

DIGITAL LENDING GUIDELINES INCLUDING FLDG ANALYSIS

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REFERENCES

This document has been made on the basis of the Guidelines on Digital Lending which were released on 2 September, 2022 and FLDG Guidelines Issued on 8th June 2023.

[View DLG](#)[View FAQs](#)[View FLDG Guidelines](#)

In this, we attempt to pictorially understand and clarify the guidelines, as well as capture the implications that they have had on the entities impacted.

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DEFINITIONS



REs

Regulated Entities

- Commercial Banks
- Primary (Urban) Co-operative Banks
- State Co-operative Banks
- District Central Co-operative Bank
- NBFCs (including HFCs)



LSPs

Lending Service Provider

- RE's agent carrying out partial / whole component of lender's functions:
- customer acquisition
 - underwriting support
 - pricing support
 - servicing
 - monitoring
 - recovery



DLAs

Digital Lending Apps/Platforms

- Mobile and web-based applications with UI facilitating digital lending:
- REs apps
 - Internet banking
 - Mobile banking
 - Any other
 - LSP apps
 - PAs also performing the role of an LSP

LOANS UNDER DLG AMBIT



Retail



MSME



Corporate



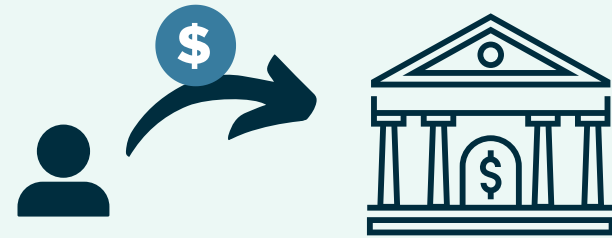
EMI on Debit Card



Priority Sector Lending

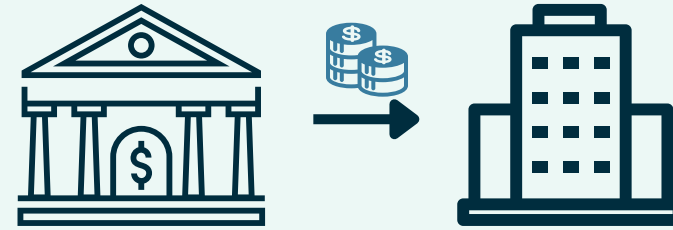
HIGHLIGHTS

No 3rd Party Collections



- Disbursals/repayments from borrower to RE
- No pass-through/ pool account of the LSP or any third party

Fintech Cannot Collect Fee



- RE will pay LSP fees or charges in credit intermediation process

Key Fact Statement



- Key Fact Statement given to borrower, which also includes All-inclusive cost of digital loans in the form of APR

Cooling Off / Look up Period



- Providing cooling-off period wherein borrowers can exit digital loans by paying principal + proportionate APR without any penalty

Consent Driven Credit Increase



- No automatic increase in credit limit without explicit consent of borrower

Grievance Redressal



- REs to ensure suitable nodal grievance redressal officers are engaged

HIGHLIGHTS

Technology & Data Requirements



Data collected by DLAs to be:

- need based
- clear audit trails
- explicit consent driven

Borrowers can

- accept or deny consent for use of specific data
- revoke previously granted consent
- delete the data collected by DLAs/LSPs

Regulatory Framework



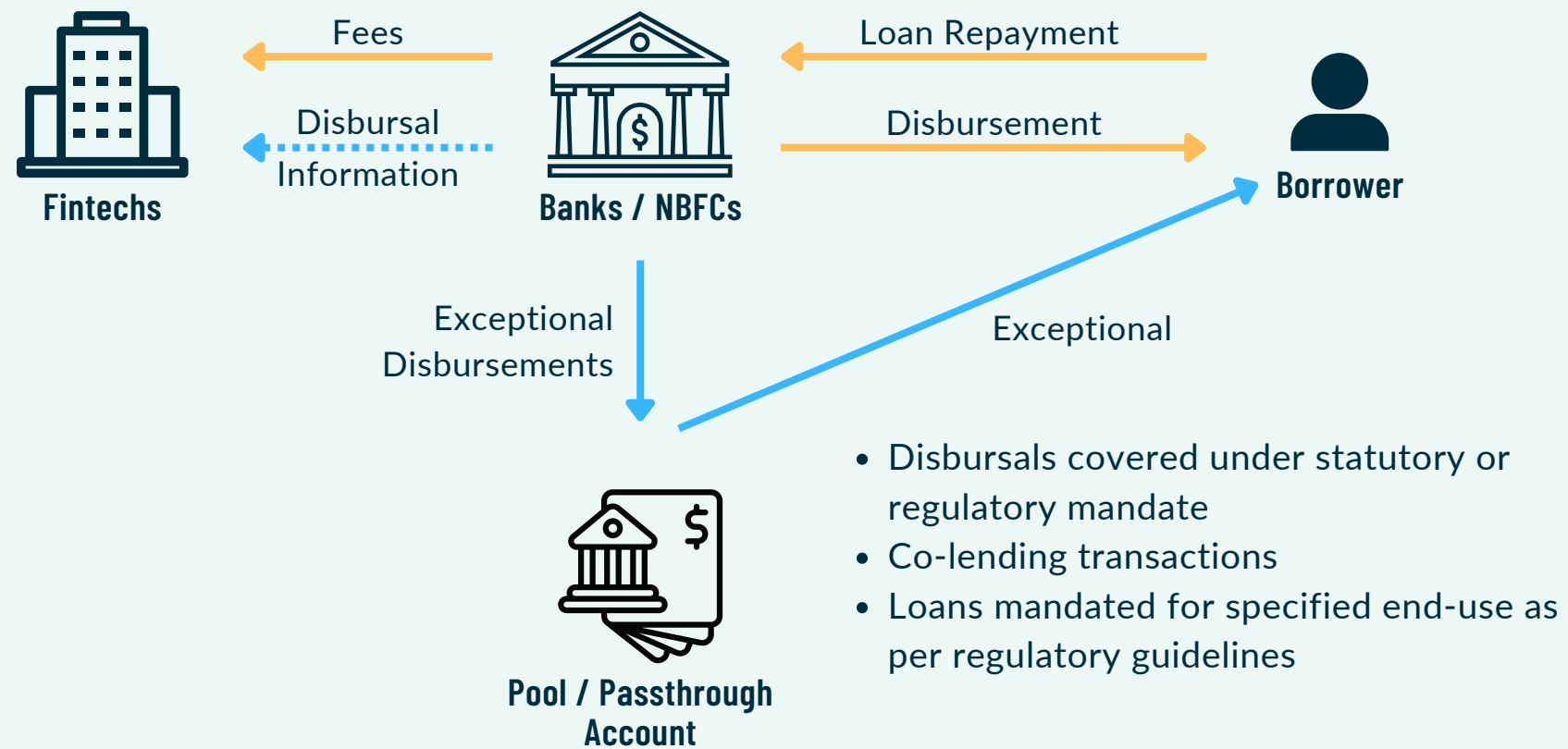
Lending sourced through DLAs (either of the RE or of the LSP engaged by RE) to report to irrespective of its **nature** or **tenor** to Credit Information Companies (CICs)



New digital lending products extended by REs over merchant platforms involving short term credit or deferred payments are required to be reported to CICs by the REs.




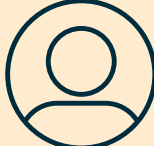
CUSTOMER PROTECTION & CONDUCT REQUIREMENTS

LOAN DISBURSAL, SERVICING, REPAYMENT & FEES



Handling Operations has become complicated

IMPLICATIONS

 <p>Banks / NBFCs</p> <ul style="list-style-type: none"> must now handle disbursements communicate information to LSPs 	 <p>LMS / LOS</p> <ul style="list-style-type: none"> LMS / LOS will become complex
 <p>Fintechs</p> <ul style="list-style-type: none"> will retain no control over capital flows cannot receive fee from borrowers, will be collected by RE and passed on 	 <p>Customer</p> <ul style="list-style-type: none"> No excess fee will be paid by them that Fintechs may have been charging prior

WAY AHEAD

Fintechs are now opting to obtain an NBFC licence

QUESTIONS

- How will Fintechs charge for tertiary services like e-commerce, travel?
- Can borrower have a Fully KYC Compliant PPI?

DISCLOSURES TO BORROWERS

REs TO PROVIDE A KEY FACT STATEMENT (KFS) WITH:

- APR as all-inclusive cost of digital loans for the borrower
- Recovery mechanism
- Grievance redressal officer designated specifically to deal with digital lending/ FinTech related matter
- Cooling-off / Look-up period

Loan amount (amount disbursed / to be disbursed to the borrower)	A
Total interest charge during the entire tenure of the loan	B
Other up-front charges	C
Processing fees	C (i)
Insurance charges	C (ii)
Others (if any)	C (iii)
Net disbursed amount	A - C
Total amount to be paid by the borrower	A+B+C
APR - Effective annualized interest rate (in %)*	D %
Tenure of the Loan (in days / months)	E
Repayment Frequency of Borrower	Monthly
Number of instalments of repayment	E
Amount of each instalment of repayment	F
Details about Contingent Charges	
Rate of annualized penal charges in case of delayed payments (if any)	G
Rate of annualized other penal charges (if any) (details to be provided)	H
Other disclosures	
Cooling off/look-up period during which borrower shall not be charged any penalty on prepayment of loan	
Details of LSP acting as recovery agent and authorized to approach the borrower	
Details of nodal grievance redressal officer designated specifically to deal with FinTech/ digital lending related complaints/ issues	

Insurance will reduce loan amount disbursed to customer

Any fees, charges, etc., which are not mentioned in the KFS cannot be charged by the REs to the borrower at any stage during the term of the loan.

FAQs

The **Penal Interest/Charges** to be based on the **default** loan amount.

FAQs

Cheque bounce/ mandate failure charges cannot be annualised. These charges must be included in KFS

DISCLOSURES TO BORROWERS

RES TO PROVIDE A KEY FACT STATEMENT (KFS) WITH:


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APR is annual rate of interest paid on a loan

$$\left[\left(\frac{\text{Fees + Total Interest}}{\text{Loan}} \right) \times \frac{365}{\text{No. of Days in Loan Term}} \right] \times 100$$

Standard definitions for the cost of digital Short Term Consumer Credit (STCC)/ micro credit as APR → Include Monetary & Non-Monetary impact of

- Early Repayment
- Partial Repayment
- Late Repayment
- Non-Repayment

 Borrowers will avoid short ticket loans due to transparency

FAQs For **floating rate loans**, APR may be disclosed at the time of origination based on the prevailing rate as per the format of KFS. Revised APR may be disclosed to the customer when floating rate changes.

FAQs Annualised Rate of Interest to be disclosed as well.

DISCLOSURES TO BORROWERS

REs TO PROVIDE A KEY FACT STATEMENT (KFS) WITH:

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Bank/NBFC to communicate to the borrower the **details of the Fintech acting as RECOVERY AGENT** when:

- loan is sanctioned
- when recovery responsibilities are passed to Fintech
- when Fintech responsible for recovery is changed



Outsourcing of Financial Services - Responsibilities of regulated entities employing Recovery Agents

- REs can recover delinquent loans in cash, which should be reflected in the borrower's account.
- Such transactions are exempted from the requirement of direct repayment of loan in the RE's bank account.
- LSPs must still receive fees, etc from RE.

FAQs

Borrower to be intimated about empaneled agents authorized to contact them in case of a default. If the loan turns delinquent, then particulars of recovery agent assigned must be communicated to borrower before recovery process.

DISCLOSURES TO BORROWERS

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- Cooling-off / Look-up period



- REs to ensure suitable nodal grievance redressal officers are engaged (who shall also deal with complaints against their respective DLAs also)
- Contact details of grievance redressal officers to be prominently displayed on the websites of the RE, its LSPs and DLAs as well as in the KFS
- Facility to lodge complaint to be on DLA and websites
- RE will be responsible for ensuring resolution of complaints arising out of actions of LSPs
- If borrower's complaints are not resolved by RE within 30 days, it is to be escalated under Reserve Bank – Integrated Ombudsman Scheme (RB-IOS)

FAQs

Only those LSPs which have an interface with the borrowers would need to appoint a nodal Grievance Redressal Officer.

DISCLOSURES TO BORROWERS

REs TO PROVIDE A KEY FACT STATEMENT (KFS) WITH:

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- Cooling-off / Look-up period

Cooling off / Look up Period to be given to borrowers wherein they can exit by paying Principal + Proportionate APR with no penalty.

Tenure	Tenure Cooling off Period
7 days +	Minimum 3 days
< 7 days	Minimum 1 day

For borrowers continuing with the loan even after look-up period, pre-payment shall continue to be allowed as per extant RBI guidelines

FAQs

Processing fees is not required to be refunded if customer exits during Cooling off period (provided same is mentioned in KFS)



- Will impact liquidity of Banks/NBFCs
- this period should also be offered in branches

Credit Information Companies must change their method of evaluating credit score to take this into consideration



Levy of Foreclosure Charges /Pre-payment Penalty on Floating Rate Term Loans

Banks




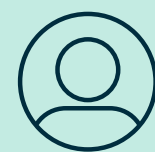

NBFCs

DISCLOSURES TO BORROWERS

REs TO PROVIDE A KEY FACT STATEMENT (KFS) WITH:

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- Grievance redressal officer designated specifically to deal with digital lending/ FinTech related matter
- Cooling-off / Look-up period

IMPLICATIONS

 <p>Banks / NBFCs</p> <ul style="list-style-type: none"> • Must increase transparency wrt loan information, third party details • must address liquidity issues that may crop up due to look-up period • increase in cost of doing business 	 <p>LMS / LOS</p> <ul style="list-style-type: none"> • LMS / LOS required to develop systems to release KFS, account for look-up period and implementation of new flows 	
 <p>Fintechs</p> <ul style="list-style-type: none"> • will face difficulty in selling their short term loan product • increase in cost of doing business 	 <p>Customer</p> <ul style="list-style-type: none"> • will avoid short ticket loans due to awareness about high costs 	 <p>CICs</p> <ul style="list-style-type: none"> • Will have to change their methodology of credit assessment due to impact of look-up period

WAY AHEAD

Fintechs may shift to bigger ticket loans

DISCLOSURES TO BORROWERS

CONSUMER AWARENESS



Key Fact Statement



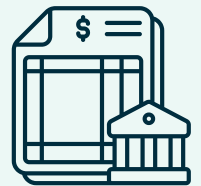
summary of product



Sanction Letter



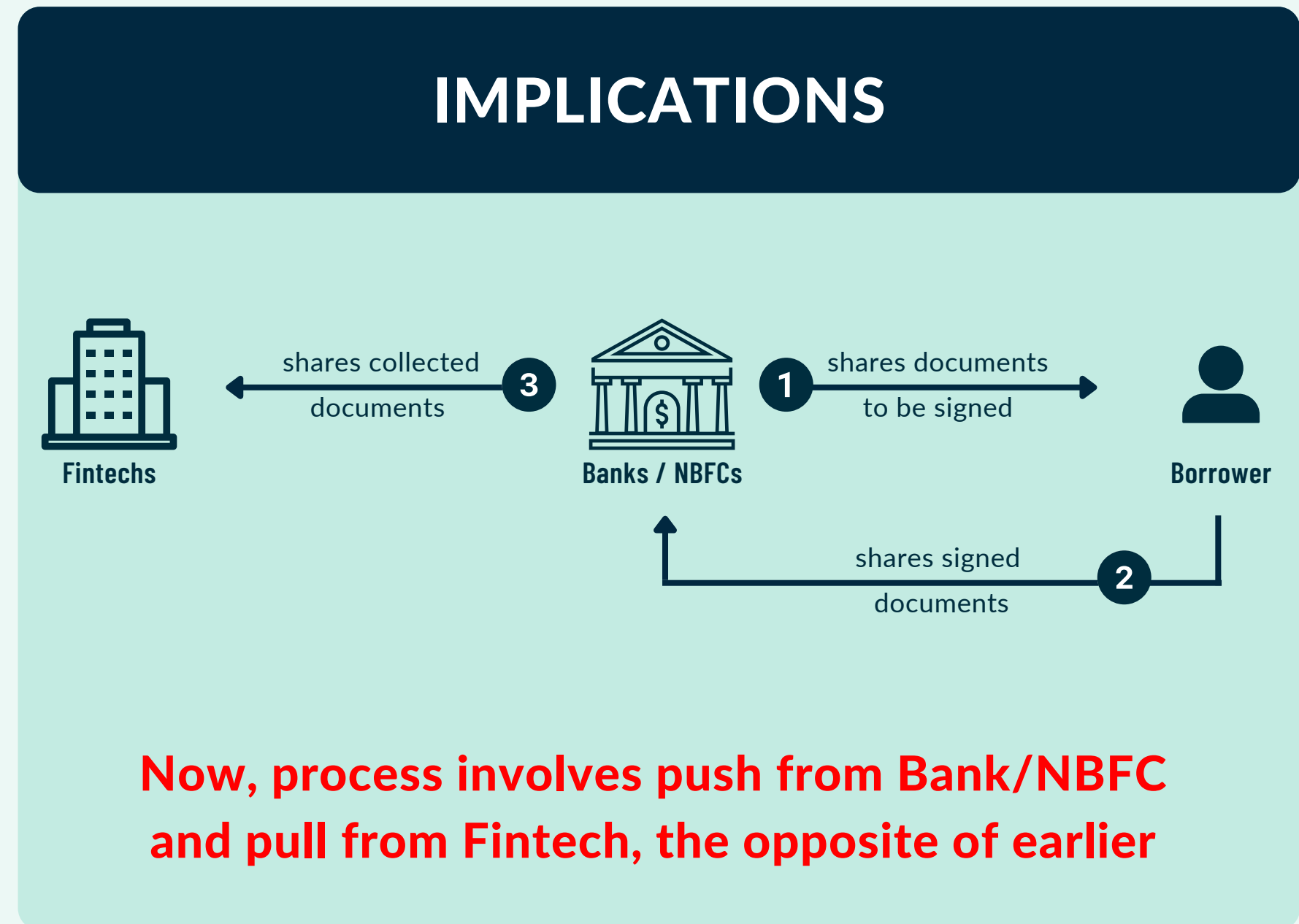
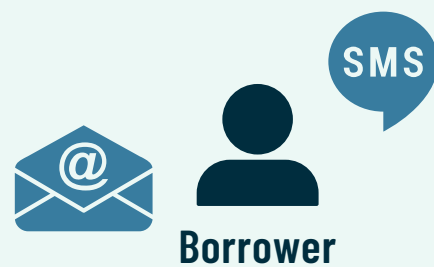
Terms & Conditions



Account Statements



Privacy Policy of LSP



DISCLOSURES TO BORROWERS

REs LIST ENGAGED LSPs

Banks/NBFCs to publish list of LSPs (and DLAs, if any) they are working with on their website along details of activities

Sample details that must reflect on website:

- Company Name
- GST ID
- Reference Number
- Details of Products Offered



DISCLOSURES TO BORROWERS

PRODUCT INFORMATION

REs to ensure DLAs / LSP's DLA to display product information at onboarding stage

Sample details that must reflect on DLA:

- Product Features
- Loan Limits
- Eligibility
- Interest Calculator chart

OTHER INFORMATION

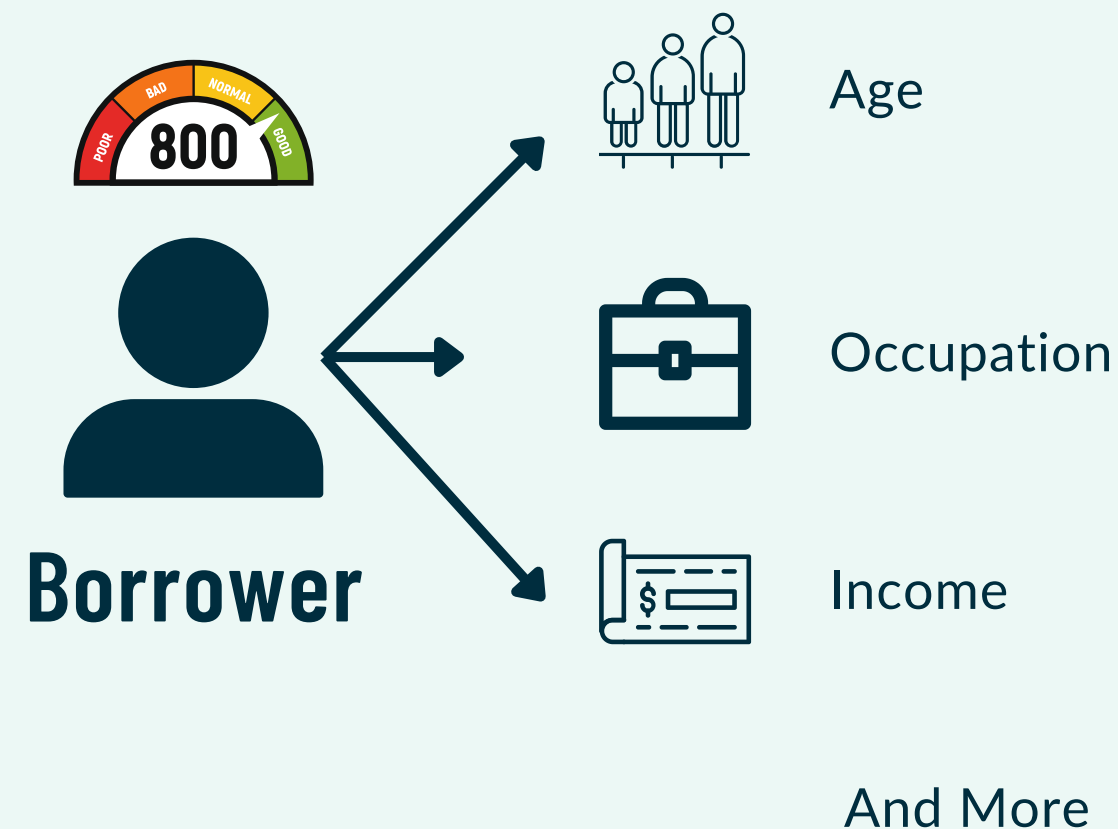
REs to ensure following information is prominently displayed on the website (and be DLAs of RE and LSP must link to them as well):

- Lender
- LSP
- Customer care
- link to Sachet Portal
- Privacy policies

DISCLOSURES TO BORROWERS

BORROWER CREDITWORTHINESS

REs to capture economic profile of the borrowers in an **auditable manner**



CONSENT MANDATORY TO INCREASE CREDIT LIMIT

Fintechs, such as those providing Line of Credit or BNPL, would increase credit limit without obtaining explicit consent from customers.

They must now seek consent from the user before increasing it.

DISCLOSURES TO BORROWERS

RE - LSP ENGAGEMENT

ENHANCED DUE DILIGENCE by the Balance Sheet Lenders before entering into partnership with an LSP

RE must consider:

- ✓ technical abilities
- ✓ data privacy policies and storage systems
- ✓ fairness in conduct with borrowers
- ✓ ability to comply with regulations and statutes

ALSO



REs shall carry out periodic review of the conduct of LSPs

REs shall impart necessary guidance to LSPs acting as recovery agents

IMPLICATIONS



- Will become difficult to onboard partners and cost will increase to Rs. 50L+ per partner



- New startups will not be able to enter this segment, thus slowing down innovation



Outsourcing of Financial Services - Responsibilities of regulated entities employing Recovery Agents


TECHNOLOGY AND DATA REQUIREMENT


COLLECTION, USAGE & SHARING OF DATA WITH THIRD PARTIES



Need-based collection of data by DLAs, with prior and explicit consent

Difficult to qualify which is needed and which is not

- 
- file and media
 - contact list
 - call logs
 - telephone functions

- 
- One time access of:
- camera
 - microphone
 - location

Borrower shall be empowered to:

- give / deny consent for use of specific data
- restrict disclosure to third parties
- data retention
- revoke consent already granted to collect personal data
- make the app delete/ forget the data

The **purpose** of obtaining borrowers' **consent** needs to be disclosed every time.

Consent to be taken before sharing personal information with any third party.

STORAGE OF DATA



RE is responsible to ensure LSPs do not store borrowers' personal information except minimal data.



No storage of biometric data with DLA of RE / LSP

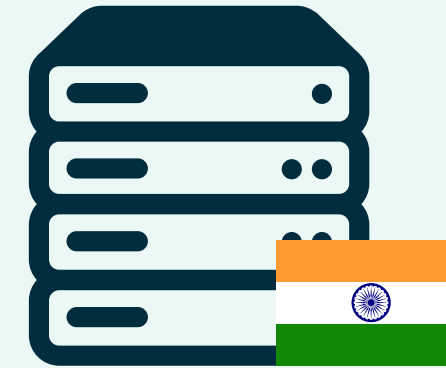
STORAGE OF DATA



RE to lay down policy guidelines regarding:

- type of data that can be held
- length of time data can be held
- restrictions on the use of data
- data destruction protocol
- standards for handling security breach

to be showcased on DLA's website and app



Data should be stored in servers located in India

COMPREHENSIVE PRIVACY POLICY

DLA to make its comprehensive **privacy policy** available in **public**

Details of any third parties, that are allowed to collect personal information to be disclosed. **Explicit consent** to be taken before sharing personal information with any **third party**



TECHNOLOGY STANDARDS

REs to ensure end-to-end compliance with technology standards/ requirements on cybersecurity.



REGULATORY FRAMEWORK

REPORTING TO CREDIT BUREAUS

CICs

Lending sourced through DLAs (either of the RE or of the LSP engaged by RE) to report to irrespective of its **nature** or **tenor** to Credit Information

Companies (CICs)



BNPL

New digital lending products extended by REs over merchant platforms involving short term credit or deferred payments are required to be reported to CICs by the REs.

IMPLICATIONS



Credit Score is dependent on:

- Number of loans taken
- Payment Default

Credit Bureaus will have to redo their credit scoring algorithm as now:

- customer will take countless loans for miscellaneous activities like having lunch, recharge, etc.
- Payment Default small amounts should not impact score very negatively

WAY AHEAD

Cost of BNPL will rise exorbitantly due to requirement of KYC and Credit Score, thus small ticket loans in the market will reduce.

FIRST LOSS DEFAULT GUARANTEE (FLDG)

WHAT IS FLDG?

A contractual arrangement between the Regulated Entity (RE) and a Lending Service Provider (LSP) or other RE with which it has entered an outsourcing (LSP) agreement, under which the latter guarantees to compensate the RE, loss due to default up to a certain percentage of the loan portfolio of the RE, specified upfront.

Any other implicit guarantee of similar nature linked to the performance of the loan portfolio of the RE and specified upfront, shall also be covered under the definition of FLDG.

STRUCTURE OF FLDG ARRANGEMENTS

FLDG arrangements must be backed by an explicit legally enforceable contract between the RE and the FLDG provider and contain:



Extent of FLDG cover



Timeline for FLDG invocation



Disclosure requirement of LSPs wherein they must publish on their website:

- total number of portfolios
- amount of each portfolio on which FLDG has been offered



Form in which FLDG cover is to be maintained with the RE. The forms are:

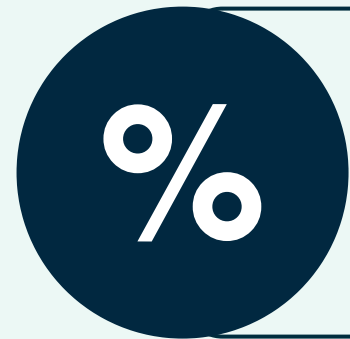
- Cash deposited with the RE
- FDs maintained with a Scheduled Commercial Bank with a lien marked in favour of the RE
- Bank Guarantee in favour of the RE

CAP ON FLDG

5%

- Maximum FLDG cover on any outstanding portfolio shall not exceed 5% of the amount of that loan portfolio.
- In case of implicit guarantee arrangements, the FLDG Provider shall not bear performance risk of more than 5% of the underlying loan portfolio.

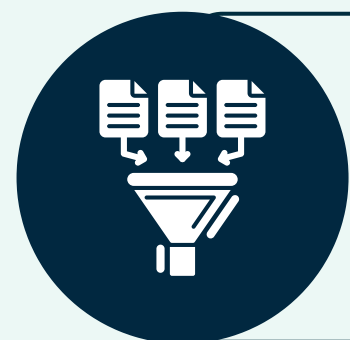
RECOGNITION OF NPA



RE shall recognise **individual loan assets** in the portfolio as NPA and look into the consequent provisioning, irrespective of FLDG cover available at the portfolio level



The amount of FLDG **invoked shall not be** set off against the **underlying individual loans**



Recovery by the RE from the loans on which FLDG has been invoked and realised can be **shared** with the FLDG provider in terms of the contractual arrangement

FLDG DETAILS



Treatment of FLDG for Regulatory Capital

Computation of **exposure and application of Credit Risk Mitigation benefits** on individual loan assets in the portfolio shall continue to be **governed** by the **extant norms**



Invocation of FLDG

RE can invoke FLDG within a maximum **overdue period of 120 days**



Tenor of FLDG

The period for which the FLDG **agreement** will remain **in force** shall be **equal to / greater than the longest tenor** of the loan in the underlying loan portfolio

REQUIREMENTS FROM FLDG PROVIDER



Board Policy for FLDG Agreement

Policy to include:

- eligibility criteria for FLDG provider
- nature & extent of FLDG cover
- process of monitoring and reviewing the FLDG arrangement
- details of the fees payable to the FLDG provider



Credit Underwriting

- FLDG arrangement shall not act as a substitute for credit appraisal requirements
- robust credit underwriting standards need to be put in place



Due Diligence

When RE enters/renews an FLDG arrangement, it shall obtain:

- declaration from the FLDG provider, certified by the statutory auditor, on the aggregate FLDG amount outstanding
- number of REs and the respective number of portfolios against which FLDG has been provided
- past default rates on similar portfolios

EXCEPTIONS



Guarantee schemes of:

- Credit Guarantee Fund Trust for Micro and Small Enterprises (CGTMSE)
- Credit Risk Guarantee Fund Trust for Low Income Housing (CRGFTLIH)
- Individual schemes under National Credit Guarantee Trustee Company Ltd (NCGTC)



Credit guarantee provided by Bank for:

- International Settlements (BIS)
- International Monetary Fund (IMF)
- Multilateral Development Banks

IMPACT OF FLDG

Digital Lending by Fintechs will scale

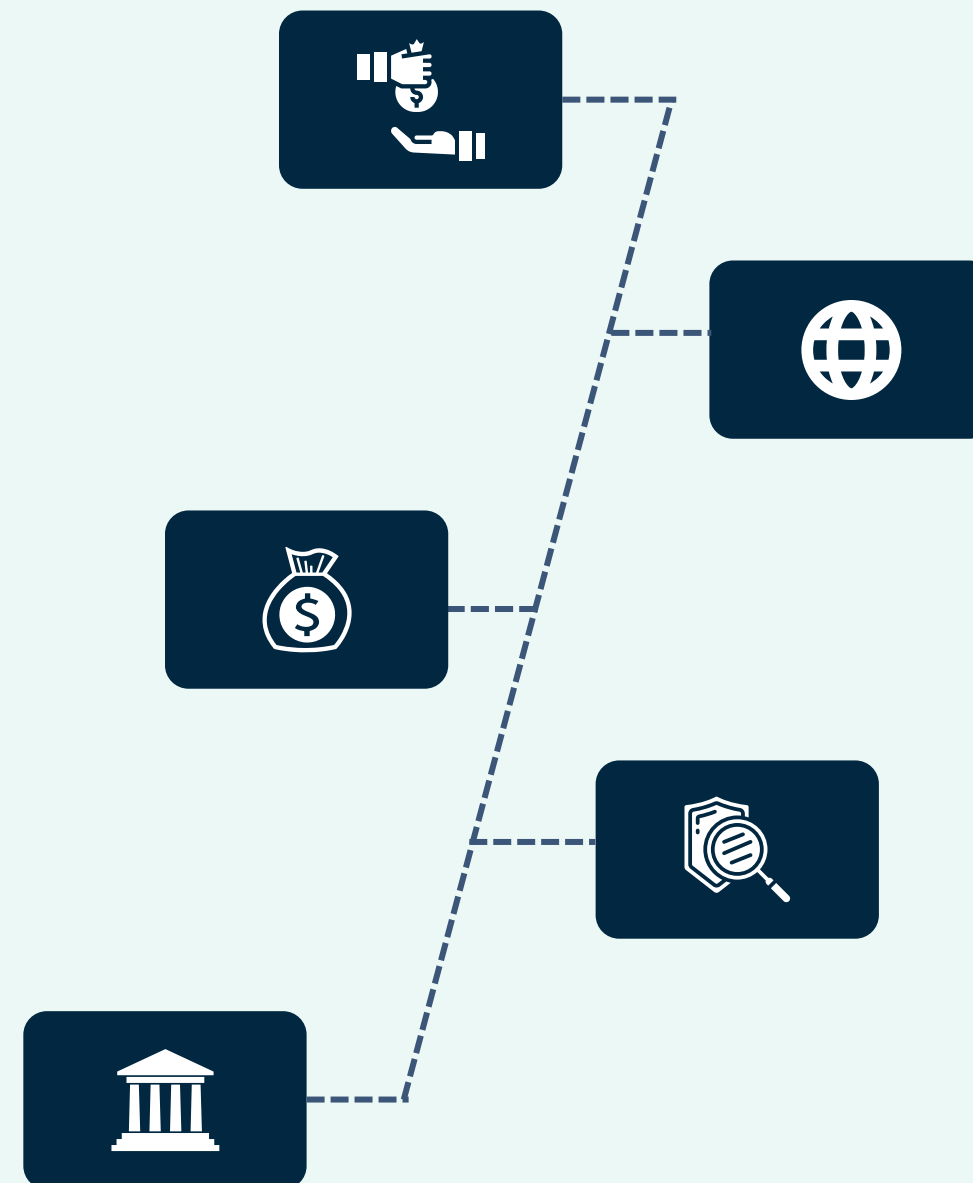
Digital Lending, which had reduced due to lack of clarity, will grow.

Funding in Digital Lending Fintechs will increase

The Digital Lending segment witnessed the highest investment in fintech in 2022. With FLDG guidelines in place, it will continue to grow.

Banks will have to create proper frameworks to adhere to these guidelines

Banks will be able to implement processes to ensure compliance and scale their partner-led digital lending initiatives.



LSPs' portfolios will be exposed for public scrutiny

As LSPs would be required to publish the total number of portfolios and the respective amount of each portfolio on which FLDG has been offered their website, their portfolios would be exposed for the public to view and scrutinise.

Increased transparency within the ecosystem

LSPs will have to expose all their relationships and portfolios (including default) with all REs. While it would increase transparency, it may open up all LSP - RE agreements for review by competitors.

ABOUT THE DIGITAL FIFTH



The Digital Fifth is India's first Fintech Consulting and Advisory firm.

Since its inception in 2017, The Digital Fifth has been the go-to solution finder for Banks, NBFCs, Fintechs and other BFSI entities across the board.

We work closely with our clients to find and implement synergistic partnerships, connect with the right customers, execute product roadmaps and help them gain a unique positioning in the industry.



Amongst the largest players in this segment in Asia



Organiser of Bharat Fintech Summit, one of the largest & most impactful Fintech events in India.



Committed to improving regulatory policies to enable customer-centric innovation



1st in India to offer practical & industry-first training programs in Fintech & Digital Finance

CONSULTING SERVICES

Digital Advisory Services

- Benchmark service for digital maturity models and digital platforms
- Digital strategy and roadmap development
- Digital Journey Design for Banking / Financial Products and Services
- Program Management for Digital Transformation Initiatives
- Digital solution model development and platform evaluation

Open Banking Advisory Services

- Development of open banking strategy and roadmap Develop Neo Bank/Digital Bank model and partnership
- API management and technology consulting services
- Embedded Finance

Fintech & Start-up Advisory Services

- Business Building and Go to Market Strategy and Roadmap
- Technology architecture and CTO consulting services
- Developing business and platform models for embedded finance
- Partnerships connect with lenders, FIs

Security & Compliance Services

- Development of information and cyber security policy framework
- Technology risk management service
- Technical governance and compliance

Digital Research & Content Management

- Deep segmentation and technology research and report development
- Content-based growth and marketing revitalization

BHARAT FINTECH SUMMIT



Check out deep interactions between industry leaders on key topics in the Fintech & Digital Finance space, exclusively on The Digital Fifth's YouTube channel.

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