Paytm's Shares Are Rising but the Regulatory Crisis Is Not Over

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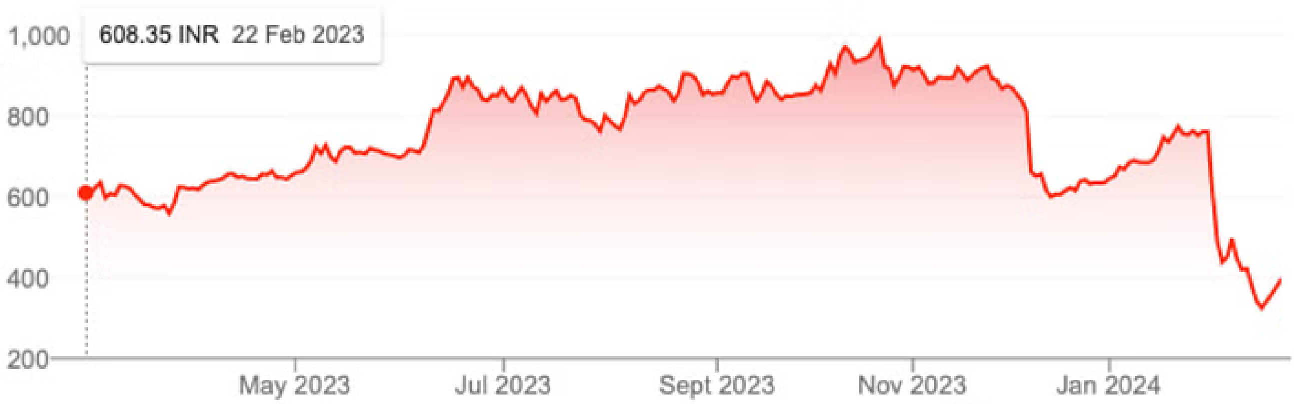
On 31 January, the Reserve Bank of India (RBI), just a day before the announcement of the Interim Union Budget, directed Paytm to stop accepting deposits or top-ups in any customer accounts, wallets, FASTags and other digital payment instruments after 29 February (now extended to 15 March).

A day later, the RBI introduced further restrictions on Paytm after a comprehensive system audit report and subsequent compliance validation report of the external auditors revealed alleged persistent non-compliances and continued material supervisory concerns in the bank, warranting further supervisory action.

Shares of One97 Communications, which runs Paytm, rallied 5 percent to hit an upper circuit level at Rs 395.25 on the Bombay Stock Exchange (BSE) earlier this week. Despite the regulatory crisis faced by the fintech company, the stock, after sliding downwards, has seen non-stop rally in the last four days. As compared to its all-time low of Rs 318.35, which was hit last Friday morning, the stock is up around 24 percent.



Open	395.05	Mkt cap	25.09TCr	52-wk high	998.30
High	395.05	P/E ratio	-	52-wk low	318.05
Low	395.05	Div yield	-		

With the PPBL's products such as wallets and FASTags set to drop, the brokerage estimates a five percent decline in payment Gross Merchandise Value (GMV) and the worst-case impact of four bps on the payments processing margin from nine bps currently, if the economics for Paytm doesn't change significantly from switching to a non-PPBL partner.

The nature of stock market volatility observed in One97 Communications' stock performance may well continue over a while till the regulatory crisis and its aftermath are fully addressed.

> Two key questions do arise though: To what extent the current regulatory crisis affects the overall operations of the company in the next few months? And given how Paytm's stock took a beating over the last few weeks, how does one make sense of the crisis afflicting the shining star of India's fintech bloom story?

The response to the formerquestion is based on a near-future test of time for the company to ensure greater trust and confidence amongst the regulators, its investors, and more importantly, its ever-growing customer base.

A response to the lattermerits a more reflective critique of Paytm's more recent business story and the nature of challenges faced by other fintech players. One can focus on that here.

This author had written a detailed analysis back in 2021, at a time when the news of Paytm's IPO release was making waves, arguing that the underlying fundamentals of many fresh IPO issuing companies (including Paytm) were telling a different tale of 'irrational exuberance'.

On the Social Media Revolution That Has Completely Engulfed India

Historical Context to Paytm's Fintech Woes

Back in 2014, the Reserve Bank of India had released draft guidelines for "Licensing of Payments Banks" and "Licensing of Small Banks".

As argued recently by journalist Mitali Mukherjee in *Frontline Magazine*, for the central bank, these banks would fulfil a common objective of furthering financial inclusion.

Payments banks would provide a limited range of products but have a widespread network of access points, particularly to remote areas, either through their branch network or Business Correspondents (BCs) or through networks provided by others.

"The underlying presumption was that there would be value-add by adapting technological solutions to lower costs. The remit for the companies that were eligible for a payments bank licence ranged from non-banking finance companies (NBFCs) to mobile telephone companies, supermarket chains, companies, real sector cooperatives, and public sector entities."

According to the rules for the payments banks, they could not lend money and could accept deposits only up to Rs 2,00,000; essentially targeting households and individuals with modest incomes. Paytm Payments Bank was among those awarded a licence and the bank started its operations in May 2017 with services that included digital banking, savings accounts, current accounts, fixed deposits with partner banks, Paytm wallet, UPI, and FASTag, among other offerings.

But Mukherjee says that the frequency of run-ins with the central bank should have had everyone concerned.

> "In June 2018, the RBI prohibited Paytm Payments Bank from opening any new account and wallet on account of supervisory concerns. Those prohibitions were lifted in December 2018. The next year, the Office of Banking Ombudsman issued a show-cause notice for Paytm Payments Bank's failure to monitor a certain account maintained with it that had shown a sudden increase in the velocity of daily transactions involving immediate transfer to other banks."

These actions, according to Mukherjee, were found to be in violation of RBI's provisions on KYC (Know Your Customer) norms.

In July 2021, the central bank issued a show-cause notice to PPBL for submitting false information about the transfer of an operating unit from One 97 Communications to PPBL.

By October of the same year, PPBL was charged a Rs one crore penalty for contravention of the Payment and Settlement Systems Act, 2007.

From the RBI’s point of view, a row of red flags was popping up: PPBL did not monitor payout transactions or carry out risk profiling of entities availing those services. In several cases, the regulatory ceiling of end-of-day balance in customer advance accounts was breached.

What Happens After 15 March?

After 15 March, according to reports, PPBL customers will not be able to deposit money into their Paytm Payments Bank accounts. No credits or deposits other than interest, cashback, sweep-in from partner banks or refunds are allowed to be credited. Customers are suggested to make alternative arrangements with another bank to avoid inconvenience.

The existing deposits of PPBL customers maintained with partner banks can brought back (sweep-in) to the accounts with PPBL, subject to the ceiling on balance (Rs two lakh per individual customer at the end of day). Such sweep-ins for the purpose of making available the balances for use or withdrawal by the customer will continue to be allowed.

However, no fresh deposits with partner banks through PPBL will be allowed.

For more on Paytm-UPI's zero-MDR (Merchant Discounting Rate), and on the gender and rural-urban gaps, click here.

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