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FINTECH NEWSLETTER: RECENT LEGAL DEVELOPMENTS AND MARKET UPDATES IN INDIA

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INTRODUCTION

The calendar year of 2022 was a year of challenges for fintechs in India, with funding falling to levels worse than pre Covid-19 levels. However, despite such challenges, there is a sense of cautious optimism in relation to the fintech industry in 2023 and in the years ahead.[1] The Reserve Bank of India ("**RBI**") has continued undertaking measures to protect market players with the aim of providing further stimulus to this expected growth in the first calendar month of 2023.

With the digitisation of payments still being in primary focus, the growth of the popularity of the Unified Payments Interface ("**UPI**") (wherein transactions hit a record high of INR 782 crore (USD 95 million)) has been a welcome development in this regard.[2] Further, in light of increased adoption of UPI extending beyond the shores of India (more specifically, to 10 countries), and an increase in the grants provided by the Central Government to this space, the fintech sector looks set to have some interesting times ahead, with the financial year of 2023 coming to a close in the next couple of months.

This newsletter highlights the key developments and measures as well as other developments in the Indian fintech space from January 01, 2023, to January 31, 2023.

RECENT LEGAL & REGULATORY DEVELOPMENTS

RBI puts NUE licensing on hold

The RBI has reportedly put the issuance of new licenses under the New Umbrella Entity ("**NUE**") framework on retail payment systems in India on hold.[3] The NUE framework was launched by the RBI in August 2020 with the aim of incorporating an entity to essentially set up, manage and operate new payment systems in the retail space in India,[4] as an alternate mechanism to the National Payments Corporation of India ("**NPCI**") which could also reduce the risks of overload on UPI infrastructure operated by the NPCI. The NUE framework would help participating entities gain greater autonomy in processing digital payments and establish their presence in the financial services ecosystem in India.

In pursuance to this framework, several tech giants applied for a license but the RBI felt that none of the applicants proposed a novel idea or breakthrough, as most of the suggestions were similar to that of the NPCI. However, this isn't the first time the NUE framework has been put on hold, as in August 2021, owing to user data safety concerns, the RBI put a hold on allowing private players from creating and operating digital payment platforms in India.

RBI's Regulatory Sandbox allows six entities to test fintech products from February 2023

The RBI by way of a press release dated January 05, 2023, has announced the applications selected for the testing phase of the Fourth Cohort under their Regulatory Sandbox ("**Regulatory Sandbox**").[5] The theme of this edition's Regulatory Sandbox is 'prevention and mitigation of financial frauds', which was launched by the RBI in October 2021.

A Regulatory Sandbox refers to the testing of new products or services in a controlled environment for which the concerned regulator, in this case, the RBI, may permit certain relaxations for the limited purpose of the testing.

The RBI believes that the benefit of a Regulatory Sandbox is that it allows all stakeholders, including the regulator, the innovator, the deployer and the final user of the technology to conduct field tests and collect evidence on the benefits and risks of the innovation, while monitoring and containing its risks, if any.[6]

Under this Regulatory Sandbox, the RBI received nine applications out of which six entities have been selected for the testing phase with the following products – (i) a comprehensive surveillance mechanism for monitoring transactions and events from loan accounts on a continuous and real time basis *(Bahwan Cybertek Pvt. Ltd.)*, (ii) an early warning system for credit monitoring and fraud identification (*Crediwatch Information Analytics Pvt. Ltd.*), (iii) risk based authentication solution aimed at providing a frictionless (without a one-time password ("**OTP**")) transaction experience for low value transactions based on risk assessment of users *(enStage Software Pvt. Ltd. (Wibmo))*, (iv) closed user group artificial intelligence/machine learning based solution which helps in card-not-present fraud detection (*HSBC in collaboration with Wibmo)*, (v) lock the login form, payment form, ATM, point-of-sale ("**PoS**") machines and enable it only for the authorised user to initiate the transaction using their credentials via napID Zero-Factor Authenticator app *(napID Cybersec Pvt. Ltd.)*, and (vi) a product that helps in address verification by running its proprietary artificial intelligence algorithms on non-personally identifiable data on subscriber usage, location signals and other such parameters to predict residential and office address of users *(Trusting Social Pvt. Ltd).*

These entities will be permitted to test their fintech products from February 2023.

UPI to be supported on international mobile numbers of ten countries

The NPCI has issued a circular dated January 10, 2023 ("**Circular**") allowing non-resident Indians ("**NRIs**") to access UPI on their international mobile numbers. As per the circular, NRIs operating non-resident external ("**NRE**") and non-resident ordinary ("**NRO**") bank accounts from ten countries i.e., Singapore, Australia, Canada, Hong Kong, Oman, Qatar, USA, Saudi Arabia, UAE and the United Kingdom, can access UPI services with their international mobile numbers. These NRE and NRO accounts shall be permitted to be used for receiving UPI services, subject to the member banks ensuring that these accounts are in adherence to the extant foreign exchange regulations and guidelines issued from time to time. The remitter/beneficiary bank must also ensure that all anti-money laundering checks and compliances are in place. The Circular further states that the NPCI will add to the list of countries in the future through an addendum to this Circular or separate NPCI guidelines.

Partner banks have been given time till April 30, 2023, to comply with the Circular.

Cabinet approved INR 2,600 crore (approximately USD 360 million) scheme for promoting RuPay debit cards and low-value UPI transactions

The Union Cabinet has approved an incentive scheme of INR 2,600 crore (approximately USD 360 million) for the promotion of RuPay debit cards and low-value BHIM-UPI transactions (person-to-merchant) for a period of one year from April 01, 2022. These incentives are in line with the Central Government's efforts to boost the digital payments ecosystem in India with a focus on promoting the use of payment platforms that are economical and user-friendly.

Under this scheme, the acquiring bank would receive a 0.4% incentive for RuPay debit card transactions at PoS and through e-commerce, with a cap of INR 100 (approximately USD 1.2) for 'other than industry programmes'. In the case of 'industry programmes', i.e., insurance, mutual funds, government, education, railways, agriculture, fuel, jewellery and hospitals, the acquiring bank would receive an incentive of 0.15 % with a cap of INR 6 (approximately USD 0.072). Similarly, the acquiring bank will receive an incentive of 0.25% for 'other than industry programmes' and 0.15% for 'industry programmes', in respect of payments made to merchants using BHIM-UPI for transactions up to INR 2,000 (approximately USD 25).

These incentives are in furtherance of the pervious financial year's INR 1,500 crore incentive to promote digital modes of payment which according to the Central Government has led to a 59% year-on-year growth in the total digital payment transactions and a 106% year-on-year growth for BHIM-UPI transactions.

The Central Government believes that the incentive scheme will facilitate building a robust digital payment ecosystem as well as promote UPI Lite (an application to process low-value transactions of INR 200 and below) and UPI 123PAY (UPI payments on feature phones without internet connectivity) as economical and user-friendly digital payments solutions.

UIDAI enables 'Head of Family' based online address update in Aadhaar

The Unique Identification Authority of India ("**UIDAI**") has introduced a facility for updating addresses in Aadhaar online with the consent of the 'Head of Family' ("**HoF**"). The relatives of a resident, such as children, spouses, parents, etc., who may not have supporting documents in their own names to update address in their Aadhaar, can utilize the HoF-based online address to update their address in Aadhaar.

This service can be availed for INR 50 (approximately USD 0.60) and can be completed by presenting a proof of relationship document, such as a ration card, mark sheet, marriage certificate, passport, etc., stating the applicant's and the HOF's names along with the nature of their relationship, before the HOF authenticates the document using an OTP. If the resident cannot present a proof of relationship document, the UIDAI allows the resident to submit a self-declaration by the HOF in the UIDAI-required format. Any resident above the age of 18 can be an HOF for this purpose and can share their address with their relatives through this process.

INDUSTRY CHALLENGES

Challenges to the One Network Digital Commerce ("ONDC")

The ONDC was set up with the intention of promoting open networks for all aspects of exchange of goods and services over digital or electronic network. The ONDC is still in an early stage of formation with the DPIIT exploring ways in which the network can be further developed.

Touted as the e-commerce revolution in India, exciting times lie ahead for the ONDC, with several big names of the industry backing its success (such as Bombay Stock Exchange Investments Limited, Axis Bank, etc.) However, in order for the ONDC to succeed in India and bring the revolution that it seeks to bring about, it is crucial for the ONDC to learn from failures that have plagued technological innovations, that were birthed in India with the intent of bringing about homegrown technological solutions.[i]

One such example is the Indus OS which was an indigenous operating system ("**Operating System**"), that was launched in 2014. It was touted as the world's first multilingual operating system that was developed for the purpose of aiding regional language users in the country. However, Indus OS fell well short of the competing market powerhouses like Android and iOS, with its selling point, that is, its multilingual interface also not being operable on platforms like WhatsApp, which is widely operated by Indian users.

Given that the ONDC initiative has largely received a very positive response, effectively navigating operational challenges to avoid the failures of Indus OS is crucial. Much remains to be seen in relation to how successfully the DPIIT manages to navigate these challenges.

i. Our detailed update on the ONDC has been captured as part of our previous newsletter available here and here.

MARKET UPDATES AND MAJOR DEALS IN INDIA[ii]

As per a recent study, the time taken by Indian start-ups to reach the USD 100 million revenue mark has decreased to just five years in 2017, down from an average of eighteen years in 2000. This indicates a significant maturity in the Indian start-up ecosystem which continues to mature and grow. The study also highlighted the contribution of investors, especially, venture capitalists who provide valuable insights (such as governance and financial prudence) to such start-ups, in addition to providing capital, in reaching the said USD 100 million revenue target.[7]

Despite Indian start-ups scaling their businesses and achieving higher revenue in comparatively shorter durations, liquidity conditions have continued to tighten, which has forced Indian companies to seek fundraising through public issues of late. Indian companies raised approximately USD 65 billion through private placements in 2022, and public issues were only to the tune of USD 900 million, a significantly lesser amount.[8]

In fact, the fintech space in India saw a decline of 47% in terms of funding and 29% in terms of rounds as against 2021, as per a recent report by a market intelligence platform. The report attributed the drop in funding to a decline in late-stage funding in 2022 of approximately 56% when compared to available data in 2021. Having said that, the report also stated that the Indian fintech sector received the third-highest amount of funding in the fintech sector, behind only the USA and the UK, with growth in the Indian fintech space expected to continue in the long run.[9]

Cryptocurrency companies also saw a reduction of 42% in investments in 2022, as against 2021, even though the total amount raised in 2022 was higher than the amounts raised each year from 2018-2020. This report pointed out that despite the fall in investments in comparison to 2021, the cryptocurrency industry has seen substantial growth over the last five years. However, the industry as a whole continues to face choppy waters with the crash of FTX,[10] along with WazirX (one of the largest cryptocurrency exchanges in India) currently being under investigation by the Enforcement Directorate for money laundering.[11]

PhonePe[iii] recently shifted its headquarters to India, and may have to pay a tax of approximately USD 1 billion to the Indian tax authorities. As per reports, the hefty tax has been imposed due to the relocation and rise in the value of PhonePe, along with the company raising funds at USD 12 billion pre-money valuation from investors such as General Atlantic, Qatar Investment Authority and others.[12]

In line with the recent slew of in-principal approvals that the RBI has granted to applicants seeking a payment aggregator license, entities including **EnKash**[iv] and **BharatPe** received such in-principal approval from the RBI. The final authorisation would be subject to the fulfilment of certain conditions as laid out by the RBI.[13]

The Bharat Operating System Solutions ("**BharOS**"), an indigenous operating system was successfully tested at the beginning of this year and was developed by an IIT Madras incubated firm. BharOs is an operating system, which is similar to Android, and allows users to choose the apps that they wish to download, with there not being any default app.[14]

Rigi,[v] a platform that assists content creators to monetize their earnings raised INR 100 crore (approximately USD 12 million) in a funding round led by Elevation Capital. Accel, Stellaris and Sequoia Capital also participated in this round. The fresh funds will be utilised to build emerging categories of content creators, and also expand to new jurisdictions overseas.[15]

Gullak, a saving investment app raised USD 3 million in a seed funding round that was led by Y-Combinator and Better Capital. Rebel Partners, Goodwater Capital, GMO fintech fund and TRTL ventures, participated in this round. The fresh funds are intended to be deployed for product development and expansion.[16]

SarvaGram Solutions, a rural household focused lender, raised USD 35 million in a Series C funding round which was led by Elevar Equity.[vi] Other investors that participated in this round were Temasek and TVS Capital Funds. The company proposes to deploy the funds to scale its business and expand to over 80 million households.[17]

ii. To the extent any transactions involve clients of INDUSLAW, the information herein is based on statements in the media and not our professional knowledge of the relevant transaction.

iii. PhonePe is a client of INDUSLAW.

iv. Enkash is a client of INDUSLAW.

V. INDUSLAW advised Rigi in this deal.

VI. INDUSLAW advised SarvaGram and Elevar in this deal.

MProfit, a fintech platform that offers portfolio management services, raised USD 2 million in a funding round that included Zerodha's Rainmatter, Gruhas Proptech, and Enam Holdings. The company aims to utilise the funds to fast-track the deployment of new initiatives, along with new features, including advanced performance reporting, tracking for international assets and API integrations.[18]

SayF a personal finance app raised USD 240,000 in its pre-seed round. The funding round was led by Titan Capital, Sunn91 Ventures, along with other angel investors. The capital will be used for funding initial team building, product refinement and early product experimentation.[19]

Newgrowth, a small business-focused fintech, raised USD 10 million in debt funding from Microvest Capital Management, a US-based impact investor. The company proposes to deploy the fresh funds to extend financing to small businesses which will help in providing the required growth capital to such businesses.[20]

KreditBee, a credit-based fintech start-up, raised USD 120 million in a Series D funding round. The funding round was led by Advent International, a US-based private equity fund. The fresh funds will be used by the company to scale its business and diversify its product offerings by exploring digitally-enabled financial products.[21]

Fello, a fintech start-up raised USD 4 million in a funding round led by US-based Courtside Ventures. Other investors including angel investors that participated in this round extend to Y Combinator, Kube Venture and Upsparks, Kunal Shah and Alan Rutledge. The company proposes to use the fresh funds to develop gamified financial products, hire talent and expand its user base in India's tier-1 and tier-II cities.[22]

Jupiter, a neobank fintech start-up run by Amica Financial Technologies Private Limited, raised INR 100 crore (approximately USD 12 million) as part of venture debt from Alteria Capital. The fresh funds will be utilised to scale the company's lending products and services.[23]

Ambit Finvest Private Limited,[vii] an RBI registered non-banking financial company ("NBFC") acquired SMECorner, another RBI registered NBFC with the trade name of Digikredit Finance, for an undisclosed sum. SMECorner's book assets along with its co-lending book and partnerships would be transferred to the company.

vii. Ambit Finvest Private Limited is a client of INDUSLAW.

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