlying objective of TILA is to foster transparency and facilitate the establishment of unambiguous terms between the parties involved.

²⁰⁵‘Digital Lending Apps: The Invisible Threat to National Security’ (*India Foundation*, 5 January 2023) <<https://indiafoundation.in/articles-and-commentaries/digital-lending-apps-the-invisible-threat-to-national-security/>>

²⁰⁶ *Dharanidhar Karimojji Vs. Union of India and Another* (2023) SCC OnLine Del 378.

²⁰⁷‘India’s Loan Scams Leave Victims Scared for Their Lives’ (*BBC News*) <<https://www.bbc.com/news/business-61564038/>>

²⁰⁸‘The Power of Digital Lending’ (*McKinsey & Company*) <<https://www.mckinsey.com/industries/financial-services/our-insights/banking-matters/the-power-of-digital-lending>>

²⁰⁹Johannes Ehrentraud, Denise Garcia Ocampo, Camila Quevedo Vega and Bank for International Settlements (BIS), ‘Regulating FinTech Financing: Digital Banks and FinTech Platforms’ (*Financial Stability Institute-FSI Insights on policy implementation No 27*)

- The Equal Credit Opportunity Act (ECOA), a federal statute, imposes a legal prohibition on lenders, mandating that they refrain from engaging in discriminatory practices against borrowers on the basis of protected characteristics, including but not limited to ethnicity, gender, religion, or national origin. The primary objective of this legislation is to foster and uphold the principle of equal credit access for all individuals.
- The Fair Credit Reporting Act (FCRA), a legislative enactment, imposes limitations on the manner in which lenders are permitted to utilize and disseminate credit information pertaining to their clientele. Consequently, this necessitates the imperative requirement for digital lending applications to promptly and precisely report said information.²¹⁰
- Lenders and debt collectors are legally obligated to adhere to the provisions set forth in the Fair Debt Collection Practices Act (FDCPA) in order to uphold the principles of ethical debt collection. In a similar vein, it is imperative that digital lending applications adhere to the provisions set forth in the Electronic Fund Transfer Act (EFTA). This legislation serves as the governing framework for electronic fund transactions and imposes an obligation upon borrowers to furnish unambiguous details pertaining to said transactions.

In light of the United States' implementation of rigorous regulatory measures pertaining to digital lending, it is worth noting that India, as a nascent participant in the international arena, encounters challenges when confronted with unscrupulous lending practices. In order to safeguard unsuspecting borrowers from the predatory practices of these unscrupulous digital lending platforms, it is imperative that the RBI diligently and rigorously enforce the prescribed guidelines.

2. European Union

The General Data Protection Regulation (GDPR), a legislative measure enacted within the European Union (EU), sets forth a comprehensive framework delineating the appropriate procedures for managing personal data.

- In light of this, digital lenders are duty-bound to adhere to these guidelines in order to safeguard the confidential information of borrowers. In order to address the issue of theft and safeguard financial data, it is mandated by the Payment Services Directive (PSD) that robust customer identification measures be implemented during the course of payment processing.
- The Digital Single Market Strategy, seeks to foster heightened levels of innovation and competition within the digital lending industry. By doing so, it aims to facilitate enhanced accessibility and promote responsible financial decision-making for customers. The burgeoning ubiquity of digital payment and lending applications has engendered regulatory endeavours across the globe aimed at safeguarding consumers and fostering judicious financial conduct.

In the jurisdiction of the United States, the realm of digital lending is subject to regulation by a confluence of federal and state statutes, which place paramount importance on the

²¹⁰Sanket Dhanorkar, 'These New Fangled Money Traps Can Hurt Millennials and Their Finances' (*The Economic Times*) <<https://economictimes.indiatimes.com/wealth/save/these-new-fangled-money-traps-can-hurt-millennials-and-their-finances/articleshow/98749751.cms/>>

principles of openness, equitable opportunity, and conscientious debt retrieval. The European Union have promulgated regulations aimed at the regulation of interest rates, safeguarding consumer data, and fostering competition within the realm of digital lending.²¹¹

In light of India's foray into the international digital lending arena, it is imperative that the nation draws lessons from the experiences of other jurisdictions, with the aim of formulating robust regulations that safeguard its populace against unscrupulous lending practices. The imperative of striking an optimal equilibrium between fostering innovation and safeguarding consumer interests assumes paramount importance in the formulation of a resilient and enduring global digital lending sector.

II. ADDRESSING THE DILEMMAS IN DIGITAL LENDING PRACTICES IN INDIA

In the context of India's private sector, it is observed that the enforcement of good governance predominantly rests upon government organizations and institutions. Consequently, this situation engenders a dearth of autonomous oversight and regulatory competencies within the private sector.²¹² Notwithstanding, it is imperative to acknowledge that this predicament is not an isolated occurrence; significant worldwide financial crises, exemplified by the one transpiring in 2008, were further aggravated, at least in part, due to the incapacity of American financial establishments to engage in self-regulation. The present analytical inquiry undertakes a comprehensive exploration of the obstacles encountered by regulators in the financial sector of India and proffers prospective remedies to foster a harmonious equilibrium between innovation and safeguarding the interests of consumers. In the jurisdiction of India, it is incumbent upon government organizations and institutions to assume the principal duty of ensuring the implementation and adherence to principles of good governance within the private sector.

- There appears to be a deficiency in the aptitude for self-regulation and the exercise of regulatory measures. The aforementioned dependence on governmental entities presents inherent challenges due to its potential to engender tardy reactions and constrictive flexibility in the face of swiftly evolving market dynamics.
- It is worth noting that private entities have the potential to develop a sense of complacency, wherein they depend on governmental oversight rather than engaging in proactive self-regulation. The global financial crisis of 2008 serves as a poignant illustration of the ramifications stemming from a dearth of adequate self-regulation.²¹³

The actions undertaken by American financial institutions, including the sale of subprime mortgages to borrowers with good creditworthiness and the securitization of subprime mortgages for institutional investors, played a substantial role in the occurrence of the crisis. This serves as a manifestation of the inherent defect within the financial sector, wherein the vice of avarice often prevails over prudence, circumspection, and adherence to ethical standards. Regulators are confronted with a formidable undertaking in the delicate

²¹¹European Banking Authority, 'Joint European Supervisory Authority Response' (2022).

²¹² V. Anantha, Nageswaran Sumita, Kale Laveesh Bhandari, 'Digital Lending: Issues, Challenges and Proposed Solutions' (*Indicus Centre*)

²¹³ 'RBI's Fair Practices Code to Help Eradicate Digital Lenders Acting as Agents for Non-Registered NBFCs' | *The Financial Express* (*RBI's Fair Practices Code to help eradicate digital lenders acting as agents for non-registered NBFCs* | *The Financial Express*, 8 April 2021) <<https://www.financialexpress.com/industry/rbis-fair-practices-code-to-help-eradicate-digital-lenders-acting-as-agents-for-non-registered-nbfc/2229655/>>

equilibrium between fostering innovation and safeguarding consumer interests. In light of the expeditious evolution of technological advancements, it is imperative for regulators to promptly adjust their regulatory frameworks to adequately govern nascent practices.²¹⁴

The imperative of striking this delicate equilibrium cannot be overstated, as it is indispensable for the cultivation of a robust and ever-evolving financial industry, all the while ensuring the safeguarding of consumer interests. The exponential augmentation in the burden imposed upon the regulator serves to further compound the predicament of effectual governance. Due to the inherent advantages possessed by the private sector, namely access to state-of-the-art technology and highly proficient professionals, it is a recurring occurrence for the regulatory body to lag behind in terms of keeping pace with advancements.²¹⁵ However, it is important to note that the regulator's quest for financial gain may potentially hinder its capacity to effectively adapt to the swiftly changing financial market. In the jurisdiction of India, various entities such as traditional banks, non-banking finance firms, lending organizations, urban communal groups, and digital lenders are all subject to the purview of regulatory oversight.

As the proliferation of entities subject to regulatory oversight expands, commensurately increasing are the intricacy and scale of regulatory hurdles, thereby mandating the establishment of resilient and flexible regulatory frameworks.

- One potential course of action entails seeking regulatory endorsement from the Director's Loan Account (DLA) prior to extending financial services to individuals utilizing smartphone applications.
- Regulators possess the authority to impose a layer of meticulous examination upon funding sources through the imposition of this requirement, thereby engendering a governance mechanism that is characterized by enhanced efficiency.
- The potential enhancement of efficiency may be observed through the delegation of certain regulatory responsibilities to NBFCs, subject to the oversight of the appropriate regulatory authority. When duly executed with adequate mechanisms of oversight, this methodology possesses the capacity to bestow upon said entities the authority to assume a more proactive stance in the regulation of their activities, all the while harmonizing their objectives with the safeguarding of consumer interests. The potential reliance on paper-based identifiers, such as Aadhaar IDs,²¹⁶ for the purpose of Know Your Customer (KYC) in the Indian context may give rise to fraudulent activities and an escalation in financial burdens. Regulators are legally obligated to thoroughly examine alternative avenues for enhancing Know Your Customer (KYC) standards, with the overarching objective of guaranteeing the precision and legitimacy of information, all the while safeguarding the privacy rights of users. Some digital lending platforms, which exhibit potential mitigation of such risks and the protection of customers from harm may be achieved through the establishment of collaborative efforts with duly authorized working groups, aimed at the development and

²¹⁴Shilpa Mankar Ahluwalia, 'Regulating Digital Lending - Shardul Amarchand Mangaldas & Co' (*Shardul Amarchand Mangaldas & Co*) <<https://www.amsshardul.com/insight/regulating-digital-lending/>>

²¹⁵'FinTales Issue 26: The Party Crashers - Fin Tech – India' (*FinTales Issue 26: The Party Crashers - Fin Tech - India*, 21 March 2023) <<https://www.mondaq.com/india/fin-tech/1295850/fintales-issue-26-the-partycrashers>>

²¹⁶Swati Bucha, 'Digital Lending Solutions: What Lenders Should Be Expecting' (*Digital Lending Solutions: What Lenders Should Be Expecting*, 10 November 2022) <<https://www.skeps.com/blog/digital-lending-solutions-what-lenders-should-be-expecting-skp/>>

implementation of robust data protection and security standards.²¹⁷ The concept of digital lending, while indeed possessing viability as a business endeavour, necessitates the establishment of unambiguous legal frameworks to ensure equitable conditions for all participants within the market.

Regulators possess the authority to incentivize corporations to accord primacy to consumer interests whilst concurrently fostering innovation through the adoption of well-defined legal frameworks. The examination of the challenges and prospective remedies concerning the regulation of India's financial sector underscores the imperative of adopting a judicious approach that fosters ingenuity while safeguarding the interests of consumers. Advocating for the implementation of self-regulatory measures within the private sector, drawing insights from past financial crises, and embracing effective practices observed in foreign jurisdictions may serve as viable strategies for regulators to effectively address the evolving financial landscape. A proactive and flexible regulatory framework is of utmost importance in ensuring the stability of the financial sector and safeguarding the interests of consumers.

III. CONCLUSION: AN APPROACH FORWARD

The technological disruptions in digital lending can serve as a catalyst to increase efficiency and service by assisting to eradicate information asymmetries (using blockchain technology and AI/ML techniques), resulting in a higher threshold for consumer service and finally substituting obsolete technology with new one. Hence, customer-centric platform is the way ahead for banks. Adaptation to these changes will be a formidable challenge to the incumbents as they will have to shift from rigid mainframes to flexible cloud and attempt to attain a higher standard of service by diving into competition with new entrants. Restructuring and tight regulatory scrutiny seems to be the way ahead. The emergence of digital technology is a stumbling block for regulators, who must modify their approach to encourage innovation and competition while safeguarding financial stability. Regulators must cooperate to balance prudential regulations and formulate a healthy competition policy while being cautious to not let it make it hard for new entrants in the market. The RBI is in a pervasive need to make current regulatory framework more robust and cogent in order to safeguard victims from the eternal pain of regressive digital lending practices. In making an innovative strategy to unravel the cumbersome issues the RBI may take inspiration from countries that made progress in the same sphere. The regulator and government can alter some basics, educate citizens about their rights and strengthen the data privacy laws all along.

“Any informed borrower is simply less vulnerable to fraud and abuse.”

— Alan Greenspan,

Former Chair of the Federal Reserve of the United States

²¹⁷Opinion | The Future of Digital Lending’ (*mint*, 13 August 2020) <<https://www.livemint.com/opinion/online-views/opinion-the-future-of-digital-lending-11597294166969.html>>