

# Paytm's Unravelling: Will it Break This Time or Make it Again?

Regarded as the poster boy of India's fintech rush and start-up ecosystem, Vijay Shekar Sharma built Paytm into India's largest digital payment platform and financial services provider. However, today, his empire is under scrutiny for repeated regulatory breaches and non-compliance as the Indian central bank has swooped down on its activities and imposed restrictions to ensure that the fintech ecosystem thrives in the world's fifth-largest economy rather than take a blow on questions of trust and integrity.

**Words** Jennifer Paldano Goonewardane



Vijay Shekar Sharma, Founder and CEO, Paytm.

Paytm is India's largest digital payment app, managed by Paytm Payments Bank Limited (PPBL). The digital payment app commenced operations in 2017 and is a subsidiary of One97 Communications Limited. It offers digital banking services via its wallets, UPI, savings and current accounts, and fixed deposits. It allows customers and merchants to transact via their smartphones, allowing them access to diverse payment methods and merchants the ease of transacting. According to descriptions of its business model, the digital payment app focuses on tier one and tier two urban cities with young and middle-aged individuals seeking an accessible payment gateway. Paytm is enormous and complements India's image as a digitalized financial market pioneer. The company spread its wings quickly and delivered on the promise of creating financial inclusion in one of the world's most populous countries, which the Reserve Bank of India (RBI) has been trying to achieve when it released draft guidelines for Licensing of Payments Banks and Licensing of Small Banks in November 2014. Payment banks were regarded as ideal platforms to promote the agenda given their limited range of products that included a cap on deposit size, which could not be more than 200,000 rupees, while it could not lend money. In addition, these entities had a widespread network of access points. Paytm grew to such an extent that it once had the backing of Warren Buffet's Berkshire Hathaway, which invested USD 356 million in 2018, and others like SoftBank and Ant Group. In January 2024, it recorded over 100 million monthly active users, with 300 million wallets, a merchant base of over 20 million, and 30 million bank accounts. As its fortunes grew, those who saw it as the future of fintech bought into its highly valued shares. The November 2021 IPO had a price band of 2080 - 2150 Indian rupees per share. Paytm IPO was supposedly the largest in India's corporate history, raising USD 2.2 billion. Those fortunes changed in February this year, as the shares tumbled three days in a row, wiping out more than USD 2.5 billion in value, as the RBI hit the gavel on the fintech giant's repeated regulations violations.

This time, Paytm stands accused of extreme failures in Know Your Customer (KYC) standards that led to money laundering concerns. The allegations also include the filing of false compliance reports to the regulator. In a long list of violations, the digital payment giant stands accused of failing to monitor pay-out transactions, violating regulatory ceilings, and delaying reporting cybersecurity issues. Paytm had been unable to maintain KYC guidelines for thousands of customers. At the same time, the company used the same Primary Account Number (PAN) for multiple

customers, in the thousands in some instances. It had allowed end-of-day balance in customer accounts beyond the stipulated maximum, sometimes running into millions. There were also many dormant accounts worth millions uncovered following the RBI investigation. They raised concerns about their use as money mule accounts, a method used by criminal elements to launder money. According to critics, Paytm's weak regulatory compliance, including its glaring lapse in KYC processes and lack of transaction monitoring, provides loopholes to launder money for illegal activities. The company vigorously denies money laundering allegations leveled by the RBI. However, these allegations and findings are not the first instance. The RBI has been raising concerns for some time and has often engaged with the

company, advising it to change course. Its woes are traceable to its early days of operations when the RBI temporarily directed Paytm to stop onboarding new customers in June 2018 in the face of flouting licensing conditions, KYC guidelines, and day-end balances. The RBI lifted the ban by the end of that year based on the management's undertaking to rectify the irregularities. Then, in October 2021, Paytm was fined for submitting false information to the RBI, followed by the glaring revelation later the same year of technology, cybersecurity, and KYC anti-money laundering compliance lapses, with the RBI halting the entity from onboarding new customers once again while proposing a comprehensive system audit of its IT system. In 2022, the RBI found that Paytm had not taken any serious action on the system auditor's report, and as the company continued non-compliance with KYC standards, it had to pay a fine of more than 14 million Indian rupees. However, this time, analysts predict that the RBI is in no mood for concessions towards Paytm, some indicating that there is no turning back. Since, Vijay Shekar Sharma resigned as the non-executive chairman and board member of PPBL.

In response to its latest barrage of violations, the RBI has imposed business restrictions on Paytm, barring it from accepting deposits and making credit transactions, thereby preventing customers from adding money to their accounts or digital wallets with Paytm from March 15, 2024. According to RBI guidelines, existing account holders can withdraw money from their existing balance with the bank after the deadline. Paytm has been reassuring its customers of the safety of their money already with the bank. Amid the restrictions, customers can transfer services and money and migrate to alternative channels, banks, and non-banking financial institutions operating in fintech. The RBI has been in step with the changing financial services landscape in India, vigorously promoting the

proliferation of financial technology for payments and transactions in the wake of the COVID-19 pandemic. Accompanying that robustness is imposing checks and balances through new regulations. As explained by RBI governor Shaktikanta Das, the RBI carries on a rigorous and tight supervisory role, no longer waiting for the symptoms as a warning sign but, through its early warning exercises, going deep into the business models of banks and non-banking institutions to identify the potential risk areas, sensitizing them right away to rectify and change course rather than trying to micromanage the situation. Therefore, the message is clear. Compliance and honoring regulatory obligations are not optional as India's financial services space grows exponentially, complementing the government's economic growth agenda. There is a great deal of momentum when it comes to digital technology driving India's next phase of economic growth, and it is taking the lead globally by offering its home-grown Unified Payments Interface (UPI), which processes over 300 million daily transactions. The National Payments Corporation of India developed the UPI as an instant real-time payment system. UPI facility is available in Sri Lanka and Mauritius. Multiple countries accept UPI payments.

In the wake of the scandal, questions abound regarding the future regulatory space for fintechs. When India's largest digital payment platform provider stands accused of irregularities and stares into an uncertain future, there is cause for concern. On the one hand, analysts point fingers at fintech start-ups for expecting regulatory leniency, touting their burgeoning status as a reason to receive maximum support from regulatory bodies and the State. But in the process, these entities quickly push accepted boundaries to grow their fledgling business into larger entities capable of enlisting prominent investors. During the World Bank Group – International Monetary Fund Annual Meetings in October 2023 in Morocco, RBI governor Shaktikanta Das said that his institution is leading the campaign for financial digitalization in ushering financial inclusion in India, revealing his desire to make the Central Bank Digital Currency, (CBDC) mainstream. However, at the same forum, the governor stressed the need for greater clarity on new technology products and their adverse consequences for domestic and global financial stability and domestic and international monetary order. He had said that they pose a real threat in facilitating terror financing and money laundering, which could lead central banks in emerging markets to lose control, exposing their unstable nature. Today, some wonder whether the RBI, in its keenness to push its agenda of financial inclusion through fintechs, had failed to tighten the regulatory screws adequately for those offering services in that space. The case of Paytm gives rise to trust issues among customers regarding the security of funds with such entities and their ability to

access them, especially in meeting financial obligations to external parties, as such regulatory slaps can disrupt business operations, planned payments, and daily life and lead to instability. In the final analysis, the real cause for concern is the stability of the financial system. Pundits have pointed out the importance of ensuring that a fallout of this nature does not spread to others operating in the same space. Several start-up companies have raised that concern in India, citing RBI's action as too stringent and pointing to its negative impact on the rest of the fintech ecosystem. However, those concerns aside, RBI's action, backed by the government, conveys that fintech companies are not exempt from regulatory oversight. Doing so would be detrimental not only to customers but also to national security and financial stability. In the future, how these fintech companies merge their ambitions with regulatory obligations is something that requires sorting.