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**Analysis of
Draft Framework
for recognising
Self- Regulatory
Organisations
for FinTech Sector**

Draft Framework for recognising Self Regulatory Organisations for FinTech Sector

INTRODUCTION

On January 15, 2024, the Reserve Bank of India (“**RBI**”) released the 'Draft Framework for recognizing Self-Regulatory Organizations for FinTech Sector' ("**Draft Framework**"). In its preamble, RBI has expressly acknowledged the pivotal role of the FinTech sector in contributing to the economic landscape and underscored the need for a judicious equilibrium between encouraging innovation and ensuring regulatory compliance to safeguard consumer’s interest. With this foundational understanding, RBI has delineated the distinctive features of FinTech Self-Regulatory Organizations (“**SRO-FT**”) within the Draft Framework, elucidating their functions, governance standards, and associated parameters.

Presently, RBI has invited stakeholders and the general public to provide their insights and feedback on the Draft Framework, with a designated window open until the end of February 2024. In September 2023, RBI Governor Shri Shaktikanta Das had urged FinTech companies to form such a self-regulatory body themselves, giving an indication of the release of such a self-regulatory framework. As an aid to stakeholders seeking to comprehend the intricacies of the Draft Framework, we have provided below a comprehensive rundown of the Draft Framework with our analysis.

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1. What is an SRO-FT, and what are the general requirements to form an SRO-FT?

RBI defines SRO-FT as a not-for-profit organization tasked with establishing and enforcing regulations and standards governing the conduct of entities within the FinTech industry, referred to as "members." The primary function of an SRO-FT is to serve as a representative for its members in dealings with the RBI. To formalize the status of an SRO-FT, its Memorandum of Association (“**MOA**”) must explicitly designate the operation as an SRO-FT among its primary objectives. In addition to the aforementioned requirement, the formation of an SRO-FT necessitates the demonstration of sufficient net worth. This financial requirement serves as evidence of the organization's capability to establish the essential infrastructure required for consistently fulfilling the responsibilities outlined in the RBI's Draft Framework, as well as those articulated in its Articles of Association (“**AOA**”) and internal code of conduct.

Moreover, an SRO-FT is expected to possess a robust Information Technology (IT) infrastructure and the capacity to implement technological solutions within a reasonable timeframe. SRO-FT is also mandated to implement systems for effectively managing instances of 'user harm' that comes to its attention, either through direct notice, referrals from the RBI, or from other stakeholders. While formal recognition from the RBI is not strictly mandatory for an SRO-FT, the Draft Framework encourages such recognition. This encouragement is underscored by the benefits of legitimacy status and regulatory comfort. Furthermore, the FinTechs have also been encouraged to obtain membership of a recognized SRO-FT and not just any SRO-FT. It is important to note that an SRO-FT seeking to establish entities or offices overseas must obtain prior approval from the RBI before proceeding with such endeavors.

AKP Comments: *FinTechs can view SRO-FT membership not just as adherence to regulatory requirements but as a strategic alliance, a forum for shared growth, and a vehicle for actively shaping the future trajectory of fintech in line with regulatory standards. FinTechs can leverage their collective influence within the SRO-FT and through SRO-FT in RBI's decision-making to actively shape regulations and standards, ensuring they are not only compliant but also conducive to innovation.*

2. Is it mandatory for FinTechs to be a member of an SRO-FT as per the Draft Framework? How can a FinTech become a member of an SRO-FT?

The membership of an SRO-FT is discretionary for FinTechs, with participation being voluntary rather than mandatory. Nevertheless, RBI in the Draft Framework has encouraged the FinTechs to become a member of a recognized SRO-FT. To become a member of an SRO-FT, FinTechs shall be required to first meet the eligibility criteria as per the terms specified by the concerned SRO-FT.

Subsequent to meeting the prescribed eligibility criteria, FinTechs shall be required to enter into a comprehensive membership agreement with the SRO-FT. This membership agreement shall capture the role of SRO-FT as a true representative of the FinTech for the purpose of dealing with the RBI, FinTechs shall be required to allow the SRO-FT to set and adopt rules, standards, code of conduct, etc., for all members to be followed. For providing membership, the SRO-FT has been allowed to develop a reasonable and non-discriminatory fee structure.

AKP Comments: *While presently obtaining membership of an SRO-FT is not mandatory, it is very likely that in the future, RBI makes the membership mandatory for FinTechs. Despite RBI's explicit mention that recognition of an SRO-FT is not mandatory, FinTechs have been encouraged to obtain the membership of a recognized SRO-FT. To ensure its affiliation with a recognized SRO-FT, FinTechs before entering into a membership agreement with an SRO-FT, must engage in due diligence to ensure that the SRO-FT is eligible for seeking recognition of RBI as per the framework and has set timeframes to commence the application filing for obtaining recognition in the future.*

It is pertinent to note that RBI in the Draft Framework has also directed SRO-FTs to have a minimum eligibility criterion for their members. However, the potential divergence in these criteria among different SRO-FTs presents a notable challenge, creating a scenario where certain FinTechs may find it unattainable to secure membership across various SRO-FTs. This lack of uniformity raises concerns about potential monopolistic practices within the FinTech sector, restricting participation in the development of regulatory frameworks to a select group of entities. To mitigate these challenges and ensure fairness, stakeholders can seek clarity from the RBI regarding the minimum eligibility criteria. This proactive approach would contribute to fostering an inclusive and transparent environment within the FinTech regulatory landscape, addressing potential issues of exclusivity and promoting a more accessible and equitable framework for industry participants.

3. What are the eligibility criteria for an SRO-FT to get a recognition from RBI?

- In addition to the general requirement mentioned above under Query 1, SRO-FTs before filing the application for recognition, should meet the following eligibility criteria:
- The SRO-FT must represent the FinTechs with membership across entities of all sizes, stage, and activities. If the representation is inadequate at the time of application, the application of the SRO-FT shall include a roadmap for achieving the aforesaid diverse membership within a reasonable timeframe.
- The agreements with all members must be there with clear delineation of all roles and responsibilities of the member and the SRO-FT along with the covenants from the member on adherence of rules and conducts framed and adopted by the SRO-FT;
- SRO-FT must be domiciled/ registered in India;
- The Board of Director (“**BoD**”) and Key Managerial Personnel (“**KMP**”) of SRO-FT should possess professional competence and have a good reputation. Any legal proceeding against the applicant SRO-FT, its BoD or KMP must be declared as a part of the application and demonstrate that such proceeding shall not impede the functioning of the SRO-FT or harm its reputation;
- SRO-FT and any of its members should not be convicted of any offence, including moral turpitude/ economic offence in the past; and
- SRO-FT, its BoD and KMP should meet the standard fit and proper criteria, and the decision of RBI on the same shall be final.

AKP Comments: *While granting the recognition to an SRO-FT, RBI as per the Draft Framework, can prescribe additional conditions as may be required to ensure that the function of SRO-FT does not become detrimental to public interest. A clarification can be sought by the stakeholders on the activities that will be deemed detrimental to the public interest. Further clarity on the minimum number of members required in an SRO-FT and whether an SRO-FT can consist of members undertaking similar activities can also be obtained from RBI. This clarification is crucial to design and finalise a roadmap of onboarding members.*

Additionally for negotiating the membership agreement, FinTechs should ensure that the roadmap to be provided by SRO-FT to RBI for achieving the recommended membership is also captured as a milestone in the membership agreement, allowing FinTech to exit from the SRO-FT if such a milestone is not achieved. This is crucial to ensure because a failure to demonstrate or attain comprehensive membership can result in denial or revocation of recognition from RBI as per the Draft Framework.

4. How can an SRO-FT apply for the RBI's recognition?

4.1 The invitation for the application of recognition of an SRO-FT shall be released by RBI in the future, either for the entire FinTech sector or for specific sub-sectors, as and when required. RBI has indicated in the Draft Framework that the number of recognitions given shall be limited and considered based on the number and nature of applications received.

The said application, as per the Draft Framework, must be authorized by the Board of the SRO-FT and accompanied by the following documentation:

- A copy of MOA and AOA and other incorporation documents of SRO-FT;
- Details of the constitution of the Board, roles/ responsibilities of its management, and the manner in which operations shall be undertaken;
- Roadmap to achieve comprehensive membership, if necessary; and
- Any other information/ clarification that may be deemed necessary by the RBI.

4.2 An application that is incomplete or does not meet the above-mentioned eligibility criteria shall be returned or rejected by the RBI, after giving due opportunity for a hearing to the applicant SRO-FT. After granting the 'Letter of Recognition' to an SRO-FT, RBI can anytime revoke the recognition subsequent to the following instances:

- a. Upon discovering that the information provided in the application is false or is misleading;
- b. The requirement of adequate membership is not met as per the roadmap or is not continued to be adhered to;
- c. The terms of Letter of Recognition are not adhered to. To test this, RBI shall conduct a periodic review of the SRO-FT, as may be deemed necessary by RBI;
- d. If RBI deems the functioning of the SRO-FT detrimental to public interest or if SRO-FT or any of its stakeholders is found to be conducting activities that are not in conformity with the objectives of the SRO-FT; and
- e. If the SRO-FT fails to adhere to the relevant directions released by RBI and provisions of relevant statutes, to the extent applicable.

AKP Comments: *The outlined process of seeking recognition from the RBI assumes a pivotal role in establishing FinTech members as credible participants within the FinTech ecosystem, earning the trust of the RBI. For FinTech entities contemplating SRO-FT membership, adopting a proactive stance becomes imperative. In anticipation of the RBI's forthcoming invitation for recognition applications, collaborative efforts between the FinTech member and the SRO-FT are essential to ensure the requisite documentation adheres meticulously to the final framework.*

It is noteworthy that the final condition concerning the revocation of recognition implies the likelihood of RBI issuing specific directives governing the operations of SRO-FTs and their members, complementing the existing Draft Framework. Consequently, to guarantee continual compliance with evolving laws, the establishment of a structured mechanism for periodic internal reviews becomes indispensable. This approach not only safeguards against the risk of recognition revocation but also ensures that both the SRO-FT and its stakeholders consistently align with regulatory requirements, reinforcing the credibility of FinTech entities in the regulatory landscape.

5. What are the roles and responsibilities of SRO as per the Draft Framework?

Operations and Mandate of SRO-FT: As an integral part of its operations, the SRO-FT assumes the crucial role of being a true representative of its members. This mandates the establishment of baseline standards, rules, and a robust grievance redressal mechanism tailored to the diverse nature of activities within the sector. It further involves effective monitoring and enforcement of these standards among its members.

The SRO-FT is entrusted with the development of a comprehensive code of conduct, including specifications on the consequences of violations, which shall be incorporated into the membership agreements of FinTechs. Beyond this, it is required to formulate standardized documents, for instance agreements between lending service providers and regulated entities, ensuring compliance with prevailing laws. To actively contribute to industry growth, the SRO-FT is also required to facilitate specialized knowledge, guidance, and capacity building through training programs, offering essential support and handholding for its members. Independence from external influence is paramount for the SRO-FT, ensuring unbiased decision-making and operational impartiality. Additionally, the SRO-FT is designated as an arbiter of disputes, necessitating the establishment of a transparent and fair resolution mechanism for its members. In fulfilling its responsibilities, the SRO-FT is mandated to promote alignment with regulatory priorities, implementing directives and recommendations from RBI. Lastly, SRO-FT is required to operate as a repository of information, collecting, analyzing, and disseminating data on its members' activities.

Correspondence with RBI and Regulatory Responsibilities: In its capacity as a representative of the FinTech sector, the SRO-FT holds the responsibility to keep the RBI informed about sector developments and promptly notify the regulator of any member violations regarding regulatory requirements. The SRO-FT is required to be actively involved in consulting with the RBI for the development and updating of the taxonomy for FinTechs. Furthermore, the SRO-FT is obligated to execute tasks assigned by the RBI, including the review of proposals or suggestions and providing requested data or information. Submission of an Annual Report and other prescribed returns to the RBI is also part of the SRO-FT's obligations.

RBI retains the right to inspect the books of the SRO-FT and conduct audits through an audit firm, with the associated expenses borne by the SRO-FT.

AKP Comments: *It is pertinent to note that through SRO-FT, RBI can ask for any information of the FinTech members and also take actions directed to a specific member through the concerned SRO-FT. The Draft Framework also indicates a paradigm shift in how RBI approaches the regulatory oversight of FinTechs. Until now, FinTechs' actions or oversights concerning applicable laws and regulations have not been subject to direct scrutiny by the RBI. However, the Draft Framework proposes to introduce a significant change by ushering in direct accountability of FinTechs to the RBI.*

Additionally, there is an absence of a clear distinction between recognized and non-recognized SRO-FTs in the Draft Framework with respect to the obligations for SRO-FTs. This raises the prospect that the RBI can issue directives without differentiation to both recognized and non-recognized SRO-FTs. The lack of this distinction holds potential implications for the regulatory landscape, as non-recognized SRO-FTs may find themselves subject to RBI directions. This underscores the comprehensive regulatory authority the RBI seeks to exert over the FinTech sector through the Draft Framework.

6. What are the obligations of SRO and its stakeholders with regards to the governance and management?

- Adherence to principles of good governance: In addition to the above-mentioned obligations, SRO-FT is obligated to uphold transparency, accountability, integrity, fairness, responsiveness, and compliance with all relevant laws.

Additionally, for governance, SRO-FTs are expected to avoid conflict of interest and conduct prompt grievance redressal.

- Requirement to have detailed AOA: The AOA of SRO-FT should contain appropriate provisions to ensure professional management, clear delineation of the functioning of the Board/ governing body/ management, and other operational matters. The AOA should also clearly specify the criteria for admission, expulsion, suspension, re-admission, etc., for its members.
- Board of SRO-FT: The Board is required to put in place a framework for the ongoing monitoring of the 'fit and proper' status of its BoD and also communicate any change in their fit and proper status to RBI. Minimum one-third of members on the Board, including the chairperson, should be an independent personal, without any active association with a FinTech entity.
- Appointment of Observer(s): RBI if it deems necessary, can also appoint observer(s) on the Board of an SRO-FT.

AKP Comments: *Considering the role of the Board in the SRO-FT, a FinTech member should ensure adequate representation in the SRO-FT while negotiating the terms of its membership.*

It is pertinent to note that the Draft Framework is silent on the funding of the SRO-FT. Hence clarity can also be sought in this regard, requesting RBI that contributions from the members be capped as per the capital of each member.



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