



Rethinking Digital Lending:

Whitepaper on Inclusion of NBFCs in
the Credit Line on UPI Infrastructure |



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Executive Summary

This project examines the evolution of the Unified Payments Interface from a pure payments rail into a credit-enabled digital public infrastructure, with a specific focus on the Credit Line on UPI framework and the complete exclusion of Non-Banking Financial Companies from direct participation. It situates this exclusion within India's broader financial architecture, recognising UPI's centrality to retail digital payments and its growing role in embedded finance (the seamless integration of financial services directly into non-financial apps and platforms, allowing users to access banking functions within their usual digital experience without switching to a bank's website or app, creating "one-stop shops" for purchases, services, or business management).

Against this backdrop, the study interrogates whether the current regulatory design reflects prudential necessity or whether it risks becoming misaligned with market realities, constitutional principles, and financial inclusion objectives.

The core objective of the project is to assess the legal, regulatory, and policy rationale for restricting Credit Line on UPI access to banks, despite NBFCs' significant role in India's credit ecosystem, particularly in the last-mile and underserved segments. It undertakes a detailed analysis of the statutory foundations governing NBFCs under the RBI Act, 1934, and the regulatory architecture of payment systems under the Payment and Settlement Systems Act, 2007. The study also evaluates the extent of regulatory convergence between banks and NBFCs under the Scale- Based Regulatory Framework, highlighting how historical distinctions have narrowed due to enhanced capital adequacy, governance, and supervisory standards.

A key finding of the project is that the blanket exclusion of NBFCs from Credit Line on UPI is not compelled by statute and may not be the least restrictive means of addressing prudential and systemic risks. The research demonstrates that NBFCs are already subject to extensive RBI oversight "from cradle to grave," maintain capital buffers well above regulatory minima, and have proven capabilities in digital lending and risk assessment. While legitimate concerns exist around systemic risk, information asymmetry, consumer protection, and recovery mechanisms, these risks are neither unique to NBFCs nor unmanageable. Comparable risks have been addressed in other contexts through calibrated regulation, such as co-branded credit cards, co-lending models, and differentiated access regimes.

From a constitutional perspective, the study finds that continued exclusion raises concerns under the principles of equality, proportionality, and reasonableness. As UPI increasingly functions as essential digital public infrastructure, denying access to an entire class of regulated financial institutions without a demonstrable, evidence-based justification risks arbitrary classification under Article 14 and disproportionate restriction on trade under Article 19(1)(g). The project emphasises that the RBI's broad regulatory discretion must be exercised in a manner that balances financial stability with competition, innovation, and public interest, particularly in promoting financial inclusion.

The project concludes by proposing a policy blueprint that is centred on a differentiated, risk-based access framework for NBFC participation in Credit Line on UPI.

It recommends the creation of a category of Financially Sound and Well-Managed NBFCs, identified through objective criteria aligned with the existing scale-based regulatory approach. Participation would be subject to stringent eligibility norms, enhanced governance and technology standards, data security requirements, transaction caps, escrow and settlement safeguards, and robust consumer protection and grievance redress mechanisms. A phased and closely supervised rollout is suggested to allow regulators to monitor risks and recalibrate safeguards.

Overall, the study positions the inclusion of eligible NBFCs in Credit Line on UPI not as deregulation, but as regulated inclusion. It argues that such an approach is statutorily permissible, constitutionally defensible, and economically necessary to deepen formal credit access, enhance competition, and strengthen India's leadership in digital financial innovation, while preserving systemic stability and consumer trust.

Research Methodology

Research statement

NBFCs, despite their deep penetration into retail and rural lending and their prudential regulation that is substantially harmonised with that of banks, have been excluded from providing a Credit Line on UPI. This paper argues that NBFCs can be included within the current framework through a calibrated approach that enhances financial inclusion while also proposing guardrails and risk mitigation measures for potential risks.

Broadly, three issues have been identified and discussed in the whitepaper:

- **Financial Exclusion:** Segments dependent on NBFCs for micro-credit (MSMEs, rural households, informal sector workers) remain underserved.
- **Market Distortion:** Banks enjoy exclusive privileges in UPI-linked credit, risking concentration and reduced competition.
- **Legal Inconsistency:** Prudential norms applicable to NBFCs mirror those of banks, yet NBFCs are denied equivalent access, raising questions of proportionality.

Objectives of this Study

- To examine the regulatory rationale for excluding NBFCs from UPI-linked credit lines.
- To assess the impact of such exclusion on competition, innovation, and financial inclusion.
- To analyse the possibility of RBI accommodating NBFCs under constitutional and regulatory principles (proportionality, reasonable classification, public interest).

- To check whether a policy framework that balances prudential risk management with inclusive access to small-ticket, unsecured digital credit is possible.

Research Questions

1. UPI Lending by NBFCs: Is this an opportunity for financial inclusion in India's digital economy?
2. Can RBI introduce this in a calibrated approach by differentiating between NBFCs based on prudential lending norms and capital requirements? Are there legal hurdles for the RBI to open the market for NBFCs based on prudential lending norms and capital requirements?
3. What are the risks that need mitigation in NBFCs that are permitted to provide UPI Lending? If yes, what guardrails would address these risks?
4. To provide maximum value to the customers, can UPI Credit Line incorporate credit-card-like features? If yes, what risks do such features raise, and how can they be mitigated without diluting customer value?

Research Methodology

Phase I: Desk Research

- Review of RBI circulars, Master Directions, and regulatory frameworks governing NBFCs and banks.
- Comparative study of prudential norms (capital adequacy, provisioning, asset classification) for banks and NBFCs.
- Survey of academic literature on digital lending, unsecured credit, and constitutional proportionality.

Phase II: Empirical & Legal Analysis

- Mapping NBFC credit penetration in rural/semi-urban India using RBI/CRISIL/CMIE data.
- Case analysis (HC/SC) on RBI regulation.
- Empirical Legal and Policy Research - Stakeholder consultation (Regulators, NBFC associations, fintech intermediaries, MSME borrowers).
 - Stakeholder Consultations (Round 1 - Online)
 - Participants: Regulators; Investor associations, financial inclusion.

Phase III: Risk Analysis and Policy Research

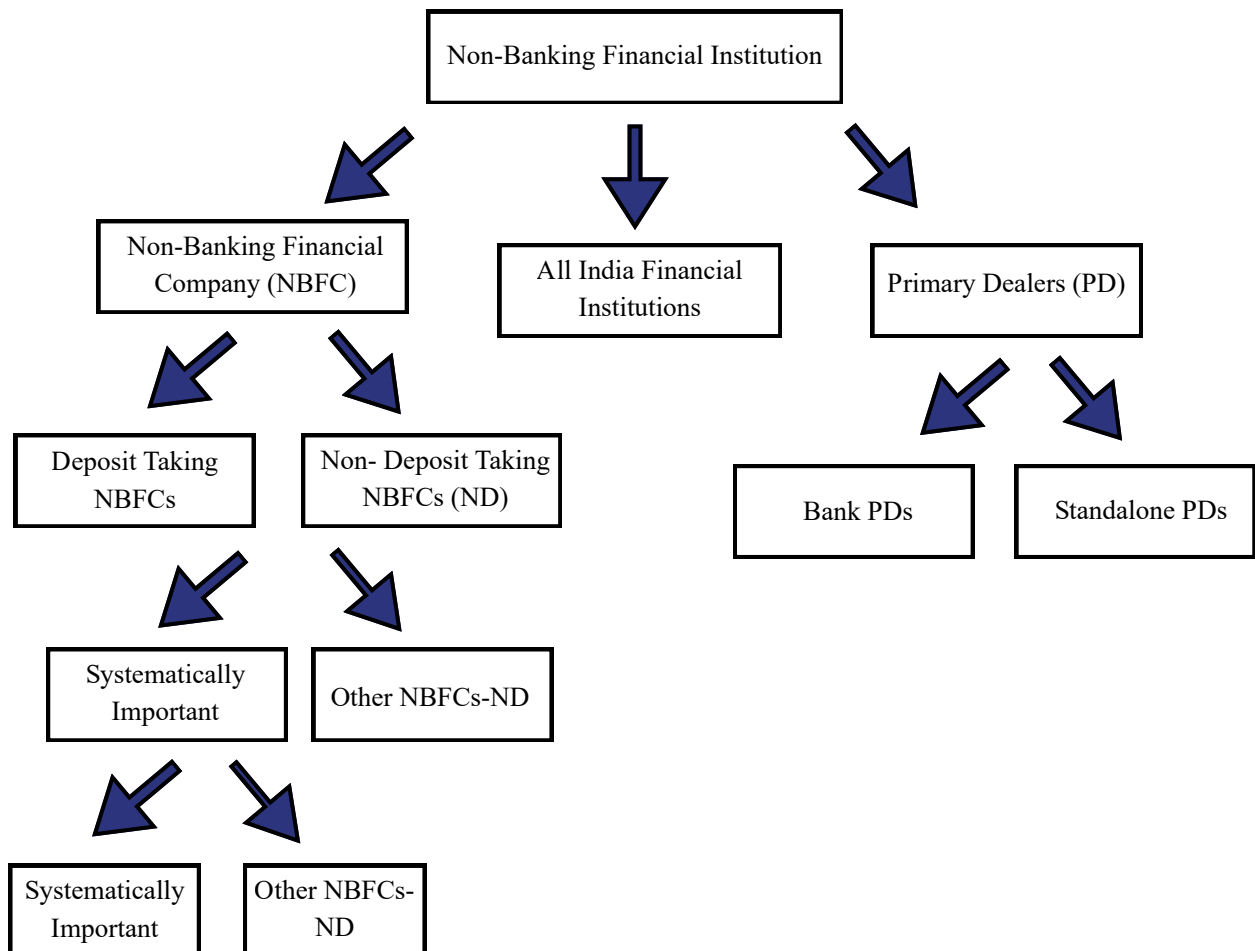
- Map potential risk based on the first Stakeholder Consultation and identify mitigation measures to create operational guardrails
- Identifying legal and policy approaches to enable NBFCs to provide UPI-linked credit.

Phase IV: Synthesis

- Final research report (whitepaper).
- Release on the CLAP website and public dissemination

Expected Outcomes

- A comprehensive legal analysis of RBI's regulatory regimes on NBFCs
- Demonstration of how NBFC inclusion could enhance financial inclusion and competition
- Identification of opportunity, potential risks and practical challenges through consultation
- Suggest operational guardrails to mitigate risks
- Policy recommendations submitted to RBI, Ministry of Finance, and Parliamentary standing committees.



1. Introduction

The Unified Payments Interface (UPI) is a real-time payment system built on the Immediate Payment Service (IMPS) infrastructure and regulated by the Reserve Bank of India (RBI). It enables instant fund transfers between bank accounts through mobile applications, integrates multiple bank accounts within a single interface, and facilitates peer-to-peer transfers, merchant payments, and payment requests. Beyond its functional efficiency, UPI represents a state-backed digital public infrastructure that has become central to India's financial governance architecture.

Since its launch in 2016, UPI has transformed retail payments in India by enabling low-cost, instantaneous transactions without procedural complexity. Its widespread adoption has been driven by ease of use, interoperability across banks, and policy support aimed at reducing cash dependency. As UPI approaches a decade of operation, regulators have increasingly sought to leverage its ubiquity to deliver adjacent financial services, marking a shift from pure payments to embedded financial products. One such development is the introduction of Credit Line on UPI (CLOU) by the RBI in 2023, which signals a decisive regulatory move toward integrating credit delivery within payment infrastructure.

This transition, however, has not been uniform across all financial institutions. While banks have been permitted to participate in credit-linked UPI products, certain regulated entities—most notably Non-Banking Financial Companies (NBFCs)—remain excluded, raising questions regarding regulatory design, access, and proportionality.

1.1 The Growth and Evolution of UPI

UPI's rapid growth reflects increasing regulatory confidence in its resilience and reliability as a national payment rail. This confidence is evident in the gradual enhancement of transaction limits, including the increase of UPI transaction caps for tax-related payments to INR 5 lakhs, announced on August 28, 2025, and implemented from September 15, 2025.¹ Such policy measures indicate a willingness to permit higher-value transactions within the UPI ecosystem.

UPI's emergence as the world's largest real-time payment system is the result of sustained investment in digital public infrastructure. Initiatives such as mass financial inclusion, digital identity through Aadhaar, and affordable mobile internet created the conditions necessary for scale. In October 2019, UPI crossed one billion monthly transactions², a milestone that marked its transition from an alternative payment method to the backbone of everyday economic exchange.

¹ Addendum to OC 185A- Implementation of higher per transaction limit for specific categories in UPI, NPCI/UPI/2025-26/OC/185B August 28, 2025 https://www.npci.org.in/uploads/UPI_OC_No185_B_FY_2025_26_Addendum_to_OC_185_A_Implementation_of_higher_per_transaction_limit_for_specific_categories_in_UPI_ba517a0902.pdf (last visited on 30 December 2025)

²The remarkable rise of UPI in 2020, PWC, December 2020, <https://www.pwc.in/assets/pdfs/consulting/financial-services/fintech/point-of-view/pov-downloads/the-remarkable-rise-of-upi-in-2020.pdf> (last visited December 29, 2025)

And as of recent years, UPI processes over 18 billion transactions per month, underscoring its systemic importance to India's financial system.³

The maturity of UPI as a payments platform laid the foundation for its evolution into a conduit for credit, transforming it from a transactional utility into a multifunctional financial infrastructure.

1.2 From Payments to Credit: RuPay Linking & Credit Line on UPI

India's efforts to build a sovereign payment infrastructure predate UPI. RuPay, India's domestic card payment network, was launched by the National Payments Corporation of India (NPCI) in 2012 pursuant to the RBI's objective of reducing reliance on foreign card networks and promoting a less-cash economy.⁴ RuPay represented an early attempt to expand digital payments and credit access through an indigenous system.

NPCI, established under the Payment and Settlement Systems Act, 2007, operates as a not-for-profit entity under Section 25 of the Companies Act, 1956 (now Section 8 of the Companies Act, 2013).⁵ Its institutional design reflects a public-interest mandate to develop and manage core retail payment infrastructure. NPCI further revealed that its AI-powered, blockchain-enabled platforms process over 22 billion transactions each month, with a cumulative value exceeding INR 42 trillion (~USD 47 billion).⁶

Despite growth in card issuance, credit cards failed to achieve deep penetration in India, with usage remaining below 6% of the population.

Structural barriers such as limited merchant acceptance, onboarding costs, and reliance on physical cards constrained their reach, particularly among small merchants and informal consumers. This limitation became a key policy driver for embedding credit within the already ubiquitous UPI ecosystem.⁷

In December 2022, NPCI enabled the linking of RuPay credit cards to UPI, allowing credit card transactions through QR-based UPI infrastructure. This development served as a regulatory proof of concept, demonstrating that credit could be delivered through UPI rails without altering its core architecture.

The exponential growth in RuPay credit card-linked UPI transactions between 2022–23 and 2024–25 reflects strong consumer acceptance and merchant readiness, validating the regulatory decision to permit credit integration.⁸ This experience informed subsequent policy choices regarding more direct forms of credit delivery through UPI.

1.3 Credit Line on UPI and the Current Exclusion of NBFCs

Building on the success of card-linked credit, the RBI and NPCI introduced Credit Line on UPI (CLOU) in 2023 as a distinct credit product. CLOU enables users to access pre-sanctioned credit lines from banks directly through UPI applications, effectively embedding lending into payment flows. Unlike credit cards, CLOU decouples credit from physical instruments and relies on real-time digital authentication and repayment mechanisms.

³ PIB, India's UPI Revolution- Over 18 billion Transactions Every Month, A Global Leader in Fast Payments, July 20, 2025 <https://www.pib.gov.in/PressNoteDetails.aspx?NoteId=154912&ModuleId=3®=3&lang=2> (last visited December 29, 2025)

⁴ RuPay By NPCI, About RuPay, <https://www.rupay.co.in/about-rupay> (last visited December 27, 2025)

⁵ NPCI- Purpose, Mission and Value, <https://www.npci.org.in/purpose-value> (last visited December 27, 2025) ⁶ NPCI and Boston Consulting Group, UPI- The Global Benchmark for Digital Payments Transforming lives at scale, October 2025, <<https://web.assets.bcg.com/73/e5/e11f0db54da18a31a7cb55c1bef2/upi-the-global-benchmark-for-digital-payments.pdf>> (last visited December 29, 2025)

⁷ Statista, Number of credit cards in use in India from 2014 to 2029 (in millions) Statista, <https://www.statista.com/forecasts/1150220/credit-cards-in-use-forecast-in-india/?srsltid=AfmBOorasMiwEITYJbD2iL3d03DTpwmYNf9wKCreBWLlbcKcApqXPLx> (last visited December 29, 2025)

⁸ NPCI/2022-2023/RuPay/019-A Operating Circular for RuPay Credit Cards linked to UPI (Amended), December 7, 2022, https://www.npci.org.in/uploads/Ru_Pay_I_OC_019_A_I_FY_22_23_I_Operating_circular_for_Ru_Pay_Credit_Cards_linked_to_UPI_Amended_b72866b48b.pdf (last visited December 29, 2025)

CLOU incorporates controlled design features, including issuer-specific UPI PINs, predefined credit limits, transaction caps, and integrated dispute resolution through UPI's ODR framework. These features reflect a prudential approach aimed at balancing the ease of access with risk containment.⁹

At present, the participation in CLOU is limited to banks and, subsequently, Small Finance Banks, with NBFCs excluded from offering credit lines through UPI independently. Credit Line on UPI (CLOU) was first opened only to scheduled commercial banks, and UPI credit card linkage began exclusively with RuPay cards. This exclusion is significant given the role NBFCs play in extending credit to first-time borrowers, gig workers, and micro-merchants—segments that are already deeply embedded in the UPI ecosystem.¹⁰

Statistically, in terms of market share, NBFCs held ~21% as of FY25, while banks held ~72%. NBFCs' share of overall systemic credit is expected to increase to 22% by FY28. Furthermore, NBFCs have shown remarkable resilience and have gained substantial importance in the financial sector ecosystem, growing to Rs 48 trillion at the end of FY25. During FY19 to FY25, NBFC credit is estimated to have grown at a CAGR of 13.2%. This rapid revival in the economy is expected to drive consumer demand in FY26, leading to continued and healthy growth for NBFCs.

Additionally, the Report on Trends and Progress of Banking in India 2024-25 reported that in March 2024, MSME credit growth by NBFCs stood at 39.0 per cent, whereas banks reported a significantly lower growth rate of 20.0 per cent. This indicates that NBFCs were expanding their MSME lending at nearly double the pace of banks during that period. The trend continued into March 2025, reinforcing the same conclusion.

Although growth moderated for both institutions, NBFCs still registered a higher MSME credit growth of 30.6 per cent, compared to 14.1 per cent for banks. The gap in growth rates remains substantial, demonstrating that NBFCs consistently outperformed banks in terms of expanding MSME credit. At the same time, banks continue to dominate in terms of overall share of MSME credit, holding around 88.7 per cent in March 2024 and 86.7 per cent in March 2025, while NBFCs account for a much smaller share of 11.3 per cent and 13.3 per cent respectively. Despite this disparity in share, the higher growth rates of NBFCs suggest that they are gaining ground faster than banks in MSME lending.

Furthermore, as discussed in this report (Chapters 2 and 3), the introduction of a separate category of NBFCs, which are Financially Sound and well-managed as a distinct regulatory category, offers a principled way to address the supervisory and systemic concerns. If appropriate guardrails are instituted to ensure strict compliance with prudential norms and allied regulatory requirements, access to the Credit Line on UPI would effectively mitigate the identified concerns while allowing NBFCs that demonstrably meet enhanced standards of financial soundness, governance, and risk management to enable this product at scale without undermining financial stability.

The idea of creating a credit line on UPI was envisaged by the RBI because the UPI network will facilitate payments financed by credit from banks, which could reduce the cost of offerings and help in the development of unique products for the Indian markets. As per the RBI, UPI handles 75% of the retail digital payments volume in India. The UPI system has been leveraged to develop products and features aligned to India's payments digitisation goals.¹¹

⁹ NPCI- Product Overview, Credit Line on UPI, <https://www.npci.org.in/product/upi/credit-line-on-upi>, (last visited December 29, 2025)

¹⁰ Analysis of NBFC Sector in India, Tata Capital Limited Industry Report, Crisil Intelligence, September 2025, https://www.tatacapital.com/content/dam/tata-capital/pdf/investors-and-financial-reports/offerdocuments/Offer_Documents/Tata%20Capital%20Limited_Industry%20Report.pdf (last visited December 27, 2025)

¹¹ RBI- Statement on Developmental and Regulatory Policies, April 6, 2023 https://www.rbi.org.in/Scripts/BS_PressReleaseDisplay.aspx?prid=55473 (last visited on January 1, 2026)

1.4 Research Objective and Scope of the Study

This study seeks to critically examine the regulatory and policy rationale underlying the current exclusion of Non-Banking Financial Companies (NBFCs) from the Credit Line on UPI (CLOU) framework, situating this exclusion within the broader evolution of UPI from a payments instrument to a credit-enabled digital public infrastructure. It aims to assess whether this exclusion is grounded in prudential necessity, statutory limitations, or risk-based regulatory design, particularly in light of the systemic role NBFCs play in India's credit ecosystem and financial inclusion landscape.

The scope of the research extends to an analysis of the legal and regulatory architecture governing UPI participation, including the RBI's powers under relevant statutes, existing access rules, and constitutional principles of equality, proportionality, and reasonableness. It further evaluates the prudential, systemic, and consumer protection risks associated with permitting NBFC participation in CLOU, drawing from past NBFC stress episodes, Basel-aligned norms, and global regulatory benchmarks.

Finally, the study explores the competitive and efficiency implications of excluding NBFCs from an essential digital public infrastructure and assesses whether a differentiated, risk-based, and phased access framework could reconcile innovation, competition, and financial stability. In doing so, the analysis remains attentive to regulatory prudence, acknowledging that a calibrated or conditional inclusion may be justified instead of the continued exclusion. Through this balanced lens, the study seeks to offer a nuanced policy blueprint that supports informed, future-facing regulatory choices by the RBI and NPCI.

2. NBFCs in India's Financial & Credit Ecosystem

At its core, the NBFC regulation in India aims to strike a balance between innovation and stability.¹² In India, NBFCs, including housing finance companies (HFCs), and fintech firms account for 84.3 per cent of personal loans below ₹50 thousand. Also, the report released by the RBI on the Trends and Progress of Banking in India further mentions that the credit extended by NBFCs has been rising over the years, underscoring their growing importance in financial intermediation. It increased to 14.6 per cent of GDP at the end of March 2025 from 13.5 in 2024.

The growing role of NBFCs is reflected in their credit growth, which surpassed that of banks in all segments except agriculture during the same period. As compared to banks, NBFCs recorded a higher credit growth, and their share in lending to the MSME sector increased during 2024-25. Combined credit from NBFCs and NBFC-MFIs to the microfinance sector, which comprises 50.7 per cent of total credit outstanding to the sector, contracted by 14.5 per cent during 2024- 25.

Furthermore, the RBI noted that unsecured NBFC lending rose partly due to base effects and not reckless expansion. Growth is observed in unsecured lending moderated through regulatory actions (risk weights, digital lending norms).¹³ This underscores its expanding influence in the financial domain.

The dependence of NBFCs on banks has moderated somewhat¹⁴ (the overall banks' exposure as a share of NBFCs' borrowings moderated from 43.1 per cent at end-March 2023 to 42.7 per cent at end-March 2024); However, NBFCs still need to further diversify their sources of funds as a risk mitigation strategy and to ensure their relevance in a fast-changing financial landscape.¹⁵

2.1 Statutory and Regulatory Foundations under the RBI Act, 1934

The Reserve Bank of India Act of 1934, under Chapter III-B, provides for Non-Banking Financial Institutions. According to the RBI Act, a non-banking institution will be treated as a financial institution if it carries on any of these activities as its business (or as part of its business).

Section 45 I (f) defines a Non-Banking Financial Company (NBFC) as a company that primarily engages in receiving deposits under various schemes or arrangements, or in lending activities.

Such institutions, commonly known as financial institutions, are essentially non-banking companies registered under the Companies Act, 1956 or Companies Act, 2013, and are engaged in activities like providing loans and advances, acquiring shares, stocks, bonds, debentures, or securities issued by

¹² "Discussion Paper on Revised Regulatory Framework for NBFCs- a Scale-Based Approach Reserve Bank of India Department of Regulation," January 21, 2021, <https://rbidocs.rbi.org.in/rdocs/Publications/PDFs/DP220121630D1F9A2A51415B98D92B8CF4A54185.PDF>. (Last visited Dec 13, 2025).

¹³ RBI Financial Stability Report, June 2025, <https://rbidocs.rbi.org.in/rdocs/PublicationReport/Pdfs/0FSRJUNE20253006258AE798B4484642AD861CC35BC2CB3D8E.PDF> (Last visited Dec 13, 2025).

¹⁴ RBI, Report on Trend and Progress of Banking in India 2024-25, 2025, <<https://rbidocs.rbi.org.in/rdocs/Publications/PDFs/0RTP291220258C89B9E5F3F240AEB82AC25A1707A8C6.PDF>> (Last visited Oct 3, 2025).

¹⁵ RBI Financial Stability Report 2025, Ibid.

¹⁶ Section 45 I (f), Reserve Bank of India Act, 1934

the Government, local authorities, or other marketable securities, as well as leasing, hire-purchase, insurance business, chit/kuri operations, and collective money schemes. However, institutions whose principal business is in agriculture, industrial activity, trading/services, or real estate (without financing others) are excluded.

To operate as Non-Banking Financial Companies (NBFCs), these institutions must comply with the requirements laid down in Chapter III-B (Provisions Relating to Non-Banking Institutions Receiving Deposits and Financial Institutions) of the RBI Act. RBI, as the primary regulator for NBFCs, governs the functioning from registration to winding up.

Section 45-IA deals with licensing and registration, ensuring that only financially sound and well-managed NBFCs are permitted to operate. The RBI Act enforces strict control to safeguard depositors and the economy by requiring NBFCs to maintain a minimum capital base (Net Owned Funds) to absorb risks. Mismanaged NBFCs may have their registration cancelled.

In the case of *Nedumpilli Finance Company Limited vs. State of Kerala and Ors.*¹⁷, it was held that the scheme of Chapter III-B of the RBI Act shows that the power of intervention available for the RBI over NBFCs is from the cradle to the grave. In other words, no NBFC can carry on business without being registered under the Act, and an NBFC that takes birth with the registration under the Act is liable to be wound up at the instance of the RBI.

Furthermore, in the matter of *Peerless General Finance and Investment Co. Limited and Ors. vs. Reserve Bank of India and Ors.*¹⁸, the Supreme Court emphasised that RBI's regulatory powers over NBFCs must be construed expansively to protect depositors. It was also held in the case of *Hongkong and Shanghai Banking Corp. Ltd. vs. Awaz and Ors.*¹⁹,

that the RBI is the prime regulator and the decision-making authority for the economic/financial decisions of the Indian economy, any endeavour by the National Commission or any other Court/Tribunal to decide at the behest of the RBI cannot be termed just, fair and equitable. These rulings on the RBI's control over NBFCs collectively demonstrate that the judiciary has reinforced the RBI's role as the sole guardian of depositor safety and overall systemic stability in the NBFC sector.

Sections 45-IB and 45-IC set out the prudential safeguards for NBFCs. Section 45-IB mandates that NBFCs invest a prescribed portion of their deposits in safe government securities to protect depositors and maintain stability, with penalties for non-compliance unless failure was due to genuine reasons. Section 45-IC requires NBFCs to transfer 20% of yearly profits into a reserve fund, which cannot be drawn upon without the RBI's approval. The Central Government may grant exemptions in special cases for already strong institutions.

Section 45-JA authorises RBI to issue policy directions related to accounting standards, risk management, capital adequacy, lending practices, and exposure limits, ensuring that NBFCs function transparently and in the public interest. Sections 45-K and 45-L empower RBI with inspection and information rights. Section 45-K ensures oversight of any company accepting deposits, even if it is not a bank, to prevent misuse and protect depositors.

It also gives RBI the power to prohibit the acceptance of deposits by that non-banking institution if the NBFC fails to comply with any directions issued by the RBI. Section 45-L extends this power by enabling RBI to supervise and guide lending by financial institutions, ensuring that such activities align with national economic priorities and do not destabilise financial markets.

¹⁷ MANU/SC/0620/2022

¹⁸ MANU/SC/0685/1992

¹⁹ MANU/SC/1383/2024

Most importantly, Section 45-Q gives the RBI Act the overriding effect over all other laws or instruments, affirming RBI's primacy in regulating NBFCs. This overriding effect has been seen in action in the case of *Hong Kong and Shanghai Banking Corp. Ltd. vs. Awaz and Ors*, as discussed earlier. The RBI's main priority is to ensure financial stability and systemic risk management. Over the years, the NBFC sector has evolved considerably in terms of size, complexity, and interconnectedness within the financial sector.

Further, the RBI exercises regulatory control over NBFCs through various standalone regulations specific to NBFCs and also a few covering the banking and financial sector in its entirety. NBFCs must meet the RBI's fit and proper criteria, audit standards, risk management rules, and maintain board independence.

2.2 Prudential norms, SBR framework, and systemic significance

RBI prescribes prudential norms in the form of guidelines on income recognition, asset classification and provisioning requirements applicable to NBFCs, exposure norms, disclosures in the balance sheet, requirement of capital adequacy, and loan-to-value (LTV) ratio for NBFCs predominantly engaged in the business of lending against gold jewellery, besides others.²⁰ The prudential norms are aimed at addressing the risk of protecting the market and the institution while signalling market stabilisation and market trust.

RBI implemented a Scale-Based Regulatory Framework (SBR Framework) for regulating NBFCs effective from October 01, 2022. The SBR Framework, based on the principle of proportionality, considers various factors such as size, activity, complexity, and interconnectedness within the financial sector to categorise NBFCs into multiple layers. The degree of regulations increases as one moves from lower to higher layers.

The SBR Framework²¹ classifies NBFCs into four layers that are considered to be systemically significant. These layers are:

1. NBFC-Base Layer (NBFC-BL)

- a. Asset size of less than INR1,000 crore.
- b. Will include NBFC-P2P, NBFC-AA, NOFHC and NBFCs without public funds and customer interface and Government-owned NBFCs.

2. NBFC-Middle Layer (NBFC-ML)

- a. Asset size with more than INR1,000 crore.
- b. Will include NBFC-D, CIC, IFC and HFC.

3. NBFC-Upper Layer (NBFC-UL)

- a. Asset size specifically identified by the RBI.
- b. Will include the top ten eligible NBFCs in terms of their asset size shall always reside in the upper layer, irrespective of any other factor. (These are identified as warranting enhanced regulatory requirements based on a set of parameters and scoring methodology)

4. NBFC-Top Layer (NBFC-TL)

- a. The layer will ideally remain empty.
- b. This layer can get populated if the Reserve Bank is of the opinion that there is a substantial increase in the potential systemic risk from specific NBFCs in the Upper Layer. Such NBFCs shall move to the Top Layer from the Upper Layer.

The RBI Act of 1934 provided NBFCs with a framework for operation, but it also limited their deposit-taking powers. This differentiates them from banks. As NBFCs have grown in size and systemic significance, the regulatory environment has become increasingly complex and sophisticated.

²⁰ Master Direction – Reserve Bank of India (Non-Banking Financial Company – Scale Based Regulation) Directions, 2023 and RBI FAQs, All you wanted to know about NBFCs, Reserve Bank of India, April 23, 2025, <https://www.rbi.org.in/commonman/english/scripts/FAQs.aspx?Id=1167> (Last visited Oct 8, 2025).

²¹ RBI Notifications, Scale Based Regulation (SBR): A Revised Regulatory Framework for NBFCs, October 22, 2021, <https://www.rbi.org.in/scripts/NotificationUser.aspx?Id=12179&Mode=0> (Last visited Oct 8, 2025).

The RBI, to ensure a financially sound and stable co-operative sector, has identified certain Urban Co-operative Banks (UCBs) as Financially Sound and Well Managed (FSWM), subject to the fulfilment of specific parameters²². In this context, a reference may be made to the framework adopted by the RBI for classifying UCBs under the FSWM category. It may be worthwhile to revisit the current layer-based approach used for classifying Non-Banking Financial Companies (NBFCs) and the requirements applicable to each layer for maintaining their certifications.

Exploring the possibility of developing a new structure more closely aligned with the UCB classification model and potentially adopting a similar approach for NBFCs could open avenues for their participation in Credit Line on UPIs.

2.3 Differences and Convergences between NBFCs and Banks

The key differences between NBFCs and Banks are as follows:

Aspect	Banks	NBFCs
Acceptance of Deposits	Can accept public deposits	NBFCs cannot accept public deposits (except the ones approved for the same)
Interest Rates	Lower, due to access to low-cost deposits. (As of October 2025, the RBI Repo Rate is 5.50%)	The RBI has deregulated interest rates to be charged to borrowers by NBFCs. However, the interest rates charged by NBFCs are structurally higher, as funding for NBFCs comes from costlier sources and not public deposits.
Reserve Requirements	Must maintain CRR (Cash Reserve Ratio) and SLR (Statutory Liquidity Ratio)	NBFCs are not subject to CRR requirements. But according to Section 45-IB of the RBI Act, 1934, they have to maintain 15% of their public deposit liabilities in Government and other approved securities as liquid assets. ²³
Minimum Net Owned Funds ²⁴	Initially, Rs. 200 crores, with a commitment to increase to Rs. 300 crores within three years. In order to meet this requirement, all banks in the private sector should have a net worth of Rs. 300 crores at all times. The banks that are yet to achieve the required level of net worth will have to submit a time-bound programme for capital augmentation to the RBI. Where the net worth declines to a level below Rs. 300 crores, it should be restored to Rs. 300 crores within a reasonable time.	Under Section 45 I(a): It should have a minimum net owned fund of ₹10 crore. (The minimum net owned fund requirements for specialized NBFCs are 1. NBFC-IFC – ₹300 crores. 2. IDF-NBFC – ₹300 crores. 3. MGC – ₹100 crores. 4. HFC – ₹20 crores, 5. SPDs which undertake only the core activities – ₹150 crores and SPDs, which also undertake non-core activities – ₹250 crores; NBFC-AA – ₹2 crores; and NBFC-P2P – ₹2 crores).

²² Reserve Bank of India, “Review of norms for classification of Urban Co-operative Banks (UCBs) as Financially Sound and Well Managed (FSWM)” (December 1, 2022) <https://www.rbi.org.in/scripts/NotificationUser.aspx?Id=12415&Mode=0#AN1> (Last visited Oct 8, 2025).

Aspect	Banks	NBFCs
Pricing interest	Generally, offers lower interest rates due as they have access to lower cost borrowings and therefore, they have to maintain stricter regulations to offer them.	Typically, higher interest rates but flexible terms for borrowers.
Credit Market Segments	Wide coverage, including prime borrowers such as individuals, businesses and institutions with stable incomes	Focused on niche segments inaccessible or unattractive to banks (e.g., underserved, self-employed individuals or small businesses) ²⁵
Availability of DICGC	The Deposit Insurance facility of the Deposit Insurance and Credit Guarantee Corporation is available to Banks.	Not available to depositors of deposit-taking NBFCs.

Traditionally, NBFCs often confine themselves to riskier or underserved segments, carving out niches that banks avoid. The absence of CRR/SLR obligations²⁶ gives NBFCs flexibility, but not enough to offset their higher funding costs. Thus, their business model is specialised and not universal. It is limited to systemic roles but allows for deeper penetration in non-prime markets.²⁷

However, in the current scenario, NBFCs, especially in the digital lending scenario, are lending at rates that are competitive to banks. This enablement of digital lending is not just confined to niche areas.

This growing role of NBFCs is reflected in their credit growth, which surpassed that of banks in all segments except in the case of agriculture and allied activities during the same period.

Furthermore, compared to banks, NBFCs recorded a higher credit growth, and their share in lending to the MSME sector increased during 2024-25.²⁸

The development of RBI issuing regulations that focus on bringing in harmonisation of the financial and banking sector is signalling a sense of convergence of NBFCs with banks²⁹.

²³ Taxmann, "NBFCs in India – Types | Regulations | RBI Framework," Taxmann Blog, May 3, 2025, <https://www.taxmann.com/post/blog/nbfc-in-india>. (Last visited Nov 3, 2025).

²⁴ Anuroop Omarkar, "Demystifying Net Owned Fund (NOF) Requirement for NBFCs in India," Mondaq.com, May 28, 2024, <https://www.mondaq.com/india/financial-services/1469846/demystifying-net-owned-fund-nof-requirement-for-nbfc-in-india>. (Last visited Nov 5, 2025).

²⁵ Rajeswari Sengupta, Lei Son, and Harsh Vardhan, "A Study of the Non-Banking Finance Companies in India a Study of the Non-Banking Finance Companies in India," 2022, <http://www.igidr.ac.in/pdf/publication/WP-2022-009.pdf>. (Last visited Oct 1, 2025).

²⁶ Cash Reserve Ratio (CRR) requires banks to hold a certain percentage of their deposits as cash with the Reserve Bank of India (RBI), while Statutory Liquidity Ratio (SLR) requires banks to maintain a minimum percentage of their deposits in liquid assets like cash, gold, or government securities. CRR controls the overall liquidity in the economy by directly impacting the money supply, whereas SLR ensures bank solvency and helps control credit expansion by ensuring banks have liquid funds to meet obligations. Reserve Bank of India, Master Circular for Maintenance of Statutory Reserves- Cash Reserve Ratio (CRR) and Statutory Liquidity Ratio (SLR) by Primary (Urban) Co-operative Banks, (2025), <https://www.rbi.org.in/commonperson/English/scripts/Notification.aspx?id=1416> (last visited Oct 21, 2025).

²⁷ L&T Finance, "What Is the Difference between Bank and NBFC?" LTFS Revamp (L&T Finance, May 2, 2025), <https://www.ltfinance.com/blog/difference-between-nbfc-anOwnedd-bank>. (Last visited Oct 3, 2025).

²⁸ Reserve Bank of India, Report on the Trends and Progress of Banking in India, at 118-133 page, (2024-25), <https://rbidocs.rbi.org.in/rdocs/Publications/PDFs/0RTP291220258C89B9E5F3F240AEB82AC25A1707A8C6.PDF> (Last visited Oct 3, 2025)

²⁹ Ahmed, F., Casiraghi, M., & Ogawa, S. (2023). "CHAPTER 3 Banking Sector and Nonbanking Financial Companies". In India's Financial System. USA: International Monetary Fund, from <https://doi.org/10.5089/9798400223525.071.CH003>, (Last visited Oct 3, 2025).

2.4 NBFCs' Role in Financial Inclusion and Last-mile Credit Delivery

The growth in the NBFC retail segment is expected to be 14-16% from FY24 to FY27, which will support overall NBFC credit growth, with a continued focus on the retail segment and multiple players announcing plans to reduce their wholesale exposure.

Compared to banks, NBFCs' credit to the retail segment forms 48% of their portfolio as of FY2024, indicating a larger focus on retail customers. NBFCs have played a significant role in meeting this need, complementing banks and other financial institutions.³⁰ NBFCs fulfil the "last-mile" role that traditional banks deem too expensive or risky to undertake.³¹

India's formal banking architecture prioritises formally documented borrowers, and 85% of India's workforce is informally employed; NBFCs can address this market.³² It is crucial to note that the NBFCs have been able to address a market that the banking sector was not addressing.

³⁰ ANI, "India's Retail Credit Boom Offers Major Growth Opportunity for NBFCs: Crisil," BusinessLine, August 6, 2025, <https://www.thehindubusinessline.com/money-and-banking/nbfc-set-to-gain-as-retail-credit-demand-surges-in-india-crisil/article69899952.ece>. (Last visited Oct 4, 2025).

³¹ Bidisha Bhattacharya, NBFCs are integral to the 'Viksit Bharat' journey. Hobbling them is counterproductive, MoneyControl June 17, 2025, available at <https://www.moneycontrol.com/news/opinion/nbfc-are-integral-to-the-viksit-bharat-journey-hobbling-them-is-counterproductive-13131967.html>

³² Raman Aggarwal, CEO, Finance Industry Development Council, Empowering the Last Mile: How NBFCs are Reshaping India's Financial Architecture, Economic Times, July 27th 2025, <https://bfsi.economictimes.indiatimes.com/blog/revolutionizing-credit-access-the-impact-of-nbfc-on-indias-financial-future/122934364> (Last visited Oct 3, 2025).

3. The Regulatory Architecture Governing UPI Participation

The inclusion of NBFCs in the Credit Line on the UPI facility in a well-calibrated and regulated framework would potentially help achieve the following goals:

1. Deepen access to formal credit for the underserved customer base.
2. Leverage UPI infrastructure to enable transparent end-use monitoring.
3. Democratise short-term consumer credit beyond traditional credit card offerings, as currently its penetration is restricted (according to RBI data, the credit card market in India is quite consolidated). On a year-on-year basis, credit card transaction volume has witnessed an uptick by 19 per cent, while the value has also increased by 6 per cent in October 2025.³³
4. Reduce systemic risk through better visibility into borrower-level credit activity.

3.1 RBI's powers under the RBI Act and the PSS Act, and the Current UPI participant access rules

Reserve Bank of India (Digital Lending) Directions, 2025, are subject to all other rules and regulations issued to the various entities regulated. NBFCs do not form part of the payment and settlement system and cannot issue cheques drawn on themselves.

The Delhi High Court³⁴ after referring to Sections 2(1)(i), 2(1)(p) and 2(1)(q) of the PSS Act which defined 'payment system', 'system participant' and 'system provider' respectively and Section 7 of the PSS Act which gave power to the RBI to grant

authorisation for payment systems, opined that NPCI was the operator of the UPI system for transactions in India and was a "system provider" which was authorised by the RBI under the PSS Act to extend its services for facilitating transactions and on the other hand, the transactions carried out via UPI through Google Pay were only peer-to-peer or peer-to-merchant transactions. They were not a system provider under the PSS Act.

Access to Customer Information: The Unified Payment Interface Procedural Guidelines, 2019, states that data might be stored under two types, namely, 'customer data' and 'customer payments sensitive data'. While the former might be stored with the app provider in an encrypted format, the latter could only be stored with the payment services provider's bank systems.³⁵

Enablement of NBFCs within the PPS system will be possible only if the RBI permits NBFCs to have access to customer payment-sensitive data. This will require adequate measures to be in place, such as those expected of Banks, which may call upon NBFCs to invest in necessary infrastructure with guardrails. NBFCs would need to meet governance, security, and infrastructure standards comparable to those applicable to banks, including robust technology architecture and multi-rail safeguards. Absent such direct participation, and where NBFCs continue to operate purely as credit providers relying on indirect or non-UPI data sources, the question of granting them access to payment-sensitive data does not arise.

³³ Shrishti Sharma, Debit Cards Transaction Volume Slumps by 18%, Credit Cards Witness 19% Uptick in October '25, ETBFSI.COM (2025), <https://bfsi.economictimes.indiatimes.com/articles/debit-cards-transaction-volume-slumps-by-18-credit-cards-witness-19-uptick-in-october-25/125564123> (last visited Jan 6, 2026).

³⁴ Abhijit Mishra vs. Reserve Bank of India, 2023 SCC OnLine Del 5094

³⁵ Abhijit Mishra vs. Reserve Bank of India, 2023 SCC Online Del 5094

3.2 Limitations for NBFCs under Existing Frameworks

From a legal standpoint, NBFCs' access to UPI would sit at the intersection of RBI's statutory powers under the Reserve Bank of India Act, 1934, and its regulatory discretion under the Payment and Settlement Systems Act, 2007 (PSS Act). The RBI Act empowers the RBI under Sections 45JA, 45L, and 58, which allow the RBI to extend and regulate UPI access for NBFCs if it believes it is in the public interest and consistent with systemic stability.

Sections 45K and 45MB restrict NBFCs' ability to handle deposits or quasi-deposit activities. Since UPI involves movement of customer funds, these sections indirectly limit RBI's ability to extend 'direct' UPI access to NBFCs. In terms of jurisdiction and its boundaries, RBI must also rely on the Payment Settlement Systems Act, 2007, particularly Sections 4, 10, and 18, to designate participants in UPI. The RBI Act alone does not explicitly empower direct UPI access; it provides supervisory powers over NBFCs, but with built-in restrictions.

Building on the structural issues, the policy implications for NBFC participation in the Credit Line on UPI are present. At present, only banks are permitted to offer credit lines on UPI, while NBFCs—irrespective of whether they are deposit-taking or non-deposit-taking—are excluded from directly providing such products. This places NBFCs at a structural disadvantage compared to banks, which can leverage both their deposit base and their regulatory permission to integrate seamlessly with UPI for digital credit delivery. The constraint is therefore not merely about deposit acceptance, but about regulatory access to the UPI credit ecosystem itself.

If UPI-linked credit lines are to scale inclusively and competitively, the RBI may need to consider a

differentiated and calibrated regulatory approach for NBFCs. Such an approach could allow well-regulated NBFCs, which are considered financially sound and well-managed, subject to prudential safeguards, consumer protection norms, and interoperability requirements, to participate more directly in UPI-based credit offerings. This would help balance innovation and competition with systemic stability, while recognising the significant role NBFCs play in last-mile credit delivery and financial inclusion.

As we can observe from the Trends and Progress of Banking in India Report by the RBI, NBFCs continued to remain well-capitalised with a capital to risk-weighted assets ratio (CRAR) at 25.9 per cent at end-March 2025, well above the regulatory prescription of 15 per cent. NBFC-MFIs, as a precautionary measure, further raised their CRAR during 2024-25 (Chart VI.20). At the end of September 2025, the CRAR of the NBFC sector stood at 24.9 per cent.³⁶ They have been able to create an entire digital lending ecosystem and become the biggest digital lenders in India.

3.1 Constitutional principles: Equality, Proportionality, Reasonableness

While the judiciary has consistently endorsed RBI's regulatory primacy, it has also underscored that regulatory discretion must adhere to constitutional parameters.³⁷

3.1.1 Doctrine of Proportionality and the Limits of Regulatory Arbitrariness

Under Articles 14 and 19(1)(g) of the Constitution, regulatory measures affecting economic actors must meet the tests of reasonableness, proportionality, and non-arbitrariness³⁸. The Supreme Court in *E.P. Royappa vs. State of Tamil Nadu*³⁹ famously articulated that arbitrariness is antithetical to equality, marking a departure from formalistic interpretations of Article 14.

Trends and Progress of Banking in India Report, 2025, Ibid. note 19

³⁷ Kesavananda Bharati vs. State of Kerala, (1973) 4 SCC 225

³⁸ Essar Steel India Ltd Committee of Creditors vs. Satish Kumar Gupta, (2020) 8 SCC 531

³⁹ 1974 SCR (2) 348

This principle was expanded in *Maneka Gandhi vs. Union of India*⁴⁰, where the Court read Articles 14, 19, and 21 together to establish that state action must not be arbitrary, unfair, or disproportionate. The doctrine of proportionality, as articulated in the case of *Justice K.S. Puttaswamy (Retd.) vs. Union of India*⁴¹, mandates that every restriction must pursue a legitimate objective, be suitable to achieve it, adopt the least restrictive means, and maintain a balance between rights and objectives.

Together, these rulings form the constitutional scaffolding for evaluating RBI's discretion in limiting or extending NBFC participation in emerging financial infrastructures like UPI. Therefore, while restrictions and regulations can be made for the NBFCs to become a part of UPI-Credit Line, they cannot be excluded from the framework completely.

The RBI Act, read alongside the Payment and Settlement Systems Act, 2007, provides the Reserve Bank of India (RBI) with ample statutory space to design differentiated access frameworks.⁴² Sections 45-JA, 45-K, and 45-L of the RBI Act empower the RBI to issue directions on accounting standards, risk management, and lending practices; conduct inspections; and guide credit deployment in the public interest. Under the PSS Act, Sections 4, 10, and 18 authorise RBI to regulate and designate participants in payment systems, including non-banks, provided systemic stability is ensured.⁴³ Thus, it is concluded from a statutory standpoint that RBI has both the authority and flexibility to extend conditional access to NBFCs for UPI-linked credit lines.

3.3.2 The Principle of Reasonableness for the inclusion of NBFCs and RBI's Regulatory Discretion

From a constitutional standpoint, the principle of reasonable classification, as outlined in Article 14, becomes critical. The RBI's present regulatory framework distinguishes between banks and NBFCs in terms of access to payment infrastructures. While this distinction was historically justified on grounds of deposit mobilisation and liquidity risk, technological convergence and scale-based regulation have blurred those lines. NBFCs now maintain governance, capital adequacy, and disclosure standards comparable to banks⁴⁴. A categorical exclusion of NBFCs from UPI-based credit line operations, therefore, risks failing the twofold test of reasonable classification⁴⁵:

1. First, that there must be an intelligible differentia distinguishing the two groups; and
2. Second, that the differentia must have a rational nexus with the regulatory objective.

When the objective is financial stability instituted by the utilisation of Credit Line on UPI via NBFCs, a conditional or risk-based inclusion framework for NBFCs would serve that goal more effectively than adopting a blanket exclusion. The continued denial of participation without a basis in evidence-based justification may thus amount to an arbitrary classification, thereby offending Article 14.

Therefore, concluding that, from the standpoint of proportionality, as articulated in *Puttaswamy*, the restriction must be the least intrusive measure necessary to achieve systemic safety. If the RBI's concern is prudential, then safeguards such as

⁴⁰ AIR 1978 SC 597

⁴¹ AIR 2017 SC 4161

⁴² Shehnaz Ahmed, "Modernising the Law for Payment Services in India," Oxford Law Blogs, November 3, 2021, <https://blogs.law.ox.ac.uk/business-law-blog/blog/2021/11/modernising-law-payment-services-india>.

⁴³ Siddharth Goel, "Payment and Settlement Systems: A Primer - Vinod Kothari Consultants," Vinodkothari.com, April 17, 2021, <https://vinodkothari.com/2021/04/payment-and-settlement-systems-a-primer/>.

⁴⁴ Accounting and Auditing Update, "Scale-Based Framework - the Revised Regulatory Framework for NBFCs Highlight the Importance of NBFCs in the Economy and the New and Enhanced Regulations Introduced for Greater Regulation," June the 2022, <https://assets.kpmg.com/content/dam/kpmg/in/pdf/2022/06/chapter-1-aau-scale-based-framework-revised-regulatory-framework-nbfc.pdf>.

⁴⁵ State of West Bengal vs. Anwar Ali Sarkar, AIR 1952 SC 75

escrow mechanisms for UPI transactions, sponsor-bank oversight, transaction caps, or enhanced liquidity coverage ratios for participating NBFCs would mitigate those risks.⁴⁶ A blanket prohibition, by contrast, would constitute an excessive and disproportionate restriction on the NBFCs' right to carry on trade under Article 19(1)(g). The Supreme Court's reasoning in *Modern Dental College & Research Centre v. State of Madhya Pradesh*⁴⁷ is instructive.

The Court held that restrictions on business or trade must not be arbitrary or excessive in relation to their legitimate purpose. Applying this principle to NBFCs, it can be justifiably concluded that a carefully assessed participation model that balances innovation and oversight would be more constitutionally sound than a total exclusion.

3.3.3 The Public Interest Dimension of including NBFCs for Credit Line on UPI

The public interest dimension further reinforces the case for inclusion. RBI's regulatory discretion must operate not only in the interest of stability but also in furtherance of equitable economic development, as reflected in the Directive Principles under Articles 38 and 39. It was observed in *Kasturi Lal v. State of J&K*⁴⁸ that if a law is made to further socio-economic justice, it is prima facie reasonable and in the public interest.

Public interest, in contemporary financial governance, encompasses financial inclusion, consumer welfare, and innovation.⁴⁹ NBFCs have historically been the forerunners of inclusive credit delivery, reaching sectors and populations underserved by traditional banks.

By leveraging a digital innovation like UPI, NBFCs can extend small-ticket, real-time credit to micro-entrepreneurs, gig workers, and rural borrowers, the segments that are central to India's inclusive growth vision. As the Finance Industry Development Council (FIDC)⁵⁰ has argued, allowing NBFCs to offer credit lines on UPI would deepen rural and semi-urban financial penetration, enhance liquidity, and foster competition in the digital credit ecosystem. These goals align squarely with RBI's own Payments Vision 2025, which envisages a more inclusive and interoperable digital payments framework.⁵¹

It is also worth recalling the Court's guidance in *State of Maharashtra v. Indian Hotel and Restaurants Association*⁵², which held that restrictions on lawful economic activity must have a proximate nexus with public interest and cannot rest on speculative or paternalistic justifications. Similarly, in *K.T. Plantation Pvt. Ltd. v. State of Karnataka*⁵³, the Supreme Court recognised that public interest must be assessed in light of proportionality and fairness. Applying these principles, the exclusion of a regulated class of institutions, such as NBFCs, from a public payment infrastructure should be justified only by their having any demonstrable risk and not by general caution.

3.3.4 Anchoring NBFC's Position to the Constitution

The NBFCs' position can be constitutionally anchored in three interlinked propositions.

1. First, RBI's discretion under the RBI Act and PSS Act, while broad, is bounded by constitutional principles;

⁴⁶ RBI Master Circular - Prudential norms on Income Recognition, Asset Classification and Provisioning pertaining to Advances (April 1, 2025) <https://website.rbi.org.in/web/rbi/-/notifications/master-circular-prudential-norms-on-income-recognition-asset-classification-and-provisioning-pertaining-to-advances> (last visited on 26 November 2025)

⁴⁷ (2016) 7 SCC 353

⁴⁸ *Kasturi Lal vs. State of J&K*, AIR 1980 SCC 1992

⁴⁹ Mitchell Grant, "Financial Inclusion: Definition, Examples, and Why It's Important," Investopedia, March 12, 2024, <https://www.investopedia.com/terms/f/financial-inclusion.asp>.

⁵⁰ The Finance Industry Development Council (FIDC), recognised by the Reserve Bank of India (RBI) as the Self-Regulatory Organisation (SRO) for NBFCs, is the apex industry association for the NBFC sector.

⁵¹ Department of Payment and Settlement Systems Reserve Bank of India Central Office, "Payments Vision 2025," [Rbi.org.in](https://www.rbi.org.in)

⁵² MANU/SC/0702/2013

⁵³ AIR 2011 SC 343

it must be exercised in a manner that is reasonable, proportionate, and non-discriminatory.

2. Second, technological and regulatory parity achieved through the SBR Framework renders historical distinctions between banks and NBFCs less defensible, especially when similar prudential objectives can be achieved by embracing tailored safeguards⁵⁴; and
3. Third, public interest today mandates inclusive innovation, where regulatory frameworks evolve to accommodate the responsible participation of diverse financial actors in national payment infrastructures

In operational terms, RBI could design a carefully assessed access regime for UPI-linked credit lines by NBFCs by instituting conditional participation. This would tailor the level of supervision and compliance requirements for NBFCs according to their size, activity, and perceived riskiness to the financial system based on the SBR Framework. This may include requiring NBFCs to:

1. partner with sponsor banks or payment aggregators for settlement flows;
2. maintain segregated escrow accounts to prevent quasi-deposit behaviour;
3. comply with enhanced reporting, capital adequacy, and cyber-risk standards; and
4. undergo periodic supervisory audits.

Such a model would reflect the constitutional principle of proportionality- protecting systemic safety without unnecessarily stifling innovation or competition. Moreover, it would advance the Directive Principle of promoting equitable economic opportunity, fulfilling the RBI's dual role as prudential regulator and developmental facilitator.

Ultimately, the path forward lies in harmonising RBI's statutory mandate with constitutional guarantees of fairness and inclusion. The Supreme Court's jurisprudence, starting from E.P. Royappa

and Maneka Gandhi to Puttaswamy, makes clear that even the broadest regulatory discretion must be exercised with reason, evidence, and proportionality. NBFC participation in Credit Line on UPIs is not a demand for deregulation but for regulation, which is a rational one and that aligns with the evolving financial architecture and constitutional ethos of equality and public welfare. Extending conditional UPI access to eligible NBFCs would therefore not dilute RBI's control; rather, it would exemplify adaptive governance grounded in constitutional fidelity and policy foresight.

In conclusion, the integration of NBFCs into the UPI credit ecosystem represents a step that is constitutionally defensible, statutorily authorised, and economically necessary towards a digitally inclusive financial future. As said by FIDC, the inclusion of NBFCs in Credit Line on UPI would democratise access to short-term credit by creating alternatives, fostering healthy competition, and accelerating the formalisation of credit at the grassroots level.

It upholds the RBI's prudential oversight while affirming India's constitutional commitment to equality, reasonableness, and public interest in economic regulation. A proportional, evidence-based inclusion framework would not only withstand scrutiny by the judiciary but also further advance India's global leadership in digital financial innovation and inclusion.

3.4 Scope for Differentiated Risk-based Access

There is no doubt that there is a clear demarcation between Banks and NBFCs; however, the regulator appears to tackle the industry through symmetrical and in some cases identical mandates. The reason for this approach by RBI is to ensure that the market is harmonised, but the risks of the NBFC are addressed based on the nature of the activity. The RBI has warned that the approach of NBFCs of "growth-at-any-cost" by some in the sector is risky for financial stability.⁵⁵

⁵⁴ Vidushi Gupta and Prashanth Ramdas, "New NBFC Regulatory Regime: Scale Based Regulation Directions 2023," Khaitan & Co, October 25, 2023, https://www.khaitanco.com/thought-leaderships/New_NBFC_Regulatory_Regime_Scale_Based_Regulation_Directions_2023.

⁵⁵ RBI Raises UPI Transaction Limit, Warns NBFCs Over Aggressive Growth Practices, Outlook Business Desk, 9 October 2024, available at <https://www.outlookbusiness.com/economy-and-policy/rbi-raises-upi-transaction-limit-warns-nbfc-over-aggressive-growth-practices> (last visited Nov 9, 2025)

RBI has communicated that the optimal level of regulation and supervision will be exercised on the NBFC sector so as to ensure it is financially resilient and robust, in addition to ensuring that financial stability in the short, medium and long-term is maintained.⁵⁶

We propose the creation of a separate category to segregate NBFCs that are suitable for engaging in credit products such as CLOU, to be classified as Financially Sound and Well-Managed NBFCs. These FSWM-NBFCs would be identified at the outset and permitted to engage in this category of credit products, in line with the RBI's structured approach to the introduction of CLOU. Such financially sound and well-managed NBFCs could potentially be less prone to risk in being permitted to operate in the pre-approved UPI lending market. Subject to the guard rails of disclosures to RBI for credit appraisal and lending practices across urban and rural markets, for first-time and regular borrowers.

This assessment gains credibility when viewed through the lens of the Reserve Bank of India's approach to Urban Cooperative Banks⁵⁷, where differentiated regulatory treatment is extended only to entities that demonstrate sustained financial strength, prudent governance standards, and robust risk-management frameworks. By applying this analogy, a similar threshold-based model for NBFC participation in UPI-linked credit products, such as a credit line on UPI, could help ensure that only entities with demonstrable balance-sheet resilience and supervisory compliance are allowed deeper integration into digital lending ecosystems.

Within this framework, participation should remain subject to clearly defined guardrails, particularly

mandatory disclosures to the RBI on credit appraisal methodologies and lending practices across both urban and rural markets, covering first-time as well as repeat borrowers.

Such disclosures would not only enable supervisory oversight but also align digital lending practices with principles of responsible credit expansion.

Payment infrastructure for lending fundamentally relies on three critical pillars: payouts, collections, and reconciliations.⁵⁸ The issue of collections of small and short-term loans has previously led to institutional failures in certain foreign markets, and there needs to be sufficient disclosures by the NBFCs in their reports to enable the regulator to address the risk early on. Recently, the Economic Times reported that in India, the digital loan disbursements grew 26% sequentially over the previous half-year. The growth in disbursement value also saw a gradual rise in ticket sizes, and the average digital loan amount rose about 14% from a year earlier, to Rs 15,177.⁵⁹

Payments are not just a backend utility anymore; they are becoming an important essential for consumer experience, compliance and capital efficiency. NBFCs are not just in the process of solving the speed or costs for the payment infrastructure; they are in the process of building a trust layer that has the potential to define the next decade of inclusive, digital-first credit delivery in India.⁶⁰

A model such as the financially sound and well-managed NBFC, which prioritises such measures, would be an addition to the credit system and would contribute to the overall consumer experience and future adoption of the product.

⁵⁶ Emerging Challenges to Financial Stability - Shri Shaktikanta Das, Governor, Reserve Bank of India - Monday, August 19, 2019 - at FIBAC 2019 – the Annual Global Banking Conference organised by IBA and FICCI, Mumbai, available at <https://rbi.org.in/commonman/english/Scripts/speeches.aspx?Id=3151> (last visited Nov 9, 2025)

⁵⁷ Review of Norms for Classification of Urban Co-operative Banks (UCBs) as Financially Sound and Well Managed (FSWM), RBI.ORG.IN (2022), <<https://www.rbi.org.in/Scripts/NotificationUser.aspx?Id=12415&Mode=0>> (last visited Jan 9, 2026)

⁵⁸ Deepak Chand Thakur, Why NBFCs must rethink payment infrastructure now, not later, ET-Edge Insights, 12th November 2025, <https://etedge-insights.com/industry/bfsi/why-nbfc-must-rethink-payment-infrastructure-now-not-later/> (last visited Dec 28, 2025).

⁵⁹ ET, Digital Lenders Disbursed Rs 97,381 Crore in H1 on Surge in Small Personal loans: Face Report, THE ECONOMIC TIMES (2025), <https://economictimes.indiatimes.com/tech/technology/digital-lenders-disbursed-rs-97381-crore-in-h1-on-surge-in-small-personal-loans-face-report/articleshow/125742014.cms?from=mdr> (last visited Jan 8, 2026).

⁶⁰ Chand, supra note 63.

4. Risks & Prudential Considerations for NBFC Access to Credit Line on UPI

The activities of NBFCs are extensive and diverse, and unlike banks, their functions are not strictly compartmentalised. Historically, NBFCs did not have access to statutory public backstops and had either limited or no access to the balance sheet of central banks.⁶¹ However, because of their interdependence with the rest of the financial system, they may pose significant systemic risks through financial intermediation, which could circumvent the prudential standards that apply to banks and reduce the efficacy of policies.⁶² There are broadly four market failures that have been identified in the NBFC space:⁶³

1. Systemic risks
2. Micro-prudential risks
3. Resolution problems, and
4. Consumer protection.

Currently, most NBFCs do not take deposits from the public (only 21 NBFCs are authorised to accept deposits from the public, of which 6 are state-owned power financing corporations).⁶⁴ This means most NBFCs do not have to assure returns, and they do not need major micro-prudential regulations. They, however, need sound regulations on the other three problems.

In this part of the report, we share our largest concern, i.e., systemic risks.

These risks are born out of information asymmetry between the creditor and the debtor. There is always the risk of moral hazard where the creditor assumes too much risk based on their incorrect estimation of the debtor's ability/ willingness to pay. Macro-prudential/ systemic regulations are needed to ensure that the NBFC does not face questions about its stability and solvency in the pursuit of offering this product.

When it comes to solvency problems, i.e., systemic risks, the product "Credit line on UPI" may suffer from some prudential risks if they are not managed properly.

4.1 Systemic and Micro-Prudential Risks

NBFCs are an old concept in India's credit ecosystem. They were given formal status in 1964, and their remit was to "accept deposits and carry on business allied to banking".⁶⁵ They were intended to serve as separate credit institutions that had:

1. A deep understanding of the real-sector risks that these borrowers are exposed to,
2. An ability to design and offer financial products which, for example, can automatically reduce financial leverage when conditions turn adverse, and

⁶¹ Aramonte, S, A Schrimpf and H S Shin (2021): "Non-bank financial intermediaries and financial stability", BIS Working Papers, no 972, October, <https://www.bis.org/publ/work972.pdf> (last visited Oct 19, 2025)

⁶² Abhyuday Harsh, Nandani Jayakumar, Rajnish Kumar Chandra and Brijesh P., An Analysis of the Recent Performance of the NBFC Sector, RBI Bulletin, September 2023. https://www.researchgate.net/profile/Rajnish-Chandra-2/publication/374068431_An_Analysis_of_the_Recent_Performance_of_NBFC_Sector/links/650c381582f01628f034e232/An-Analysis-of-the-Recent-Performance-of-NBFC-Sector.pdf (last visited Oct 20, 2025)

⁶³ Ajay Shah, NBFCs do not need much regulation, Business Standard, 17 December 2018, https://www.mayin.org/ajayshah/MEDIA/2018/nbfc_not_much_regulation.html (last visited Nov 21, 2025)

⁶⁴ Reserve Bank of India, RBI.ORG.IN (2025), <https://www.rbi.org.in/commonman/English/scripts/NBFCs.aspx#NI> (last visited Nov 21, 2025).

⁶⁵ Section 45I in the RBI Act, 1938, introduced by the Banking Laws (Miscellaneous Provisions) Act, 1964.

3. An ability to offer these products such that the underlying cost structures are sustainable.⁶⁶

NBFCs quickly dominated three important credit sectors: (i) hire/purchase of vehicles, (ii) investment into industrial plants, and (iii) retail and small business lending. The governance structure largely remained unchanged until the 1990s—when the Usha Thorat Committee recommended that only “systemically important” NBFCs with stringent solvency and adequacy requirements be allowed to take deposits. Other NBFCs would not be allowed to take deposits, and they may engage in more open market-side operations.⁶⁷

It was also made clear that NBFCs were to complement banks and not compete against them.⁶⁸ NBFCs are not “money creators” or “credit creators” in the monetary supply system—only banks can serve that function. NBFCs are only supposed to be more efficient allocators of credit. Banks continue to play the “money creator” role, and NBFCs are expected not to duplicate this function.

4.1.1 UPIs’ in-built information mechanisms are unavailable to NBFCs

When one refers to the NPCI circular dated 20 September 2023⁶⁹, the following statement stands out: “User shall be able to apply for an EMI facility on the linked credit accounts on the UPI app. UPI App shall take UPI PIN as user consent on acceptance of relevant terms & conditions. This shall enable the user to convert their:

1. Past purchases performed using a credit account with EMI through the linked UPI App, from the transaction history.
2. Purchases into EMI at the time of making the transaction.

The UPI app shall display the existing EMIs in the relevant section. Since the EMI shall be termed as a loan, the user shall not be allowed to modify/delete the EMI, except for the foreclosure, as per the terms of the Issuer entity.”

This makes it clear that the credit provider’s information asymmetry mitigation mechanism lies in access to the past transactions of the user. While NBFCs may obtain information on the expenditure patterns and creditworthiness, etc., of users, this will be secondary information obtained from other financial institutions. Additionally, access to credit history and bank statements of borrowers will be available through the Credit Information Company and the Account Aggregator ecosystem. Suitable modifications may need to be made to the predictive models.

There is no doubt that this market has large potential, especially after the issuance of the NPCI circular dated 10 July 2025, which expanded the scope of “credit line on UPI” to credit on fixed deposits, stocks, property, loans, and gold, in addition to unsecured credit for personal or business use. Non-payment of these credit lines on time will result in an adverse credit score based on the Credit Information (Regulation) Act, 2005.

4.1.2 Debt Enforcement/ Recovery Mechanisms May Be Prohibitively Inefficient

As is made clear from the extract of the circular produced above, the UPI line of credit is in the nature of a debt. The Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest (Amendment) Act, 2024 requires that the security interest to be recovered through the DRT process must exceed Rs. 10 lakhs. Since the UPI credit line shall not exceed Rs. 2 lakhs, the SARFAESI Act is not applicable and relevant to the UPI credit line product.

⁶⁶ Deepti George, Dwijaraj Bhattacharya, Madhu Srinivas, Sowmini Prasad, Regulatory and Supervisory Approaches for NBFCs, Dvara Research, March 2021. <https://dvararesearch.com/wp-content/uploads/2023/12/Regulatory-and-Supervisory-Approaches-for-NBFCs.pdf> (last visited Oct 20, 2025)

⁶⁷ See the text of the report <https://rbidocs.rbi.org.in/rdocs/PublicationReport/Pdfs/FRWS250811.pdf> and Usha Thorat’s speech at the BIS <https://www.bis.org/review/r070626f.pdf>. (last visited Oct 20, 2025)

⁶⁸ Dvara Research (Supra no. 66)

⁶⁹ NPCI, UPI OC 171- Operating Circular for Pre-Sanctioned Credit Lines at Banks through UPI, September 20, 2023, https://www.npci.org.in/uploads/UPI_OC_171_Operating_Circular_for_Pre_Sanctioned_Credit_Lines_at_Banks_through_UPI_74aff87e51.pdf (last visited Oct 20, 2025)

Therefore, the recovery of outstanding amounts must be done through the National Automated Clearing House (NACH) system, which is to be treated in the same manner as dishonour of a cheque.⁷⁰ NACH mandates are not compulsory under the law, but the financial services provider may require NACH mandates for specific products. The best manner of recovering payments due to the NBFC is to require all UPI credit product users to register under NACH for the recovery of dues. The threat of imprisonment may help in reducing the ratio of incidences of defaults.

4.2 Information Asymmetry, Solvency Implications, and Information Access Issues

The information asymmetry amongst the stakeholders while taking decisions has, of late, been understood as a cause of disarray within the credit ecosystem, resulting in unnecessary delays in the grant of credit facilities, realisation of debts and increased disputes and conflicts amongst the stakeholders.⁷¹ Therefore, the availability of reliable information with real-time efficiency is of paramount importance, which can be achieved by establishing repositories of financial data with authenticated and verified data, allowing all stakeholders equal access to financial information.

Digital lenders may assess the creditworthiness of borrowers using Artificial Intelligence (AI) algorithms that rely on “alternative sources of evaluating creditworthiness” such as text messages, location, online and social media activity, expenditure and consumption patterns of users, etc. This information (non-financial personal information) serves as a proxy for financial information (credit score, financial history, etc.), which is more commonly used to assess creditworthiness.

While this expands the informational base available for underwriting, it also underscores ongoing challenges around data reliability, transparency, and borrower understanding, all of which shape the quality of solvency assessments. It is possible that this alternative form of data can provide both explanatory and predictive benefits in credit risk management, which has helped overcome the issues that have known to arise from information asymmetry.⁷²

In India, the introduction of both the Account Aggregators Directions in 2016⁷³ and, recently, with the introduction of the Digital Lending Guidelines, 2025, is working together to reduce the long-standing structural gaps of financial information in India’s credit ecosystem. By enabling secure, consent-based sharing of financial data, the Account Aggregator system directly narrows information asymmetry between borrowers and lenders, allowing lenders to assess repayment capacity more accurately and borrowers to access products better suited to their profiles.⁷⁴

This improved visibility into cash flows and liabilities also strengthens solvency assessments, reducing the risk of over-leveraging and enabling more responsible underwriting. At the same time, the Digital Lending Guidelines impose transparency, disclosure, and grievance-redress requirements that curb opaque practices and ensure borrowers understand the terms they are agreeing to, improving access to trustworthy information. Together, these frameworks foster a more efficient, equitable, and stable credit market by expanding access to reliable data while protecting borrowers from misuse.

⁷⁰ Section 25, Payment and Settlement Systems Act, 2008 read with section 138, Negotiable Instruments Act, 1881.

⁷¹ Ankeeta Gupta, Addressing Challenges of Information Asymmetry in Financial Sector Unusing Information Utility, University of Western Australia Law Review, Volume 50, Issue 1, 2023 (last visited Oct 20, 2025)

⁷² Roeder, Jan, "Alternative Data for Credit Risk Management: An Analysis of the Current State of Research" (2021). BLED 2021 Proceedings. 6. <https://aisel.aisnet.org/bled2021/6> (last visited Oct 23, 2025)

⁷³ RBI, Master Direction - Non-Banking Financial Company - Account Aggregator (Reserve Bank) Directions, 2016, <<https://website.rbi.org.in/web/rbi/-/notifications/master-direction-non-banking-financial-company-account-aggregator-reserve-bank-directions-2016-updated-as-on-december-29-2022-10598>> (last visited Oct 20, 2025) ⁷⁴ Press Information Bureau, Government of India, September 2, 2025, <https://www.pib.gov.in/PressReleasePage.aspx?PRID=2162953®=3&lang=2>

⁷⁴ Press Information Bureau, Government of India, September 2, 2025, <https://www.pib.gov.in/PressReleasePage.aspx?PRID=2162953®=3&lang=2>

4.3 Past NBFC Crises: the Relevance and their Non-Relevance

NBFCs have formally been a part of the Indian Credit System since 1964, as elucidated in Chapter 2 (2.4.1). While the prudential risks that run with NBFCs are micro-prudential and systemic. These risks have consistently affected only the NBFCs that do not accept deposits from the public.⁷⁵ The previous crises⁷⁶, which had emerged in the NBFC sector, were a result of operational failures and are not relevant to the product, Credit Line on UPI. However, when it comes to the role of NBFCs in the credit ecosystem, we distil the findings of some of the committees that have shaped the legal architecture governing the ecosystem.

The Malegam Committee Report (2011) had recommended a separate NBFC-MFI category with caps on interest rates and stricter borrower-protection and transparency norms for small-ticket loans to vulnerable borrowers.⁷⁷ It shaped subsequent RBI policy on NBFC-MFIs and highlighted the need for clear pricing, transparent disclosure and robust credit-assessment standards for small-value lending. For any Credit Line on UPI product that targets micro/small borrowers, these principles for more borrower-centric policies and structured sector oversight (separate categorisation, limits on pricing practices, and borrower suitability checks) remain highly relevant.

FSLRC (2013/14) sub-committees on Banking and Payments: the reports argued for clearer, function-based regulatory architecture, modernised payment systems law and stronger consumer-protection features across payment and credit products. Applied to NBFCs, this means regulators expect institutional controls, clear allocation of

regulatory responsibilities (payment rails vs. credit provider), and interoperability/consumer remedies embedded in product design.⁷⁸ FSLRC's emphasis on legal clarity for payments supports why integrating with NPCI's UPI framework requires tight legal/contractual arrangements.

Ratan Watal Committee (2016) report made specific recommendations to boost digital payments adoption- metrics, incentives, reduced cost for merchants, and leveraging public infrastructure (Aadhaar/eKYC) - which led to many policy pushes that expanded UPI adoption. For NBFCs, the Watal recommendations underscore that product economics for a Credit Line on UPI must factor in merchant acceptance incentives, low transaction friction, and alignment with broader national digital-payments objectives.

Therefore, while these reports and documents shed light on important macro-economic risks, it does not appear to us that their lessons may be useful in the context of the UPI credit line product

4.4 Basel-Aligned Requirements and parallels with credit card issuances

In India, the RBI adopts a "scale-based"⁷⁹ approach based on the size, number of transactions, and exposure of the NBFC. Therefore, according to the regulation framework, an NBFC that proposes to enter into a tie-up for a co-branded credit card product must demonstrate overall financial soundness, a satisfactory track record of operations, and full regulatory compliance. The prudent asset quality and absence of supervisory concerns are essential.

⁷⁵ Dvara Research (Supra no. 2),

⁷⁶ IL&FS crisis of 2018 had triggered a liquidity crisis. The crisis did not originate from retail credit (loans to individual consumers) but from the high-risk, long-term financing of infrastructure projects. The DHFL crisis of 2019 was revealed by a forensic audit revealed that the company's promoters had systematically siphoned off funds through shell companies and fraudulent loans. The Microfinance crisis of 2010 in Andhra Pradesh was triggered by extensive lending practices by microfinance institutions that led to massive over-indebtedness, borrower suicides and widespread defaults.

⁷⁷ <https://rbidocs.rbi.org.in/rdocs/publicationreport/pdfs/yhmr190111.pdf>

⁷⁸ Report of the Working Group on Banking Financial Sector Legislative Reforms Commission, (2013), https://macrofinance.nipfp.org.in/fslrc/documents/wg_banking_report.pdf (last visited Oct 23, 2025).

See also https://macrofinance.nipfp.org.in/fslrc/documents/wg_payments_report.pdf

⁷⁹ RBI Master Direction –Non-Banking Financial Company – Scale based Regulation Directions, 2023,

<https://website.rbi.org.in/documents/d/rbi/non-banking-financial-companies--registration-exemptions-andframework-for-sbr> (last visited Oct 23, 2025)

The NBFC must comply with the capital adequacy norms applicable to it under the framework, which generally require a minimum CRAR of 15%, subject to limited category-specific variations. Where applicable, based on size and regulatory layer, the NBFC must also maintain a Liquidity Coverage Ratio of 100%.

These ratios are in furtherance of the implementation of Basel-III norms in India. It is, however, likely that NBFCs offering the Credit Line on UPI may have to meet, at the very basic level, these requirements in order to function in the capacity of Credit Line on UPIs.

However, understanding the Credit Card framework is necessary to determine some of the probable market risks and failures that can emerge from it. One of the ways in which this can be overcome is by introducing a regime that is complementary to the current Credit Card framework that we have. This has been discussed as follows.

4.5 Risk Mitigation Pathways and Guardrail Design

The UPI was originally intended to be a payment interface. It was later realised that the platform had the potential to offer macro-credit products at a large scale and low cost.

In August 2022, the NPCI allowed RuPay credit card providers to link their cards with the UPI system. UPI, as a platform, has now become a viable space for innovation with new credit products.

Therefore, based on the NPCI circular dated 20 September 2023, the NPCI has allowed scheduled commercial banks to set up pre-sanctioned credit lines extended by banks or NBFCs, accessible via UPI apps.⁸⁰ The objective was to create a “seamless, Credit Line on UPI life cycle” for consumers.

The product was initially made available to scheduled commercial banks and was later expanded to include small finance banks in December 2024.⁸¹

According to the statements made by the RBI Governor, this will further deepen financial inclusion and enhance formal credit, particularly for ‘new to credit’ customers.⁸²

As discussed in Chapter 3, including financially sound and well-managed NBFCs in the Credit Line on UPI would be a beneficial step towards mitigating risk when introducing a Credit Line on UPI for NBFCs. However, the question remains as to what criteria would be used to select such an NBFC and what conditions would ensure its continued soundness.

We suggest a principles-based approach. We suggest that the regulator frame rules based on the following principles:

1. The product must have a robust consumer grievance redress framework to reduce frictions and improve incentives for repayment.
2. The potential risks carried by the product line must be well-provisioned for. The NBFC should not face solvency risks due to defaults. A staggered, phase-wise rollout of the product with constant monitoring and feedback, perhaps as a six-month trial period in limited geographies, may provide valuable insights into the larger consumer default and exogenous risks.
3. The staggered rollout would also help address systemic risks — given that the typical user of the product would be someone who seeks short-term credit, but they may not have access to more advanced products like credit cards, there is a likelihood of large-scale consumer credit defaults.

⁸⁰ RBI Statement on Developmental and Regulatory Policies, 6 April 2023, https://www.rbi.org.in/Scripts/BS_PressReleaseDisplay.aspx?prid=55473 (last visited Dec 16, 2025).

⁸¹ RBI Statement on Developmental and Regulatory Policies, 6 December 2024, https://www.rbi.org.in/Scripts/BS_PressReleaseDisplay.aspx?prid=59245 (last visited Dec 16, 2025).

⁸² Governor’s Statement: December 6, 2024 - RBI, (2024), <https://website.rbi.org.in/web/rbi/-/press-releases/governor-s-statement-december-6-2024> (last visited Jan 6, 2026).

5. Market Competition & Economic Efficiency

The question of whether NBFCs should be permitted to extend UPI-linked credit is not a narrow regulatory or firm-specific matter but one that implicates India's broader competition policy architecture. Digital payment rails such as UPI function today as foundational market infrastructure, and rules governing access to such infrastructure operate *in rem*, shaping competitive conditions for all participants rather than adjudicating private disputes between particular entities.

Competition policy, especially in jurisdictions with rapidly evolving digital markets like India, requires regulators to ensure that essential digital platforms remain neutral, interoperable, and non-discriminatory so that innovation, entry, and consumer choice are not inadvertently foreclosed. India's own policy trajectory, which is evident in the proposal for a Digital Competition Bill, 2024⁸³, which, although lapsed, was heavily influenced by a similarly placed Digital Markets Act, 2022 of the European Union⁸⁴, which is operative.

The said bill recognised the systemic role of digital 'gatekeepers' and underscored that competition policy must extend beyond ex-post enforcement to encompass structural questions about platform access, parity of treatment, and prevention of concentrated control over critical digital pipes. In this light, the blanket or unexplained exclusion of NBFCs from offering Credit Line on UPI services raises concerns not because of any alleged misconduct by banks or fintech firms, but because the design of access rules themselves may distort market structure, entrench incumbency, and impede allocative, productive, and dynamic efficiencies. The analysis that follows, therefore, approaches

the issue from a competition policy standpoint, assessing whether the present framework promotes competitive neutrality and consumer welfare in India's digital credit ecosystem.

The restriction on NBFCs from offering UPI-linked lending facilities raises significant concerns from the standpoint of the Competition Act, 2002 (hereinafter 'the Act') and market access. By confining UPI-based credit products such as pre-approved credit lines and credit cards to banks alone, the regulatory framework effectively limits participation in a fast-expanding segment of the digital credit ecosystem. Such exclusion not only constrains competition in the lending market but also undermines the broader policy objectives of 'financial inclusion' and 'democratisation of credit access' that underpin both financial regulation as well as competition law in India.

The absence of a level playing field between banks and NBFCs reduces consumer choice, entrenches incumbency advantages, and risks perpetuating market concentration in digital lending. In this context, the ensuing discussion examines the implications of the existing regulatory architecture through the lens of competition law, assessing whether such differential treatment may inadvertently distort competition and inhibit the development of a more inclusive and efficient credit market.

5.1 NBFCs as Significant Competitors in Unsecured Lending:

Although RBI acknowledges that NBFCs are similar to banks, it also identifies significant differences in the nature of their activities.

⁸³ Ministry of Corporate Affairs, Report of the Committee on Digital Competition Law, 2024, available at <https://www.mca.gov.in/bin/dms/getdocument?mids=gzGtvSKE3zIVhAuBe2pbow%253D%253D&type=open>.

⁸⁴ EU Digital Markets Act, 2022; Regulation (EU) 2022/1925 of the European Parliament and of the Council of 14 September 2022 on contestable and fair markets in the digital sector and amending Directives (EU) 2019/1937 and (EU) 2020/1828.

For instance, unlike banks, NBFCs cannot accept demand deposits or form a part of the payment and settlement systems, etc.⁸⁵ Unsecured lending, being a distinct credit lending sector, distinguishes itself from secured lending in the availability of security/collateral in favour of the financial institution.⁸⁶ However, both NBFCs and banks are active players in the market for unsecured lending. As per the recent report of CRISIL⁸⁷, in the sector of unsecured business loans, NBFCs as lending institutions have demonstrated massive growth during FY 25, growing at a rate of CAGR of 18.7% followed by private sector banks. Further, among such lenders, NBFCs had the best asset quality⁸⁸ and also increased interest yields.⁸⁹

Keeping in consideration the prudential norms applicable to NBFCs and banks as discussed in Chapter 2 of this report, it can be premised that, irrespective of the distinct regulatory norms, NBFCs exert ‘significant competitive constraint’ in the market for unsecured lending. This ability can be assessed on three fronts:

1. *Product type*: the product/ service being an unsecured loan is very diverse in nature and can range from personal loans, buy now pay later (BNPL) schemes, business loans, education loans, to even credit card facilities. Since NBFCs are authorised to provide unsecured lending,⁹⁰ on the product front, it is clear that NBFCs exert competitive constraint on other players.
2. *Producer/supplier side*: The Prudential Norms on Income Recognition, Asset Classification and Provisioning, 2025 align NBFC norms closer to those of banks, further integrating

2. them into the formal credit ecosystem.⁹¹ NBFCs demonstrate operational agility as they are less constrained by branch-based operations and can adopt digital underwriting, instant credit disbursal, and an AI-based scoring model, which enable rapid scale-up in unsecured portfolios. Further, partnerships with banks under the Co-Lending Model and Open Credit Enablement Network allow NBFCs to distribute unsecured loans at scale, leveraging banks’ balance sheets while retaining customer interface advantage.⁹²
3. *Consumer/end-user side*: The end-user segment of unsecured lending may be divided into broad categories such as individuals, small and medium enterprises and large enterprises.⁹³ While large business users or high net worth individuals may particularly rely on secured loans, it is the segment of small and medium enterprises and private individuals having low net worth that has created a demand for the democratisation of credit. From the demand side, NBFCs’ lending models create competitive pressure on banks by serving customer segments that would otherwise remain constrained of formal credit. The penetration of NBFCs into unrecognised.

5.2 UPI as essential digital public infrastructure:

Since the introduction of UPI in India in 2016, it has become the backbone of our digital economy. As per government data, by FY 2022-23, UPI had processed about 8375 Crore transactions amounting to Rs. 139 crores.⁹⁵ This has only grown, as is evident by the August 2025 number, wherein

⁸⁵ Reserve Bank of India, Frequently Asked Questions, All you wanted to know about NBFCs, April 2025, available at:

< <https://www.rbi.org.in/commonman/english/scripts/FAQs.aspx?Id=1167>>

⁸⁶ Tara Chadda, ‘An Analysis and Survey of India’s Unsecured Loan Market: Types, Sources and Risks’, 10(4) International Journal of Advance Research, Ideas and Innovations in Technology (2024).

⁸⁷ CRISIL, ‘Report on Loans and Financial Services Industry in India’, Market Intelligence & Analytics (2025), available at: <https://www.veritasfin.in/CRISIL-report.pdf>

⁸⁸ Ibid, pp. 64

⁸⁹ Ibid, pp. 66.

⁹⁰ Reserve Bank of India (Non-Banking Financial Company Scale Based Regulation) Directions, 2023.

⁹¹ Prudential norms on Income Recognition, Asset Classification and Provisioning pertaining to Advances Clarifications dated November 12, 2021.

⁹² Reserve Bank of India, Co-Origination of Loans by Banks and NBFCs for Lending to Priority Sector, September 2018. < <https://www.rbi.org.in/commonman/english/scripts/Notification.aspx?Id=2721>>

⁹³ Data Intelco, Unsecured Lending Market, available at: <https://dataintelco.com/report/unsecured-lending-market>

⁹⁴ Reserve Bank of India, Financial Stability Report, December 2024, available at: <https://www.rbi.org.in/Scripts/PublicationReportDetails.aspx?UrlPage=&ID=1279>

UPI surpassed 20.01 billion transactions in a single month, amounting to Rs. 24.85 Lakh Crore.⁹⁶ This meteoric rise is attributable to the sheer penetration of the UPI system in the retail market across geographical landscapes, connecting even the remotest areas to the central digital economy. to increase adoption. Transactions are possible through mobile number-based or identity-based proxies and interoperable quick response (QR) codes.⁹⁷

India's digital payment ecosystem and experience of UPI hold important insights for the industrial organisation of payment markets across jurisdictions. Over time, the payments market has developed with support from a range of public infrastructures and regulatory initiatives. While some large players are dominant providers of payment services, UPI has enabled a vibrant market with strong investments.⁹⁸ The system has been strengthened by an active partnership with the private sector. UPI has some key attributes: an open architecture infrastructure, multi-party transactability, ease of doing transactions, strict data regulations, and a carefully calibrated regulatory environment. The following factors explain the rapid adoption of UPI as a leading digital public infrastructure.⁹⁹

1. *Ease of development:* First, UPI offers an open architecture that enables third-party developers to construct their own applications integrated with UPI. This facilitates tech companies and banks to freely use UPI or develop their own apps using the UPI,¹⁰⁰
2. *Ease of use:* *Second*, UPI facilitates transactions across multiple applications. This allows users across various platforms to execute secure and swift transactions to any

2. UPI-registered account, whether it is linked to applications of third-party payment service providers or banks. Users are not confined to a specific bank's app but can use any UPI-enabled app for transactions, streamlining the process and eliminating the need for multiple accounts or apps.¹⁰¹
3. *Data protection:* Third, UPI is governed by strict data regulations, instilling a sense of trust in the system. Technology companies, both big tech and fintechs, cannot collect individual data on transactions made through these platforms;¹⁰²
4. *Partnering with the private sector:* Fourth, UPI has witnessed robust private investments even as zero transaction costs are levied on end-users. These trends have been an important part of overall digital infrastructure initiatives, alongside digital identity (Aadhaar), which has facilitated the rapid opening of bank accounts that can connect with the payment system.¹⁰³
5. *Adept regulation:* The fifth crucial element is regulation. The authorities in India aim to promote innovation, enhance consumer and producer welfare and promote financial stability. To achieve these goals, regulators like the RBI and NPCI have introduced various policies and guidelines to facilitate innovation, ensure security and reduce the risks associated with digital payments. As a result, innovations and products, such as tokenisation, offline payments and cross-border financial integration, are being introduced in a phased manner while being mindful of financial stability.¹⁰⁴

⁹⁵ UPI crosses 20 billion transactions in August, records 24.85 lakh crore value, The Economic Times, available at: <https://economictimes.indiatimes.com/industry/banking/finance/banking/upi-crosses-20-billion-transactions-in-august-records-24-85-lakh-crore-value/articleshow/123633627.cms?from=mdr> (last visited Oct. 9, 2025).

⁹⁶ Press Information Bureau, Government of India, <https://www.pib.gov.in/FeaturesDeatils.aspx?id=155224&NotelD=155224&ModuleId=2> (last visited Oct. 9, 2025).

⁹⁷ Ibid.

⁹⁸ Bank for International Settlements, BIS Paper No. 152, https://www.bis.org/publ/bppdf/bispap152_e_rh.pdf (last visited Oct. 9, 2025).

⁹⁹ Ibid.

¹⁰⁰ Ibid.

¹⁰¹ Ibid.

¹⁰² Ibid.

¹⁰³ Ibid.

¹⁰⁴ Ibid.

UPI's reach is nationwide and growing abroad. As of mid-2024, there were roughly 350 million active UPI users and 340 million UPI merchant QR codes deployed across India.¹⁰⁵ More than 600 banks (around 30% of all banks) are live on UPI, enabling any linked account to transact. Furthermore, UPI's role has shifted from person-to-person remittances to commerce: since 2022, UPI person-to-merchant transactions have outpaced peer-to-peer, exceeding P2P by about 3.6 billion transactions per month by July 2024.¹⁰⁶

Today, UPI supports all kinds of digital retail payments like in-store QR payments, online checkouts, bill payments, etc. and processes well over 75% of India's retail digital payments. It has also gone global, and UPI is live in multiple countries like the UAE, Qatar, Singapore, Bhutan, Nepal, Sri Lanka, France, and Mauritius, allowing Indians abroad and tourists to use the same payment infrastructure.¹⁰⁷

All of this underscores UPI's essential nature as a universal, interoperable payments rail across India; this system can be further operationalised for better access to the digital ecosystem for those left behind.¹⁰⁸

What was once reserved for pure payments has now been expanded to a broader financial services platform. In 2022, the government permitted linking the RuPay credit cards to UPI IDs, allowing users to make credit card payments without the physical card. Most fundamentally, to us, UPI now supports pre-approved credit lines. Apps like PhonePe launched "Credit Line on UPI", letting consumers connect their bank-provided short-term credit lines on UPI.¹⁰⁹

In tandem, late last year, RBI allowed small finance banks to offer the same pre-approved credit lines over UPI (this is in the nature of unsecured credit). The RBI is aiming for low-ticket, short-duration loans (like unsecured micro-loans) through a consumer-friendly UPI interface. This rapid morphing of a financial channel capable of dispersing payments and credit to consumers at scale is a natural expansion of its potential to create stable infrastructure and open a formal lending space for disenfranchised consumers and businesses, making credit availability instant and ubiquitous.

5.3 Competitive Harms arising from exclusion of NBFCs

The current regulatory/operational design confines UPI-linked pre-sanctioned credit largely to scheduled commercial banks (and, recently, a narrow set of banks such as small finance banks) while excluding NBFCs from offering similar UPI-linked credit lines. This approach has important ramifications from the lens of the Competition Act, 2002 ('Act'), which has a legislative intent that is not merely punitive in controlling anti-competitive behaviour but also to promote and sustain equitable market growth to further economic growth and consumer welfare.¹¹⁰

The preamble of the Act is intended "to provide, keeping in view the economic development of the country, for the establishment of a Commission to prevent practices having adverse effect on competition, to promote and sustain competition in markets, to protect the interests of consumers and to ensure freedom of trade carried on by other participants in markets, in India".¹¹¹

¹⁰⁵ Press Information Bureau, Government of India, <https://www.pib.gov.in/FeaturesDeatils.aspx?id=155224&NoteId=155224&ModuleId=2>.

¹⁰⁶ Federal Reserve Bank of Kansas City, The Role of Nonbanks and Fintechs in Boosting India's UPI Person-to- Merchant Transactions, available at <https://www.kansascityfed.org/research/payments-system-research-briefings/the-role-of-nonbanks-and-fintechs-in-boosting-indias-upi-person-to-merchant-transactions/#:~:text=financial%20services%20access%20to%20any,Shukla%202024>.

¹⁰⁷ NPCI, Global UPI Acceptance- List of Countries, <https://www.npci.org.in/product/upi/all-members>

¹⁰⁸ Shailesh Rastogi, Chetan Panse, Arpita Sharma & Venkata Mrudula Bhimavarapu, 'Unified Payment Interface (UPI): A Digital Innovation and Its Impact on Financial Inclusion and Economic Development', 9 *Universal J. of Accounting & Finance* 518 (2021).

¹⁰⁹ PhonePe, PhonePe Enables Credit Line on UPI on Its Platform (Aug. 22, 2024), available at:

<https://www.phonepe.com/press/phonepe-enables-credit-line-on-upi-on-itsplatform/#:~:text=National%2C%2022nd%20August%202024%3A%20PhonePe,manage%20their%20monthly>.

¹¹⁰ Abir Roy, *Competition Law in India: A Practical Guide* (2024).

¹¹¹ The Competition Act, 2002, No. 12 of 2003, India Code (2002)

In other words, the primary goals are promoting and sustaining competition, protecting consumer interests and ensuring freedom of trade; all these goals are very broadly worded. Specifically, Section 19 of the Act enables the Competition Commission of India (CCI) to adopt an effect-based approach when investigating competitive wrongs by considering objective justifications such as accrual of benefits to consumers, improvements in production and distribution and promotion of technical, scientific and economic development, etc. and weighing them against the alleged appreciable adverse effect on competition so claimed.¹¹²

This position reiterates the importance of competition law and market efficiency while also being cautious of possible chilling effects on innovation. To put it simply, the endeavour of the Act and CCI during investigations is not merely to ensure static efficiency but also dynamic efficiency. In this background, arguably, excluding NBFCs to compete with other market players in the market for unsecured lending via UPI channels has critical consequences from a competitive lens:

- (i) it entrenches incumbents who control the payment distribution bottleneck;
- (ii) it raises concentration risks and consumer-harm through reduced choice; and
- (iii) it produces financial exclusion and allocative, productive and dynamic inefficiencies in the unsecured lending market.

This is particularly argued given the fact that the UPI network has evolved to absorb an ‘essential’ character, and ousting some players, particularly the ones governed by similarly placed prudential norms as those of banks, will necessarily have chilling effects on innovation.

Although the classical ‘essential facilities doctrine’ in the domain of competition law has developed in competition law jurisprudence primarily in the context of a dominant entity’s refusal to grant

access to a critical input or infrastructure, its underlying logic is instructive in assessing the systemic exclusion of NBFCs from UPI-linked unsecured lending. The said doctrine, articulated in *United States vs. Terminal Railroad Association*¹¹³ and later refined in *Otter Tail Power Co. vs. United States*¹¹⁴ and the EU’s *Oscar Bronner GmbH & Co. KG vs. Mediaprint Zeitungs*¹¹⁵, recognises that where an infrastructure is indispensable for effective competition and cannot be practically duplicated, denying access can produce exclusionary outcomes and distort market efficiency.

In the Indian context, while the Act does not explicitly codify this doctrine, its principles resonate with Section 4(2)(c) and Section 4(2)(e). These provisions prohibit conduct that limits market access or leverages dominance across markets. While CCI has been cautious about mechanically applying an imported ‘essential facilities’ test, the doctrine’s economic logic helps establish the four practical elements often used in analysis:

- (a) control of the facility (present case: UPI distribution reach);
- (b) impracticality of duplication (present case: duplicating UPI’s scale and bank network is infeasible for a new entrant);
- (c) denial of use (present case: NBFCs lacking equivalent access); and
- (d) feasibility of access remedies (present case: technical/contractual means exist to permit regulated third-party lenders to link via bank or payment service provider arrangements).

Even if CCI avoids labelling UPI as an ‘essential facility’ per se, the systemic exclusion of NBFCs can be investigated through this lens as it does result in appreciable adverse effects on market competition, as discussed in the following paragraphs.

¹¹² The Competition Act, 2002, No. 12 of 2003, India Code (2002)

¹¹³ 224 U.S. 383 (1912).

¹¹⁴ 410 U.S. 366 (1973).

¹¹⁵ C-7/97, ECLI:EU:C:1998:569.

CCI has implicitly acknowledged these principles in certain cases¹¹⁶, including cases concerning digital platforms.¹¹⁷ Notably, in its scrutiny of Google's practices in the UPI ecosystem¹¹⁸, access to distribution channels and self-preferencing behaviour were recognised as competition-sensitive. The case underscores CCI's recognition that control over payment distribution channels can create exclusionary bottlenecks with downstream competitive effects.

CCI examined how practices such as pre-installation of UPI applications, preferential default settings, and self-preferencing by dominant application providers could distort user access and entrench incumbents. CCI's reasoning implicitly acknowledges that where a platform intermediates access to a critical market infrastructure, for instance, UPI, it wields the capacity to shape competitive outcomes in adjacent or downstream markets.

Transposing this reasoning, the systemic exclusion of NBFCs from UPI-linked unsecured lending produces a comparable structural foreclosure effect. By confining the ability to offer instant, UPI-integrated credit to banks, the regulatory design entrenches existing players in the credit market and denies non-bank lenders access to the same high-volume, low-friction digital rail that consumers now ubiquitously use for financial transactions.

This not only reduces consumer choice, forcing borrowers to rely on bank-linked credit lines regardless of pricing or suitability, but also exacerbates financial exclusion by marginalising borrowers who depend on NBFCs, the latter typically serving lower-income, geographically remote, or non-salaried consumers. Further, such exclusion generates a distributional bottleneck as access to the most efficient and widely used payment infrastructure becomes conditional upon institutional identity rather than capability or competitiveness.

This constraint stifles dynamic efficiency by limiting NBFCs' ability to innovate in risk assessment, underwriting, and digital credit delivery, areas where, as demonstrated under point 5.1, NBFCs have historically outperformed traditional banks.

Thus, it can be argued that restricted access to a foundational digital infrastructure impairs competition, curtails innovation, and entrenches structural inequities in market participation.

UPI has evolved into an 'essential digital infrastructure' for retail payments and, increasingly, for the distribution of small-ticket credit. Its near-universal adoption, network effects, and integration with merchant and consumer interfaces make it functionally non-substitutable for real-time, low-cost retail transactions.

For lenders, particularly those operating in the unsecured credit market, participation in the UPI framework is indispensable to compete effectively in delivering instant, point-of-sale credit. UPI offers strong network effects where merchants, consumers and third-party apps coordinate on a single technical and behavioural standard. Because of ubiquity and near-zero marginal cost of transactions for consumers, UPI is functionally the platform through which instant retail payments and many embedded financial services flows.

Excluding NBFCs from this infrastructure, therefore, has a functionally equivalent effect to a denial of access to an 'essential facility', even if no single entity holds dominance in the conventional sense.

Such systemic exclusion not only forecloses a class of competitors but also undermines allocative efficiency, innovation, and consumer welfare, i.e. the objectives that underpin both competition law and the broader regulatory framework for financial inclusion in India.

¹¹⁶ Arshiya Rail Infrastructure Ltd. vs. Ministry of Railway; Case Nos. 64 of 2010, 02 of 2011 & 12 of 2011; Shamsheer Kataria vs. Honda Sael Cars India Ltd. & Ors. Case No. 03 of 2011
Case No. 03 of 2011.

¹¹⁷ In re: Federation of Hotel & Restaurant Association of India & Ors. vs. Make My Trip and Ibibo and Oyo., Case Nos. 14 of 2019.

¹¹⁸ In re: XYZ vs. Google LLC & Ors., Clubbed: Case No. 07 of 2020, 14 of 2021 & 35 of 2021.

Recognising the essential nature of UPI thus provides a conceptual basis to argue for non-discriminatory access and proportionate regulatory openness, ensuring that prudential considerations do not inadvertently create structural barriers to competition.

The exclusion of NBFCs from direct participation in the UPI ecosystem gives rise to significant competitive harms in both the digital payments and unsecured lending markets.

By designating only banks as eligible participants, the current regulatory structure creates a closed-access infrastructure around an essential payments' facility, thereby distorting competition between banks and NBFCs.

This exclusion increases barriers to entry for NBFCs seeking to provide seamless, point-of-sale digital credit, while simultaneously reinforcing the incumbency advantages of banks that already dominate the UPI space through Payment Service Provider arrangements.

The resulting asymmetry weakens intra-platform competition (among credit providers using the same UPI rails) and inter-platform competition (between banks and NBFCs), leading to a concentration of market power within a limited number of vertically integrated players.

Moreover, from a consumer welfare perspective, this structural exclusion imposes higher switching and search costs, constrains choice diversity, and reduces price and non-price competition, which together diminish allocative and dynamic efficiency in the digital credit ecosystem.

The foreclosure of NBFCs from UPI-based lending channels also constrains innovation, as smaller and more agile financial intermediaries, who are often the drivers of niche, low-ticket, and high-frequency credit, are unable to leverage UPI's interoperable, real-time infrastructure to serve underserved segments.

Collectively, these outcomes generate a form of systemic exclusionary effect, where regulatory design, rather than competitive merit, determines market access and innovation potential.

1. *Financial exclusion & uneven access*: NBFCs historically serve customer segments that banks underserve, i.e. small-ticket, new-to-credit borrowers, geographically/ digitally marginalised groups. Preventing NBFCs from offering instant UPI-linked lending perpetuates exclusion as customers who rely on NBFCs for short-term liquidity cannot obtain the same frictionless instant credit experience as compared to account holders whose banks or bank-partnered applications provide credit via UPI. This is a distributional harm as access to an essential modern retail credit product becomes tied to the status of one's banking relationships, not creditworthiness. This part under point 2 emphasises the potential of NBFCs to widen formal credit access, provided the UPI credit channel itself is not constrained.

2. *Reduced consumer choice and higher switching costs*: With UPI now serving as the principal gateway for point-of-sale digital credit, excluding NBFCs from this channel directly heightens switching and search costs for consumers. Borrowers who wish to access NBFC credit must navigate fragmented or delayed disbursement mechanisms outside the UPI ecosystem, resulting in an inferior user experience. Alternatively, they are constrained to accept bank-linked credit products, which may carry different pricing structures or contractual conditions. In both scenarios, the competitive process is weakened on myriad fronts, namely: consumer choice narrows, price discovery becomes less efficient, and competition on non-price dimensions such as convenience, transparency, and service quality is substantially diminished.

3. *Concentration and foreclosure risks:* When distribution remains concentrated among banks or a small set of players who control the consumer interface, providers can leverage the UPI interface to foreclose rivals. For instance, by privileging the placement/prioritisation of their own credit offers, or by controlling the Application Programming Interface that makes credit truly instant. This may lead to foreclosure effects driven by bottlenecks and self-preferencing activities.

4. *Reduced efficiencies:* NBFCs often use alternative data and faster decisioning models to price risk and extend credit to underrepresented borrowers. Excluding NBFCs from the instant distribution channel prevents these innovations from interacting with the biggest retail payments flow, i.e. UPI, which reduces allocative efficiency as credit flows less to borrowers who might be able to repay, and slows dynamic competition in product design. Additionally, restricting participation in UPI-linked credit and related functionalities exclusively to banks also risks chilling innovation in the downstream market for UPI-based technologies and applications. When access to the core UPI infrastructure is limited to a narrow set of incumbents, potential entrants such as fintech firms and/or NBFCs are unable to experiment with new interface designs, payment integrations, or credit-linked product architectures that could enhance user experience and efficiency. This vertical restriction thus stifles competition not merely in the credit market but in the technological ecosystem that develops around UPI. The CCI recognised a parallel concern in *XYZ vs. Google LLC & Ors.*¹¹⁹, where it held that Google's restrictive practices on in-app payment systems deterred innovation and entry in downstream app development markets dependent on its platform.

Similarly, limiting UPI access to banks entrenches their technological dominance and discourages the emergence of new, interoperable solutions, thereby constraining dynamic efficiencies and the evolutionary growth of India's digital payments infrastructure.

5.4 Efficiency Analysis: Allocative, Productive, Dynamic:

More particularly, three categories of efficiencies, i.e. productive efficiency, allocative efficiency and dynamic efficiency, are of critical importance for a developing country like India.¹²⁰ Static Efficiency concerns itself with the optimal allocation and utilisation of resources and is understood in terms of allocative and productive efficiency:¹²¹ Allocative efficiency ensures that resources are allocated in their most valued form, i.e. goods and services are produced in equitable quantities that reflect consumer preferences at the least possible cost. On the other hand, productive efficiency concerns the minimisation of production and transaction costs and the avoidance of dead-weight loss.

Lastly, dynamic efficiency is a more critical form of efficiency in technology and data-driven markets. This essentially concerns a market capacity to innovate, adapt, and evolve. It reflects Schumpeterian competition, which is the idea that rivalry 'for' the market is more valuable than rivalry 'in' the market for innovation.¹²² This form of efficiency envisages both product as well as process innovation. The following are the two integral aspects for increasing innovation: UPI is both a digital public good and a platform for private innovation, and thus, excessive concentration in the hands of certain banks suppresses entry-driven innovation and reduces their incentive to invest in complementary technologies. This model, with UPI at its core, can easily promote interoperability to avoid the pitfalls of monopoly-driven systems.

¹¹⁹ Case No. 07 of 2021.

¹²⁰ Competition Commission of India vs. Steel Authority of India Ltd. (2010) 10 SCC 744.

¹²¹ Zbigniew Jurczyk, The Role of Economic Efficiency in Competition Law, 10 Yearbook of Antitrust & Regulatory Studies 167 (2017), <https://ssrn.com/abstract=3160504>.

¹²² Joseph A. Schumpeter, Science and ideology, 39(2) American Economic Review 345 (1949).

The presence of multiple players ensures that users are not forced into one application and have plenty of choice. This type of digital payments ecosystem can become the flag-bearer of all three forms of efficiencies discussed above, as it can facilitate interoperability, open access, and systemic innovation based on user experience and needs.

In this context, if NBFCs are allowed to provide unsecured lending via UPI channels, allocative efficiency could translate into NBFCs using the UPI infra to serve the underserved, creditworthy individuals, ensuring capital flows. Productive efficiency could also soar due to standardisation via UPI QR codes, which allows economies of scale and eliminates the possibility of duplication. It also means that NBFCs could leverage the existing low-cost infrastructure to dispense credit and reduce barriers and operational expenses. Lastly, and most critically, given the very nature of digital lending, it is dynamic efficiency that can be significantly enhanced.

It can ensure product innovation for NBFCs in order to effectively compete with banks; they will be incentivised to create entirely new financial products, such as small-ticket or pay-as-you-go credit lines integrated directly into the UPI payment flow, or dynamic working capital loans for merchants based on real-time transaction history. It will also ensure process innovation as the entire lending lifecycle, i.e. from underwriting to real-time disbursement, enabled by the UPI mechanism, would represent a radical innovation in the delivery of financial services, given the inclusion of underdelivered customer groups that are not targeted by banks.

5.5 Implications for Innovation, Consumer Choice, and Market Fairness:

In this backdrop, RBI's decision to permit banks to extend pre-approved credit lines through the UPI network, although is a welcome step, it is particularly problematic from the lens of 'competition law'.

Consumers undisputably now have the ability to access and transact using such credit lines seamlessly via their UPI-linked accounts. This regulatory development significantly enhances convenience and promotes instantaneous access to short-term credit, further deepening the digital credit ecosystem. Nevertheless, the scope of Credit Line on UPI presently remains confined to banks, whether in the form of credit cards or pre-approved credit lines. NBFCs have, thus far, been precluded from leveraging the UPI infrastructure to extend similar credit facilities to their customers. Given that NBFCs are now subject to prudential, governance, and supervisory standards that closely mirror those applicable to scheduled commercial banks, there is a compelling rationale for extending such operational permissions to them as well.

Therefore, allowing eligible NBFCs that are found to be both financially sound and well-managed to participate in UPI-based credit disbursement would not only foster competitive neutrality within the credit market but also expand credit accessibility to underpenetrated segments. Extending UPI-linked credit facilities to such NBFCs would unlock a strong multiplier effect that the current framework cannot fully achieve.¹²³ The real economic gains from credit on UPI arise when small-ticket, high-frequency credit is embedded into everyday transactions, triggering repeated cycles of consumption, business turnover, and data generation rather than one-time lending events. NBFCs are uniquely positioned to drive this multiplier effect because they already serve MSMEs, thin-file consumers, and cash-flow-based borrowers whom banks often exclude.

Allowing a separate class of NBFCs that are deemed to be financially sound and well-managed to offer credit lines over UPI would enable working capital to flow at the precise point of transaction, such as supplier payments or inventory purchases, leading to faster business rotation, higher digital payment volumes, and deeper formalisation.

¹²³ Raunaq Sharma & Ranjeet Rane, 'From Payments to Prosperity: Expanding Credit Line Over UPI to NBFCs', The Dialogue, October 2025 <<https://thedialogue.co/wp-content/uploads/2025/10/Policy-Brief-From-Payments-to-Prosperity-Expanding-Credit-Line-over-UPI-to-NBFCs.pdf>>

Each credit extension thus generates downstream benefits which include increased UPI usage, richer transactional data for underwriting, and expanded access to formal finance, reinforcing a self-sustaining cycle of inclusion and growth that is unlikely to materialise without NBFC participation.

As we have discussed in Chapter 2 of this report, the introduction of a category of NBFCs as Financially Sound and well-managed NBFCs (FSWM NBFCs) would be the route to take here. This would be further expanded upon in the later chapters of the report. Further, as has been argued by the Financial Industry Development Council,¹²⁴ allowing NBFCs to directly participate in the UPI network would have wide-ranging benefits, including but not limited to promoting financial inclusion, enhancing competition, spurring innovation, and strengthening credit delivery mechanisms:

1. Financial Inclusion: NBFCs occupy a crucial position in India's financial architecture by serving customers in rural, semi-urban, and peri-urban areas, where formal banking penetration remains limited. Their operational flexibility, relationship-based lending models, and deep distribution networks enable them to reach borrower segments historically excluded from traditional banking channels. Integrating NBFCs into the UPI network would democratise access to digital payment infrastructure, allowing underserved populations to transact seamlessly through their existing NBFC relationships. It would also catalyse the flow of small-ticket transactions, which remain underrepresented in the current UPI credit-linked ecosystem. Presently, the volume of credit on UPI transactions remains minimal due to the restricted set of participants, which are primarily banks. Allowing NBFCs to operate on UPI could substantially increase both the breadth and depth of digital transaction volumes. Moreover, such access would enable co-lending partnerships, where banks and NBFCs combine their strengths,

i.e. banks' low-cost capital and NBFCs' customer reach. This would advance the broader national agenda of inclusive growth through digital finance.

2. Customer Centricity and Reduced Transaction Costs: Expanding UPI access to NBFCs would enhance competition in the financial services market, yielding tangible welfare gains for consumers. When more financial institutions are permitted to offer payment and credit services over a common interoperable infrastructure, competitive pressure compels improvements in user experience, service quality, and pricing. NBFCs, particularly digital-first lenders, are often more technologically adaptive than traditional banks. Their participation can lower transaction and operational costs through streamlined processes, efficient digital onboarding, and innovative customer interfaces. This customer-centric orientation would make digital credit and payment services more responsive to the needs of diverse borrower segments, especially micro-entrepreneurs and informal workers, thereby improving market efficiency and inclusivity simultaneously.

3. Expansion of the Digital Payments Ecosystem: Including NBFCs in the UPI framework would naturally expand the digital payments ecosystem, creating a more competitive and resilient architecture. The growth of UPI has been one of the central drivers of India's transition toward a cashless economy, but this transition remains incomplete without the participation of all significant classes of financial intermediaries. Allowing NBFCs to join the UPI network will multiply points of digital interaction, thereby accelerating adoption and usage across demographic and geographic segments. The presence of multiple classes of regulated entities would also reduce systemic dependence on a narrow group of banks, enhancing operational resilience and redundancy in the payments network.

¹²⁴ Finance Industry Development Council, 'Challenges Faced by NBFCs', 2024, available at: <<https://fidcindia.org.in/wp-content/uploads/2024/05/FIDC-DFS-NBFC-CHALLENGES-24-05-24.pdf>>

4. *Improved Credit Access:* NBFCs play a pivotal role in bridging the credit gap for individuals and small enterprises that lack access to formal banking services or adequate collateral. Their inclusion in the UPI network would enable them to seamlessly integrate credit and payment functions, offering customers a unified digital interface to borrow, transact, and repay. This integration can transform credit access by allowing NBFCs to disburse microloans instantly through UPI-linked accounts; facilitate real-time repayments, reducing delinquencies; and offer credit lines embedded within payment applications, similar to banks' offerings. Such integration would democratise access to digital credit, reducing reliance on informal lenders and aligning with the RBI's vision of expanding formal financial inclusion through technology-enabled credit flows.

5. *Efficiency in Payment Services:* NBFCs' inclusion would also enhance the operational efficiency of the UPI ecosystem. Many NBFCs have adopted advanced fintech tools, which range from automated KYC verification to data-driven credit scoring that enables leaner operations and faster turnaround times. By linking directly to UPI, these entities could process payments and settlements more efficiently, reducing redundancies and transaction delays. Increased competition in the payments value chain would likely result in process optimisation, faster settlement cycles, and lower costs for consumers and merchants. These efficiency gains would benefit the broader economy by improving the velocity of digital money and reducing the friction in micro-payments and merchant transactions.

6. *Building Robust Underwriting Models:* The most transformative benefit of NBFC participation lies in data-driven innovation. Access to UPI transaction data, such as frequency of payments, instances of insufficient funds, merchant categories, and geographical transaction patterns, can serve as alternative

data inputs for building robust credit-underwriting models. Such data, when used responsibly under RBI's data governance and consent frameworks, would enable NBFCs to refine borrower risk assessment with unprecedented precision. This is especially significant for low-income borrowers lacking formal credit histories.

Over time, it would help create a richer, more inclusive credit information infrastructure, reducing information asymmetry and improving portfolio quality across the lending ecosystem.

By leveraging UPI data to supplement traditional credit metrics, NBFCs could develop predictive and adaptive underwriting systems, enhancing both allocative and productive efficiency, i.e. better targeting of credit, and dynamic efficiency, i.e. continuous improvement through innovation.

Allowing Financially Sound and Well-Managed NBFCs direct membership in the UPI network aligns with the twin objectives of India's financial regulation to promote financial stability and inclusion while advancing the competition law goals of enhancing consumer choice and market efficiency, while, at the same time, having an approach that is cautious and works in favour of consumer protection.

Their participation would deepen the reach of digital finance, expand credit availability, foster technological innovation, and reduce concentration in payment intermediation. In essence, inclusion of NBFCs is not merely a question of regulatory parity but of market completeness.

By bridging the institutional divide between banks and non-banks within UPI, policymakers can unlock the next phase of inclusive digital financial transformation, ensuring that India's most powerful payment rail serves not just as a channel of transfer but as a platform for equitable growth and innovation.

Treating UPI as a critical distributional rail for retail credit converts what might have been a payments and regulatory question into a competition question as well. Excluding regulated NBFCs from UPI-linked unsecured credit entrenches incumbents, reduces consumer choice, and risks financial exclusion for borrowers who rely most on NBFC channels.

CCI and other sectoral regulators have complementary roles where CCI can police exclusionary conduct and recommend access/remedies where appreciable adverse effect on market competition is shown, while RBI/NPCI can design a calibrated access architecture that preserves prudential goals while opening the rail to responsible non-bank lenders.

6. Designing Credit Line on UPI for Consumers: Product Architecture & Safeguards

At present, neither banks nor regulators have fully looked into conceptualising the benefits of a Credit Line on UPI. While the idea itself holds great promise, its success will depend on offering additional incentives comparable to those of credit cards. A UPI-linked credit line will not succeed merely as an extension of digital payments; it must be designed as a distinct lending product embedded within India's interoperable payments ecosystem. The current discourse largely views the model through the lens of convenience and rewards, but its architecture needs to balance accessibility with prudential discipline. Unlike credit cards, which operate on specialised networks and merchant discount fee models, UPI runs on zero-MDR rails with direct account-linked transactions. This distinction changes the economic incentives for issuers and service providers: there is no interchange revenue to subsidise loyalty programmes or EMI conversions, and repayment assurance cannot rely on billing cycles. The product, therefore, must be grounded in transparent cost structures, calibrated limits, underwriting aligned with borrower affordability, and robust consumer governance mechanisms. When executed with these design principles, it may provide a pathway for individuals and small merchants to access short-term formal credit without replicating the excesses that created overleveraged credit card cohorts.

6.1 Can a credit line on UPI integrate credit-card-like features?

The idea of integrating credit-card-like features into a Credit Line on UPI would mark a significant evolution in India's digital finance ecosystem.

The goal would be to extend the appeal of credit cards to a UPI-based credit instrument. This would be feasible only if incentives and repayment options are recalibrated for the UPI environment. Revolving structures, reward programmes and merchant-specific promotions will have to operate without the cross-subsidisation typically afforded by merchant fees.

This calls for issuer-led incentive pools or usage-based benefits tied to repayment behaviour rather than transaction volume. EMI features may be offered either at the point of purchase or retroactively, but transparent disclosure at the moment of selection is essential to avoid deferred-cost traps. Dynamic credit limits should evolve in response to repayment patterns and verified income signals rather than consumption behaviour alone, thereby avoiding the "spend-everywhere" dynamic that drives delinquency in unsecured lending.

The core innovation in this would be to retain UPI's real-time payment flow while embedding a structured lending layer above it. Specifically, one that is interoperable across PSPs and does not trap the borrower within a single app or lender ecosystem.

6.2 Consumer Risks: Indebtedness, Mis-selling, Data/Privacy Risks

Embedding credit within a frictionless payment environment heightens vulnerabilities that extend well beyond conventional concerns of mis-selling or high-interest charges. When lending is layered onto instant UPI transactions, the absence of billing

cycles or repayment cues can mask the fact that each tap is a borrowing decision. This is particularly risky for first-time or financially inexperienced users, who may accumulate dues without grasping their repayment obligations or the compounding effect of revolving balances. Interface designs that encourage impulse spending—through nudges, gamified incentives, or default BNPL options—can further amplify behavioural biases and drive unintended indebtedness.

These risks intensify if NBFCs deploy UPI- linked credit lines without robust RBI guardrails, taking advantage of regulatory grey zones to extend liberal limits or embed opaque charges in digital terms of service.

NBFCs, although they are not banks, are subject to prudential norms on par with banks and carry higher risk weights for unsecured lending. However, the latest statistics released by the RBI in their Report on the Trends and Progress of Banking Sector have revealed that the structural risks for NBFCs have reduced. The report reveals that over two-thirds of loans and advances extended by NBFCs had maturity beyond 12 months, implying there is a lower degree of asset-liability mismatch and thereby avoiding liquidity stress.

The asset quality of the sector showed further improvement in 2024-25. The GNPA ratio has declined to 2.9 per cent at end-March 2025 from 3.5 per cent at end-March 2024. NNPA ratio also followed a downward trajectory, reflecting effective resolution of NPAs and adequate provisioning.

NBFCs continued to remain well capitalised with a capital-to-risk-weighted-assets ratio (CRAR) at 25.9 per cent at end-March 2025, well above the regulatory prescription of 15 per cent.¹²⁵

However, the introduction of the CLOU as a product for the NBFC sector requires guardrails. This can be potentially solved by the introduction of a Financially Sound and Well-Managed NBFC criterion that will clearly delineate which entities may form a part of the CLOU infrastructure. This will ensure that the NBFCs operate in accordance with the established prudential norms, and furthermore, they scale up to the introduction of the product in a manner that is sufficiently protected by well-established entry thresholds and supervisory safeguards.

As reported by Financial Express, the repayment for credit cards has stress, most of which is in the 91-180 days overdue range. Despite the growing debt, credit card usage in India is booming. As of May 2025, total outstanding credit card debt stood at Rs 2.90 lakh crore, up from Rs 2.67 lakh crore the year before. Spending is also on the rise: by March 2025, credit card transactions had hit Rs 21.09 lakh crore, a 15% jump from the previous year, the Indian Express report mentioned.¹²⁶ The unpaid amount in this category has gone up to Rs 29,983.6 crore, from Rs 20,872.6 crore the year before, almost double what it was two years ago.¹²⁷

Mis-selling, opaque pricing and hidden fees—already prevalent in credit card markets—could resurface in digital form if disclosures remain fragmented or non-standardised. Without clear norms on interest rates, penalty structures, repayment cycles or prepayment charges specifically tailored to UPI-based credit, borrowers may face asymmetrical information that leaves them disadvantaged. The problem is compounded by the architecture of the ecosystem itself. A UPI credit product is rarely delivered by a single actor; payment apps, lenders, analytics providers, and account aggregators all touch borrower data and influence user experience.

¹²⁵ RBI, Report on Trend and Progress of Banking in India 2023-24, (2025) <https://rbidocs.rbi.org.in/rdocs/Publications/PDFs/0RTP261220247FFF1F49DFC04C508F300904A90C7439.PDF> (Last visited Oct 8, 2025).

¹²⁶ Credit card defaults up 28 per cent last year touched Rs 6742 crore, The Indian Express, April 7, 2025, <<https://indianexpress.com/article/business/banking-and-finance/credit-card-defaults-up-28-per-cent-last-year-touched-rs-6742-crore-9928846/>> (Last visited Oct 8, 2025).

¹²⁷ Syed Wahab Ali, The Financial Express, FINANCIALEXPRESS.COM (2025), <https://www.financialexpress.com/business/indians-struggling-to-repay-credit-card-bills-overdues-soar-44-to-rs-33886-cr-3928512/> (last visited Dec 19, 2025).

This diffusion of responsibility blurs accountability in disputes, leaving consumers uncertain whether grievances concern underwriting, transaction execution, or platform negligence.

Moreover, data-driven personalisation, while commercially attractive, can produce discriminatory outcomes, with pricing or credit limits calibrated not to affordability but to behavioural profiling. Weak consent protocols or permissive data-sharing arrangements risk enabling targeted marketing, exploitative interest models, or the use of non-financial signals for credit scoring. Although the RBI's Digital Lending Directions, 2025, seek to curb earlier abuses, their effectiveness in the context of a Credit Line on UPI will depend on whether these protections are embedded into product architecture—limiting usage, preventing cash-out arbitrage, enforcing single-entity liability—rather than treated as optional compliance afterthoughts.

6.3 Safeguards under RBI Digital Lending Directions, 2025

The Reserve Bank of India (Digital Lending) Directions, 2025¹²⁸ deal with the concerns that primarily relate to unbridled engagement of third parties, mis-selling, breach of data privacy, unfair business conduct, charging of exorbitant interest rates, and unethical recovery practices.

These Directions consolidate the earlier instructions along with certain new measures for arrangements involving Lending Service Providers partnering with multiple regulated entities, as mentioned under para 6 (RE-LSP arrangements involving multiple lenders), and for the creation of a directory of digital lending apps as mentioned under para 17 (Reporting of DLAs to RBI) of these Directions.

Its core purpose is to ensure that credit origination, servicing and recovery remain within regulated perimeters, even when delivered through digital intermediaries.

Therefore, we can conclude that in order for NBFCs to successfully initiate Credit Line on UPI, they would have to include the following:

1. *Consumer Safety Framework*- The design must embed a robust consumer safeguards framework aligned with the RBI's digital lending guidelines. This would be inclusive of standardised disclosures on interest rates, late fees, and repayment schedules in plain language; explicit, granular consent for data use; and accessible grievance redress systems integrated into the UPI app interface.
2. *Digitisation and Technology use*- They will need to ensure compliance with all applicable technology and cybersecurity standards prescribed by the RBI and other relevant authorities for digital lending activities. The Digital Lending Directions of 2025 mandate explicit consent flows, standardised loan facts statements, and digitally traceable repayment channels. Lenders must disclose interest rates, penalties, and repayment schedules in unambiguous language and cannot offload underwriting risk through opaque "first loss" arrangements that encourage reckless disbursement. These safeguards are especially pertinent when lending is layered on UPI, where speed and transaction volume may incentivise scale over prudence. These measures will form the foundation of their broader obligations in the digitisation process.
3. *Operational Requirements*- The rules mandate lenders to strengthen their internal policies, update loan documentation, conduct due diligence, and provide clear guidance to recovery agents. To operationalise a Credit Line on UPI within this framework, regulated entities will need end-to-end compliance infrastructure: secure data storage within India, audited recovery processes, granular consent management for all data transfers, and clear

¹²⁸Reserve Bank of India (Digital Lending) Directions, 2025, <https://www.rbi.org.in/Scripts/NotificationUser.aspx?Id=12848&Mode=0>

withdrawal rights at the consumer level. Only by embedding these protections into the product's core design—not as later compliance patches—can the system prevent a repeat of earlier digital lending abuses.

6.4 Operational and LSP oversight requirements

The Digital Lending Directions of 2025 consolidate previous lending guidelines and reiterate trust, transparency, and accountability as the core principles of India's digital lending ecosystem, placing borrowers' interests squarely at the centre of the framework, which was made pursuant to the recommendations of the "Working Group on Digital Lending".¹²⁹

1. Operational responsibility for borrower funds must remain with regulated lenders, even when platforms facilitate origination or servicing.
2. Lending Service Providers may design the interface or perform customer onboarding, but loan disbursement and repayment flows must move directly between the borrower and the regulated entity. This prevents commingling, ensures traceability, and avoids shadow wallets that conceal credit exposure.
3. Contracts with intermediaries should define roles with precision, including data handling duties, grievance responsibilities and audit frequency. All lending-related information must be stored on domestic servers, with deletion protocols aligned to statutory retention requirements.
4. Platforms that match borrowers with multiple lenders must present offers without discriminatory ranking, avoid dark patterns, and provide visibility into unmatched options. These requirements reinforce consumer agency and reduce informational asymmetry.¹³⁰

As digital lending scales to reach more users in India, the true challenge will be translating these principles into practice, without compromising agility. Achieving this balance will require active cooperation across the ecosystem, including sustained regulatory engagement.

6.5 Global benchmarks (FCA UK, MAS Singapore)

Benchmarking against global customer experience frameworks, such as the UK's Financial Conduct Authority's "Consumer Duty" or Singapore's MAS guidelines, underscores that digital financial products must be evaluated on the basis of consumer outcomes, not simply their access or utilisation.

The FCA's Consumer Duty¹³¹ is designed to set higher and clearer standards of consumer protection across financial services and requires firms to put their customers' needs first. The Duty introduces a new principle, Principle 12: 'a firm must act to deliver good outcomes for retail customers'. This principle is supported by three cross-cutting rules and four customer outcomes. The UK's Consumer Duty regime compels financial institutions to design, price, and distribute products in ways that demonstrably deliver fair outcomes, not merely avoid harm.

In contrast, MAS Guidelines¹³² establish principles-based expectations for FIs and their digital marketers to advertise financial products and services via digital media in a "responsible and professional manner". The MAS Guidelines apply to all Singapore-licensed FIs and their appointed third parties, including external collaborators like influencers and affiliate marketers.

¹²⁹ RBI's Report of the Working Group on Digital Lending including Lending through Online Platforms and Mobile Apps, November 11, 2021, <https://www.rbi.org.in/Scripts/PublicationReportDetails.aspx?UrlPage=&ID=1189#S43>

¹³⁰ Palak Kapoor & Huzefa Tavawalla, India's New Digital Lending Law: Building Trust, Transparency and Accountability, Regulatory Hotline- Nisith Desai Associates, May 28, 2025, <https://nishithdesai.com/default.aspx?id=15354> (Last visited Oct 11, 2025).

¹³¹ Financial Conduct Authority, Focus Areas- Our Consumer Duty Focus Areas, September 30, 2025, <https://www.fca.org.uk/publications/corporate-documents/consumer-duty-focus-areas> (Last visited Oct 11, 2025).

¹³² Monetary Authority of Singapore, FSG-03 Guidelines on Standards of Conduct for Digital Advertising Activities, September 25, 2025, <https://www.mas.gov.sg/-/media/mas/regulations-and-financial-stability/regulations-guidance-and-licensing/financial-advisers/guidelines/guidelines-on-standards-of-conduct-for-digital-advertising-activities.pdf> (Last visited Oct 11, 2025).

Content disseminated through tie-ups (e.g., referral codes for investment sign-ups) is explicitly treated as advertising. Non-compliance may impact assessments of an FI's fitness and propriety under the *Financial Advisers Act* ("FAA") and *Securities and Futures Act* ("SFA"). Singapore's approach emphasises responsible promotion of financial services and applies accountability standards to influencers and affiliate partners, recognising that digital distribution can shape consumer behaviour as strongly as formal marketing.

These models show that compliance cannot hinge solely on disclosures; firms must continuously monitor the real-world consequences of their product design. If India's framework for Credit Line on UPI is guided by comparable principles, it can discourage exploitative credit, encourage inclusion through affordability-sensitive underwriting, and build trust in digital lending ecosystems without overengineering product regulation. Therefore, success will hinge on designing a model where access and accountability advance together, ensuring that digital credit remains a tool for inclusion, not indebtedness.

6.6 Complementing the Credit Card Framework in India

India's established credit card ecosystem offers valuable institutional lessons, but its safeguards cannot be imported wholesale into a UPI-linked credit model. Credit cards operate within a closed-loop environment built on issuer–network–merchant relationships and funded through interchange revenues. This structure enables reward systems, risk pooling, and underwriting standards tied to merchant fees, even when consumers enjoy interest-free periods or loyalty programmes. Regulation has evolved accordingly: card issuers must disclose pricing terms upfront, resolve billing disputes within specified timelines, restrict unsolicited issuance, and assume liability once loss or theft is reported. These protections function because transactions on card networks are mediated, time-

-stamped, and subject to post-settlement reconciliation.

A Credit Line based on UPI inverts this architecture. For UPI, payments settle in real time from the lender's funds to the payee, bypassing the deferred billing cycles that allow card issuers to manage risk and cash flow.

Incentive design cannot rely on merchant-funded MDR because UPI rails prohibit MDR for most retail transactions. This shifts the economic burden of rewards and operational costs onto issuers unless a new revenue model emerges.

For this reason, a Credit Line on UPI must be structured around affordability, clarity of repayment obligations, and measured exposure, not around transaction expansion or cross-selling volume.

Along with offering perks and innovation, it should prioritise transparency of borrowing terms, dynamic limit calibration, and simple repayment pathways that help borrowers avoid revolving debt traps.

1. The Reserve Bank of India (RBI) plays a pivotal role in setting guidelines that ensure fair practices in credit card issuance and usage.¹³³ Banks are required to clearly disclose all terms and conditions, including interest rates, fees, and charges, before issuing a credit card. Customers must receive detailed billing statements outlining due dates, minimum payment amounts, and applicable charges. The RBI also prohibits the issuance of unsolicited credit cards or automatic upgrades without the explicit consent of the consumer, holding banks accountable for any misuse of such cards. Billing disputes must be resolved within sixty days of a complaint, and interest rates should be transparent, reasonable, and non-discriminatory. Furthermore, once a loss or theft is reported, the cardholder's liability is capped, protecting consumers from fraudulent transactions.

¹³³ Master Circular on Credit Card, Debit Card and Rupee Denominated Co-branded Pre-paid Card Operations of Banks and Credit Card issuing NBFCs, July 2015, <https://www.rbi.org.in/commonman/english/scripts/Notification.aspx?Id=1574#B> (Last visited Oct 11, 2025).

2. Complementing the RBI's oversight, the *Banking Codes and Standards Board of India (BCSBI)*¹³⁴ sets out fair practices that promote ethical conduct by banks. These standards mandate upfront disclosure of all fees, interest rates, and penalties, as well as reasonable grace periods for repayment. Banks are also required to communicate any changes to terms and conditions promptly. In cases of card loss or theft, similar liability protections apply once the customer notifies the bank.
3. The *Consumer Protection Act* combats unfair trade practices and data manipulation, but is reactive: redressal occurs after harm, not as an ex-ante guardrail.¹³⁵ The risks include the deployment of dark patterns, manipulative choice architectures, opaque algorithmic nudging, and exploitative data-driven personalisation that distort consumer autonomy and informed consent. Any proposed guardrails must therefore emphasise ex-ante intervention by embedding preventive obligations, risk-assessment requirements, and design-level accountability mechanisms at the development and deployment stages of digital systems, thereby mitigating consumer harm before it materialises. Existing consumer protection laws provide a broader safety net, but even here, adaptation is necessary.
4. The *Payment and Settlement Systems Act*, by contrast, regulates the integrity of transaction systems, imposing liability on system providers for failure or fraud.
5. Finally, to streamline grievance redressal, the RBI introduced the *Integrated Ombudsman Scheme, 2021*,¹³⁶ which creates a single, centralised reference point for grievances. The scheme enhances accessibility and efficiency in consumer protection, but it assumes that

the consumer understands who the responsible entity is. UPI credit will challenge this assumption because multiple intermediaries—PSPs, lenders, account aggregators, analytics partners—may each shape a borrower's experience. The diffusion of responsibility across this layered ecosystem risks leaving consumers uncertain about accountability and may dilute effective redressal, underscoring the need for clearer ex-ante allocation of responsibility that explicitly extends to NBFCs operating within such arrangements.

To maintain trust, consumers must never be forced to “guess” whether the harm originated in underwriting, execution, or recovery. A regime of single-entity liability anchored to the regulated lender, backed by mandatory recording of digital transactions and time-stamped data trails, would provide necessary clarity. This structure preserves innovation in the front end while ensuring that regulatory accountability remains anchored in the core credit provider.

A UPI-linked lending product lives at the intersection of these frameworks—it is simultaneously a payment rail use-case and a credit instrument—and therefore requires concurrency in enforcement. Dispute handling cannot be left to either PSPs or lenders in isolation; accountability must be distributed along the point of origination, transaction authorisation, and data flow.

6.7 Customer-facing Dimension

From a consumer standpoint, a UPI-linked credit line, the product design should carefully balance usability, flexibility, and financial discipline, merging the simplicity of UPI with selective, consumer-centric credit features. The underlying logic is that users respond not only to utility but also to perceived value. Thus, incentives linked to financial discipline, such as timely repayments or

¹³⁴BCSBI: Code of Bank's Commitment to Customers, January 2018, <https://www.iba.org.in/retail-banking/code-of-bank-comme.html> (Last visited Oct 12, 2025).

¹³⁵ Priyanka Debnath, Understanding Consumer Protection Laws for Credit Card Users, *OUTLOOK MONEY* (2024), <https://www.outlookmoney.com/banking/credit-card/understanding-consumer-protection-laws-for-credit-card-users> (last visited Dec 20, 2025).

¹³⁶The Reserve Bank - Integrated Ombudsman Scheme, 2021 <https://rbidocs.rbi.org.in/rdocs/notification/PDFs/384MD14012026E275757688DE4E68AF9813B3B9491E4B.PDF> (Last visited Feb 10, 2026).

prudent credit utilisation, could be built into the product architecture.

1. Dynamic credit limits calibrated to repayment patterns would ensure inclusivity without encouraging reckless spending.
2. Technologies such as AI-driven analytics could be leveraged to personalise offers, giving users a sense of agency over their credit behaviour while ensuring affordability.

Credit features such as revolving options, EMI conversions, and cashback or loyalty benefits can be part of the design but should be calibrated toward stability rather than volume. For example, interest rebates for early repayment, or incremental credit increases tied to verified income rather than transaction frequency, can promote prudent usage without exposing novice borrowers to revolving debt traps.

Credit limits should evolve dynamically, not as a marketing hook but as a safety instrument.¹³⁷ While advanced analytics and AI can be powerful tools for personalising offers, they should operate within strict guardrails. Personalisation must not privilege behavioural profiling over affordability. Targeted product suggestions, pricing differentials, or discount mechanisms should be explainable, auditable, and grounded in transparent financial criteria, not inferred behavioural or demographic proxies.

A consumer-centric design, therefore, avoids opacity at two levels:

1. It prevents invisible nudges that blur the line between payments and borrowing, and
2. It prohibits data-driven segmentation that exposes low-income users to predatory credit.

Ultimately, if UPI-linked credit lines are to advance financial inclusion, they must not merely widen access to digital borrowing; they must deliver clarity, controllability, and consistency in the user's experience. This means embedding safeguards—repayment visibility, friction at borrowing moments, and transparent cost communication, into the core

interface. The consumer should never be required to decipher hidden terms, chase lenders across platforms, or infer risks from fragmented disclosures.

Therefore, the goal is to create a well-designed product that aligns the interests of lenders and borrowers: providing liquidity when needed, preventing misuse, and rewarding disciplined engagement, all while preserving the intuitive trust that has made UPI a cornerstone of India's digital public infrastructure.

This will ensure that innovation in digital finance remains both inclusive and sustainable, supporting India's ongoing transition toward a resilient and user-centric financial system.

7. A Policy Blueprint for NBFC Participation in Credit Line on UPI

This blueprint aims to facilitate the calibrated participation of Non-Banking Financial Companies (NBFCs) in the Unified Payments Interface (UPI) ecosystem, promoting financial inclusion, responsible innovation, and competition while safeguarding consumer interests, data protection, and systemic stability.

Furthermore, we propose an approach that is statutorily permissible, constitutionally defensible, and economically necessary and is guided by the principles of proportionality, risk-based regulation, interoperability, and consumer-centricity, consistent with the Reserve Bank of India's overarching vision for secure and inclusive digital payments to deepen formal credit access, enhance competition, and strengthen India's leadership in digital financial innovation, while preserving systemic stability and consumer trust.

7.1 A Tiered and Phased Access Framework

- The NBFC participation in the UPI ecosystem shall follow a tiered and phased access model, calibrated to the financial soundness, governance maturity, systemic importance, and risk exposure of participating entities.
- Only Financially Sound and Well-Managed NBFCs (FSWM-NBFCs), introduced in chapters 2 and 3, and as identified under the eligibility framework in Section 7.2, shall be considered for participation.
- Initial access shall prioritise limited and well-defined use cases, with progressive expansion contingent upon demonstrated compliance, operational resilience, and positive consumer outcomes.

- Participation tiers may correspond to differing levels of functional access, such as limited transaction initiation, restricted use-case deployment, or full-stack participation, subject to regulatory determination.
- Participation should be described using existing UPI ecosystem access models. Under current NPCI rules, entities participate either as approved system participants or through sponsor bank arrangements. Any NBFC access model should therefore operate either through a sponsor PSP bank structure already recognised within UPI, or through a new NPCI-recognised participant category introduced with RBI concurrence.

7.2 The Eligibility Criteria: Capital Adequacy, Governance, and Technological Readiness

- The Eligibility for UPI participation shall be restricted to FSWM-NBFCs that meet enhanced prudential, governance, and operational benchmarks. These shall include:
 - minimum net owned funds and capital adequacy norms as prescribed by the RBI,
 - a satisfactory supervisory and compliance track record,
 - robust board oversight and risk management frameworks, and
 - demonstrable technological and cybersecurity readiness.
- The classification of FSWM-NBFCs and their placement within participation tiers shall take into account existing RBI classifications, supervisory assessments, systemic importance, and activity profiles, and shall be subject to periodic regulatory review.

- NBFCs seeking deeper integration or direct access to UPI infrastructure shall be subject to higher thresholds, including:
 - advanced internal control and audit mechanisms;
 - independently audited IT and cybersecurity systems; and
 - proven capacity to manage settlement, fraud, operational continuity, and consumer protection risks at scale.

7.3 Consumer Protection and Disclosure Regime

- Consumer protection shall form a central pillar of NBFC participation in UPI, particularly where payment services are integrated with credit products.
- Participating FSWM-NBFCs shall adhere to heightened transparency and fairness obligations, including standardised pre-transaction disclosures on charges, interest rates, repayment schedules, default consequences, and grievance redressal mechanisms.
- Design and deployment of UPI-linked credit features shall adhere to principles of product suitability, informed choice, and avoidance of dark patterns, including prohibitions on auto-enrolment, deceptive nudging, or frictionless activation of credit without explicit consent.
- Grievance redressal timelines, escalation mechanisms, and liability frameworks for fraud, unauthorised transactions, or technical failures shall be harmonised with RBI and NPCI standards to ensure timely, accessible, and effective consumer remedies.

7.4 Interoperability and Innovation Safeguards

- All NBFC-led UPI services shall comply with interoperability requirements and shall not impose technical lock-ins or discriminatory access conditions.
- Permissible use cases may include peer-to-merchant payments, credit-linked UPI transactions, EMI-based payments, and automated repayment mechanism

subject to the NPCI operating guardrails.

- Innovation shall be encouraged through controlled pilots and phased rollouts, with expansion into new functionalities guided by consumer impact assessments and systemic risk evaluations.

7.5 Implementation Roadmap for RBI and NPCI

- A coordinated and staggered implementation roadmap shall be adopted by the RBI and NPCI, with clearly defined milestones for eligibility assessment, onboarding, pilot operations, and full-scale integration.
- The RBI shall retain primary regulatory and supervisory authority over NBFC participation, while NPCI shall oversee operational standards, technical integration, and enforcement of interoperability.
- Escrow-based settlement arrangements with scheduled commercial banks shall remain mandatory unless otherwise notified, ensuring protection against non-delivery, non-payment, and fraud.
- A joint RBI–NPCI coordination mechanism shall periodically review the systemic risks, market conduct, competition outcomes, and consumer protection indicators.

8. Conclusion

The evolution of UPI from a payments rail into a credit-enabled digital public infrastructure marks a pivotal moment in India's financial regulatory journey. Credit Line on UPI (CLOU) has the potential to reshape small-ticket, real-time credit delivery fundamentally, but its success depends on a careful reconciliation of innovation with systemic stability.

This study demonstrates that these objectives are not mutually exclusive. Innovation can be enabled without undermining trust in the payments ecosystem if regulatory design is grounded in proportionality, evidence-based calibration, and phased risk management.

The core regulatory question, therefore, is not whether NBFCs should be included in CLOU, but how such inclusion can be structured without diluting prudential discipline.

A framework that restricts access to well-capitalised and well-governed NBFCs, supported by transaction caps, escrow arrangements, enhanced supervision, and robust data governance, allows UPI to expand its functional scope while preserving its reliability as national digital infrastructure.

Equally important is ensuring that there is a balance between competition and prudential safeguards. Despite UPI's dominance by volume, its share by value stood at only 8.7% in March 2024, reflecting the platform's concentration in small-ticket transactions and its deep penetration among a broad user base.¹³⁸ UPI has effectively become an essential facility in India's retail finance ecosystem.

The prolonged exclusion of NBFCs from CLOU risks entrenching structural advantages for banks in digital credit markets, potentially distorting competition, limiting consumer choice, and hindering innovation in credit product design. Given NBFCs' established role in unsecured lending, MSME finance, and last-mile credit delivery, their absence from UPI-based credit products is not competition-neutral.

At the same time, this study recognises that competition cannot be advanced through regulatory dilution. Historical episodes of NBFC stress and the unique risks associated with instant, revolving digital credit necessitate strong prudential safeguards. The appropriate response lies in differentiated, risk-based regulation—where access is conditional, supervision is intensive, and compliance obligations scale with systemic relevance—rather than blanket inclusion or exclusion.

Viewed through this lens, India stands at a significant opportunity frontier in digital credit. With UPI's unparalleled reach, India can leapfrog legacy, card-centric credit models and build a uniquely inclusive, real-time credit ecosystem aligned with its economic structure. A central objective of this report is the democratisation of CLOU as a product. Limiting CLOU to a narrow set of providers or consumers has demonstrably constrained adoption, as reflected in the slow uptake following its launch, driven by bank caution and regulatory ambiguity despite strong initial interest. While several banks have piloted the product, transaction volumes remain negligible relative to overall UPI usage.¹³⁹

¹³⁸ Guilio Cornell, Jon Frost, Leonardo Gambacorta, Sonalika Sinha and Robert M Townsend, The Organisation of Digital Payments in India - Lessons from the Unified Payments Interface (UPI), (2024), https://www.bis.org/publ/bppdf/bispap152_e_rh.pdf (last visited Jan 19, 2026).

Allowing NBFC participation, consistent with the safeguards and phased access models recommended across this report, would deepen formal credit penetration among first-time borrowers, micro-entrepreneurs, gig workers, and other underserved segments. This would not amount to deregulation, but to regulated expansion aligned with the RBI's scale-based regulatory philosophy and constitutional principles of equality and proportionality.

Ultimately, the inclusion of NBFCs in Credit Line on UPI is not merely a sector-specific reform but a broader statement about the future direction of India's digital financial governance. By embracing risk-based inclusion, India can demonstrate that digital public infrastructure can simultaneously foster innovation, preserve stability, promote competition, and advance financial inclusion.

If implemented in line with the recommendations set out in this study, CLOU—extended to qualified NBFCs—can become a cornerstone of India's next phase of digital credit growth, reinforcing consumer trust while consolidating India's leadership in global digital finance.

¹³⁹ Ajinkya Kawale, Unclear Guidelines Hold Back Growth of Credit Line on UPI since Launch, @BSINDIA (2025), https://www.business-standard.com/finance/news/unclear-guidelines-hold-back-growth-of-credit-line-on-upi-since-launch-125100500501_1.html (last visited Jan 19, 2026).

