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## **Regulation following Innovation: Self-regulation in the FinTech Sector**

At a time of increased regulatory oversight in the FinTech industry, the Reserve Bank of India (RBI) introduced the 'Framework for Self-Regulatory Organisation(s) in the FinTech Sector' (SRO-FT Framework) on 30 May 2024. The framework aims to address the uncertainties surrounding innovative business models in the FinTech space, offering a platform for increased engagement with the RBI, and promoting self-regulation within the FinTech ecosystem.

## BACKGROUND

SROs are industry led entities, which aim to bridge the gap between regulation and industry-specific requirements. The SRO-FT Framework contemplates establishment of a self-regulatory organisation (SRO) in the FinTech space (SRO-FT) to enforce regulatory standards, promote transparency, provide structure, build consensus, and encourage cooperation among FinTech entities. Self-regulation is not new to India's financial sector. Despite increased involvement of sectoral regulators, there is a growing trend towards empowering SROs to self-regulate certain sectors. These bodies, endorsed by regulators, industry, and statutes, such as Association of Mutual Funds in the mutual fund sector and Insurance Brokers Association of India in the insurance sector, play vital roles in establishing benchmarks, disciplining rogue behaviour, while also advocating for the needs of the regulated market players.

## FINTECH SRO - ELIGIBILITY

### (a) General Requirements.

The SRO-FT Framework outlines the following fundamental requirements for recognition as an SRO-FT:

- (i) The applicant must be registered under Section 8 of the Companies Act, 2013 as a not-for-profit company.
- (ii) The memorandum of association must include 'operation as an SRO-FT' as a primary objective.

- (iii) No single entity or group of entities should hold 10% or more of its paid-up share capital.
- (iv) The applicant must have a net worth of at least INR 2,00,00,000 either within one year of recognition as an SRO-FT or before commencing operations, whichever is earlier.
- (v) The SRO-FT must demonstrate the ability to establish necessary infrastructure, including robust IT infrastructure.
- (vi) Systems for managing instances of 'user harm' such as fraud, mis-selling, and unauthorized transactions should be effectively put in place.

### (b) Application.

The SRO-FT Framework delineates a comprehensive application process and requirements, while also incorporating broad criteria for recognition as an SRO-FT. These include fulfilling general requirements, establishing fit and proper board of directors, ensuring compliance with applicable laws, and assessing the impact on public interest, among others.

## FINTECH SRO - FUNCTIONS AND RESPONSIBILITIES

### (a) Demonstrable characteristics.

The SRO-FT should, *inter alia*, demonstrate the following characteristics:

- (i) True Representation of the FinTech Sector: The SRO-FT should truly represent the FinTech sector in terms of size, developmental stage, sectors, and activities, enhancing its credibility to establish market standards.
- (ii) Development-oriented: The SRO-FT should contribute to the

advancement and progression of the industry by providing specialized knowledge, guidance, and training programs, and participating in the formulation of forward-thinking policies.

- (iii) Independence and Impartiality: The SRO-FT should operate independently and free from the influence of any member(s). This ensures unbiased decision-making, enhancing credibility and confidence among industry participants and the regulator.
- (iv) Legitimate Arbiter of Disputes: The SRO-FT should establish a transparent and fair mechanism for resolving disputes among its members, instilling confidence and trust in the FinTech sector.
- (v) Encouraging Members to Subscribe to Regulatory Expectations: The SRO-FT should encourage its members to align with regulatory priorities and derive the authority to set rules and standards through membership agreements, with adequate powers to investigate and take disciplinary action against its members for non-adherence to the codes / standards / rules.
- (vi) Data Repository: The SRO-FT should collect, analyse and disseminate relevant data related to the activities of its members, which would serve as a valuable resource for trend analysis, industry research and policy making.

(b) **Functions.**

The functions of an SRO-FTs include:

- (i) Standard-setting: The SRO-FT is responsible for formulating rules, codes of conduct, corresponding penalties, industry benchmarks, governance and technology standards, standardized documents, and accreditation

mechanisms for the FinTech ecosystem.

- (ii) Oversight and Enforcement: The SRO-FT is required to implement surveillance, encourage reporting, while also establishing clear standards of conduct and consequences for violations.
- (iii) Developmental: The SRO-FT is tasked with promoting compliance, disseminating sector-specific information, fostering research and development, and providing support specifically to smaller entities within the FinTech sector.
- (iv) Grievance Redressal and Dispute Resolution: The SRO-FT is required to establish efficient, fair, and transparent grievance redressal and dispute resolution frameworks.

(c) **Responsibilities towards the RBI.**

The responsibilities of an SRO-FT *inter alia* include (i) ensuring compliance by FinTech entities with statutory and regulatory frameworks, industry standards, and best practices, (ii) acting as a collective voice for the FinTech sector, (iii) updating the RBI on sector developments, (iv) collecting and sharing sectoral information, (v) submitting reports and information, (vi) allowing inspection of books, (vii) guiding / facilitating the RBI on the regulation of entities in the FinTech sector, and (viii) facilitating the collection of market intelligence inputs.

(d) **Governance and Management.**

The SRO-FT Framework outlines certain requirements in order to ensure high standards of governance for the effectiveness of the SRO-FT. These requirements include framework for monitoring of 'fit and proper' status of its directors, independent board members, adequately skilled human resources and robust technical capability to monitor the sector.

## COMMENTS

The implementation of the SRO-FT Framework is eagerly awaited. The framework stands as a significant move for the FinTech industry, providing a coherent and structured framework for regulatory oversight and industrial growth. The SRO-FT Framework aligns with RBI's regulatory approach centred on following innovation with regulation. Such industry-led framework provides RBI with real-time visibility into industry dynamics through the reporting requirements of the SRO-FTs, which in turn will aid in improved policymaking and governance by the RBI. Further, SRO-FTs have been given substantial powers both in terms of regulation and enforcement, conferring them with regulatory teeth for ensuring stricter adherence to the rules and regulations. The framework opens the door to formal recognition of some of the industry bodies who are closely working in this space.

Self-regulation also encourages FinTech entities to proactively set industry standards and best practices, fostering innovation without formal regulation. FinTech entities can be expected to be incentivised to be a

part of an SRO as it can lead to enhanced credibility in the industry, networking opportunities, a voice in shaping regulatory policies, risk mitigation through guideline adherence, and competitive advantages. The practice of granting accreditation to members of SROs may also lead to a culture of competitive excellence in governance. It would be interesting to see the terms and standards that will be adopted by SRO-FTs in permitting memberships of FinTech entities.

However, SRO-FT Framework lacks clarity on the optimal number of SROs per sector / vertical. While multiple SROs within a sector may foster healthy competition, an overcrowded landscape could impede coordination, consensus building, and effective representation of industry interests before regulatory bodies. The RBI's approach to recognizing relevant SRO-FTs will be pivotal in navigating this balance.

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