



Understanding KYC

-KANAKPRABHA JETHANI

VINOD KOTHARI CONSULTANTS P. LTD.

Coverage

- Meaning and genesis of KYC
- Need of KYC
- Anti-Money Laundering Framework in India
- Introduction of KYC Directions
- Flow of a typical credit sanction process
- Modes of undertaking KYC and intricacies in each of the modes
- Major compliance requirements under the KYC Directions and Prevention of Money Laundering Act and Rules.

What is KYC?

KYC stands for Know Your Customer

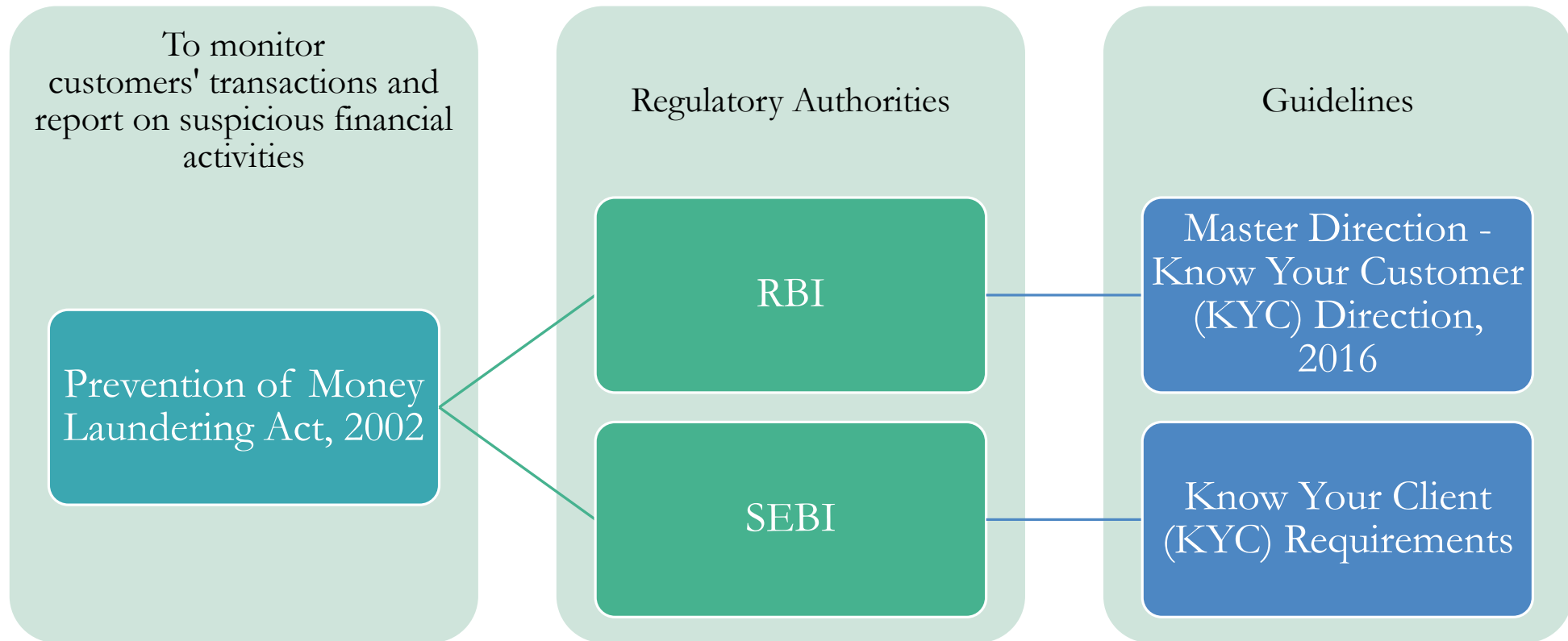
It is a process of establishing a person's identity

Essentially, it means verifying the details of the person and confirming the same from a trusted source

Why is KYC needed?

- Risk of money laundering in every financial transaction
- For lending institutions, there is an additional risk of financing terrorism
- Risk of impersonation
- Risk of frauds

Anti-Money Laundering Framework in India





Understanding
KYC
Directions

Important Terminology

OVD- *means :*

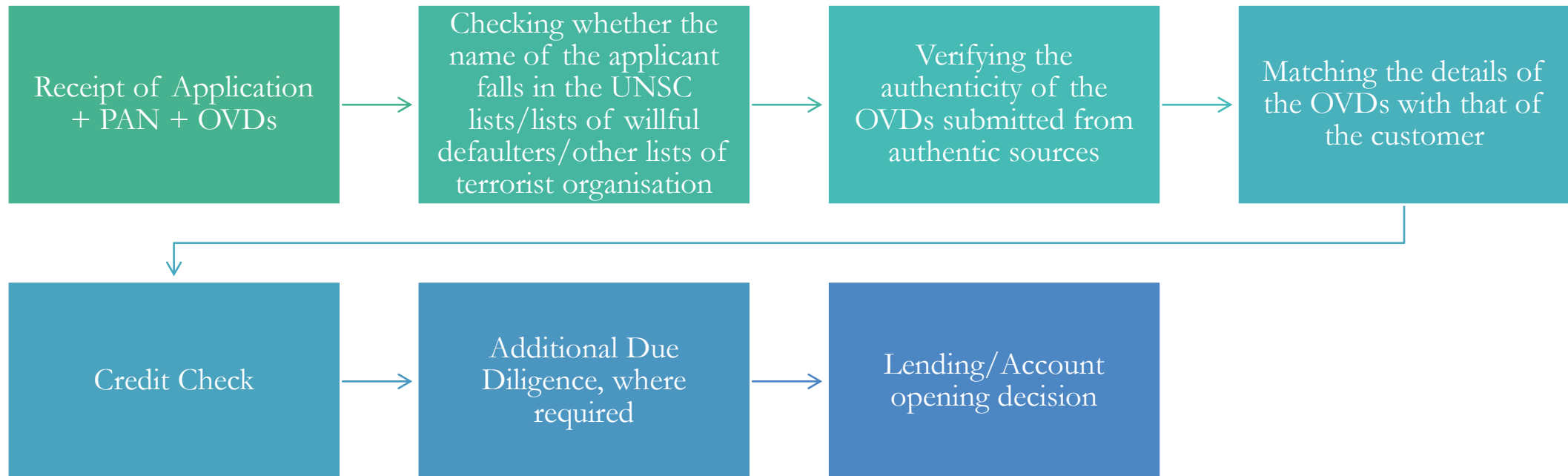
- *the passport*
- *the driving license*
- *proof of possession of Aadhaar number*
- *the Voter's Identity Card issued by the Election Commission of India*
- *job card issued by NREGA duly signed by an officer of the State Government*
- *letter issued by National Population Register with details of name and address.*

Equivalent e-documents- *means an electronic equivalent of a document, issued by the issuing authority of such document with its valid digital signature including documents issued to the digital locker account of the customer as per rule 9 of the Information Technology (Preservation and Retention of Information by Intermediaries Providing Digital Locker Facilities) Rules, 2016.*

Regulated Entity (RE)- *means all banks, AIFIs, NBFCs, Payment System Providers/ System Participants and Prepaid Payment Instrument Issuers and all authorised persons regulated by the RBI.*

Customer Due Diligence (CDD)- *means identifying and verifying the customer and the beneficial owner.*

Credit Sanction Process Flow



Modes of conducting CDD

Physical

- Customer submits a copy of OVDs, photograph and PAN with loan application
- RE matches the copy with the original OVD shown by the customer
- Signatures of the customer obtained in wet ink

Digital KYC

- Extension of physical KYC
- Rather than obtaining a physical copy of OVD, the RE captures image of original OVD in an application
- Live photograph of the applicant is also captured
- The rest of the process is same

V-CIP

- Customer submits an equivalent e-document of OVDs/aadhaar XML/QR code/KYC Identifier with loan application and PAN
- The OVDs submitted by applicant are verified using various means
- RE does a video call with the applicant, where he/she displays original OVD on call
- Loan agreement is executed digitally

OTP based eKYC

- Manner of authentication of Aadhaar
- Aadhaar can be authenticated by sending an OTP to the customers registered mobile no.
- **Only for banks**
- Usually used for digital lending
- Temporary mode- valid for 1 year

CKYCR

- Customer submits his/her KYC identifier
- RE downloads KYC records from the CKYCR and matches the details with that provided by the applicant
- Loan documents are executed digitally/physically

CDD for Entities

Sole Proprietorship

Undertake CDD of proprietor

Any 2 of following additional documents to be obtained:

- Registration certificate
- Certificate/licence under Shop and Establishment Act.
- Sales and income tax returns.
- GST certificate (provisional/final).
- Certificate by Tax authorities.
- IEC (Importer Exporter Code)
- Complete Income Tax Return
- Utility bills

Partnership Firm

Undertake CDD of BO/Manager, officers or employees holding power of attorney to act of behalf of firm

BO- Person entitled to more than 15% per cent of capital or profits

Any 2 of following additional documents to be obtained:

- Registration certificate
- Partnership deed
- PAN of the partnership firm and

Company

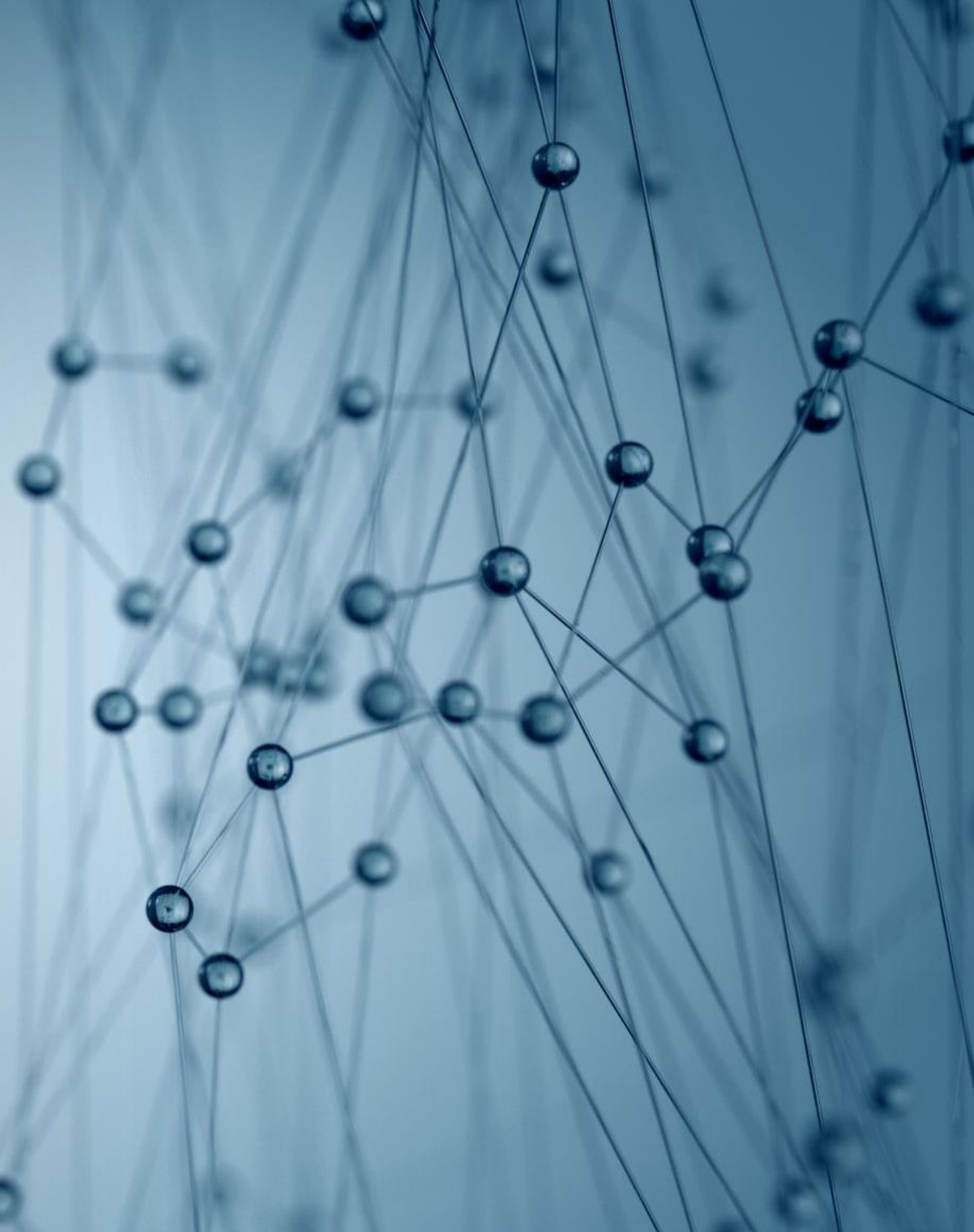
Undertake CDD of BO/Manager, officers or employees holding power of attorney to act of behalf of company

BO- Person having Controlling Interest i.e. 25% of the shares or capital or profits

Any 2 of following additional documents to be obtained:

- Certificate of incorporation
- Memorandum and Articles of Association
- PAN of the company
- A resolution and power of attorney granted to person transact on its behalf

Intricacies in
modes of
carrying out
KYC



Physical Mode

- Aadhaar number can be obtained only by banks
 - Authentication using e-KYC authentication facility provided by UIDAI
- REs other than banks can obtain proof of possession of Aadhaar only
 - If provided by customer, ensure the same is redacted
 - Authentication using offline verification
- Copies of other OVDs may also be obtained
 - Usually self-attested by customer

Digital KYC

- Extension of Physical KYC
- Application to be developed for digital KYC process
 - Access of the Application shall be controlled by the REs
- Customer shall visit the location of the authorized official of the RE or vice-versa
 - Ensure customer has original OVD
 - Same shall be captured along with live photo of customer and location tagging
- Banks may use the services of Business Correspondent (BC) for this process

V-CIP

- Can be used for CDD of individuals, proprietors of proprietorship firm, authorised signatories and Beneficial Owners (BOs) of Legal Entities
 - In case of other than individuals, additional documents to be obtained
- May also be used for conversion of existing OTP based accounts to full KYC accounts and periodic updation of KYC
- Application to be operated only by officials of RE
 - This mode of carrying out KYC verification cannot be outsourced
- Can obtain equivalent e-document including documents issued through Digilocker
- Verification of documents using- OTP based authentication/ Offline verification of Aadhaar/KYC records downloaded from CKYCR/verification of equivalent e-document from the database of issuing authority
- PAN to be verified from the database of the issuing authority
- Account shall be operational only after concurrent audit- Ensure no tampering
- Details of KYC and person performing V-CIP to be maintained

V-CIP Infrastructure

- Comply with RBI guidelines on minimum baseline cyber security and resilience framework for banks
- Technology infrastructure to be housed in own premises
- V-CIP connection and interaction to necessarily originate from RE's own secured network domain
- Technology related outsourcing may be done, in accordance with RBI guidelines
- Customer consent to be recorded in an auditable and alteration proof manner.
- Infrastructure to be capable of preventing connection from IP addresses outside India or from spoofed IP addresses.
- Recordings to contain the live GPS co-ordinates and date-time stamp of customer.
- Quality of video to be adequate to allow identification of the customer beyond doubt.
- Tests such as Vulnerability Assessment, Penetration testing and a Security Audit

OTP based eKYC

- Can be undertaken by banks only
- Specific consent of customer to be obtained
- Limits on account:
 - aggregate balance of the deposit account shall not exceed Rs. 1 lakh
 - aggregate of all credits in a financial year, in all the deposit account taken together, shall not exceed Rs. 2 lakhs
 - only term loans shall be sanctioned
 - aggregate amount of term loans sanctioned shall not exceed rupees Rs. 60,000 in a year.
 - account shall not be allowed for more than one year unless complete KYC is done
 - Otherwise, the account shall be closed immediately.
- Declaration to be obtained that no other account has been opened nor will be opened using OTP based KYC
- Clearly indicate in CKYCR records

CKYCR

- If customer submits KYC identifier, take declaration that there has been no change in the KYC information submitted
 - Ensure data on CKCYR is updated
- In case obtaining KYC documents from customer for the first time- upload on CKYCR within 10 days
- Communicate KYC Identifier to customer
- Is this mode a valid mode of KYC?



Other Major Provisions

Major provisions of KYC Directions (1/3)

REs to have a KYC Policy in place

- Policy should usually include:
 - Procedure for identification and acceptance of customer
 - Broad contours of the KYC process to be followed
 - Guidance for secrecy and maintenance of information
 - Governance Framework for KYC
 - Manner of ongoing due diligence and periodic updation

Outsourcing

- Outsourcing of KYC function may be done to the extent it does not outsource decision making power
- Only the function of collecting and processing information can be outsourced
- Information security guidelines must not be breached
- Records or the information to be obtained within two days from the service provider
- Responsibility of RE shall not cease

MLTF risk

- Financial institutions are more prone to the risk of ML an dTF
- Carry out assessment- geography, type, customer seg
- Place before BOD
- Must form part of policy

Major provisions of KYC Directions (2/3)

Designated Director and Principal Officer

- Designated Director (DD) ensures overall compliance with the obligations imposed under Chapter IV of the PML Act and the Rules
- Principal Officer (PO) - responsible for ensuring compliance, monitoring transactions, and sharing and reporting information
- PO and DD not to be the same person
- Details of PO and DD to be communicated to the FIU-IND.

Customer Acceptance

- CDD to be done at UCIC level
- CDD to be done for all joint account holders
- Ensure the name of customer does not appear in UNSC/ RBI sanctions list/willful defaulters list etc.
- PAN to be verified only from verification facility
- In case of e-documents, digital signature to be verified as per IT Act, 2000

Risk Management

- Customers to be divided in 3 categories:
 - High
 - Medium
 - Low
- Parameters for categorization
 - customer's identity, social/financial status
 - nature of business, location etc.

Major provisions of KYC Directions (3/3)

Periodic Updation

- Risk based approach
- If no change in KYC information- obtain self-declaration for the same
- If change in address-
 - In case of individual- self-declaration of the new address + verification within 2 months
 - In case of other than individual- conduct CDD
- Change in other KYC information- conduct CDD

Record Management

- Records of transactions to be maintained for 5 years from date of transaction
- Records of identity to be preserved for 5 years after relationship ends

Secrecy Obligations

- KYC information is personal information
- Not to be divulged to any person without prior consent of the customer
- Exceptions:
 - Compulsion of law
 - Duty to disclose
 - Required by RBI/courts

The background of the slide features a close-up, slightly blurred image of several yellow, cylindrical pills. Each pill has a dark number embossed on its top surface. Visible numbers include '10', '25', and '75'. The pills are scattered across the frame, creating a textured, medical-themed backdrop.

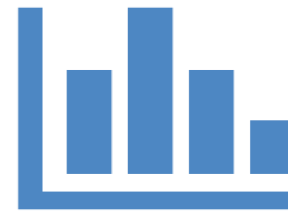
Prevention of Money Laundering Act and Rules

Major provisions



Maintenance of Records

- Maintain records of all transactions
- Specifically:
 - cash transactions of Rs. 10 lakhs or more- individual or series
 - cash transactions where forged or counterfeit notes have been used
 - suspicious transactions
 - all cross border wire transfers of more than Rs. 5 lakhs
 - purchase./sale of immovable property of Rs. 50 lakhs or more



Reporting

- Upon occurrence of any suspicious transactions, report to FIU within 7 working days
- Purchase/sale of immovable property of Rs. 50 lakhs or above- to be reported by 15th of succeeding quarter
- Other specified transactions to be reported by 15th of next month

Thank you

