

Technology Law Analysis

January 18, 2024

FINTECH WRAP 2023

INTRODUCTION

While 2023 had been fraught with price and interest rate surges, extraordinary volatility in financial markets, it also witnessed a whirlwind of innovation and regulatory developments in India's fintech landscape. The volume of digital payment transactions reached INR 116,600 million.¹ Regulators have kept pace with cutting edge technology and newer payment solutions by bringing the same within the governance framework, allowing entities dealing in innovating payment and lending solutions, and even cryptocurrencies to better position themselves with more legitimacy in the regulatory eye. We revisit some of the key developments this year in the Indian FinTech space:

1. New cross-border payment aggregators framework: On October 31, 2023, the Reserve Bank of India ("RBI") liberalized the framework on cross-border payments for e-commerce transactions by introducing the *Regulations for Payment Aggregator – Cross Border*.² The regulations govern all entities facilitating the processing or settlement of cross-border payment transactions for import and export of goods and services in online mode. Such activities were previously within the exclusive domain of authorized dealer banks in collaboration with Online Payment Gateway Service Providers ("OPGSP") or collection agents. The role of OPGSPs and collections agents, although, was limited to providing the front-facing interface. The regulations do away with the previous fragmented and ad hoc system and set out the framework for carrying out such activities, including eligibility criteria, conditions for authorization, minimum net worth and due diligence requirements, nodal collection account requirements, etc. There are certain operational complexities that may arise in the applicability of the regulations, for instance, the *mutatis mutandis* application of the RBI Guidelines on Regulation of Payment Aggregators and Payment Gateways dated March 17, 2020³. The same will need to be evaluated going forward.

Our detailed analysis of the Regulations for Payment Aggregator – Cross Border is available [here](#).

2. Cross-border Payments Gateways recognized as Reporting Entities under the PMLA: The Delhi High Court on July 24, 2023 ruled⁴ that PayPal, a technology application provider in India operating as a payment gateway, is a "payment system operator" under the *Prevention of Money Laundering Act, 2002* ("PMLA") and subject to the reporting obligations therein. PayPal had argued that it was not involved in the actual handling of funds nor did it qualify as a "payment system" under a similar definition under the Payment and Settlement Systems Act, 2006 ("PSS Act"). However, the Court undertook a purposive interpretation of the PMLA as a statute to regulate money laundering, distinguishing it from the intent of the PSS Act, and held that PayPal would fall within the said definition of a payment systems operator. The Court, nevertheless, set aside the penalty imposed by the Financial Intelligence Unit, India ("FIU-IND") as clearly unjustified, holding that PayPal's stand that it was not a payment system operator was not "wholly specious or in willful disobedience" of a legal obligation but rather a bona fide belief as to its inapplicability. Further to this decision, the Regulations for Payment Aggregator – Cross Border now explicitly require all non-bank cross-border payment aggregators to register themselves with the FIU-IND. PayPal has sought to challenge this decision of the single judge of the Delhi High Court and the next date of hearing is scheduled for March 7, 2024.⁵

Our detailed analysis of the case is available [here](#).

3. PMLA extended to virtual digital assets: The Ministry of Finance vide notification dated March 7, 2023⁶, extended the applicability of the obligations under the PMLA to persons undertaking activities involving virtual digital assets. Owing to the anonymity and difficulty in traceability seen in virtual digital assets, they had been an infamous choice as a conduit in illicit activities such as money laundering. In response, regulators across the world have increased efforts to implement monitoring mechanisms. The Directorate of Enforcement ("ED") has attached proceeds from several money laundering cases against companies running cryptocurrency exchanges worth hundreds of crores.⁷ As a response to these growing concerns, the Ministry of Finance issued the notification dated March 7, 2023.

The notification specified that persons who carries out the following activities for or on behalf of another person in the course of business are categorized as "person carrying on designated business or profession" ("PCDBP") under the PMLA:

- (i) exchange between virtual digital assets and fiat currencies;
- (ii) exchange between one or more forms of virtual digital assets;
- (iii) transfer of virtual digital assets;
- (iv) safekeeping or administration of virtual digital assets or instruments enabling control over virtual digital assets; and
- (v) participation in and provision of financial services related to an issuer's offer and sale of a virtual digital asset.

Research Papers

FAQs on Setting Up of Offices in India

December 13, 2024

FAQs on Downstream Investment

December 13, 2024

Gaming Law 2024

December 12, 2024

Research Articles

The Revolution Realized: Bitcoin's Triumph

December 05, 2024

The Bitcoin Effect

November 14, 2024

Acquirers Beware: Indian Merger Control Regime Revamped!

September 15, 2024

Audio

Securities Market Regulator's Continued Quest Against "Unfiltered" Financial Advice

December 18, 2024

Digital Lending - Part 1 - What's New with NBFC P2Ps

November 19, 2024

Renewable Roadmap: Budget 2024 and Beyond - Part I

August 26, 2024

NDA Connect

Connect with us at events, conferences and seminars.

NDA Hotline

Click here to view Hotline archives.

Video

"Investment return is not enough" Nishith Desai with Nikunj Dalmia (ET Now) at FI18 event in Riyadh

October 31, 2024

Analysing SEBI's Consultation Paper on Simplification of registration for FPIs

Accordingly, such PCDBPs, as 'reporting entities' under the PMLA, are mandated to comply with KYC verification standards, reporting standards, due diligence requirements, etc.. This move will also help in identification, monitoring and reconstruction of suspicious transactions involving virtual digital assets under the aegis of FIU-IND.

Our detailed analysis of the notification and its impact is available [here](#).

4. RBI Guidelines on Outsourcing of IT services by Regulated Entities: The RBI had issued the Master Direction on Outsourcing of Information Technology Services⁸ on April 10, 2023, which came into effect on October 1, 2023. The directions reaffirm that the outsourcing of arrangements do not undermine the responsibility of the reporting entities nor diminish their obligations towards customers. The directions impose requirements of a grievance redressal framework, obligations of due diligence, monitoring and risk management by the reporting entities. It also places a special focus on confidentiality and security of customer data, with access only on a need-to-know basis. Given the largescale outsourcing undertaken by financial institutions, operationalizing these requirements by reporting entities is the need of the hour, considering the financial, operational and reputational risks sought to be addressed by the directions.

5. New UPI Features: The National Payments Corporation of India ("NPCI"), the umbrella organization that operates the Unified Payments Interface ("UPI") system in India, launched several new features on September 6, 2023.⁹ The launch followed a significant milestone of 10 billion UPI transactions a month.¹⁰

(vi) **Credit Line on UPI:** Payment Service Provider ("PSP") banks can now connect pre-approved credit lines and other digital credit products as mode of payment through UPI.¹¹ Banks can even offer interest grace period for such transactions, incentivizing credit by improving affordability. This feature requires banks to establish a transparent schedule of charges and facilitate mandatory customer engagement channels.

(vii) **Hello UPI:** A conversational UPI payment option using voice-enabled features, currently available in Hindi and English but expected to include regional languages in the near future. UPI features such as user onboarding, balance enquiry, financial transactions, complaint resolution etc are all enabled through voice commands by the user. All participants in the UPI ecosystem are required to enable the Hello UPI feature by March 31, 2024.¹²

(viii) **UPI Lite X:** This feature will enable users to undertake fund transfers without an internet connection through the usage of 'near field communication' ("NFC") technology. Devices equipped with NFC at close range can make payments between the sender and receiver's on-device wallet. This is different from UPI Lite launched last year which enabled payments, up to a threshold of INR 500, without requiring a UPI pin.

(ix) **UPI Tap and Pay:** This feature, also powered by NFC technology, enables users to make payments by tapping their phone on a contactless reader, similar to the previous Scan and Pay and Pay to Contacts feature. NPCI has kickstarted the deployment of this feature, requesting participants to go live with this feature by January 31, 2024.¹³

(x) **UPI usage abroad and by NRIs:** The Indian government has entered into arrangements with several countries (such as France, UAE, UK, Saudi Arabia, Bhutan, Oman etc.) to enable Indian travelers to pay for purchases through UPI while travelling abroad. In fact, India and Singapore have linked UPI with Singapore's peer-to-peer funds transfer service, PayNow, in a move to significantly aid in cross-border remittances.¹⁴ NPCI has also permitted usage of UPI by NRIs from certain countries with an international mobile number linked to their Non-Resident External or Non-Resident Ordinary accounts.¹⁵

6. Central Bank Digital Currency pilot project: The RBI had launched a pilot project of the Central Bank Digital Currency ("CBDC") for both wholesale and retail segments in November and December of 2022.¹⁶ Amidst reluctance against private cryptocurrencies by the government and financial regulators, the launch of the CBDC has been positioned as a safer, cost-effective and energy conscious payment solution. The CBDC in the retail segment is a form of digital token that represents legal tender issued in the same denominations as paper currency and coins. It can be used through digital wallets offered by the participating banks. The pilot is currently covering closed user groups in the following five participating cities – Mumbai, New Delhi, Bengaluru, Bhubaneswar and Chandigarh.¹⁷ It can be used for peer-to-peer and peer-to-merchant transactions. As per reports, the progress in the retail segment was around 18,000-20,000 transactions per day, with an expected target of 10 lakh transactions per day by December 2023.¹⁸ The pilot is expected to evaluate the behavioral pattern of users to accordingly impact policy and design choices. The CBDC pilot in the wholesale segment was launched for settlement in the secondary government securities market. As per reports, the pilot is operational in nine banks as of now and is likely to be launched for transactions for interbank borrowing and the call money market.¹⁹ The RBI had also announced plans for interoperability of CBDC with UPI via QR codes, which are currently operational by several banks, in a move to further incentivize usage of CBDC.²⁰

7. RBI Guidelines on Default Loss Guarantee in Digital Lending: On June 8, 2023, the RBI issued guidelines²¹ to regulate first loss default guarantee ("FLDG") offered by lending service providers ("LSP") or other regulated entities. FLDGs which are contractual arrangements by which an FLDG provider guarantees to compensate a regulated entity, for a percentage of loss due to default on loans, were earlier treated as 'synthetic securitization' or 'loan participation' and regulated under the relevant RBI directions.²² The guidelines permit such arrangements subject to requirements on permissible structures for FLDGs, cap on the cover, manner of invocation, due diligence and disclosure requirements etc. These requirements apply over the due diligence and disclosure requirements already applicable under the Digital Lending Guidelines previously issued in September 2022²³.

Our detailed analysis of the digital lending guidelines and its implications are available [here](#).

8. Proposed regulation of 'Finfluencers' by SEBI: On August 25, 2023, the Securities and Exchange Board of India ("SEBI") issued a consultation paper on restricting the association of SEBI registered intermediaries/regulated entities with unregistered entities such as 'finfluencers'.²⁴ Financial influencers or 'finfluencers' had come under the radar of SEBI on multiple occasions last year. The securities regulator barred several persons operating as unregistered investment advisers with large social media followings from dealing in the securities market ordering them to pay back amounts, ranging up to several crores, for luring client through misleading/false information and influencing them to deal in

securities.²⁵ Such unregulated entities often do not possess the requisite professional or educational qualifications or expertise, may have conflicts of interest with the products they endorse, and are typically compensated by way of a referral fee or some contingent compensation with the promoted entity. The Advertising Standards Council of India has also placed additional responsibility on financial influencers under the Guidelines for Influences Advertising in Digital

Media²⁶ requiring mandatory registration/licensing and disclosure requirements. The existing registration requirements may not be the most appropriate solution (for example, the definition of Investment Advisors under the SEBI (Investment Advisors) Regulations, 2013 refers only to persons who provide investment advice for consideration which is not the business model of finfluencers). Complete disassociation requirements between regulated entities and finfluencers may also prove counterproductive by limiting access to informative content and excessive restriction on freedom of speech. It remains to be seen how SEBI will tackle this issue going forward.

9. RBI to set up FinTech Repository: FinTech players have been leveraging emerging technology like artificial intelligence, blockchain, Internet of Things etc leading to a surge in innovation in the space. The RBI has been attempting to keep pace with rising innovation and global best practices in an effort to promote financial inclusion, microfinance etc. In line with the same, RBI announced²⁷ its intention to set up a FinTech Repository to better understand such developments and improve transparency in the sector. FinTech entities may voluntarily provide information to the repository to aid regulators in appropriately designing policies through a better understanding of the activities, products and technology. The repository is expected to be operationalized by the Reserve Bank Innovation Hub by April 2024 and poised to be an important resource representing the RBI's commitment to dynamic growth.

WAY FORWARD

2023 was a year of regulatory innovation. It addressed some of the important issues arising out of new-age business models such as cross-border remittances (through UPI or payment aggregators), virtual digital assets, financial outsourcing, FLDG models, etc. It demonstrated that the regulator is not as far behind on keeping up with business innovation as conventional perceptions go. A forward-thinking regulatory framework should also ensure that sufficient checks and safeguards are put in place. This may paint an encouraging picture for investors and industry players alike. However, implementation of regulations for innovative businesses is a challenging exercise and will only cause players as well as regulators to mature in their approaches. We might as well see an exciting 2024 with more capital flowing into the industry and a more active enforcement mechanism. Bring on 2024!

– Karishma Karthik, Purushotham Kittane and Huzefa Tavawalla

You can direct your queries or comments to the authors.

¹See <https://pib.gov.in/PressReleasePage.aspx?PRID=1988370#:~:text=The%20Minister%20further%20stated%20that,2023> (last accessed on January 16, 2024)

²See <https://www.rbi.org.in/Scripts/NotificationUser.aspx?Id=12561&Mode=0> (last accessed on January 16, 2024)

³See <https://rbi.org.in/Scripts/NotificationUser.aspx?Id=11822&Mode=0> (last accessed on January 16, 2024)

⁴PayPal Payments Private Limited v. Financial Intelligence Unit – India & Anr., W.P.(C) 138/2021.

⁵PayPal Payments Private Limited v. Financial Intelligence Unit – India & Anr., LPA 594/2023 & C.M.Nos.42770-42773/2023, 54383/2023.

⁶See <https://fiuindia.gov.in/pdfs/downloads/VDASP04072023.pdf> (last accessed on January 16, 2024)

⁷See <https://pib.gov.in/PressReleaseDetail.aspx?PRID=1896722> (last accessed on January 16, 2024)

⁸See https://www.rbi.org.in/Scripts/BS_ViewMasDirections.aspx?id=12486 (last accessed on January 16, 2024)

⁹See <https://www.npci.org.in/PDF/npci/press-releases/2023/NPCI-Press-Release-RBI-Governor-Launches-Key-Digital-Payment-Initiatives-at-Global-Fintech-Fest-2023.pdf> (last accessed on January 16, 2024)

¹⁰See <https://timesofindia.indiatimes.com/gadgets-news/upi-crosses-10-billion-transactions-the-four-biggest-numbers/articleshow/103293470.cms> (last accessed on January 16, 2024)

¹¹See <https://rbidocs.rbi.org.in/rdocs/notification/PDFs/CREDITONUPI6DBE2D06A61540D19322CFA718643920.PDF> (last accessed on January 16, 2024)

¹²See <https://www.npci.org.in/PDF/npci/upi/circular/2023/NPCI-UI-OC-175-Guidelines-for-Hello-UI.pdf> (last accessed on January 16, 2024)

¹³See <https://www.npci.org.in/PDF/npci/upi/circular/2023/UI-TAP-and-PAY-OC-186-Introduction-of-UI-TAP-and-PAY-mode-of-Payments.pdf> (last accessed on January 16, 2024)

¹⁴See <https://pib.gov.in/PressReleasePage.aspx?PRID=1911736> (last accessed on January 16, 2024)

¹⁵See <https://pib.gov.in/PressReleasePage.aspx?PRID=1944427> (last accessed on January 16, 2024)

¹⁶See [https://pib.gov.in/PressReleasePage.aspx?PRID=1882883#:~:text=Central%20Bank%20Digital%20Currency%20\(CBDC,components%20based%20on%20blockchain%20technology&text=The%20Reserve%20Bank%20of%20India,%20on%20October%207%2C%202022](https://pib.gov.in/PressReleasePage.aspx?PRID=1882883#:~:text=Central%20Bank%20Digital%20Currency%20(CBDC,components%20based%20on%20blockchain%20technology&text=The%20Reserve%20Bank%20of%20India,%20on%20October%207%2C%202022) (last accessed on January 16, 2024)

¹⁷See <https://www.pib.gov.in/PressReleasePage.aspx?PRID=1896721#:~:text=The%20e%20e%20B%20DR%20pilot,and%20coins%20are%20currently%20issued> (last accessed on January 16, 2024)

¹⁸See <https://www.financialexpress.com/business/banking-finance-rbi-begins-cbdc-pilot-in-call-money-market-3279613/> (last accessed on January 16, 2024)

¹⁹See <https://www.thehindubusinessline.com/incoming/rbi-initiates-pilot-run-to-test-e-rupee-for-inter-bank-borrowing/article67439060.ece#:~:text=start%20by%20October,-,The%20pilot%20is%20believed%20to%20have%20been%20introduced%20via%20the,IDFC%20First%20Bank%20and%20HSBC> (last accessed on January 16, 2024)

²⁰See https://rbi.org.in/scripts/BS_ViewBulletin.aspx?Id=22051 (last accessed on January 16, 2024)

²¹Guidelines on Default Loss Guarantee (DLG) in Digital Lending, available at <https://rbidocs.rbi.org.in/rdocs/notification/PDFs/NT4142A9CBCE6AC04882AD2C3B1E8718965C.PDF> (last accessed on January 16, 2024)

²²See https://rbi.org.in/Scripts/BS_ViewMasDirections.aspx?id=12165; https://rbi.org.in/Scripts/BS_ViewMasDirections.aspx?id=12166 (last

accessed on January 16, 2024)

²³See <https://rbi.org.in/Scripts/NotificationUser.aspx?Id=12382&Mode=0> (last accessed on January 16, 2024)

²⁴See https://www.sebi.gov.in/reports-and-statistics/reports/aug-2023/consultation-paper-on-association-of-sebi-registered-intermediaries-regulated-entities-with-unregistered-entities-including-finfluencers-_75932.html (last accessed on January 16, 2024)

²⁵See https://www.sebi.gov.in/enforcement/orders/oct-2023/interim-order-cum-scn-in-the-matter-of-unregistered-investment-advisory-activities-of-mohammad-nasiruddin-ansari-baap-of-chart_78333.html (last accessed on January 16, 2024);
See https://www.sebi.gov.in/enforcement/orders/may-2023/settlement-order-in-respect-of-mansun-consultancy-private-limited-mr-p-r-sundar-and-ms-mangayarkarasi-sundar_71701.html (last accessed on January 16, 2024).

²⁶See <https://www.ascionline.in/wp-content/uploads/2023/08/GUIDELINES-FOR-INFLUENCER-ADVERTISING-IN-DIGITAL-MEDIA.pdf> (last accessed on January 16, 2024)

²⁷See https://www.rbi.org.in/Scripts/BS_PressReleaseDisplay.aspx?prid=56889 (last accessed on January 16, 2024).

DISCLAIMER

The contents of this hotline should not be construed as legal opinion. View detailed disclaimer.

This Hotline provides general information existing at the time of preparation. The Hotline is intended as a news update and Nishith Desai Associates neither assumes nor accepts any responsibility for any loss arising to any person acting or refraining from acting as a result of any material contained in this Hotline. It is recommended that professional advice be taken based on the specific facts and circumstances. This Hotline does not substitute the need to refer to the original pronouncements.

This is not a Spam mail. You have received this mail because you have either requested for it or someone must have suggested your name. Since India has no anti-spamming law, we refer to the US directive, which states that a mail cannot be considered Spam if it contains the sender's contact information, which this mail does. In case this mail doesn't concern you, please unsubscribe from mailing list.