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REGULATING DIGITAL NEOBANKS AND FINTECH CREDIT UNDER INDIA'S CENTRAL BANK FRAMEWORK

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INTRODUCTION

With the onset of the COVID-19 pandemic, people moved away from traditional in-person banking, choosing instead to use digital payment apps for their everyday transactions.[1] These platforms have since grown, positioning themselves as competitors to established financial institutions.[2] However, this shift has led to economic imbalances, as increased access to credit boosts spending power beyond production capacity, disrupting supply and demand dynamics.[3] In response, the Reserve Bank of India has implemented measures to manage potential inflation.[4]

DIGITAL LENDING LANDSCAPE

The digital lending sector has undergone a pragmatic shift, transitioning from traditional credit assessments to evaluating consumer behaviour through digital footprints, which track spending and repayment patterns.[5] The emergence of "Buy Now, Pay Later" services, introduced by various neo-banks, has further transformed the lending and EMI landscape.[6] However, this

[1] Saraswati Chauhan & Narendra Singh, Covid Era and Online Payment Systems in India, 52 Industrija 41 (2024), https://doi.org/10.5937/industrija52-50991.

[2] Jon Frost et al., BigTech and the Changing Structure of Financial Intermediation, 34 Economic Policy 761, 764 (2019), https://doi.org/10.1093/epolic/eiaa003.

[3] Mohit Kumar Shrivastav, Saranga Gogoi & Hemangi Dhanke, Navigating Post-COVID Inflationary Pressures: A Systematic Review of India's Monetary Policy Framework and Its Economic Impact, International Journal of Research and Innovation in Social Science 389 (2025), https://doi.org/10.47772/ijriss.2025.915ec0024.

[4] Mohit Kumar Shrivastav, Saranga Gogoi & Hemangi Dhanke, Navigating Post-COVID Inflationary Pressures: A Systematic Review of India's Monetary Policy Framework and Its Economic Impact, International Journal of Research and Innovation in Social Science 389 (2025), https://doi.org/10.47772/ijriss.2025.915ec0024.

[5] Ishwar Singh Darji, AI-Driven Credit Scoring for Underbanked Population in India, 10 Research Review International Journal of Multidisciplinary 176 (2025), https://doi.org/10.31305/rrijm.2025.v10.n6.018.

[6] Renu Singh & Ekta Kasana, Digital Lending Dilemma, in Advances in Finance, Accounting, and Economics Book Series 275 (2024), https://doi.org/10.4018/979-8-3693-1503-3.ch013.

expansion has introduced systemic risks; as these smaller neo-banks increasingly rely on capital from established financial institutions, there are concerns regarding rising default rates and potential impacts on economic stability.[7]

FINTECH CREDIT SCALING

Neo-banks have gained significant popularity in India, partly due to the rapid growth of the Unified Payments Interface (UPI). These platforms often optimize loan approval processes by leveraging alternative data such as customer spending patterns and repayment history rather than relying solely on traditional credit scoring models.[8]

MARKET GROWTH DYNAMICS

Driven by the Digital India movement in 2016, the market growth of digital lending platforms has risen from 6 million users in 2021 to a projected 60 million by 2027, which is even more than 100 percent growth each year.[9]

REGULATORY COMPLIANCE FRAMEWORK

The Reserve Bank of India came up with several guidelines for digital banking units[10] on April 7, 2022.[11]

CENTRAL BANK GUIDELINES

The loan amount shall be directly transferred from the bank to the account of the beneficiary. By no means shall the neo-banks transfer the money into their own bank accounts. No DBU shall leak or misappropriate the database of its customers. It should be stored in a cloud in India itself. The loan amount and interest thereon shall be properly stated, and no hidden charges

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[7] Manas Rohilla & Vaibhav Nishad, "Better Safe than Sorry": Preventing Systemic Risks from FinTech Firm Insolvency in India, 21 Indian Journal of Law and Technology (2025), https://doi.org/10.55496/tigm2656.

[8] Yichen Liu & Xiaoyue Ni, Enhancing Loan Approval Systems in Digital Banking: A Data-Driven Framework for High-Recall Predictions, 257 Advances in Economics, Management and Political Sciences 1 (2026), https://doi.org/10.54254/2754-1169/2025.31254.

[9] Pallavi Pandey, Bilal Mustafa Khan & Harish Kumar Singla, Digital Payments: India Gears up the Digital Fast Lane by Innovation Zipping, Paripex Indian Journal of Research 44, 45 (2021), https://doi.org/10.36106/paripex/6406903.

[10] Punita Kumari, Digital Branches and the Future of Indian Banking: A Pathway to Financial Inclusion, 7 International Journal for Multidisciplinary Research (2025), https://doi.org/10.36948/ijfmr.2025.v07i05.55091; Elisa Indriasari et al., Digital Banking, 18 International Journal of E-Business Research 1 (2022), https://doi.org/10.4018/ijebr.309398.

[11] Avi Modi & Vaibhav Kesarani, Digital Lending Laws in India and Beyond: Scrutinizing the Regulatory Blind Spot, 3 Zenodo (CERN European Organization for Nuclear Research) 1 (2023), https://zenodo.org/record/7985989.

shall be there. It further proposes a cooling period wherein a borrower can return only the principal and no interest if they deem fit. Lenders cannot force borrowers or use physical force for recovery.

DATA GOVERNANCE ISSUES

Data leakage and the unauthorized use of data by other nations have come to light very often. This was evident in the case of Paytm, where multiple accounts were opened with a single PAN card of Paytm Payments Bank.[12] This incident underscores the critical necessity for robust algorithmic auditing to prevent the systemic vulnerabilities arising from flawed identity verification processes.[13]

COMPARATIVE ANALYSIS

Earlier, the loan approval paperwork was bulky and time-consuming. Now, with the introduction of KYC using Aadhaar authentication and video-based KYC without requiring the physical presence of the person, processing time has substantially reduced. Though this has substantially reduced time, it has also increased the risk of cyber fraud and deceitful means to obtain a loan.[14]

CONSUMER PROTECTION POLICY

With the consumer as the central priority, all necessary measures have been taken to enforce and strengthen the regulatory mechanism in this dynamic business environment. Continuous evaluation of policy by the RBI has reduced the predatory nature of neo-banks and struck a balance between the original banks licensed under Schedule III of the RBI and the neo-banks.[15]

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[12] Shivani Kumari, Reformation and Restrictions on Paytm Payment Bank: Issues and Challenges, 8 International Journal of Scientific Research in Engineering and Management 1 (2024), http://dx.doi.org/10.55041/ijsrem32649; Prof. Ramesh Jagdeo Sardar, The Rise and Fall of Paytm: Crisis, Controversy, and Consequences, Zenodo (CERN European Organization for Nuclear Research) (2026), https://doi.org/10.5281/zenodo.18358274.

[13] Dr. P. Govindaraj & Dr. V. Murugesh, Transforming India's Credit Ecosystem: The Evolving Role of NBFCs in the Era of Digital Lending and Regulatory Reforms, EPRA International Journal of Multidisciplinary Research (IJMR) 444 (2026), https://doi.org/10.36713/epra26241.

[14] S. Ragini & Dr. A. Narasimharao, Assessing the Role of Digital KYC and E-Governance Systems in Strengthening NBFC Regulatory Frameworks, Zenodo (CERN European Organization for Nuclear Research) (2023), https://doi.org/10.5281/zenodo.17865805.

[15] Meenaxi Shivappa Madiwalar, RBI's Regulatory Framework: Balancing Stability and Growth in Indian Banking, 5 ShodhKosh Journal of Visual and Performing Arts (2024), https://doi.org/10.29121/shodhkosh.v5.i2.2024.6110.

ENFORCEMENT MECHANISMS

Under the RBI's Master Directions on outsourcing, if a neo-bank commits a violation of regulation, the RBI holds the sponsor bank accountable, as these small neo-banks work under the patronage of a properly licensed bank. This creates a principal-agent relationship between the two entities. A third party is called upon for periodic audits to ensure compliance.[16] Strong digital lending enforcements and grievance redressal mechanisms have further strengthened consumer rights protection.

CONCLUSION

Ultimately, the RBI is not a hurdle, a roadblock, or a dead end[17] for neo-banks, but a pathway to ensure slow and sustainable growth without disrupting the inflationary stability in India. It also ensures credit availability during the closure of banks or delays in paperwork. In due course of time, dedicated legislation must be passed, considering the growing shift and demand of Gen Z towards neo-banks at large. What is emerging, then, is less a contest between neo-banks and traditional banks than a slow convergence, where both are being pushed toward the same standards of transparency and accountability. Whether that convergence keeps pace with how quickly young, digitally native borrowers are adopting these platforms remains an open question, and one that dedicated legislation will eventually have to answer directly.

[16] Puneet Bhatnagar & Anupama Rajesh, Neobanking Adoption – An Integrated UTAUT-3, Perceived Risk and Recommendation Model, 5 South Asian Journal of Marketing 93, 94 (2023), https://doi.org/10.1108/sajm-06-2022-0040.

[17] Avi Modi & Vaibhav Kesarani, Digital Lending Laws in India and Beyond: Scrutinizing the Regulatory Blind Spot, 3 Zenodo (CERN European Organization for Nuclear Research) 1 (2023), https://zenodo.org/record/7985989.