Digital Lending in the Shadows

Regulating India's Online Lending Apps After a Year of Warning Signs

FINANCIAL TECHNOLOGY & DIGITAL FINANCIAL INCLUSION · December 2021

Executive Summary

A year after the Reserve Bank of India set up a working group to study online lending apps, the sector remains a regulatory grey zone — and the human cost of that gap is becoming harder to ignore.

In January 2021, the RBI constituted a working group to examine digital lending through online platforms and mobile apps, responding to a rapid proliferation of lending apps — many operating without any RBI registration at all. The working group submitted its report in November 2021, recommending direct-to-borrower loan disbursal, mandatory Key Fact Statements disclosing loan terms upfront, and named grievance officers at every lending entity. None of this is binding yet. This brief looks at what prompted the review, what the working group recommends, and why 2022 needs to be the year these recommendations become enforceable rule rather than remaining a report on a shelf.

1. Background: A Sector That Outgrew Its Oversight

India's digital lending sector grew explosively through 2020 and 2021, driven by smartphone penetration, thin-file borrowers' appetite for quick credit, and the sheer ease of app-store distribution. But a meaningful share of that growth happened entirely outside RBI's regulatory perimeter: apps registered as non-banking financial companies (NBFCs) in name only, apps operating through offshore shell structures, and apps with no lending licence at all, all competing for the same borrower base as fully regulated banks and NBFCs.

The consequences of that gap have been increasingly visible over the past year. Reports of coercive and abusive recovery practices — including harassment of borrowers' contacts, doctored morphed images used as intimidation, and relentless call-and-message campaigns — have drawn sustained media and law-enforcement attention across multiple states. Several loan-app operators have been the subject of police action for extortion-adjacent recovery tactics. It is this pattern, more than abstract regulatory tidiness, that pushed the RBI to act.

2. What the Working Group Recommends

- **Direct disbursal:** Loan proceeds should be disbursed directly into the borrower's own bank account, not routed through a lending-service-provider's pooled account — closing off a common vector for concealed fees and improper deductions.

- **A Key Fact Statement (KFS):** Every borrower should receive a standardised, upfront statement of the loan's annual percentage rate, all applicable fees, and the recovery mechanism, before the loan contract is executed.
- **Named grievance officers:** Every regulated entity offering digital loans, and every lending-service-provider acting on its behalf, should designate a specific grievance officer for digital lending complaints, with a defined escalation path to the RBI.
- **Data-collection limits:** Digital lending apps should collect only the data strictly necessary for KYC and underwriting, with explicit borrower consent, rather than the broad device-permission harvesting (contacts, photos, call logs) that has enabled the worst harassment practices.

3. International Context

India is not alone in confronting a wave of unregulated digital lending apps, and comparative experience is instructive for what the RBI's eventual rule might learn from.

- **China’s 2017–2019 crackdown on unregistered online lending platforms,** which combined licensing requirements with aggressive app-store delisting, offers a template for the distribution-side enforcement (working with Google Play, in India’s case) that pure financial-sector regulation alone may not achieve on its own.
- **Kenya’s mobile-lending sector,** built substantially on M-Pesa’s mobile-money rails, has faced similar predatory-app concerns, and Kenya's central bank has since moved to bring previously unregulated digital lenders under formal licensing — a regulatory arc India's working group report suggests this market may be about to follow.

The common thread across these comparisons is that voluntary industry self-regulation has, in every case, proven insufficient on its own — reinforcing the case for the RBI to move from recommendation to binding rule sooner rather than later.

4. Stakeholder Implications

- **For borrowers, particularly first-time and thin-file borrowers:** The absence of binding rule means the burden of distinguishing a legitimate, registered lender from a predatory unregistered one currently falls almost entirely on the borrower — an unreasonable expectation given how convincingly unregistered apps can mimic legitimate ones.
- **For registered NBFCs and banks operating digital lending products:** The current ambiguity is a competitive disadvantage: legitimate players bear reputational association with the sector's worst actors, without yet having a clear, binding compliance standard they could point to as differentiation.
- **For app-store platforms:** Google and other app marketplaces currently make listing decisions about financial apps without a clear regulatory reference point to defer to — a binding RBI rule would give them a concrete compliance bar to enforce against, rather than relying on their own judgment case by case.

- **For state law-enforcement agencies:** Cyber-crime cells are currently responding to digital-lending harassment complaints without sector-specific guidance on what regulatory violation, if any, underlies a given complaint — a binding rule would give police a clearer basis for escalation and referral to financial regulators.

Key Terms

Lending Service Provider (LSP): An agent that carries out lending-related functions (customer acquisition, servicing, recovery) on behalf of a regulated entity, without itself being the lender of record.

Digital Lending App (DLA): The mobile or web application through which a digital loan is originated, serviced or recovered — operated either by a regulated entity directly or by its LSP.

Key Fact Statement (KFS): A standardised, upfront disclosure of a loan's true cost, terms and recovery mechanism, proposed by the RBI working group as mandatory before a loan contract is executed.

First Loss Default Guarantee (FLDG): An arrangement where a third party (often the LSP itself) guarantees to cover a defined share of loan defaults — a structure the working group's report flags for closer regulatory scrutiny.

5. Why the Gap Between Report and Rule Matters

A working-group report is not regulation. Until the RBI converts these recommendations into a binding circular or master direction, compliance is voluntary — and the entities most responsible for predatory practices are, by definition, the ones least likely to comply voluntarily. Every month this recommendation sits unconverted is a month in which unregistered apps continue operating exactly as before, while registered lenders wait for a compliance deadline that has not yet been set.

> *A recommendation is not a rule. Until the RBI moves from report to circular, the borrowers this working group was set up to protect remain exactly as exposed as they were in January.*

6. Recommendations

1. The RBI should convert the working group's recommendations into a binding circular within the first half of 2022.

The evidentiary case has been made; further delay converts a policy recommendation into a policy failure.

2. App marketplaces (Google Play, in practice) should require proof of RBI registration or partnership with a regulated entity before listing any lending app.

Much of the current harm flows from apps that would not survive even a basic registration check — a distribution-level gatekeeping step could close this gap faster than lending-side regulation alone.

3. State cyber-crime cells need dedicated capacity and training for digital-lending harassment complaints specifically.

General cyber-crime infrastructure is not well matched to the specific harassment patterns (morphed images, contact-list harvesting) these apps use, and specialised training would improve response time and outcomes.

4. Industry bodies representing registered NBFCs and digital lenders should adopt the working group's Key Fact Statement format voluntarily, ahead of any binding mandate.

Early, voluntary adoption by legitimate players would both protect borrowers sooner and sharpen the contrast with non-compliant apps, strengthening the case for swift regulatory action against the latter.

7. Conclusion

2021 has been the year India's digital lending sector was studied. 2022 needs to be the year it is regulated. The working group has done the analytical work; what remains is the considerably less glamorous, but far more consequential, task of turning a report into an enforceable rule before the next wave of predatory apps arrives.

References

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