DIGITAL LENDING - GS III MAINS

Q. Critically analyse the factors contributing to the tremendous growth of Digital lending in India in recent years. (10 marks, 150 words)

News: *Regulation of digital lending in India*

What's in the news?

- Digital lending in India has seen tremendous growth in recent years.
- Easy access to the internet and rising levels of aspirational consumerism have sparked this growth.

Key takeaways:

- The Reserve Bank of India ("RBI") had constituted a working group on digital lending to explore regulation of the emerging sector in January 2021.
- The RBI later published its Guidelines on Digital Lending ("Guidelines") in September 2022, based on the recommendations of the working group.

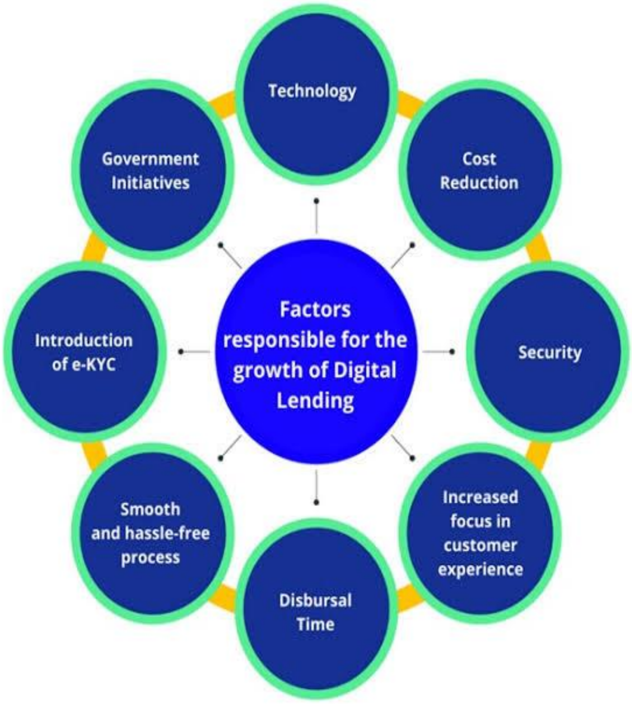
Digital Lending:

- Digital Lending refers to **lending through web platforms or mobile apps by use of technology.**
- It utilizes automated technologies and algorithms for customer acquisition, credit evaluation, decision making, authentication, disbursements and recovery.
- Lending Service Providers (LSPs) act in partnership with Non-Banking Financial Companies (NBFCs) who disburse credit (or a line of credit) to the customer using the former's platform, making it a multi-sided platform.

Current Status:

- Digital lending is one of the **fastest-growing fintech segments in India**. It has grown exponentially from a volume of US$ 9 billion in 2012 to nearly US$ 110 billion in 2019. It is further expected that the digital lending market would reach a value of around **US$ 350 billion by 2023.**
- This business is mainly covered by **fintech startups, neo-banks and Non-Banking Finance Companies (NBFCs).**
- Its customers particularly include **small borrowers without a documented credit history and thus, not served by traditional financial institutions.** Their product mix primarily imbibes short-term loans, especially those which have shorter tenures of less than 30 days.
- Commercial banks are also fast joining the genre of financial intermediaries either lending digitally on their own or joining with NBFCs to share the synergies.

Causes for Growing Popularity for Digital Lending in India:



- **Rapid advancements in cloud computing, artificial intelligence, and blockchain**, as well as faster and more affordable internet connectivity, have fuelled the rise of FinTech start-ups, and lending has also transformed and become "digital."
- Synergy of the robust customer base created by banks in the last ten years, more importantly after the launch of **Pradhan Mantri Jan Dhan Yojana (PMJDY)** scheme in August 2015 is now available to lenders.
- The sector presents a huge opportunity which is attracting a lot of **investment** towards it. The digital lending platforms have witnessed a compound annual growth rate of 19.6% over the previous 7 years.
- The **rapid digitization of the economy and services** has been a key driver in financial inclusion and digital lending.

Key benefits of Digital Lending:

1. Easier loan disbursement:

- The digital lending platforms have **minimized the geographical barriers** allowing borrowers to quickly take up loan applications.
- They come with easy data entry, personalized user experience, and smooth loan application procedures.

2. Less Errors:

- With digital lending, the chances of human errors are minimal as it is easier to capture an applicant's details.
- The validity of documents can be scanned digitally making the process **quicker** and error-free.

3. Increases efficiency:

- A digital lending platform can cut down overheads by half and increase efficiency at the same time.
- Digital lending **saves time, boosts revenue, growth and improves lender borrower relationships.**

4. Better customer experience:

- Digital lending has a quick turnaround time, is **transparent**, and relieves applicants from the long waiting period for a credit decision.
- For banks, it also reduces the cost of managing loans, and reduces time spent on underwriting loans.
- Banks can process more loans and products and offer a better experience to borrowers with quick loan approval and funds.

5. Financial Inclusion:

- It helps in meeting the huge unmet credit need, particularly in the microenterprise and low-income consumer segment in India.

6. Reduce Borrowing from informal channels:

- It helps in reducing informal borrowings as it simplifies the process of borrowing.

7. Time Saving:

- It decreases time spent on working loan applications in-branch. Digital lending platforms have also been known to **cut overhead costs by 30-50%.**

Concerns:

- **Charging exorbitant interest rates.**
- Pursuing aggressive and **unethical recovery practices** and resultant tragic suicides.
- **Data privacy issues .**
- Committing fraud through **fake applications.**
- Unbridled engagement of **third parties.**
- **Mis-selling** - LSPs often resort to reckless lending practices by endowing credit beyond a borrower's repayment capacity.

RBI's Recommendation:

The RBI has divided the digital lenders into 3 groups such as

- **Entities regulated by the RBI** and permitted to carry out lending business.
- **Entities authorized to carry out lending** according to other statutory/regulatory provisions but not regulated by the RBI.
- **Entities lending outside the purview of any statutory/regulatory provision.**

RBI provides guidelines for the first category i.e., entities regulated by the RBI. For other entities under the second and the third categories, the RBI has asked the respective regulator/controlling authority/ the Union Government to formulate guidelines.

Key guidelines by RBI:

- **No intermediaries** - Regulated entities must ensure that loan servicing and repayments are executed directly in their bank account without any third party's pass-through or pool account. The disbursements also need to be made into the borrower's bank account.

- **Cooling off period** - Regulated entities will also have to provide a cooling-off period during which the borrowers can exit digital loans by paying the principal and the proportionate costs without any penalty.
- **Grievance Redressal** - Regulated entities must ensure all loan service providers engaged by them have a nodal grievance redressal officer to deal with digital lending-related complaints.
- **Informed Customer** - Standardized 'key fact statement' must be provided to the borrower before the loan contract is executed.
- **Transparency** - All costs pertaining to the loan, including interest rates, fees, origination charges, discount points, and agency fees - the annual percentage rate (APR) - must be disclosed to the borrower.
- **Consent of the customer** - Automatic increase in credit limit without explicit consent of the borrower is prohibited.
- **Data security** - On technology and data requirements, RBI said lending applications should collect data on a need basis, with clear audit trails and with the prior explicit consent of the borrower.
- **Regulation** - RBI also recommended that to ensure only authorized and trusted lending apps are used by consumers, an independent body styled as Digital India Trust Agency should be set up.

WAY FORWARD:

- This regulation would also **address concerns emanating from TechFin** which are companies that are primarily tech-based service providers, say e-commerce, and also offer financial services.
- **Share:** The share of digital lending may be small at present, but given their scalability they may potentially become significant players soon.
- With the **economic activity reviving** at a decent pace post pandemic and our expectations of a GDP growth of 7.3% this fiscal it is expected that demand for loans across the credit ecosystem will be higher this fiscal despite higher inflation and interest rates.
- The **guidelines are aimed at curbing rising malpractices** in the digital lending ecosystem.