"Compliance overload is killing us": India's fintech firms

From crushing paperwork to mounting costs of regulatory compliance, the fast-moving sector is caught in a morass.

Arti Singh
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"The future of fintech and Industry 4.0 is emerging in India."
— Prime Minister Narendra Modi at the Singapore Fintech Festival, November 2018

"*One thing that makes me think I should not have started a fintech business in India in the first place is over-regulation and compliance*."
— founder of a payments startup

There's a silent rage bubbling in India's vaunted fintech ecosystem. The industry, which the government is projecting as a world beater, seems hopelessly lost in an unwieldy regulatory maze.

On November 29, ET Prime captured the chaos that fintech firms had to suddenly cope with after the Supreme Court ban on Aadhaar-based KYC. Now, for a dozen companies across different fintech segments — from payments to wallets to non-banking financial companies (NBFC) to mutual funds to insurance — complying with regulations is turning out to be their "biggest" pain.

Most founders are anxious that their opinions remain off the record as they do not want their "licences to be cancelled".

To be sure, as long as a company limits itself to the tech component of fintech, there isn't much to worry about except following corporate laws and the Information Technology Act. Get into any domain that requires a licence, however — such as payments or wallet, lending, mutual funds, or insurance — and the nightmare begins.

In the world of technology businesses, it is a truism that regulators have to play catch up, often in an ugly, unseemly fashion, with fast-moving startups. But in fintech, which the Indian government has sought to co-opt as part of its development drive, the dissonance seems particularly jarring.

Take this CEO of an online insurance company who spoke to ET Prime strictly on the condition of anonymity. "If you ask me what keeps me up at night, I wouldn't say competition. Sometimes not even the customer," he says. "It's always compliance."

Too many cooks

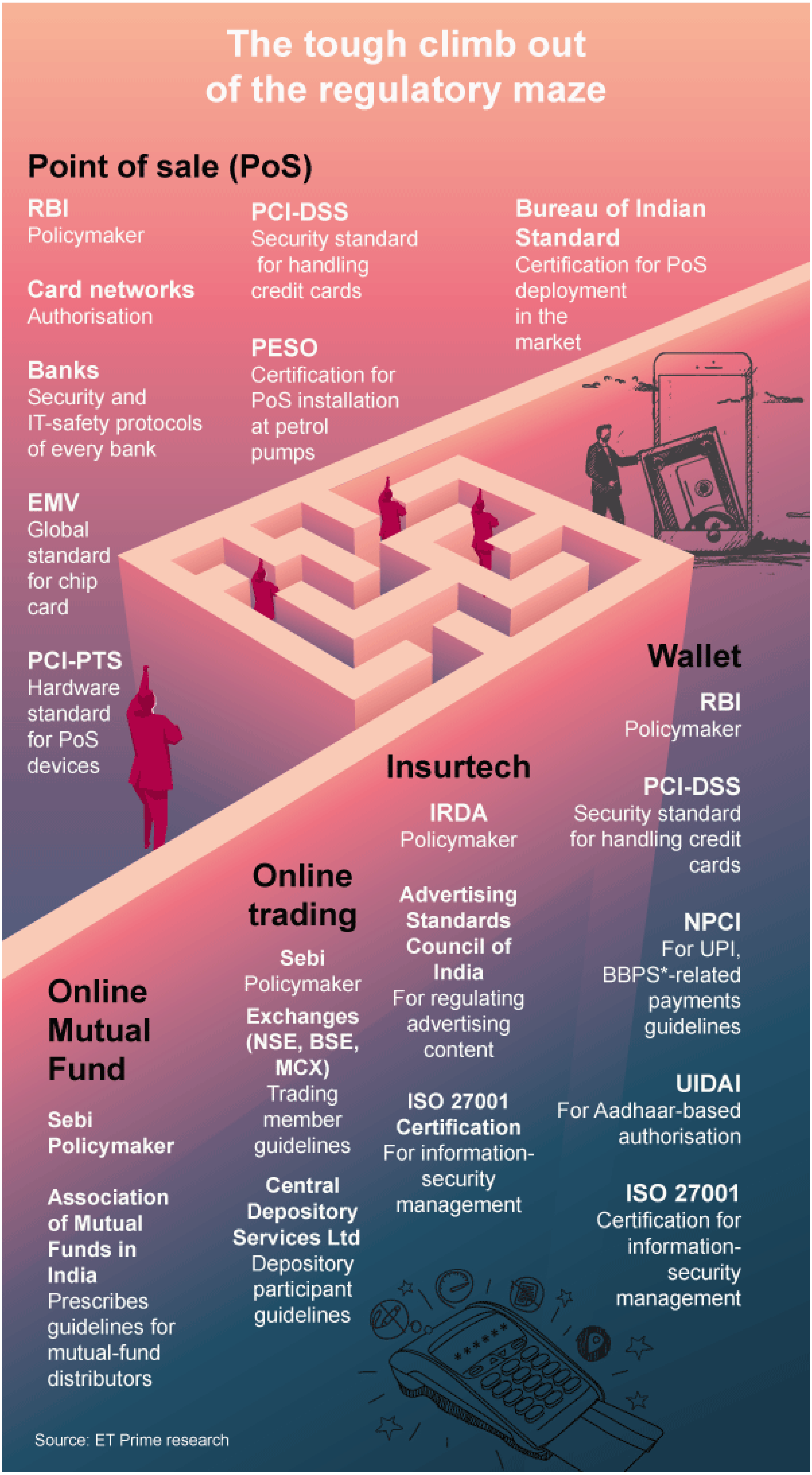
Wriju Roy, founder of background-verification service provider Idfy, says fintech regulations fall under three broad categories, involving a jumble of agencies with different jurisdictions:

- Know your customer (KYC)
- Anti-money laundering (AML)
- Data localisation, information security, etc.

Lending firms are the only ones saved from dealing with multiple bodies, since their interactions are mostly limited to the Reserve Bank of India (RBI). But for other payments firms — specifically point-of-sale (PoS) and wallet players — the grind can be exhausting (see graphic below).

Even fintech lenders resent RBI's "constantly changing" guidelines. The founder of a fintech NBFC player says, "The RBI [comes up with] so many rules every day. For instance, it will say, 'Now there is a new rule and you have to have an independent director if you are above a particular ticket size'. The moment you start looking for an independent director, it will say, 'To comply with the IT Act, you have to do this audit mandatorily'. It goes on and on."

Another fintech NBFC founder adds, "The RBI can't be the judge and the jury. Suddenly you have this financial intelligence unit saying, 'You have to appoint a compliance officer, or we will cancel your licence'. Then, there are data-privacy and -storage guidelines. One has to look at four or five regulatory angles before doing a single transaction."


The tough climb out of the regulatory maze
Point of sale (PoS)
RBI
Policymaker
Card networks
Authorisation
Banks
Security and IT-safety protocols of every bank
EMV
Global standard for chip card
PCI-PTS
Hardware standard for PoS devices
PCI-DSS
Security standard for handling credit cards
PESO
Certification for PoS installation at petrol pumps
Bureau of Indian Standard
Certification for PoS deployment in the market
Wallet
RBI
Policymaker
PCI-DSS
Security standard for handling credit cards
NPCI
For UPI, BBPS*-related payments guidelines
UIDAI
For Aadhaar-based authorisation
ISO 27001
Certification for information-security management
Insurtech
IRDA
Policymaker
Advertising Standards Council of India
For regulating advertising content
ISO 27001 Certification
For information-security management
Online trading
Sebi
Policymaker
Exchanges (NSE, BSE, MCX)
Trading member guidelines
Central Depository Services Ltd
Depository participant guidelines
Online Mutual Fund
Sebi
Policymaker
Association of Mutual Funds in India
Prescribes guidelines for mutual-fund distributors
Source: ET Prime research

Fintech companies selling multiple products, say mutual funds, loans, and insurance, need to satisfy multiple regulators. Even otherwise, let's say an RBI-regulated fintech NBFC firm receives funding from alternative investment funds — it is obligated to make certain declarations to the market regulator Security and Exchanges Board of India (Sebi).

Of course, all fintech companies adhere to some common requirements such as goods and services tax (GST), income tax, and labour laws. But the "most challenging" stricture, say most of them, is complying with the Ministry of Corporate Affairs' (MCA) Registrar of Company (RoC) filing norms.

"When it comes to taking investment, the compliance burden has gone up as far as the MCA is concerned," says LoanTap CEO Satyam Kumar.

On the pain that comes with foreign investments, Manish Kumar, CEO of crowdfunding platform Grex, says companies have to negotiate an alphabet soup apart from RoC filings: FCGPR, FIRC, and a third, consolidated filing.

"A startup filing quarterly numbers, board meetings, etc. — at the end of the day you are running it like a public-sector company," argues Rajat Gandhi, founder of peer-to-peer lending startup Faircent.

Compliance in fintech, according to insurtech firm Coverfox's CEO Premanshu Singh, has mounted over the last couple of years, particularly with the advent of GST. Most of the month passes by in a host of GST-related filings, he says.

In a relief of sorts, the government is working on a new regulator, the Alternate Markets Commission, which will regulate non-public markets. Once this is in place, fundraising activities would be exempted from the existing norms under the Sebi, MCA, and RBI.

Compliance costs money, but lost time hurts more

Here's a story shared by one of the fintech founders ET Prime spoke with.

"When we were very small, unfortunately the focus of the regulation in our sector was on us. When we were a 10-people organisation, 25% of our staff was working on compliance. When the compliance manager was not comfortable with our organisation, he blackmailed me and said I am going to spoil your relationship with the regulator ... and, I paid him for three months. That's the reality."

A couple of companies say when they started they had to struggle to build the organisational knowledge needed to navigate all the paperwork. This meant spending on consultants and even getting former employees of regulatory bodies on board.

All these companies have an army of legal and compliance personnel dedicated to keep track of shifting regulatory sands. For instance, payments firm MobiKwik has three full-time employees in the legal team and 10 consultants, while its merchant and customer-compliance team is 40-strong. Online insurance seller Policybazaar employs more than 20 people to look after compliance, and brokerage firm Zerodha has nearly 25 people in its legal and compliance teams. Out of 40 employees at LoanTap, four are dedicated to legal and compliance work. And the 100-member company Faircent has six legal and compliance employees. Each company also works with external legal and compliance professionals.

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>
> Rajat Gandhi, founder, Faircent

All this costs a lot of money.

“Each certification takes from a few lakhs to tens of lakhs. Some of them are one-time but most of them are periodic. It is not cheap,” says Bhakta Keshavachar, co-founder of payments platform Ezetap. When asked if the legal and compliance costs are a drain on the funding raised by the company, Keshavachar says, “Yes. It is significant.”

Then there is the cost of fundraising itself, which can be between INR50 lakh and INR1 crore every time, adds Singh of Coverfox.

What they spend

Company	Revenue (FY18)	Annual legal/ compliance cost* (INR crore)
Policybazaar	385**	10
MobiKwik	44.35***	4
Coverfox	12	1.5
Zerodha	650	4.8

All figures in INR crore

*Includes legal/compliance team's salaries, cost of certifications related to compliance, and consultancy fees

**The revenue and profit figures are on a consolidated basis for Etechaces Marketing and Consulting, which operates Policybazaar and Paisabazaar.

***FY17 figure

Source: ET Prime research

The founder of a peer-to-peer lending firm says it’s not the big regulation that troubles you, but at the operating level, how to implement the different policies and regulations is the thorny question.

“More than the cost, it’s the amount of time that is required from the CEO. And, one thing going wrong, especially when you are getting foreign direct investment, I can’t even tell you — it is just frustrating at times. Money has come to the country, there is a KYC that needs to be done by the bank, but I am running around,” says the founder of a Gurugram-based lending firm.

“Physical KYC, etc. add up to the cost of compliance. The KYC norms for banks and fintech firms are absolutely the same. As far as lending is concerned, we operate like any bank,” says V Raman Kumar, founder of personal-loan provider CASHe.

Adding to this, FlexiLoans co-founder Manish Lunia explains that lending is not a compliance-oriented but a savings-oriented business. “If you look at the last six months, you can see the impact [of the changes in KYC processes]. The savings could have been in the range of 3%-4% of the loans lent and even up to 10% for micro loans. [But] the KYC compliance cost has shot up dramatically after the Aadhaar ban.”

A Gordian knot

There are times when the pressure of compliance pushes companies into iffy business decisions.

If your business is small, but there is no respite from compliance costs — right from KYC to due diligence to reporting requirements to certifications — your opportunity to earn and grow versus the cost is low. It leaves you with little option but to diversify.

The result: dealing with more regulators and additional compliance.

“Since there are no synergies or alignments between the regulators, the compliance burden grows with you growing into different segments,” says Payments Council of India chairman Naveen Surya.

The biggest problem, according to Mukesh Kalra, founder of ET Money, which offers loans, mutual funds, and insurance, is the pace at which the compliance requirements change. In the digital world, a workflow has to be wired and is working fine. If suddenly a new regulation forces a change in one part of that workflow, everything has to be reworked. This increases the cost of opportunity and hampers the ability to innovate, Kalra says. (ET Money and ET Prime are both owned by Times Internet.)

The economy is going digital; regulations must follow suit

A few entrepreneurs like Zerodha founder Nithin Kamath believe India is better than other markets. “[The burden here is] much less in terms of costs, even considering opportunity is lower too,” says Kamath.

PoS company MSwipe’s founder Manish Patel says blaming the RBI or any other regulator is wrong. “The RBI is one of the most forward-thinking regulators in the world,” he says. “It thinks about the stability of and risk in the entire ecosystem.”

The concept of compliance is still evolving in India, and the expectations from at least non-banking entities or quasi-financial intermediaries is not that complicated, believes Hem Raj Hyanki, founder of

Compliance Pillar, which advises housing-finance companies and NBFCs on regulatory compliance and governance frameworks.

Most of the regulatory compliances, certifications, and licences require physical paperwork. Fintech firms feel the economy has changed, but the way regulations are enforced remains ancient.

Bipin Preet Singh, founder and CEO of MobiKwik, says, “Regulators are open, but I think the industry needs to put more pressure on them to be more open and get them to see things from the point of view of [fast-moving technology], which very often they miss.”

“Regulators can conduct online audits instead of coming every month or quarter and say, ‘Open up your books’. It would be easy for us to give them a window on our online books — and they can even check it on a daily basis,” proposes CASHe’s Kumar. Also, with so much technology available, security compliances can be completed real fast, adds Lunia of FlexiLoans.

The RBI and the government seem to be making efforts to accelerate digitisation — the GST itself is a good example. “However, if we compare [the situation here] with other countries like Singapore, China, the UK, and the US, a lot more can be done in terms of compliance management,” says Bhavin Patel, CEO and co-founder of peer-to-peer lending firm LenDenClub.

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Fintech firms also say they need far more transparent and supportive systems to experiment and grow. For this, they suggest a sandbox-like environment, and a centralised body that can make permissions smoother. Most startups have small teams and would rather hire more people on the business and tech side than on compliance.

A co-founder of a Sebi-regulated company says, “You can’t wait for regulations to be in place to innovate. So, you end up walking into a grey area, because if you go to Sebi, it will straightaway refuse. And for any question, it takes three or four months to answer. Everyone in the fintech ecosystem is scared of regulators, so they don’t approach them unless they are asked to.”

A majority of the companies ET Prime spoke with want fintech regulation to be separated from regulation for traditional financial services.

“The RBI is not aggressive enough to come out with an alternative to Aadhaar-based KYC. Is it waiting for many of these companies to die?” says the founder of a payments firm.

There has not been any initiative yet to bring all the fintech bodies together. Lunia of FlexiLoans says, “In a recent notification, RBI sought feedback from fintech founders on how many people they employ, the business they do, whether they are funded, etc. They are probably trying."

The question is whether "trying" is good enough, given the scale of the industry's ambitions.

(*Graphics by Sadhana Saxena*)