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# A Conceptual and Legal Study of the Regulatory Framework, Governance, and Emerging Challenges in FinTech Companies in India

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**Abstract—India has become one of the world's largest FinTech markets, built on public digital infrastructure such as the Unified Payments Interface (UPI), Aadhaar-based e-KYC and the Account Aggregator framework. Yet no single statute governs FinTech. Companies operate under a layered mix of banking, payment-systems, securities, data-protection and consumer law, administered by several regulators. This paper offers a conceptual and doctrinal study of that framework, of the governance mechanisms through which regulators supervise FinTech firms, and of the challenges now emerging. It examines the digital lending, payment aggregator and self-regulatory organisation frameworks of the Reserve Bank of India (RBI), the Digital Personal Data Protection (DPDP) regime, the Promotion and Regulation of Online Gaming Act, 2025 and recent measures of the Securities and Exchange Board of India (SEBI), and uses the 2024 action against Paytm Payments Bank as a governance case. The study finds a shift from entity-based licensing towards activity-based and contract-mediated regulation, and identifies fragmentation, data-protection overlap, digital-fraud liability, AI governance and abrupt policy shocks as the main open challenges. It closes with recommendations for a more coherent and proportionate regime.**

**Index Terms—Data protection, Digital lending, FinTech regulation, Governance, India, Payment aggregators, Reserve Bank of India, Self-regulation.**

## I. INTRODUCTION

Financial technology (FinTech) describes technology-enabled innovation in financial services that produces new business models, products and processes. In India the sector spans payments, digital lending, wealth and investment platforms, insurance technology and regulatory technology. Its growth rests on public digital infrastructure, notably UPI, Aadhaar-based e-KYC and the Account Aggregator framework, which let private firms build services on shared rails. The same speed has exposed consumers and the financial system to predatory lending apps, misuse of personal data, payment fraud and concentration risk.

India has not created a dedicated FinTech licence. Firms are regulated through the sector in which their activity falls: the RBI for banking, lending and payments, SEBI for securities and investment advice, the Insurance Regulatory and Development Authority of India (IRDAI) for insurance, and the Ministry of Electronics and Information Technology (MeitY) for data protection and cyber law. A single product, such as a lending app that collects payments through a gateway and markets through social media, can therefore engage several regimes at once.

This paper asks four questions. What is the conceptual basis on which FinTech is regulated? What legal framework applies to FinTech companies? How is governance and supervision exercised over them? And which challenges are emerging as the framework matures? The position stated is that of October 2026.

## II. RESEARCH METHODOLOGY

The study is doctrinal. Primary materials are statutes, RBI directions and press releases, and notified rules. Because several 2025–2026 instruments are most accessible through professional analyses, law-firm and academic commentary is used as secondary material and is cited where relied upon. The study is not empirical; it does not measure compliance outcomes. Regulation in this area changes quickly, and readers should confirm current text on the regulators' websites before relying on any provision.

## III. CONCEPTUAL FOUNDATIONS

### *A. FinTech as a Regulatory Category*

FinTech is a commercial label, not a legal category. In practice FinTech companies fall into three groups: regulated entities (REs) such as banks, non-banking financial companies (NBFCs), prepaid instrument issuers and authorised payment aggregators; technology service providers that act as agents of REs, for example lending service providers (LSPs); and platforms that touch finance without holding any financial licence. Regulatory exposure differs sharply across the three groups.

### *B. Entity-Based versus Activity-Based Regulation*

Entity-based regulation licenses an institution and supervises all it does. Activity-based regulation attaches rules to a function, such as lending or payment aggregation, whoever performs it, in line with the principle of "same activity, same risk, same regulation." India uses a hybrid. Entities are authorised (for example under the Payment and Settlement Systems Act, 2007 [18]), but recent RBI directions define and regulate the activities themselves, as with digital lending [1] and payment aggregation [4].

### *C. Regulation by Contract*

A distinctive feature is that the RBI reaches unlicensed technology partners through the regulated entities they serve. The RE must ensure that its LSPs and apps comply, and must bind them by contract. Commentators describe this as "regulation by contract," because it widens the regulatory perimeter without a statutory amendment and creates indirect supervision of technology firms [17]. The approach is fast and flexible, but it places compliance cost on bilateral contracts and leaves the unlicensed party without a direct relationship with its regulator.

### *D. Innovation, Proportionality and Consumer Protection*

Regulators must balance innovation against consumer and systemic risk. Proportionality asks that obligations scale with risk; sandboxes and self-regulation are the usual tools for lowering the cost of experimentation. The RBI has

used both, and has also shown that it will act firmly where it finds persistent non-compliance [7].

## IV. LEGAL AND REGULATORY FRAMEWORK

Table I lists the principal instruments. They are discussed below by regulatory domain.

TABLE I
KEY INSTRUMENTS GOVERNING FINTECH COMPANIES IN INDIA

| Instrument | Authority | Core regulatory focus |
|---|---|---|
| Payment and Settlement Systems Act, 2007 [18] | RBI | Authorisation and oversight of payment systems |
| Regulation of Payment Aggregators Directions, 2025 [4] | RBI | PA-P, PA-O and PA-CB classes; escrow, net worth, merchant due diligence, disputes |
| Digital Lending Directions, 2025 [1] | RBI | LSP and DLA oversight, disclosures, data, grievance redressal, CIMS reporting |
| SRO-FT Framework, 2024 [6] | RBI | Recognition and duties of FinTech self-regulatory bodies |
| Authentication Mechanisms Directions, 2025 [11] | RBI | Risk-based authentication of digital payments (from 1 Apr 2026) |
| DPDP Act, 2023 and Rules, 2025 [9], [19] | MeitY; Data Protection Board | Consent, fiduciary duties, breach notification, penalties |
| Online Gaming Act, 2025 [12] | Central Govt. | Prohibits online money games and payment facilitation |
| IA and RA Regulations; finfluencer measures [16] | SEBI | Registration and conduct of investment advice and research |

### *A. Banking, NBFC and Payments Law*

The RBI Act, 1934, the Banking Regulation Act, 1949 and the Payment and Settlement Systems Act, 2007 [18] form the statutory base. The last of these requires authorisation for operating a payment system and empowers the RBI to issue binding directions. On 15 September 2025 the RBI issued the Regulation of Payment Aggregators Directions, 2025, consolidating the 2020 and 2021 guidelines on aggregators and gateways and the 2023 cross-border framework [4], [5]. Aggregators are now classified as PA-P (physical or proximity), PA-O (online) and PA-CB (cross-border), which brings face-to-face aggregators within direct regulation for the first time [5]. The Directions address merchant due diligence, escrow arrangements, time-bound dispute resolution and refunds, and a minimum net worth of INR 15 crore for non-bank applicants at the time of application.

### *B. Digital Lending*

The RBI (Digital Lending) Directions, 2025, issued on 8 May 2025, consolidate and replace the 2022 digital lending guidelines and the 2023 guidelines on default loss guarantees [1]. They extend to All-India Financial Institutions in addition to banks, co-operative banks and NBFCs, and widen the definition of an LSP to any agent of an RE that performs one or more digital lending functions [2]. REs had to report their digital lending apps (DLAs) to the RBI's Centralised Information Management System (CIMS) by 15 June 2025, with certification by the Chief Compliance Officer [17]. The Directions also relax earlier rules on data location: processing outside India is permitted, but data must be deleted abroad and brought back to India within 24 hours [3]. Borrower-facing duties continue the 2022 approach of transparent disclosure, direct flow of funds between lender and borrower, and structured grievance redressal [1].

### *C. Securities and Investment Technology*

Robo-advisory, trading and investment platforms fall under SEBI. Investment advisers and research analysts must register under the 2013 and 2014 Regulations respectively. A regulatory gap emerged with "finfluencers", who give stock tips on social media without registration; the Investment Advisers Regulations also carve out advice that is widely available through electronic media, creating uncertainty about their reach [16]. SEBI has responded through enforcement under the Prohibition of Fraudulent and Unfair Trade Practices Regulations, 2003, an advertisement code for registered advisers (April 2023), and guidelines from 2024 that bar regulated entities from associating with unregistered finfluencers [16].

### *D. Data Protection*

The Digital Personal Data Protection Act, 2023 [19] is India's first general data protection statute. The DPDP Rules, 2025 were notified on 14 November 2025 and are being implemented in phases: the institutional provisions, including the Data Protection Board, took effect immediately; consent manager registration under Rule 4 follows after one year, in November 2026; and the main fiduciary obligations apply after eighteen months, around May 2027 [9], [10]. Financial services are among the most affected sectors, since FinTech firms process large volumes of identity, transaction and credit data. Penalties under the Act can reach INR 250 crore for serious failures such as inadequate security safeguards.

### *E. Other Applicable Laws*

The Information Technology Act, 2000 governs electronic records, intermediaries and cyber incidents. Anti-money-laundering law and the RBI's Know Your Customer (KYC) Master Direction, which was updated in 2025 [11], bind most FinTech activity. The Promotion and Regulation of Online Gaming Act, 2025, which received assent on 22 August 2025, prohibits online money games and bars financial institutions from facilitating payments for them; facilitation is a cognizable, non-bailable offence carrying imprisonment of up to three years and a fine of up to INR 1 crore [12], [13].

## V. GOVERNANCE OF FINTECH COMPANIES

### *A. Accountability within the Regulated Entity*

The digital lending framework places the RE at the centre of accountability. The RE must hold board-approved policies, disclose the names of its LSPs and apps on its website, remain responsible for outsourced functions, and operate a grievance mechanism [1], [17]. The CIMS registry and the Chief Compliance Officer's certification give the RBI a direct record of which apps operate under which RE, and the Directions bar third-party apps from implying that listing amounts to RBI approval [17].

*B. Self-Regulation*

On 30 May 2024 the RBI finalised its framework for recognising Self-Regulatory Organisations for the FinTech sector (SRO-FT) [6]. An SRO-FT is expected to set conduct standards, handle member grievances and disputes, collect sectoral data, report violations to the RBI, and take part in regulatory dialogue. Membership is voluntary, the RBI retains approval rights over key board positions, and recognition can be withdrawn if the SRO-FT's functioning is against public interest [6]. The framework states that SRO norms cannot replace explicit regulation. Its main risk is that the body gradually becomes a pseudo-regulator without statutory authority or accountability.

*C. Supervisory Enforcement: Paytm Payments Bank*

The most visible governance episode is the RBI's action against Paytm Payments Bank Ltd under Section 35A of the Banking Regulation Act, 1949. After barring new customer onboarding in March 2022, the RBI on 31 January 2024 prohibited fresh deposits and credit transactions after 29 February 2024, later extended to 15 March 2024, and directed termination of the nodal accounts of the group's payment entities, citing persistent non-compliance and supervisory concerns [7], [8]. To protect users and limit concentration risk, the RBI asked the National Payments Corporation of India (NPCI) to examine the parent company's request to become a UPI third-party application provider [8]. The episode shows that the licence of a FinTech-linked bank is conditional on compliance, and that regulators will act on governance and IT-audit failures even where the business is large and popular.

## VI. EMERGING CHALLENGES

*A. Fragmentation and Overlapping Obligations*

Each regulator legislates for its own perimeter, so firms face parallel and sometimes inconsistent duties. Data location is an example: payment-system data must be stored in India under the RBI's 2018 circular, the digital lending framework now allows offshore processing with return of data within 24 hours [3], and the DPDP regime adds its own consent and cross-border rules [10]. Smaller FinTech firms lack the compliance capacity of banks and must comply with all three.

*B. Data Protection and Consent Architecture*

FinTech firms will need dual compliance with the DPDP Act and sectoral RBI rules. The consent manager framework, due in November 2026 [9], will interact with the Account Aggregator model that already carries consented financial data, and it is not yet clear how the two will be reconciled in practice. Breach notification, purpose limitation and data-erasure duties will require changes to product design, particularly for lending apps that rely on alternative data.

*C. Digital Fraud and Allocation of Liability*

The RBI's Authentication Mechanisms for Digital Payment Transactions Directions, 2025, finalised on 25 September 2025 and applicable from 1 April 2026, move beyond SMS-based one-time passwords towards risk-based and technology-neutral authentication, and fix responsibility on the issuer [11]. A draft of 6 March 2026 would overhaul the 2017 customer-liability framework, widen it to fraudulent transactions, and provide compensation for small-value losses [14]. On 31 July 2026 the RBI issued Digital Payment Security Controls Directions for commercial banks and small finance banks [15]. The open question is how loss is shared along a chain that includes a bank, a payment service provider and a FinTech front end, and whether fintech intermediaries will carry direct liability or only contractual exposure.

*D. Artificial Intelligence and Algorithmic Credit*

The RBI's FREE-AI Committee submitted its Framework for Responsible and Ethical Enablement of Artificial Intelligence on 13 August 2025. It proposes an AI innovation sandbox and recommends future amendments to master directions on fairness audits, transparency of decisions, testing of models for accuracy and fraud risk, and protocols for AI-related cyber incidents [11]. For FinTech lenders that use machine learning for credit scoring, explainability and bias testing will become compliance questions, not only technical ones.

*E. Policy Shocks and Regulatory Certainty*

The Online Gaming Act, 2025 was introduced, passed by both Houses and assented to within about two days in August 2025 [12]. Gaming firms shut paid services before the law was notified, leaving payment aggregators and FinTech firms with sharply lower volumes; press reports put gaming-linked FinTech revenue at roughly INR 1,500 crore in the previous year [20]. The Act has been challenged in court on grounds including lack of consultation [20]. The episode shows how abrupt, sector-wide prohibitions can impose heavy costs on the intermediaries that served the sector, and why transition periods and impact assessment matter.

*F. Concentration and Systemic Risk*

A small number of apps carry most UPI volume. The RBI's handling of the Paytm app, where NPCI was asked to consider a multi-bank arrangement to reduce concentration risk [8], indicates that platform dominance is now a supervisory concern. How far competition and systemic-risk tools should extend to non-bank platforms remains unsettled.

## VII. RECOMMENDATIONS

The analysis suggests the following directions for reform.

1) A standing inter-regulatory coordination mechanism for FinTech, for example through the Financial Stability and Development Council, to align overlapping rules and sequence major changes.
2) Joint guidance from the RBI and the Data Protection Board on how sectoral data rules and DPDP duties apply together, particularly on consent managers and cross-border processing.
3) Tiered, proportionate obligations so that early-stage FinTech firms are not subject to bank-scale compliance before they reach comparable risk.
4) Published standards, governance safeguards and a review process for SRO-FT bodies, to keep self-regulation distinct from statutory regulation.

5) A clear statutory or regulatory allocation of fraud losses across banks, payment service providers and FinTech intermediaries.

6) Public consultation, regulatory impact assessment and defined transition periods before sweeping prohibitions, with attention to the intermediaries affected.

7) Model-risk, fairness-audit and disclosure norms for AI-based credit decisions, building on the FREE-AI recommendations.

## VIII. CONCLUSION

India's FinTech regulation has moved from permissive observation to detailed, activity-oriented supervision, with the RBI at the centre. The 2025 digital lending and payment aggregator directions, the DPDP Rules and the SRO-FT framework together mark a maturing regime built on accountable regulated entities, contractual extension of the perimeter and growing, though bounded, self-regulation. The challenges that remain are less about the absence of rules than about their coherence: overlapping data and payment requirements, unsettled fraud liability, new AI risks and the cost of abrupt policy change. A coordinated, proportionate and predictable framework will do more to sustain both innovation and consumer trust than additional rules issued in isolation.

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