

# India Regulator Keeping Close Watch On Payments Banks After KYC Issue

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**India's central bank is taking no prisoners over its demanding know your customer (KYC) rules, experts say, after it carried out enforcement action against two high-profile payments banks.**

The Reserve Bank of India (RBI) recently told Fino Payments Bank and Paytm to stop enrolling new customers until the two institutions address deficiencies in their onboarding processes, marking the latest example of the regulator keeping a close watch on payments firms.

**"This is still a new framework in India and is evolving," said Aaron Kamath, a lawyer at Nisith Desai Associates. "It appears that the RBI is proactively keeping an eye on this, as well as periodically issuing directives and guidelines to payments banks."**

The order against Paytm came as a surprise to some, and ambiguities remain over the exact violation of the KYC requirements. As a payments bank, the company is permitted to onboard customers remotely using the Aadhaar national identity system.

According to Akash Karmakar, an associate at Veritas Legal, e-KYC — a simplified paperless Aadhaar-based process for fulfilling KYC requirements online — is a "tried and tested" process, and so it is not clear what precise discrepancies the RBI has observed to take such an "extreme step".

"In the past whenever they have imposed such restrictions, it is to incentivise the regulated entity that is allegedly non-compliant to respond quickly," he said, speaking in a personal capacity.

"Precedents have shown that regulated entities have complied with extreme speed and efficiency when faced with such diktats. This will put extreme pressure on the companies to bring their systems into compliance."

The payments bank regime was [introduced in 2015](#) as part of the government's push to bring India's unbanked population into the formal financial system.

Licensees are permitted to accept deposits of up to Rs1 lakh (\$1,450) per customer in a savings or current account, and offer debit cards and online banking; however, credit services and loans remain out of bounds.

In the case of Fino Payments Bank, an audit conducted by the RBI found it had allowed customers to deposit amounts that exceeded the regulatory limit. The firm said it was "in the process of making the necessary product and technology changes" but had stopped accepting new customers until the upgrades were completed following the regulator's orders.

After receiving its payments bank status in March last year and launching the following September, Fino said it now has close to 1m customers. Paytm, as one of the wallets to proliferate after the demonetisation, processes 5bn transactions annually, according to company data.

According to local media reports, a further concern with Paytm was its relationship with parent company One97 Communications, which has a 49 percent stake in the payments bank.

The company did not respond when contacted by PaymentsCompliance, and Fino declined to comment further.

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**"There has also emerged a second aspect to this, which is deposits in excess of the prescribed limit being made into the e-wallets," said Akash Karmakar of Veritas Legal. "This could be another factor which has led the RBI to issue such a directive."**

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Earlier this week, Prime Minister Narendra Modi announced the launch of the Post Office Payments Bank with at least one bank in every district and a focus on rural areas. But of the initial cohort of licensees, three have abandoned the authorisation process as the profit margins were deemed too low in an intensely competitive market.

Airtel Payments Bank has recently been given permission to recommence Aadhaar-based verification of customers, after being suspended from using the system towards the end of last year.

The company was accused of using electronic Aadhaar-based KYC data to open payments accounts of its subscribers without proper consent.

According to Shilpa Mankar, a partner at Shardul Amarchand Mangaldas and Co, prepaid wallet providers are still grappling with the KYC rules [introduced by the RBI](#) in October last year.

In the wake of the government's shock demonetisation programme, when the most widely used banknotes were [withdrawn from circulation](#) overnight, digital wallets had proliferated.

However, since the central bank rules took effect in February, compliance difficulties have [driven](#) market consolidation and even forced some entities to shut down.

The lawyer said that the compliance burden has become heavier due to a restriction imposed by the Unique Identification Authority of India (UIDAI) preventing non-regulated entities from accessing the Aadhaar database.

"What most companies are doing is sending their employees to a customer location to complete biometric verification or do KYC," she added. "That has very significant cost implications."

The UIDAI restriction was prompted by concerns raised by the Supreme Court in a related hearing that too many companies, especially those that are unregulated, have access to the identity system.

However, the final outcome of that case will be crucial in deciding whether prepaid payment instruments will be permitted to use Aadhaar for KYC purposes.