Digital Lending in The Regulatory Blind Spot: Supervisory Jurisdiction, Enforcement Deficits, And Inter-Agency Coordination Failures in India's Fintech Lending Sector

Aditya Singh
BBA LL.B. (Hons.) Candidate, Amity Law School, Amity University, Noida

***Abstract*—The predatory digital lending crisis of 2019-2022 revealed two broad and systemic flaws in the very structure of the Indian financial regulatory regime governing the enforcement of financial regulation, in addition to its substance. This article looks at three interconnected aspects of the failure of regulation: the structure of the Reserve Bank of India's registration-based supervisory authority, enforcement issues relating to unregistered and foreign-domiciled loans, and the fragmentation of enforcement power across six agencies running parallel with overlapping but non-synchronized powers. The article suggests that harm at scale has continued because there has been a lack of institutions robust enough to enforce the rules, and recommends five institutional reforms increase in technical supervisory capacity, a penalty regime that is calibrated to deter harm, a statutory private right of action, formal inter-agency coordination, and proactive app-store verification requirements.**

***Index Terms*—Digital Lending; Reserve Bank of India; NBFC Regulation; Consumer Protection; Fintech; Inter-Agency Coordination; Digital Lending Guidelines 2022.**

I. INTRODUCTION

From the beginning, financial innovation has been a process of lagging behind regulation. The digital lending industry is a case in point. In the time span from 2019 to 2022, the number of mobile lending apps in Indian app stores surged, providing loan services on exorbitant interest rates and engaging in aggressive recovery methods known to have caused borrowers' deaths. The Digital Lending Guidelines issued by the Reserve Bank of India (RBI), in September 2022, are an important normative step. However, their crisis was one that at the time of their promulgation had already been harming millions of borrowers on a scale.

Perhaps the crux of the problem was that the lack of clear rules was not the main cause of the failure, but rather the structure of the rules' enforcement had been unable to keep up with the technological sophistication, offshore location, and cleverness of the actors thus far. Three inter-related institutional shortcomings are explored: a leaky supervisory fence, weak enforcement capabilities and weak inter-agency coordination.

II. THE NATURE AND BOUNDARIES OF SUPERVISORY JURISDICTION.

The RBI's supervisory powers over fintech lenders are based on the provisions of Part III-B of the Reserve Bank of India Act, 1934 which extends the regulatory powers of RBI over NBFCs that do lending. This jurisdiction is based on registration and not technology-based lending as only those that are registered under RBI certificate of registration come in their direct supervision.

In the area, RBI has a lot of impressive equipment on-site inspections of systemically important NBFCs, binding directions, penalty powers under Section 58-G, public registry of approved digital lending apps, which has been in existence since 2021. These tools are, however, designed for a financial system in which everything is done in real space, and using paper records. A digitally native NBFC could run completely on the cloud and receives thousands of applications for loans and approves them via an automated system, without creating a traditional audit trail. Even the digitally active subset of over ten thousand NBFCs registered by 2023 is more than the Bank is able to supervise. The greater challenge is that of the systematic exclusion of the highest harm actors. Their operations were fee-based services or credit facilitation arrangements during 2019-2022 to prevent NBFC characterisation of their operations, with thousands of lending applications. The RBI's argument that any organisation lending on interest repayment terms will have to register, is well founded in the statute book. The drawback of this is that it leaves out of the regulatory system the participants who are not willing to be registered, and the enforcement of the regulatory system assumes that they will be registered.

III. UNREGISTERED AND FOREIGN DOMICILED APPLICATIONS

Investigations by the Enforcement Directorate, state cybercrime units, and the Ministry of Corporate Affairs revealed that a significant proportion of fraudulent lending applications were owned by entities incorporated in the People's Republic of China, with Indian-resident front directors and loan funds channelled through remittances structured to minimise scrutiny under the Foreign Exchange Management Act, 1999.[12] The RBI possesses no extraterritorial jurisdiction. Applying Indian financial regulation to offshore principals requires mutual legal assistance treaties and FEMA proceedings instruments that are inherently slow, resource-intensive, and of uncertain effectiveness with the result that the principals of the most harmful operations were largely insulated from accountability during the period of active harm.

App store intermediaries compounded the problem. Google Play Store and Apple App Store were the primary distribution channels for non-compliant applications. Both platforms removed hundreds of flagged applications in 2021 at MeitY's direction, acting on RBI advisories. Deactivated applications routinely re-emerged under new names within weeks, however, exploiting the simplicity of resubmitting a renamed application through the review process. The Information Technology (Intermediary Guidelines and Digital Media Ethics Code) Rules, 2021 impose reactive removal obligations on intermediaries[3] but no proactive obligation to verify the regulatory compliance of financial applications before listing. A reactive framework cannot prevent harm at scale: by the time an application is identified and removed, the harm has already materialised.

IV. ENFORCEMENT LIMITATIONS

Three structural constraints limit enforcement effectiveness within the registered perimeter. First, financial penalties under Section 58-G are capped at Rs. 1 crore for most violations, with enhanced penalties of Rs. 2 crore for repeat offenders.[4] Against platforms originating hundreds of crores in loans monthly, this ceiling operates as a cost of doing business rather than a regulatory deterrent a stark contrast to the Consumer Financial Protection Bureau, which may impose civil money penalties of up to one million US dollars per day for knowing violations of federal consumer financial law.[5] Proposals to enhance the ceiling have remained unenacted.[6]

Second, the RBI's enforcement cycle from inspection initiation to penalty conclusion typically spans one to two years in cases of any complexity. Within this interval, a non-compliant platform may onboard millions of borrowers before any regulatory consequence materialises. The 2022 Guidelines introduced complaint volume as a supervisory risk indicator,[7] but this mechanism depends on borrowers formally lodging complaints, rendering complaints a lagging rather than a leading indicator of consumer harm. Third, no provision of the RBI Act, the Banking Regulation Act, or the Digital Lending Guidelines confers a private right of action on individual borrowers for breach of regulatory standards. A harmed borrower may approach the Ombudsman (narrow monetary jurisdiction), the Consumer

[1]RBI WG Report, supra note 3, at 22–24.

[2]Foreign Exchange Management Act, 1999; Prevention of Money Laundering Act, 2002.

[3]Information Technology (Intermediary Guidelines and Digital Media Ethics Code) Rules, 2021, r. 4(2)(a).

[4]Reserve Bank of India Act § 58-G.

[5]Dodd-Frank Wall Street Reform and Consumer Protection Act § 1055(a)(2)(B), 12 U.S.C. § 5565(a)(2)(B) (2010).

[6]Standing Committee Report, supra note 4, 7.2.

[7]Digital Lending Guidelines, supra note 2, 6.

Disputes Redressal Commissions (significantly congested), or civil courts (economically disproportionate to the sums typically in dispute). The practical result is that regulatory violations frequently go unremedied at the individual level even where the breach is clear.

V. INTER-AGENCY COORDINATION FAILURES

At least six regulators are involved in fintech lending, namely, RBI, MeitY, Ministry of Corporate Affairs, Enforcement Directorate, Central Bureau of Investigation and state cybercrime cells. The Data Protection Board is a new seventh actor in the Digital Personal Data Protection Act, 2023. This plurality without coordination was clearly seen in the response to the 2019-2022 crisis. FEMA and PMLA intelligence were with the Enforcement Directorate, forensic and complaint data with state units, corporate registration data with MCA and supervisory data with NBFC front entities with RBI. There was no structure to bring together all these streams, nor was there an all-seeing eye; parallel, disjoint investigations were conducted, and enforcement results were delivered much later than could have been achieved under a unified response.

The jurisdictional gap between the RBI and MeitY is particularly consequential. An app store complying with the Intermediary Guidelines by removing a flagged application incurs no obligation to verify the compliance of its replacement. The RBI's approved-applications register and MeitY's platform governance framework are not formally integrated. At the consumer redress level, the split jurisdiction between the Ombudsman and the Consumer Commissions identified by the Standing Committee on Finance in its 2022 Report[8] ensures that many meritorious complaints are filed in the wrong forum, dismissed on jurisdictional grounds, and not refiled.

VI. A FIVE-POINT REFORM AGENDA

There are five reforms at the institutional level that are needed. First, RBI needs to build a real technical supervisory capacity; that is, tools to regulate the algorithmic lending practices in real time, similar to the tools that have been created by the Financial Conduct Authority and the CFPB. Second, the ceiling on Section 58-G penalties needs to be aligned with the principles of Indian competition and data protection law, and should be on a percentage-of-assets or percentage-of-turnover basis to make it effective. Third, borrowers who suffer as a result of Digital Lending Guidelines violations should have a statutory private right of action; and a fast-track process should be in place to award actual, statutory and exemplary damages suitable in proportion to the extent of systematic violations. Fourth, there should be a standing inter-agency task force with proper protocols for sharing information and a lead agency responsible, with an annual reporting requirement to the Parliament, comprised of the RBI, the Ministry of Information Technology and Electronics (MeitY), the MCA, the Enforcement Directorate and the Data Protection Board. Fifth, the Intermediates Guidelines need to be further amended to require the app stores to proactively verify the financial applications listing on their platform in the future not just as a requirement for removal of applications already in their platform. Fifth, the Intermediates Guidelines need to be further amended to make the register of approved applications by RBI a gatekeeping condition, not a reactive condition that the app store will engage in for removal of an application already in their platform.

VII. CONCLUSION

Institutional failures, rather than the absence of a regulatory substance, were key to the predatory digital lending crisis experienced in 2019-2022. The problems were not that there were no rules to be followed, it was that there was no system in place to identify and enforce the rules quickly and efficiently enough to meet the needs of the digital lending market. Substantive deficit is covered by the Digital Lending Guidelines 2022. Unless the five institutional changes outlined in this article are implemented, they have a strong chance of following the path of the last decade establishing good rules that are not well enforced, by individuals who are structurally able to take advantage of the lack of enforcement.

[8]Standing Committee Report, supra note 4, 9.1.