



ERGO

Analysing developments impacting business

SELF-REGULATORY ORGANISATION FOR PAYMENT SYSTEM OPERATORS

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Introduction:

The Reserve Bank of India (RBI) has, in exercise of its powers under the Payment and Settlement Systems Act 2007, notified the Framework for Recognition of a Self-Regulatory Organisation for Payment System Operators (SRO Framework) on 22 October 2020. The SRO Framework can be described as a regulatory nudge which aims to encourage banks and non-bank Payment System Operators (PSOs) to establish a self-regulatory body, whose agenda would be to proactively frame and enforce rules and standards relating to the conduct of its member entities.

Policy genesis:

The policy recommendation for formulation of a self-regulatory body of FinTech companies can be traced back to the report of the 'Inter-Regulatory Working group on Fin-tech and Digital Banking' dated 23 November 2017. The report had recommended constitution of a self-regulatory body comprising of representatives of various FinTech companies to undertake consultation/ engagement with regulators to facilitate the orderly growth of the FinTech industry and address regulatory concerns. This policy recommendation was reiterated in the 'Vision statement for 2019-2021 for payment systems in India' published by the RBI on 15 May 2019. Subsequently, the RBI had as part of its 'Sixth Bi-monthly Monetary Policy Statement - 2019-20' dated 6 February 2020 announced its intention of introducing a framework for establishing a self-regulatory organisation for payment system operators, and thereafter a draft policy framework was placed for public comments on 18 August 2020. The SRO Framework follows this draft and is based on the comments received from the relevant stakeholders.

The SRO Framework sets out the baseline conditions for the recognition of the Self-Regulatory Organisation (SRO) by the RBI and details the key functions of, and the governance framework for, the SRO. This ERGO encapsulates a brief overview of the SRO Framework.

Objectives/functions of SRO:

- The SRO is expected to identify behavioural and professional standards and enforce them (authority for enforcement is to be drawn from membership agreements).

- The SRO is expected to frame objective and well-defined rules making processes and put in place a standardised transparent dispute resolution mechanism for resolving disputes amongst members.
- The SRO is also tasked with putting in place effective means of oversight of its members (including surveillance methods for effective monitoring), and ensure that member adhere to rules, regulations and professional standards.
- The SRO is expected to serve as the representative voice of its members in consultations with the RBI and other regulatory bodies.
- The SRO is also expected to work towards framing benchmarks, ethical and behavioural standards.
- The SRO is obligated to inform RBI of breach (by its members) of any payment system related regulations and guidelines.
- The SRO is also tasked with carrying out tasks assigned to it by the RBI (including examination if proposal or suggestions) and providing RBI with data on a periodic basis.
- The SRO is expected to play a constructive role in supplementing and complementing existing regulatory / supervisory arrangements.

Governance framework:

- One-third of members of the board of the SRO is required to be independent and not associated with any of the member institutions.
- Appointment to the board of the SRO may be subject to RBI's prior approval, and any change in constitution of the board is required to be intimated to the RBI.
- The Board of Directors and management of the SRO shall also satisfy the relevant fit-and-proper-criteria prescribed by the RBI.
- The SRO is required to follow transparent practices in relation to the governance process.

Eligibility conditions – SRO:

- The SRO is required to be set-up as a not-for-profit company, which is professionally managed.
- The SRO is required to be financially viable to fulfil its objectives; however, the fee for membership is required to be reasonable and uniform across all members.

Membership – SRO:

- The SRO framework states that only regulated payment system entities (banks and non-bank PSOs) can be members of an SRO, and that the memorandum / bye laws of the SRO shall specify the criteria for admission of members and the functions that it will discharge.

Comments:

Mandatory membership: The SRO Framework does not state that membership to the SRO will be mandatory for all PSOs. However, given that the SRO will draw its powers from the membership agreement, and like any other self-regulatory body its success

too would be predicated on the class and number of its members; in our view, it is imperative that the membership is mandated for PSOs or at least certain class/category of PSOs (as a first step).

Cost of administration: The SRO Framework states that SRO shall be financially viable to carry on the activities handled or assigned to it (which includes monitoring of all market participants). However, the SRO Framework also stipulates that the fee for membership of the SRO shall be reasonable and uniform across all members. While this regime should dispel any concerns around conflict of interests, given that all markets participants are not evenly placed in terms of market-share/access, it is unclear whether a uniform membership fee will be viable when significant resources will have to be spent by the SRO in monitoring larger market participants.

Checks on regulatory capture: The mandatory requirement to have at least 1/3rd independent members on the board of the SRO should contribute towards ensuring transparency and accountability in the functioning of the SRO and should preclude any possibility of "regulatory capture" by market participants. However, it is fair to assume that additional checks and balances will have to be incorporated, as the payment-systems landscape becomes wider and larger.

Non-regulated participants: The SRO Framework is restricted to payment system entities, viz, banks and non-bank PSOs. However, if the intent is to include all stakeholders in the consultative process, then the scope of membership will have to be widened to include non-regulated participants.

Conclusion:

The payment-systems landscape is complicated and fast evolving. Given that the industry participants have a better understanding of the systemic risks and the challenges involved, they are better placed to pre-empt and respond to such challenges. The charter to setup an SRO will certainly help bolster greater transparency and accountability in the Indian payment systems. From RBI's perspective, having a single point of contact for consultative law-making is also a plus point. However, the SRO Framework in its current form does not appear to be a comprehensive code but rather a constitution/charter document which paves the way for setting up of the SRO in the FinTech space in India, and one can expect the finer details pertaining to the functioning and outreach of the SRO to be notified at a later stage.

Nevertheless, the SRO Framework is indeed a step in the right direction in addressing some of the challenges involved in regulating an emerging sector and should certainly play a constructive role in supplementing the existing regulatory framework governing the FinTech sector in India.

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