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Prasanna S,

Chairman of Institute of Legal Education (Established by I.L.E. Educational Trust)

No. 08, Arul Nagar, Seera Thoppu,

Maudhanda Kurichi, Srirangam,

Tiruchirappalli – 620102

Phone : +91 94896 71437 - info@iledu.in / Chairman@iledu.in



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A COMPARATIVE STUDY OF THE REGULATORY FRAMEWORK OF FINTECH IN INDIA AND USA

AUTHOR – ANU RAPHY, LL.M SCHOLAR AT CORPORATE AND COMMERCIAL LAW, CHRIST DEEMED TO BE UNIVERSITY, BANGALORE

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ABSTRACT

Financial Technology leveraging the potential of AI is the current trend. With its pros and cons the industry rules the world making predictability and reliability its dual mottos. However like all technologies being accompanied with potential harms and bias it can cause to users, the need for regulating the sector emerges. This paper analyses the regulatory frameworks existing in various countries and recognises the need for implementing similar methods suitable for Indian economic, legal and political landscape.

Key Words: Fintech, AI, Regulatory frameworks

I. INTRODUCTION

FinTech, or Financial technology, which incorporates technology into the financial sector is a young industry growing at a steady pace. This transformative technology is not only making financial operations more efficient but also more secure.²⁹⁵ Fintech includes within its ambit cryptocurrencies, initial coin offerings, online lending, payments, wealth management, account aggregation, robo-advisors, payment apps and peer-to-peer (P2P) lending apps. Clients of FinTech includes Business-to-business (B2B) for banks, clients of B2B banks, Business-to-consumer (B2C) for small businesses and consumers.²⁹⁶

With growth in FinTech grows the concerns related to data confidentiality and customer protection and with integration of AI arises the issues of liability for algorithmic bias. A comprehensive legislation in place which can cover all these aspects is the need of the hour.

²⁹⁵ Financial technology law – a new beginning and a new future (George Walker) *The International Lawyer*, vol. 50, no. 1, 50th anniversary issue (2017), pp. 137-216

²⁹⁶ Regulations and Fintech: A Comparative Study of the Developed and Developing Countries P. Vijayagopal, Bhawana Jain, Shyam A. Viswanathan, *Journal of Risk and Financial Management* (Multidisciplinary Digital Publishing Institute), Vol. 17, Iss: 8, pp 324-324

There should be a Fintech law which regulates the entire aspect of financial technology industry for ensuring that customer data is stored correctly or that online financial companies perform thorough know your customer (KYC) checks to reduce fraud and money laundering.²⁹⁷ Effective collaboration among regulators, Fintech firms, and other stakeholders is essential for creating a more effective regulatory environment.

The regulatory frameworks for Fintech exist across various countries. A comparative analysis of these regulatory frameworks will give a detailed idea regarding the effectiveness and lacunas existing in our national regulations.

This paper will compare the regulatory frameworks existing in USA in Fintech sector and those existing in India for getting a clear understanding of lacunas in our existing regulations.

II. NEED FOR REGULATIONS

Regulating fintech is essential for establishing trust among stakeholders, ensuring sustainable growth and promoting fairness within the

²⁹⁷ Status and Regulation of the Fintech Industry, Pengyu Luo, *Advances in Economics, Management and Political Sciences*, ISSN: 2754-1169

industry. Compliance with regulatory standards , particularly in areas such as KYC and anti money laundering is crucial for fintech companies to gain the confidence of banks and consumers alike. A lack of robust compliance can lead to reputational damage and legal repercussions , which can stifle a company's growth prospects. Moreover as fintech firms often operate in a competitive landscape alongside traditional financial institutions, a well defined regulatory framework creates a level playing field, ensuring that all participants adhere to the same standards. In addition to encouraging innovation this guarantees that customer data and financial transactions are handled securely and responsibly protecting customers. In an environment where regulatory scrutiny is increasing Fintech companies prioritise compliance are better positioned to maneuver challenges and seize opportunities for long term success.

III. REGULATORY FRAMEWORK OF FINTECH IN INDIA

With numerous Fintech companies ,which are involved in a varied spectra of activities like lending, investments, wealth management, online payments, credit ratings, Insurance etc, India is the third largest Fintech ecosystem worldwide²⁹⁸ with a high growth potential. India's Fintech industry is expected to be valued at USD 150 billion in 2025²⁹⁹. Fintech in India is expected to experience a compound growth in the coming years especially in the payments sector as the aforementioned statistics demonstrate.

India has a distinct approach to financial services regulations that combines commercial possibilities , technical enablers and regulatory initiatives that are exclusive to the nation and laws governing FinTech companies are complex and constantly evolving. The possible regulations or restrictions on a FinTech company to a large extent is heavily dependent on the businesses being undertaken by those

entities. India does not have a comprehensive all encompassing legal framework for Fin Tech. Instead the key regulators in India are Reserve Bank of India (RBI), Securities Exchanges Board of India (SEBI) and Insurance regulatory And Development Authority of India (IRDAI). Apart from this Pension Fund Regulatory and Development Authority (PFRDA), IFSCA, MISC and MCA also regulates certain aspects of Fin Tech. The aforementioned authorities govern a number of areas such as online payments, payment gateways and aggregators, lending, trading of securities and derivatives etc. Prior approvals and licenses from the SEBI, RBI or IRDAI are required for many financial offers before a business is commenced.

A] REGULATORY GUIDELINES BY RBI

As the central bank of the country, RBI is in charge of maintaining monetary stability as well as running the country's credit and currency systems and monetary policy. The RBI oversees the foreign exchange, payment and banking sectors. In essence , it is in charge of overseeing India's foreign exchange and money markets. Banks, NBFC's, payment system providers, credit bureaus are all subject to RBI regulation. RBI also grants licenses and authorisations to industry participants in its capacity as regulator. The prominent RBI guidelines are as follows.

B] THE RBI ACT, 1934³⁰⁰ AND THE BANKING REGULATION ACT, 1949³⁰¹

While RBI Act, 1934 established RBI as nation's central Bank tasked with overseeing the currency and credit system, regulating banknotes issuance, ensuring monetary stability, and managing foreign exchange , Banking Regulation Act outlines operational framework for banks in India, mandating that they secure a license from RBI to function. This Act grants RBI authority to oversee banking companies, safeguard the interests of depositors and maintain the stability of the

²⁹⁸US Fintech Market Size and share Analysis , <https://www.modorintelligence.com> (last visited on 2 october 2024)
²⁹⁹Ibid

³⁰⁰ The RBI Act, 1934, No.2, Act of Parliament, 1934 (India)

³⁰¹ The Banking Regulations Act, 1949, No. 10, Act of Parliament, 1949 (India)

banking sector through regulatory supervision and compliance measures. Together these laws provide a structured approach to maintaining a secure and regulated banking environment in India.

C] THE PAYMENT AND SETTLEMENT SYSTEMS ACT, 2007

The Act is intricately related to Fintech industry by necessitating fintech companies involved in payment and settlement systems to comply with the provisions of the Act and have to obtain prior license from RBI to operate legally. Apart from this Act requires these firms to adhere to the safety standards set by the Act to protect users from fraud and misuse. Act also requires firms to ensure that the innovations are secure and reliable.

D] RBI MASTER DIRECTIONS ON PREPAID PAYMENT INSTRUMENTS 2022³⁰²

Under this Act, agreements with the PPI issuer, the holder of the prepaid instrument may use the value stored against it to transfer to other holders or to pay merchants who accept the prepaid instrument. An entity that wants to run a payment system for the issuing of prepaid instruments must like other payment systems get an authorisation from RBI in accordance with the payment systems Act.

E] GUIDELINES ON REGULATION OF PAYMENT AGGREGATORS AND PAYMENT GATEWAYS, 2020³⁰³

RBI released the "Guidelines on regulation of payment aggregators and payment gateways" which outlined a number of regulations for payment aggregators doing business in India. These regulations included those pertaining to governance, licensing, know your customer and onboarding settlement and escrow account maintenance.

F] GUIDELINES ON DIGITAL LENDING, 2022³⁰⁴

³⁰⁵The guideline mentioned above are applicable to lenders including commercial banks and nonbanking financial institutions and it governs digital lending activities in India. The digital lending guidelines acknowledge that lending service providers are a part of financial ecosystems apart from Banks and NBFC's.

G] IRDAI (INSURANCE WEB AGGREGATORS) REGULATIONS 2017³⁰⁶

To control the operations of web aggregators the IRDAI published the IRDAI (Insurance Web Aggregators) Regulations, 2017. In addition to this any InsurTech company that wants to act as a corporate agent must follow the 2015 IRDAI (Registration of Corporate Agents) Regulations.

Apart from this, other regulations and guidelines include Master Direction - KYC direction, 2016³⁰⁷, Securities and Exchange Board of India (Investment Advisers) Regulations, 2013³⁰⁸, RBI Master Directions on Credit Card and Debit Card - Issuance and Conduct, 2022³⁰⁹, Circular on Tokenisation - Card transactions, 2019³¹⁰, Circular on Processing of e-mandate on cards for recurring transactions, 2019³¹¹, Framework for Recognition of a Self-Regulatory Organisation for Payment System Operators, 2020³¹², Guidelines for Licensing of Payments Banks, 2014³¹³ and Operating Guidelines for Payments Banks, 2016³¹⁴, Directions for opening and operation of Accounts and settlement of payments for electronic payment transactions involving intermediaries, 2009³¹⁵ etc.

³⁰⁴ Ibid

³⁰⁵ Ibid

³⁰⁶ <https://www.irdai.gov.in> (last accessed on 2 Oct 2024)

³⁰⁷ Ibid

³⁰⁸ <https://www.sebi.gov.in> (last accessed on 2 Oct 2024)

³⁰⁹ Supra Note at 8

³¹⁰ Ibid

³¹¹ Ibid

³¹² Ibid

³¹³ Ibid

³¹⁴ Ibid

³¹⁵ Ibid

³⁰² Reserve Bank Of India, Notifications, <https://www.rbi.org> (last visited on 2 Oct 2024)

³⁰³ Ibid

IV. FINTECH IN USA AND THE REGULATORY FRAMEWORK

With its long standing advantages in financial services, ICT, telecoms and transportation as well as the size, diversity and vibrancy of US economy, US continues to lead the world in terms of Fin Tech.³¹⁶ US is considered as the global leader in Fintech³¹⁷. The Fintech industry operates under a complicated regulatory framework in the United States, where many federal and state agencies are endorsed with the duties of monitoring distinct facets of the sector. The following are some of the main US regulatory frameworks that affect fintech:

A] OFFICE OF COMPTROLLER OF CURRENCY (OCC) AND FINCEN³¹⁸

The office of comptroller of Currency (OCC) & the Financial crimes Enforcement network (FinCEN) are the two main organisations in charge of providing secure and legal financial services in the US. To detect and prevent financial crimes FinCEN gathers transactions data and the Comptroller of the Currency oversees companies to make sure they abide by fintech rules and regulations³¹⁹.

B] SECURITIES EXCHANGE COMMISSION (SEC) AND CFPB³²⁰

The Securities Exchange Commission (SEC) and the Consumer Financial Protection Bureau (CFPB) are two other important regulatory bodies. The SEC oversees all businesses involved in the selling of securities, issues guidelines for reporting fintech cyber threats and events

C] STATE LEVEL REGULATIONS³²¹

Fintech companies have to abide by the state level rules in addition to federal laws, which might differ greatly. While some states have

³¹⁶ Supra note at 4

³¹⁷ David Grünberg, Fintech Regulation, A comprehensive guide to navigating Regulatory Frameworks, Tech magic, (Oct 2, 2024, 6.23 PM), <https://www.techmagic.com>

³¹⁸ James Howell, An overview of Fintech regulations in the world, 101 Blockchains, (Oct 2, 2024 6.22 PM) <https://www.101blockchains.com>

³¹⁹ Overview of Fin Tech regulations in the World, Sanction Scanner, <https://sanctionsscanner.com> (last accessed on 2 Oct 2024)

³²⁰ Ibid

³²¹ Ibid

enacted new rules and regulations explicitly targeted at fintech companies, others have established regulatory sandboxes that allow these companies to test new goods and services without having to worry about complying with all state requirements.

D] CRYPTOCURRENCY ACT, 2020³²²

The bill clarifies the agencies authorised to regulate digital assets and to comply with the requirements of notifying public of licenses, certifications, or registrations required to trade in such assets. The Commodities Futures Trading Commission will be the main authority regulating cryptocommodities according to the bill. The SEC will be the principal regulator of synthetic stable coins and crypto securities, according to the bill's final provision.

E] THE GRAM-LEACH BILEY ACT (GLB), 1999³²³

This Act is the main privacy regulation in the US that mandates that financial institutions protect the confidentiality of personal data, give customers access to privacy policies and provide them the ability to opt out of having their personal data disclosed.

F] THE BANK SECRECY ACT³²⁴

The Act aims at the detection and prevention of money laundering. Financial firms have a duty to keep an eye out for unusual activity on their systems and to report any possibly illegal transactions.

V. ANALYSIS OF REGULATORY FRAMEWORKS OF INDIA AND USA

The regulatory landscapes of Fintech existing in India and US is largely dependent upon the economic conditions, technological advancements and regulatory philosophies of each country. US when compared to India is more advanced in Fin Tech sector as per the statistical data and US follows a decentralised approach of regulations where power to regulate

³²² Ibid

³²³ Anastasia Osypenko, Compliance regulations in Fintech, What to consider when making a fintech app, Madappgang, (Oct 2, 2024, 6.33 PM) <https://www.madappgang.com>

³²⁴ Ibid

fintech industry is demarcated and distributed between federal and state entities. Whereas in India only central agencies are responsible for regulating Fin Tech.

To enhance innovation India has created regulatory sandboxes which allows fintech companies to test new products in controlled environments³²⁵. It helps in balancing innovation with customer stability. In India, RBI published its final regulations for a Fintech regulatory sandbox in the year 2019. However in US when it comes to new financial products, there is no federal regulatory sandbox concept and the SEC has been cautious and frequently demands thorough disclosures and compliance audits before permitting new fintech solutions to hit the market. When opposed to India's more adaptable sandbox strategy this may impede innovation.³²⁶ With regard to consumer protection in India, guidelines are issued by RBI and SEBI. However in US, there are various regulations by FTC and state regulators burdening the process but it offers wider and more consumer protection.

United States has drafted a Cryptocurrency Act 2020 for regulating digital assets. But in India there is an ambiguity as to the acceptance of concept of crypto currency as Indian government has shown mixed signals regarding its regulation. The regulatory framework for fintech in US and India reflects their distinct economic environments and regulatory philosophies. While US offers a more fragmented but developed market with strong consumer protection, India's approach is centralised and supportive of innovation.

VI. CONCLUSION

The regulatory framework for Fintech in India and US highlights their unique economic context and regulatory philosophies. The US operates with a decentralised structure where various federal and state agencies oversee a

diverse fintech ecosystem. This complexity ensures robust consumer protection but can create inconsistencies for fintech companies navigating regulations. In contrast India's centralised approach by RBI fosters innovation through initiatives like regulatory sandboxes allowing fintech firms to test solutions in controlled environments. However the absence of a comprehensive legal framework poses challenges particularly in regulating emerging technologies like cryptocurrencies. Both countries have distinct strengths and weaknesses. US offers extensive consumer protection but is fragmented. While India supports rapid growth and innovation but requires further refinement to enhance consumer safeguards.

As fintech evolves effective collaboration among regulators, fintech firms and stakeholders is vital for developing an environment that promotes sustainable growth, consumer trust and technological advancements.

³²⁵ Overview of Fin Tech regulations in the World, Sanction Scanner, <https://sanctionscanner.com> (last accessed on 2 Oct 2024)

³²⁶ Jitender Singh Dahiya, Fintech Titans, Exploring the top 5 countries and the road ahead for India, LinkedIn, (Oct 2, 2024, 9:44 PM) <https://www.linkedin.com>