Why did the government punish the leading fintech pioneer in India?

On January 31st, the RBI imposed operational restrictions on Paytm Payments Bank Ltd. (PPBL) due to non-compliance issues and supervisory concerns.

The Ministry of Information Technology received complaints about data risks from these apps. Paytm has a 9.89% stake owned by Ant Group, a Chinese company. The Indian government is worried about data leaks to China due to this ownership.

BY FEBRUARY 29TH, PAYTM PAYMENTS BANK WON'T ACCEPT NEW DEPOSITS, AND THEY CAN'T MAKE TRANSACTIONS USING SAVINGS ACCOUNTS, WALLETS, FASTAG, OR UPI.

No bank, no problem

Paytm Payments Bank has been consistently hauled up by the RBI over a range of issues

- **2015** – Aug – Paytm receives RBI's in-principle **approval for payments bank licence**
- **2017** – May – Paytm Payments Bank **commences operations**
- **2018** – Jun – RBI **bans** it from **onboarding new users** for accounts and wallets
- **2019** – Jan – **Ban is lifted**
- **2021** – Oct – Gets **included** in the list of **scheduled banks**
- **2022**
  - Mar – RBI directs the company to **stop onboarding new customers** and conduct a comprehensive IT systems audit
  - Sep – Enforcement Directorate **raids** Paytm’s Bengaluru premises in connection with illegal Chinese lending apps case
  - Oct – Paytm Payments Bank gets **final report** of RBI-appointed external systems auditor
  - Nov – RBI **rejects** Paytm Payment Services' payment-aggregator licence application
- **2023** – Oct – RBI imposes **Rs 5.4 cr penalty** on Paytm Payments Bank for KYC non-compliance
- **2024** – Jan
  - National Highways Authority of India **bans** Paytm Payments Bank from **selling Fastags**
  - RBI directs Paytm Payments Bank to terminate nodal accounts by Feb 29, 2024, **effectively halting operations**

THE KEN

Graphic by Adhithi Priya R, 31 Jan '24

Source: RBI, Paytm

What makes Paytm Payment bank differ from a normmal Banks?

The difference between Paytm Payments Bank and traditional banks lies in their structure and offerings. Paytm Payments Bank operates as a simplified version of a traditional bank, offering limited banking services where you can keeo upto 2 Lakhs. Unlike traditional banks, Paytm Payments Bank does not provide services such as loans, credit cards, or investment products. Instead, it focuses on basic banking functions such as savings accounts, digital payments, and remittances. Additionally, Paytm Payments Bank has restrictions on the maximum balance allowed in accounts and the types of transactions it can undertake. Overall, while Paytm Payments Bank provides essential banking services, it operates with a more streamlined approach compared to traditional banks

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When you deposit money into a Payment Bank, you can earn interest because the bank invests your deposits. However, your money isn't directly deposited with the Payment Bank. Instead, it's moved to a fixed deposit with a partner bank, such as IndusInd Bank. The interest generated from this fixed deposit is then passed on to you, the customer.

Similarly, when it comes to loans or credit cards, Payment Banks can offer these services through partnerships with third-party providers. For example, Paytm has partnered with various lenders like Aditya Birla Finance Capital and Tata Capital for personal loans. This is the main difference between a Payment Bank and traditional banks

Why can't you buy directly from Aditya Birla and why can't Aditya Birla cut out Paytm and sell directly to customers?

Well, they could, but Paytm brings its superpower of technology and data. For example, when applying for a personal loan, traditional banks require extensive documentation and multiple branch visits. However, Paytm has access to your transaction history and identity documents, allowing it to process loans digitally in just 5 minutes. This is the superpower of a Paytm Payment Bank.

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When you use UPI to transfer money by scanning a QR code, the virtual money is sent from your bank account through Paytm to a nodal account. The transaction confirmation is then sent to the merchant. Within 24 hours, the money is transferred to the merchant's account. A nodal account acts like an interim escrow account where payments are pooled before being sent to merchants.

The suffix of your UPI account indicates the bank where your nodal account is located. For example, "PTM" indicates that your nodal account is with Paytm Payment Bank. Similarly, other UPI apps like PhonePe and Google Pay have different suffixes indicating their respective nodal account banks. However, after February 29th, Paytm Payment Bank will no longer be able to operate its Mobile Wallet, accept deposits, or conduct credit transactions. Customers using Paytm wallets won't be able to top them up. Paytm must change its nodal account to another bank to survive. This change is significant because in December 2023, Paytm Payment Bank faced restrictions imposed by the RBI.

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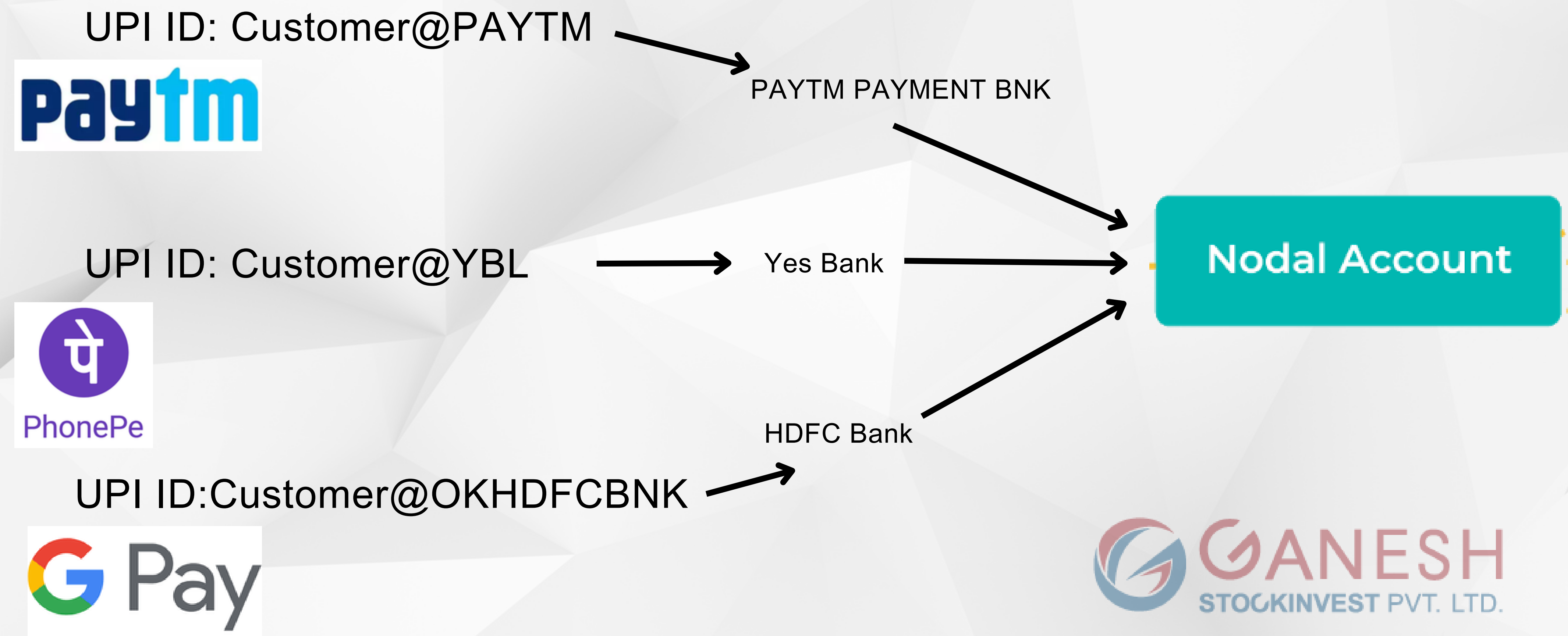

Out of 12 billion transactions, Paytm has 2.8 billion transactions made via Paytm Payment Bank. They need to find partners to process almost 3 billion transactions before February 29th.

Setting up a nodal account alone is a big task, let alone processing 3 billion transactions. Industry experts believe that Yes Bank or ICICI Bank may have the infrastructure to seize this opportunity. If this happens, Yes Bank and ICICI Bank will benefit.

What investors can expect?

PAYTM's strategy to navigate this situation involves transitioning from Paytm Payment Bank to other bank partners, enabling them to expand their payment and financial services offerings. Services using alternative banking partners will continue, potentially benefiting banks like **Yes Bank, HDFC, or ICICI Bank**. Merchant payment network offerings like Paytm QR, Paytm Soundbox, and PAYTM card machines will also persist. However, this transition poses logistical challenges, such as updating QR codes on millions of devices linked to PTM Payment Bank accounts, requiring coordination with merchants and users.

As shareholders or users, there may be concerns, but these services will likely remain unaffected. The key lesson here is to adhere to government regulations, consider geopolitics, and exercise caution when operating in markets not favorable to India.

The directive will be heavy on Paytm's balance sheet, too. "Depending on the nature of the resolution, the Company expects this action to have a worst-case impact of Rs 300–500 crore ($36–60 million) on its annual Ebitda going forward. However, the Company expects to continue on its trajectory to improve its profitability," Paytm said in its statement on 31 January.

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