Fintech Lending Risk Barometer 2024

Understanding the perception of risks in the Fintech lending sector in India

November 2024

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Contents

Foreword

The Fintech lending sector in India is at a crucial point, experiencing rapid adoption and innovation. The second edition of risk barometer study highlights an important issue: the presence of unlawful Fintech lenders in the market. These lenders pose significant risks to the reputation and business of legitimate Fintech companies and their consumers due to threats like cybercrime, fraud, and money laundering. These problems reflect last year's theme of trust erosion caused by irresponsible and poor market practices.

Regulatory authorities have responded by emphasising the need for more robust compliance frameworks and regulations. However, the industry opines challenges from rapidly evolving regulations, which create an uncertain business environment. This uncertainty can slow innovation, affect investment sentiment, and make compliance more difficult.

Despite these challenges, strong regulatory frameworks are essential for building consumer trust and creating a healthier ecosystem for all stakeholders in the lending industry. When robust regulatory frameworks are in place, they make a positive ripple effect. Consumers gain better protection and trust, knowing they are safeguarded against unfair practices, which increases their use of digital lending services. This increased consumer confidence pushes digital lenders to improve their risk management practices, reducing default rates and enhancing their reputation. Investors, seeing a stable and well-regulated market, are more likely to invest, providing the industry with the capital needed for growth and innovation. Regulatory bodies can effectively monitor and enforce compliance, ensuring fair competition and market integrity further promoting financial inclusion and economic growth. This interconnected chain of benefits leads to a more transparent, reliable, and resilient digital lending ecosystem, ultimately contributing to a healthier financial landscape for everyone involved.

Fintech Association for Consumer Empowerment (FACE) and Grant Thornton Bharat are pleased to collaborate on this study to understand the market perception of risks. The report is expected to provide a shared understanding of risks in the sector and converge efforts for collective action to address them. As the sector continues to evolve, innovate, and overcome various challenges, this study aims to provide valuable insights and support the development of a robust and trustworthy digital lending environment.

01

Digital lending in India

The digital economy in India is rapidly transforming, driven by increased internet penetration and smartphone usage among the younger population. This shift has led to a remarkable adoption of Fintech lending by young borrowers in less than a decade of its emergence around 2015-16.

Today, NBFCs and Fintech firms account for 70% of lending to individuals aged 35 and below, with Fintech lending expected to surpass traditional bank lending by 2030, according to the RBI. The strong government support in terms of a conducive policy framework, evolving Digital Public Infrastructure and regulatory landscape, shaped by proactive measures from the RBI, contribute to increasing adoption of digital credit by ensuring transparency, data privacy, and consumer protection.[1]

Fintech companies are at the forefront of this revolution, disrupting the digital lending market and aiding financial inclusion. Fintech's unique focus on unaddressed consumer segments & needs, the ability to harness advanced algorithms and big data analytics to assess creditworthiness and digital distribution to offer quick, hassle-free loans are key success factors. This unprecedented shift can be attributed to the younger generation (less than 25 years and 26-30 years) who are the major consumers of Fintech loans, constituting 59%.[2]

These platforms have democratised access to credit, reaching underserved and unbanked populations previously excluded from formal financial services. Over two-thirds of Fintech loans for personal consumption were disbursed beyond metro and tier-one cities. By leveraging digital footprints and alternate data, Fintech firms can make more informed lending decisions, reducing the barriers and limitations of reliance on conventional credit scores.[2]

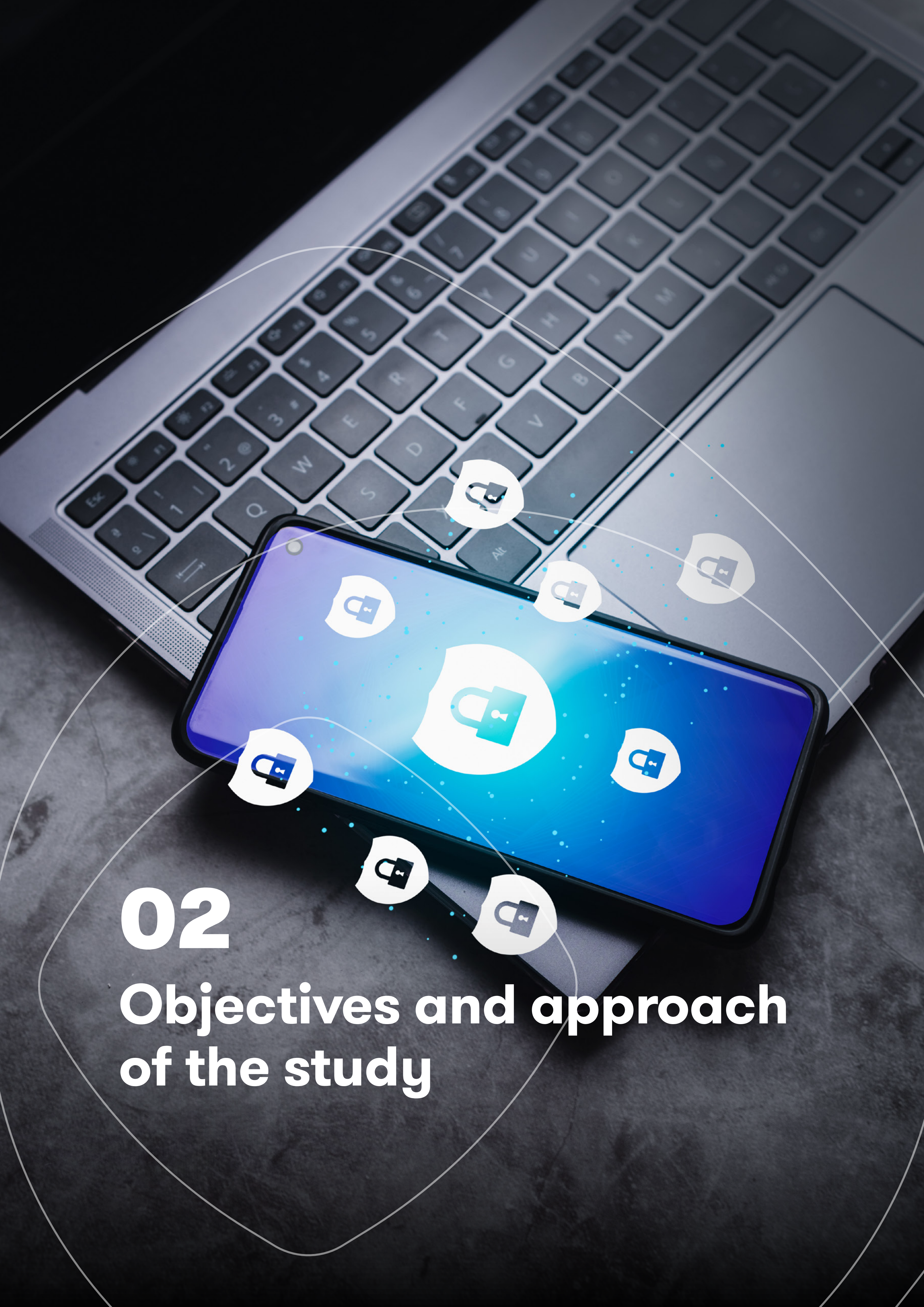
Technological advancements like AI and ML enhance credit risk assessment, fraud detection, and customer service, enabling lenders to offer personalised loan products and improve operational efficiency. Digital lending platforms significantly boost financial inclusion by reaching underserved populations and providing a vast range of loans and other financial products in a seamless digital and customer-centric way. Strategic partnerships between Fintech companies and traditional financial institutions create synergies, leveraging established customer bases and infrastructure to provide innovative solutions.

Traditional banks, recognising the potential of digital lending, have also embraced this shift. Many have partnered with Fintech companies or developed their own digital platforms to streamline their lending processes. This collaboration has led to a more integrated financial ecosystem, where banks benefit from the technological innovations of Fintech firms, and Fintech companies gain from the credibility and customer base of established banks.

Supporting elements like payment infrastructure, credit bureaus, and cybersecurity firms are integral to the digital lending ecosystem. Payment infrastructure facilitates seamless transactions, ensuring that funds are transferred quickly and securely. Credit bureaus provide essential data for assessing borrowers' credit profiles, helping lenders make informed decisions. Cybersecurity firms protect sensitive information from cyber threats, ensuring the integrity and security of digital lending platforms. Together, these components create a robust and dynamic ecosystem that fosters financial inclusion and drives economic growth in India.

According to the RBI's report, digital lending market share reached **2%** of the total amount disbursed by surveyed banks in December 2020. During 2022-23, **five** SCBs with 53% share in the personal loan market disbursed approximately **40%** of loans digitally. The NBFCs surveyed also stated that **11.4%** of loans were digitally distributed amidst overall lending activity in December 2020. Further, the credit extended through credit cards via e-commerce platforms, consisting of both EMI plans and lumpsum credit, increased by 32.4% YoY in 2023-24 to INR 11 lakh crore.[2] Indian Fintech and digital lending firms sanctioned **10.19 crore** loans in FY 2023, increasing **35%** YoY and the total loan value reached **INR 1,46,517 crore**, rising **49%**. The average ticket size reached **approximately INR 12,648 in FY 2023, compared to INR 11,094** in the previous year.[3]

1. India Finance Report 2023 | Centre For Advanced Financial Research And Learning (CAFRAL, RBI)
2. Report on currency and finance 2023-24 India's Digital Revolution | RBI
3. FACETS Issue 10 Press-Release



02

Objectives and approach of the study

Survey timeline

The survey was conducted between July and September 2024.

Participants

54 companies

- 41 lenders (including banks, NBFCs, and fintechs).
- 13 non-lenders (including investors, think tanks, and consumer associations).

Risk assessment

23 risks associated with fintech lending were ranked by participants on a scale from 1 (lowest severity) to 7 (highest severity).

Importance of study

Aims to understand and manage risks for a sustainable growth in digital financial services.

The expansion and surge in digital lending have also heightened risks, necessitating robust risk management frameworks to mitigate cyberattacks, data breaches, and credit defaults.

This study, the second issue of the Risk Barometer by the Fintech Association for Consumer Empowerment (FACE) in collaboration with Grant Thornton Bharat, aims to assess these risks and their perceptions among Fintech lenders, investors, and other stakeholders. By analysing the evolving perception of risks in the market, this study provides industry-speak and prioritisation of the risks to address them collectively. Understanding and managing these risks is essential for the industry's sustainable growth, making this study a vital resource for guiding stakeholders towards a secure digital financial future.

This Fintech lending risk barometer study employed a mixed methods approach. An online survey was conducted from July to September 2024 to gather initial perceptions of risks from lenders and non-lenders (see Annex 1 for the questions). The survey respondents, all from the Fintech lending sector in India, include 54 companies, 41 lenders and 13 non-lenders.

Participants were asked to rank 23 risks associated with Fintech lending on a scale from 1 (lowest severity) to 7 (highest severity). The survey also captured comments and feedback on these risks. For this report, **"lenders"** refers to all entities regulated by the Reserve Bank of India (RBI), including banks, non-bank finance companies (NBFCs), as well as Fintechs directly engaging with consumers throughout the credit journey but not regulated by the RBI. **"Non-lenders"** include investors, think tanks, representatives of consumer associations, and other institutions that do not directly transact with consumers. Respondents were asked to assess 23 risks associated with Fintech lending, ranking them on a scale of 1 (lowest severity) to 7 (highest severity).

03
Ranking risks

Top 10 Risks

The table below presents the top 10 risks overall out of the 23 risks listed. These 10 risks had an average rank of 5 and above, while the remaining 13 were ranked between 4 and 4.90.

Unauthorised Fintech lenders emerged as the most severe risk, a finding consistent with this year's results. They continue to pose significant challenges for both lenders and consumers in the digital finance ecosystem. Cyber fraud and crime also maintain their position in risk ranking, given the increased scale and sophistication of cyber frauds and crimes. Perception of risk around regulation, costs and reputation has increased. Another key shift in the last 18 months is a higher perception of risks associated with costs and the reputation of the Fintech sector.

Ranking and rating of risks by lenders and non-lenders

The report also analysed the ranking of risks by lenders and non-lenders, which apparently differed due to variations in how they interact with and look at the business. Non-lenders generally assigned higher risks to their top 10 risks compared to lenders. Lenders focus more on business risks such as compliance, costs, funding, reputation, insolvency, etc. On the contrary, non-lenders were more concerned about risks associated with consumers, such as insufficient data, grievance redressal and data privacy.

LENDERS

Rank	Risk indicator	Average rank
1	Unauthorised Fintech lenders	6.0
2	Compliance	5.7
3	Regulation	5.6
4	Cyber frauds & crime	5.6
5	Costs	5.6
6	Funding	5.2
7	Unfair conduct practices	5.2
8	Reputation	5.0
9	Insolvencies	4.8
10	Indebtedness	4.8
11	Macro-economy	4.8
12	Privacy	4.7
13	Lack of data	4.7
14	Outsourcing	4.6
15	Governance	4.2
16	Competition	4.2
17	Technology	4.2
18	High growth	4.1
19	Customer expectations	4.0
20	Talent	4.0
21	Risk management	4.0
22	Transparency	3.9
23	Grievance redressal	3.4

NON-LENDERS

Rank	Risk indicator	Average rank
1	Cyber frauds & crime	6.4
2	Unauthorised Fintech lenders	6.4
3	Indebtedness	6.2
4	Lack of data	6.1
5	Unfair conduct practices	6.1
6	Grievance redressal	5.9
7	Regulation	5.9
8	Governance	5.7
9	High growth	5.7
10	Privacy	5.7
11	Compliance	5.6
12	Outsourcing	5.4
13	Reputation	5.4
14	Funding	5.2
15	Insolvencies	5.2
16	Transparency	5.2
17	Macro-economy	5.2
18	Competition	4.9
19	Talent	4.6
20	Costs	4.5
21	Customer expectations	4.5
22	Technology	4.5
23	Risk management	4.1

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Top 10 risks

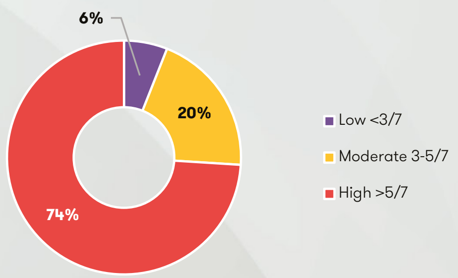
1. Unauthorised Fintech lenders

Meaning: It refers to those unlawful Fintech lenders in the market harming customers with unethical practices, creating reputational and other risks for the Fintech lending industry.

"Unlawful and unethical behaviour can severely damage the credibility of the Fintech lending sector and adversely affect consumers." - **Interview respondent**

Risk indicator	Average rating	Rank of concern compared to all risk indicators
Overall	6.1	1
Lenders	6.0	1
Non-Lenders	6.4	2

Rating of unauthorised FinTech lenders



According to the survey results, unauthorised Fintech lenders were ranked first with an overall average rating of 6.1, making it the most severe risk in the industry. 74% of respondents believe that unauthorised Fintech lenders pose a high risk to the sector, whereas 20% of respondents assessed it as moderately risky while only 6% ranked it as low risk. The respondents stated that unauthorised lenders place a high risk in the market and require the regulator's intervention as it poses a threat to the entire industry.

With India's growing Fintech adoption of 87% and a market estimated to generate revenues of more than USD 190 billion by 2030. The proliferation gives ground to illegitimate lenders who exploit customers and damage the credibility of the Fintech lending sector.[2]

FACE joined hands with the Google Play Store to curb this menace by successfully removing several hundred illegal digital loan apps from the Google Play Store in the last two years, enhancing a secured digital lending ecosystem. The rigorous process of onboarding loan apps on the PlayStore and ongoing monitoring have significantly curtailed the presence of illegal loan apps. Still, illegal lending apps continue to find alternative distribution channels through social media platforms and direct messaging, etc, and customers find it hard to establish the legitimacy of loan apps. Recently, RBI announced[4] a public repository of Digital Lending Apps (DLAs), which aims to support customers in verifying the partnership between loan apps and regulated entities (REs).The REs must report and update information about DLAs in the repository. This measure will help borrowers identify any unauthorised lending apps.[5]

4. RBI Press Release | 8 August 2024
5. RBI Press Release | Governor's Statement: August 8, 2024

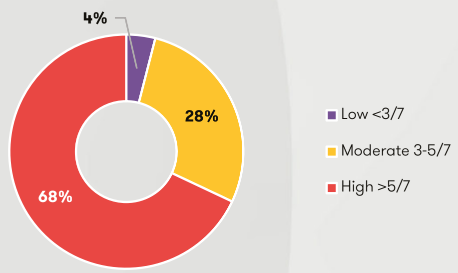
2. Cyber frauds and crime

Meaning: These involve reputation risks and potential business losses to Fintech lender and their consumers due to threats such as cybercrime, fraud, and money laundering.

"These threats are getting more sophisticated by the day, and smaller players do not have the understanding or capacity to take appropriate measures. These also often put the entire value chain to risk." - **Interview respondent**

Risk indicator	Average rating	Rank of concern compared to all risk indicators
Overall	5.8	2
Lenders	5.6	4
Non-Lenders	6.4	1

Rating of cyber frauds and crime



The issue of cyber fraud and crimes weighs heavily on the market. As per the survey, 68% of the businesses rated cyber fraud and crime as a high risk, followed by 28% rating it as a moderate risk, while 4% rated it as a low risk.

The respondents spoke about the challenges presented by fraud, cybercrime, and money laundering. They stated that the implications are two-fold as it not only affects the reputation of financial lenders, undermining consumer trust but might also provoke a reaction from the regulator based on an unfortunate event.

The digital-only nature of Fintech lending and the responsibility of protecting customer data and technology infrastructure means that Fintechs must constantly prepare and invest against cyber threats. The lack of a shared information network/database on frauds and structured exchange platforms between industry and government agencies to exchange intelligence on emerging threats creates barriers to dealing with cyber fraud effectively.

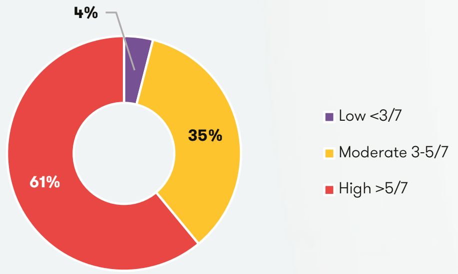
3. Regulation

Meaning: Excessive and frequently changing regulations for Fintech lenders create an uncertain business environment, slowing down innovation, affecting investment sentiment, and complicating compliance efforts.

"Clear regulations and not blanket guidance will be a better resolution" - **Interview respondent**

Risk indicator	Average rating	Rank of concern compared to all risk indicators
Overall	5.7	3
Lenders	5.6	3
Non-Lenders	5.9	7

Rating of regulation



As per the survey responses, 61% of the businesses reported regulation as high risk, while 35% perceived it as a moderate risk, and 4% ranked it as low risk.

Constantly changing regulations impact business growth and create an environment of uncertainty and complexity. Ultimately, the impact of continually evolving regulations extends beyond businesses to consumers. When companies face higher compliance costs and operational inefficiencies, these costs are often passed on to consumers through higher prices or reduced service quality.

This year, RBI launched Finteract and Finquiry as a monthly interaction platform to engage with Fintechs and address their concerns, challenges, and apprehensions. Such an initiative helps the regulator and the Fintech community to interact and find solutions to advance financial inclusion and digital financial services. Recognition of Self-regulatory Organisations in the FinTech Sector also aims to create a more structured dialogue process between the industry and the regulator for an appropriate and consultative regulatory framework.

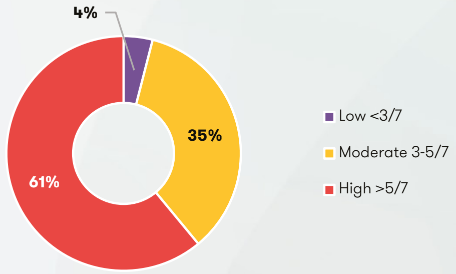
4. Compliance

Meaning: This risk arise from non-compliance due to ambiguous and rapidly changing rules.

"Ambiguous and rapidly changing rules can create an environment of uncertainty, increasing the likelihood of non-compliance and its associated risks." - **Interview respondent**

Risk indicator	Average rating	Rank of concern compared to all risk indicators
Overall	5.7	4
Lenders	5.7	2
Non-Lenders	5.6	11

Rating of compliance



According to the survey results, compliance received an overall average rating of 5.7. 61% of the respondents categorised it as high risk, 35% identified it as moderate risk, and only 4% perceived it as low risk. It is interesting to note that while lenders see it as the second-highest risk, non-lenders do not consider it in the top 10.

The nature of digital lending involves a broader range of partnerships between multiple regulated entities, LSPs and TSPs and wider DPI. These partnerships require compliance and oversight across a long and complete value chain. Usually, Fintechs work with multiple regulated entities, and varying and inconsistent interpretations lead to compliance and operational challenges.

Overall, there have been higher scrutiny and more supervisory actions across banks and NBFCs. The Fintech lending sector has also witnessed much-heightened scrutiny of business, partnerships and compliances in the last few years. As the regulations continue to expand and evolve, the lender community is trying to catch up on compliance expectations and investing in technology, governance and talent, bringing compliance function to the core of the business landscape. Notably, the regulator expects compliance in 'spirit' AND with the written guidelines. While the 'spirit' can sometimes be challenging for the young Fintechs to assess or grasp at times, they will be better placed to allocate attention and seniority to the compliance function so that they don't run foul with regulatory expectations on compliance matters.

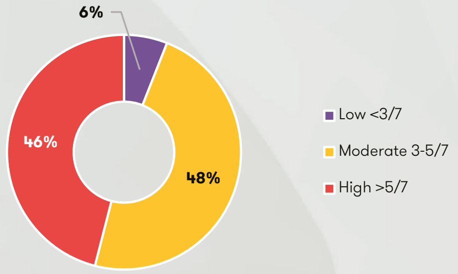
5. Unfair conduct practices

Meaning: The risk of aggressive marketing and collection practices, such as persistent harassment and deceptive tactics, harms customers and undermines trust in the Fintech lending sector.

"Given the serious implications for consumer well-being and industry trust, aggressive and deceptive practices can cause significant harm to customers and erode confidence in the entire Fintech lending sector."- Interview respondent

Risk indicator	Average rating	Rank of concern compared to all risk indicators
Overall	5.4	5
Lenders	5.2	7
Non-Lenders	6.1	5

Rating of unfair conduct practices



According to the survey results, an average of 5.4 was assigned to unfair conduct practices. 46% of the respondents consider it a high risk, 48% consider it a moderate risk, and 6% of the players believe it to be a low risk for the business.

Unfair conduct practices from rogue/unauthorised digital lending operators have sullied the reputation of digital lenders in recent times. It is a significant area of concern for both lenders and non-lenders as it impacts the reputation of the market participants in general amongst consumers and regulators alike. If not addressed actively, this may undermine the trust-building exercise the sector has undertaken over the last few years. Through participation in SRO-FT, the sector is working to correct the perception through active monitoring and proactively flagging off unfair conduct practices by certain players to course correct. The SRO framework allows the players to promptly share the misconduct and nudge the companies towards responsible behaviour.

Further, The Central Bank is relentlessly taking several customer-centric measures to improve service quality and protect customers. This practice signifies ethical treatment and transparency while interacting with consumers.[2]

It is well-known that misconduct, a handful of episodes by a small group of players, can severely impact the sector's overall performance, perception and reputation. Hence, from the standpoint of Fintech lending, it is essential that the sector collectively improves its conduct to meet the expectations of customers and regulators.

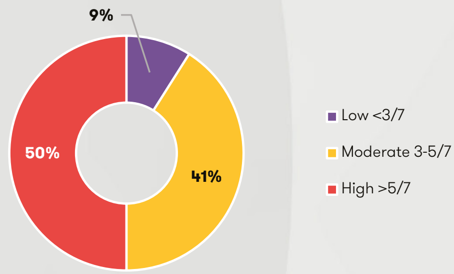
6. Costs

Meaning: Refers to the rising cost in funding, operations, technology, compliance, and HR affecting margins and the accessibility of affordable loans.

"Tech is for volume business so cost of operation is initially high but in long run it reduces significantly." - Interview respondent

Risk indicator	Average rating	Rank of concern compared to all risk indicators
Overall	5.3	6
Lenders	5.6	5
Non-Lenders	4.5	20

Rating of costs



Costs ranked 6th and was assigned an overall average rating of 5.3 by the respondents. The non-lenders, however, ranked it at the 20th place at an average rating of 4.5. 50% of the businesses categorised it as a high risk, 41% assessed it as a moderate risk, and 9% mentioned it as a low risk.

The Funding costs for Fintech lenders have recently increased due to increased risk weights by the RBI on bank credit to NBFCs and credit exposure of NBFCs in the retail segment. Since Fintech lenders leverage technology, significant up-front investments that are amortised over many business cycles are required. The scale of business and emerging technologies also comes with regulator investments in technology and talent. There has also been an increase in credit costs for lenders due to higher NPA in the segment, and in general, higher spending has been necessitated to improve their overall compliance posture with regulatory guidelines. It is possible that the Fintech lenders have absorbed increased costs, and therefore, their APR have not changed materially, resulting in other non-lender stakeholders not viewing it as a high-risk item.

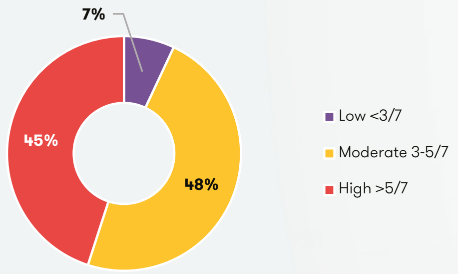
7. Funding

Meaning: The risk that Fintech lenders lack access to diversified sources of debt or equity funding at an affordable rate.

"Limited access to diversified and affordable funding sources can constrain growth, reduce competitiveness, and impact the ability to offer affordable loans to consumers." - **Interview respondent**

Risk indicator	Average rating	Rank of concern compared to all risk indicators
Overall	5.2	7
Lenders	5.2	6
Non-Lenders	5.2	14

Rating of funding



As per the survey analysis, 48% perceive funding as a moderate risk for the business, while 45% believe it to be a high risk whereas, 7% categorised it as a low risk.

Fintech lenders constituting 52% of the market share of personal loans turned to private credit to raise funds and diversify borrowing sources. However, the resilience of private credit in a credit downturn remains untested.[6]

According to the respondents, regardless of the large banking sector in the country, the debt pool for the non-priority sector can be shallow. The RBI increasing the risk weights on bank credit to NBFCs by 25% has made bank credit a source of fund scarce and expensive. This problem gets compounded sue the under-developed Indian debt market, limiting access of cheaper funds for the Fintech lenders. Furthermore, increase in risk weight by 25% by the RBI on NBFC's credit exposure to retail segment increased cost of equity for the sector. Even though, India emerged as the 3rd highest funded ecosystem[2] for Fintech startups, raising equity capital has remained challenging for the Fintech sector in general, and the current market sentiment is being termed as a 'funding-winter'. Market corrections and continuous evolving regulatory checks impacts the investment avenues by local and foreign investors.[2] Given that the non-lenders may not be too concerned about the cost structures and access of funds to the Fintech lenders, it consequently doesn't figure high in their risk perception ladder. Since funding is a significant input for Fintech lenders for their continued operations in the sector, it figures quite high in their priorities.

6. RBI Bulletin | Volume LXXVIII Number 9
7. RBI Notification | August 08, 2024

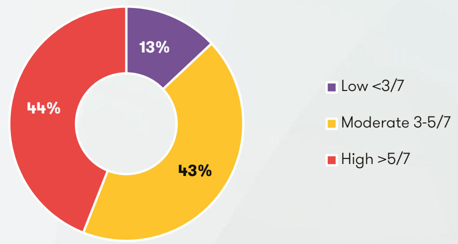
8. Indebtedness

Meaning: The inability of lenders to assess consumers' credit repayment and absorption abilities lead to the customer getting over-indebted.

"Inadequate assessment of creditworthiness can lead to significant negative outcomes for both consumers and lenders, impacting financial stability and overall market health." - **Interview respondent**

Risk indicator	Average rating	Rank of concern compared to all risk indicators
Overall	5.1	8
Lenders	4.8	10
Non-Lenders	6.2	3

Rating of indebtedness



According to the survey results, 44% of the businesses reported indebtedness as a high risk, while 43% perceive it as a moderate risk and 13% believe it to be a low risk.

As per the respondents, the risk of lenders being unable to assess consumers' credit repayment and absorption abilities is extremely severe, as it results in customers becoming over-indebted, which not only harms consumer financial health but also increases default rates and regulatory scrutiny on lenders. Fintech lenders deploy income assessment models using surrogate data to compute the true income levels of the borrowers. Therefore, data used to train such models become paramount for obtaining outcomes that are accurate and do not have inherent biases. This risk may also contribute to the way indebtedness levels are computed by the Fintech lenders, and hence reflects higher on their perception ladder from risk standpoint.

Industry welcomed RBI updates[7] of its Directions on the Frequency of Reporting Credit Information by Credit Institutions to Credit Information Companies, shifting from monthly submissions to fortnightly. Further, RBI issued guidelines that Credit Information Companies (CICs) must process the data received from Credit Institutions within five calendar days, in accordance with their data acceptance rules. These initiatives are a welcome step by industry to resolve for risks of indebtedness arising from gaps in risk assessment of the credit borrowers. Further, RBI also introduced Draft Circular - Regulatory Principles for Management of Model Risks in Credit[8] to safeguard entities against any model risks.

8. RBI Circular | August 05, 2024

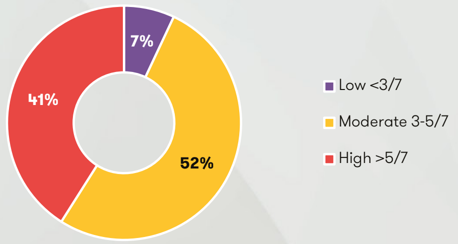
9. Reputation

Meaning: The risk that the Fintech lending sector suffers from poor reputation/lack of trust by regulators, government, customers and other stakeholders.

"This is getting in control and would further improve with SRO initiation." - **Interview respondent**

Risk indicator	Average rating	Rank of concern compared to all risk indicators
Overall	5.1	9
Lenders	5.0	8
Non-Lenders	5.4	13

Rating of reputation



The survey highlights that reputation risk is a major concern in the lending sector, with 52% of players viewing it as moderate and 41% considering it high. Only 7% see it as a low risk.

Maintaining trust and credibility with regulators, government bodies, customers, and other stakeholders is crucial for lenders. A poor reputation can lead to increased regulatory scrutiny, reduced customer engagement, and overall industry instability. To build and sustain a positive reputation, lending companies must prioritise transparent practices, such as informing customers about their data storage policies, implementing consent management, requesting only relevant app permissions, and ethically storing data (e.g., masking Aadhaar numbers, debit, and credit card numbers) to prevent leakage and misuse of customer information. Additionally, establishing a robust grievance redressal system is essential to ensure strict regulatory compliance and foster open engagement with all relevant parties.

Additionally, reputational damage in the lending sector often results from cybercrime, fraud, and money laundering, which can severely undermine consumer trust and industry stability. To combat these threats, lenders must invest in advanced cybersecurity, conduct regular audits to detect fraud, and establish robust anti-money laundering programs.

The industry is quite diverse, catering to retail and small businesses across a wide spectrum of segments and products. However, there is a lack of rigorous research and data specifically highlighting the impact of Fintech lending on driving the positive narrative.

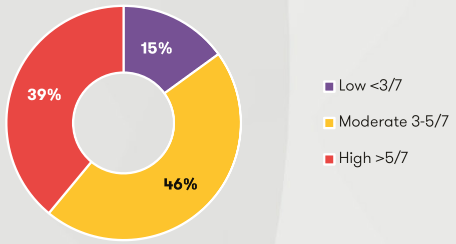
10. Lack of data

Meaning: The inability to assess consumer creditworthiness due to incorrect/inadequate data (unusable data trails, non-standard data, implementation of DPDP Act) and algorithmic biases leading to sub-optimal risk assessment, rejection of viable customers and exclusion of the customers.

"Inaccurate or biased assessments can result in unfair treatment of customers and hinder the effectiveness of lending operations." - **Interview respondent**

Risk indicator	Average rating	Rank of concern compared to all risk indicators
Overall	5.1	10
Lenders	5.0	13
Non-Lenders	5.4	4

Rating of lack of data



According to the survey, 46% of businesses identified a lack of data as a moderate risk, 39% categorised it as a high risk, and 15% classified it as a low risk. The respondents emphasised that the primary risk for businesses and customers stems from the misinterpretation of data rather than its scarcity. To mitigate this, Fintech firms often utilise alternative data sources or develop proprietary tools to generate customer insights, enabling more informed decision-making.

Notably, this risk is not seen as significant by lenders but by the non-lender community. The reason may be primarily because overall access to alternate data is improving (with better digital footprint and transaction data available for customers) and have relatively easy so far without any major legislative framework on data sharing, retention, and use. It follows that non-lenders view the ease of access of personal data as a serious risk. Addressing these concerns, the Digital Personal Data Protection Act (DPDPA) of 2023 mandates collecting and processing only accurate and relevant data. This minimises the risk of using incorrect or inadequate information, thereby enhancing the reliability of data used in credit evaluations. The Act also emphasises transparency and accountability, requiring organisations to inform consumers about their data practices and allowing them to access and correct their personal data. Additionally, the DPDPA mandates regular audits and data protection impact assessments to ensure data integrity.

05 Conclusion

The survey results provide deep insights on how the lenders and other stakeholders perceive the risks in the dynamic digital lending ecosystem. The perceived risks will shape the evolution of the digital lending segments amongst the Fintechs in the medium term as they take steps to mitigate these risks, while striving to grow their business.

The sector has, in recent times, faced instances of business disruptions due to regulatory action, either on specific entities or through revised regulatory guidelines as applicable for the sector. The survey results provide inside out view from Fintech lenders perspective which will also serve as an input for the regulators as they monitor the sector and align the sector participant's perception with regulatory expectations. The alignment of regulatory expectations with sector participants perception will enable the orderly development of this relatively young ecosystem.

It is interesting to note that the perceptions on risks associated with 'regulation', 'costs', 'funding', 'indebtedness', and 'reputation' have seen a significant uptick from last year. The RBI increasing the risk weights on bank credit to NBFCs resulted in higher funding costs for the Fintech lenders. At the same time, due to increase in risk weights for NBFC sector on consumer credit exposure of NBFCs categorised as retail loans by 25%, the cost of fund for the Fintech lenders increased even further. The sector has also seen higher credit costs in recent times, on account of higher NPAs. The cost pressure for Fintech lenders was further compounded due to RBI's strong focus on compliance posture in the sector, which has resulted in increased spends by the market participants on ensuring compliance with the extant guidelines. Further, with RBI reiterating in multiple forums that they see increase in indebtedness of customers, which is resulting in higher-than-normal NPA in the unsecured lending sector, has possibly heightened the perceived risk of 'indebtedness' amongst Fintech lenders, and rightly so. Since quite a few Fintech lenders use surrogate data to assess income levels of borrowers, it is an area that merits a closer look by them. As Fintech lenders scale, they realise that to succeed in the financial services sector, fostering trust amongst consumers, investors, the government, and the regulator is key. 'Reputation' is that key metric that measures trust across stakeholders. It is heartening to note that 'Reputation' is being seen as an area of focus by the Fintech lending community since it will result in better outcomes from an overall market conduct perspective for the sector.

The risk barometer throws up significant variations in terms of how risks are perceived by Fintech lenders and non-lenders. Aspects on 'privacy', 'grievance redressal', and 'high growth' are rated as high on perceived risks amongst non-lender stakeholders. Whereas these three risks don't figure in top 10 risks perceived by the lenders. Interestingly, all three risks play out in the sector because of deficiency emanating a common theme, i.e., market conduct of the Fintech lenders. This is a key outside-in insight for the Fintech lenders to reflect upon since their market conduct would determine how they are perceived as business entity by the outsiders and is a material consideration for them for their long-term success.

The survey results do throw up a few surprising results as well. The regulator has been reiterating that governance, risk management and customer grievance redressal and key themes for the sector to focus on. However, the Fintech lenders do not perceive these themes as 'high-risk' for their business operations, as reflected on the survey results where these themes do not figure in the top-ten. It is pertinent to note that in general lapses in governance and risk management contribute to market conduct issues, customer grievances and compliance failures, resulting in regulatory action which may disrupt business-as-usual for the Fintech lenders. It may be so that the Fintech lenders believe that they have taken adequate steps to address risks pertaining to risk management and governance, and hence do not see it as a key risk for their respective businesses. However, with the recent regulatory action on some of the market participants, it appears that a lot more needs to be done in this area and that the Fintech lenders would be well advised to re-visit these risks and take corrective action wherever needed.

Financial Services is one of the most regulated sectors in the country and operating in this space comes with a lot of responsibility. Since the RBI uses principle-based regulations rather than rule-based, it is pertinent that the Fintech lenders operate in compliance with the 'letter and spirit' of the applicable guidelines. Fintech lender ecosystem is still very young and are already contributing in significant manner to serving the under-served segments of the country, resulting in greater financial inclusion. They are well on their way to be become a significant stakeholder in the financial services sector, and as they navigate the complex regulatory landscape and challenging business environment.

Annexures

Annexure - 1

Survey questions

About the respondent
Company Name
Name
Designation
Email

About the company	
Name	
Category	Lender/Non-Lender
Engagement with digital lending	LSP with an in-house/group RE, Debt funder, RBI Registered NBFC, LSP working with Res, TSP working with LSPs/REs, Research/ ThinkTank/Advisory/Audit
LSP/RE directly engaging with consumers/firms in credit delivery	Company has an in-house/group company regulated by RBI, Company is not regulated by RBI and work as LSP with multiple Res, Company is regulated by RBI
Willing to be interviewed	Yes/No
Willing to be quoted	Yes/No
Willing to have company be disclosed in the list of survey participants	Yes/No

Assessment of risk	
Extremely negligible	1
Slightly negligible	2
Somewhat negligible	3
Neither negligible nor severe	4
Somewhat severe	5
Severe	6
Extremely severe	7

Risk	Definition	Rating
Competition	The risk of reduced (for example due to availability of technology stacks) or increased (due to regulations/compliance/cost of capital) entry barriers to Fintech lending can prevent healthy competition. For example, the entry of traditional NBFCs/Banks, Big-techs, and other technology providers. Also, competition to incumbent lending Fintech players from emerging open lending ecosystem, private and public.	
Compliance	Risk of non-compliance due to ambiguous and rapidly changing rules.	
Costs	Rising cost in funding, operations, technology, compliance, and HR are affecting margins and the accessibility of affordable loans.	
Cyber frauds & crime	Reputation risks and potential business losses to Fintech lender (and their consumers) due to threats such as cybercrime, fraud, and money laundering.	
Customer expectations	Risks that Fintech lenders may not be able to meet the shifting customer preferences on data privacy, pricing, loan products, grievance redressal.	
Funding	The risk that Fintech lenders lack access to diversified sources of debt or equity funding at an affordable rate.	
Governance	Weakness at the board level leading to poor oversight and control.	
Grievance redressal	The risk that consumers do not know or are unable to use grievance redressal systems due to digital nature of the business.	
High growth	Focus on high business growth undermines other necessary imperatives like risk management, market conduct, compliances, appropriate risk-based pricing framework.	
Indebtedness	The inability of lenders to assess consumers' credit repayment and absorption abilities lead to the customer getting over-indebted.	
Insolvencies	The insolvency of Fintech companies, influenced by factors such as business model viability, compliance challenges, regulatory actions, and credit losses, has significant implications for the broader environment of Fintech lending companies.	
Lack of data	Inability to assess consumer creditworthiness due to incorrect/inadequate data (unusable data trails, non-standard data, implementation of DPDP Act) and algorithmic biases leads to sub-optimal risk assessment, rejecting viable customers and exclusion of the customers	
Macro-economy	The risk of Fintech lenders and their customers being adversely affected by macroeconomic trends like inflation, sluggish growth, high interest rates, unemployment, and climate change.	
Outsourcing	The risks Fintech lenders/their customers face due to integration with multiple players or open lending ecosystem like privacy/data security and integrity, vulnerability due to APIs, mis-selling by merchants.	
Privacy	Risks of poor visibility on data ownership (who owns data) and compliance issues regarding data collection, consent, and consumer rights for data deletion/changes, as well as insufficient mechanisms to safeguard and ethically utilise consumer data.	
Regulation	Excessive and frequently changing regulations for Fintech lenders create an uncertain business environment, slowing down innovation, affecting investment sentiment, and complicating compliance efforts.	
Reputation	The risk that the Fintech lending sector suffers from poor reputation/lack of trust by regulators, government, customers and other stakeholders.	
Risk management	The risk that Fintech lenders lack the capacity to identify and mitigate business risks.	
Talent	Difficulty in recruiting or retaining suitable talent, especially individuals with technical proficiency in IT, data science, cybersecurity, and risk management.	
Technology	Technology risk involves the costs and challenges associated with adopting and integrating new technologies like artificial intelligence and machine learning algorithms. For example, prejudices built into training data sets, decision making, efficiency benefits, talent requirement, audits etc.	
Transparency	The risk of consumers being unaware of loan terms, including processing fees, interest rates, penal charges, and privacy policies, which can affect their loan decisions and experiences.	
Unauthorised Fintech lenders	Many unlawful Fintech lenders in the market harming the customers with unethical practices, creating reputational and other risks for the Fintech lending industry.	
Unfair conduct practices	The risk of aggressive marketing and collection practices, such as persistent harassment and deceptive tactics, not only harms customers but also undermines trust in the Fintech lending sector	

Annexure - 2

Rating and ranking of risks

Risk indicator	AVERAGE RATING (OUT OF 7) Overall	Lender	Non-lender	RANKING Overall	Lender	Non-lender
Unauthorised Fintech lenders	6.1	6.0	6.4	1	1	2
Cyber frauds & crime	5.8	5.6	6.4	2	4	1
Regulation	5.7	5.6	5.9	3	3	7
Compliance	5.7	5.7	5.6	4	2	11
Unfair conduct practices	5.4	5.2	6.1	5	7	5
Costs	5.3	5.6	4.5	6	5	20
Funding	5.2	5.2	5.2	7	6	14
Indebtedness	5.1	4.8	6.2	8	10	3
Reputation	5.1	5.0	5.4	9	8	13
Lack of data	5.0	4.7	6.1	10	13	4
Privacy	4.9	4.7	5.7	11	12	10
Insolvencies	4.9	4.8	5.2	12	9	15
Macro-economy	4.9	4.8	5.2	13	11	17
Outsourcing	4.8	4.6	5.4	14	14	12
Governance	4.6	4.2	5.7	15	15	8
High growth	4.5	4.1	5.7	16	18	9
Competition	4.4	4.2	4.9	17	16	18
Technology	4.3	4.2	4.5	18	17	22
Transparency	4.2	3.9	5.2	19	22	16
Customer expectations	4.1	4.0	4.5	20	19	21
Talent	4.1	4.0	4.6	21	20	19
Grievance redressal	4.0	3.4	5.9	22	23	6
Risk management	4.0	4.0	4.1	23	21	23

Annexure - 3

Changes in ranking in 2024

Rank	Top risks in August'24	Definition	Ranking of these risks in August'24	Ranking of these risks in January'23	Change in rating
1	Unauthorised Fintech lenders	The unlawful Fintech lenders in the market harm customers with unethical practices, creating reputational and other risks for the Fintech lending industry.	1	1	No Change
2	Cyber frauds & crime	These pose reputation risks and potential business losses to Fintech lender (and their consumers) due to cybercrime, fraud, and money laundering threats.	2	2	No Change
3	Regulation	Excessive and frequently changing regulations for Fintech lenders create an uncertain business environment, slowing down innovation, affecting investment sentiment, and complicating compliance efforts.	3	6	Increase ↑
4	Compliance	The risk of non-compliance due to ambiguous and rapidly changing rules.	4	4	No Change
5	Unfair conduct practices	The risk of aggressive marketing and collection practices, such as persistent harassment and deceptive tactics, that not only harm customers but also undermines trust in the Fintech lending sector	5	5	No Change
6	Costs	The risks are associated with rising costs of funding, operations, technology, compliance, and HR affecting margins and accessibility of affordable loans.	6	11	Increase
7	Funding	The risk that Fintech lenders lack access to diversified sources of debt or equity funding at an affordable rate.	7	8	Increase ↑
8	Indebtedness	The inability of lenders to assess consumers credit repayment and absorption abilities lead to the customer getting over-indebted.	8	9	Increase ↑
9	Reputation	The risk that the Fintech lending sector suffers from poor reputation/lack of trust by regulators, government, customers and other stakeholders.	9	15	Increase ↑
10	Lack of data	The risk involved is the inability to assess consumer creditworthiness due to incorrect/ inadequate data (unusable data trails, non-standard data, implementation of DPDP Act) and algorithmic biases leading to sub-optimal risk assessment, rejecting viable customers and exclusion of customers.	10	7	Decrease ↓

About FACE

The Fintech Association for Consumer Empowerment (FACE) is an RBI-recognised self-regulatory organisation in the FinTech Sector (SRO-FT), dedicated to fostering a responsible and consumer-centric Fintech ecosystem in India. Established as a non-profit organisation in 2020, FACE brings together Fintech companies, regulators, and other stakeholders to promote transparency, data privacy, and consumer protection. By engaging with the RBI, government bodies, and industry players, FACE aims to advance fair practices and empower consumers, ensuring the Fintech sector's sustainable growth and positive societal impact.

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