KNOW YOUR CUSTOMER (KYC) NORMS – A CHALLENGE FOR BANKS IN INDIA

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ABSTRACT
In today’s world, KYC guidelines are laid down to prevent banks from being used, intentionally or unintentionally, by criminal elements for money laundering or terrorist financing activities. RBI also simplified various KYC norms to minimize frauds and risks and protect banks reputation. RBI has also accepted e-KYC through aadhaar to reduce document risk and frauds and reduce cost. Banking Regulation Act was amended and gave powers to RBI to impose a penalty for single violation. Elements of KYC policy are customer acceptance and customer severance, customer identification procedures, monitoring of transaction and risk management.

Keywords: KYC Norms; Customer; Banks; RBI

INTRODUCTION
The objective of KYC (Know Your Customer) / ALM (Anti Money Laundering) / CFT (Combating of Financing of Terrorism guidelines is to prevent banks from being used, intentionally or unintentionally, by criminal elements for money laundering or terrorist financing activities. KYC procedures also enable banks to know / understand their customers and their financial dealing better which in turn help them manage their risks prudently.

Definition of Customer
• A person or entity that maintain account and / or has a business relationship with the book,
• One on whose behalf the account is maintained (i.e. beneficial owner)
• Beneficiaries of transaction conducted by professional intermediaries, solicitors, etc. as permitted under the Law, and
• Any person or entity connected with the financial transaction which can pose significant reputational or other risks to the bank, say, a wire transfer or issue of a high value demand draft as a single transaction.

OBJECTIVES OF KYC NORMS
1. To prevent banks from being used, by unscrupulous or criminal elements for their criminal activities including money laundering.
2. To minimize frauds and risks and protect banks reputation.
3. To avoid opening of accounts with fictitious name and address.
4. To weed out bad customers and protect good ones.
RESEARCH METHODOLOGY

The present study is based on secondary method of data collection. Different aspects related to KYC norms are studied. A detailed study of RBI guidelines is made. Data was collected from different Websites of RBI and other Websites.

RBI Simplifies KYC Norms Ahead Of Jan Dhan Yojana Launch

RBI announced simplified KYC norms for low risk customers ahead of the launch of the Prime Minister’s Jan Dhan Yojana. Under the new norms low risk customers can provide KYC documents within six months of opening the account.

The Pradhan Mantri Jan Dhan Yojana will be launched by Prime Minister Narendra Modi on completion of 100 days of the new government. The scheme envisages financial inclusion by initially providing every household with a bank account. Subsequently through this account the unprivileged will get subsidies, insurance cover and overdraft facilities.

Those persons who do not have any of ‘officially valid documents’ can open ‘small accounts’ with banks. A small accounts’ can be opened on the basis of a self-attested photograph and either a signature or thumb print in the presence of an official of the bank. Such accounts have limitations regarding the aggregate credits (not more than Rupees one lacs in a year), aggregate withdrawals (not more than Rupees ten thousand in a month) and balance in the accounts (not more than Rupees fifty thousand at any point in time). These small accounts would be valid normally for the period of twelve months. Thereafter, such accounts would be allowed to continue for a further period of twelve more months, if the account holder provides a document showing that he/she has applied for any of the officially valid document, within twelve months of opening the small account.

RBI had clarified that there is no requirement of submitting two separate documents for proof of identity proof of address. If the officially valid document submitted for opening a bank account has both, identity and address of the person, there is no need for submitting any other documentary proof. Officially valid document for KYC purpose include: ID card, PAN card, Aadhaar letter issued by UIDAI and job card issued by NREGA signed by a state government official.

Since migrant workers and transferred employees often face difficulties while submitted a proof of current address for opening bank account, such customers can submit only one proof of address (either current or permanent). While opening a bank account or while undergoing periodic updation if the current address is different from the address mentioned on the proof of address submitted by the customer, a simple declaration about current address would be sufficient.

Guidelines

1. Branches should keep in mind that the information collected from the customer for the purpose of opening of account is to be treated as confidential and details thereof are not to be divulged for cross selling or any other like purposes.
2. Branches shall ensure that any remittance of funds by way of demand draft, mail / telegraphic transfer or any other mode and issue of traveler’s cheque for value of rupees fifty thousand and above is effected by debit to the customer’s account or against cheques and not against cash payments.
3. Branches shall ensure that the provision of foreign contribution and regulation Act, 1976 as amended from time to time wherever applicable are adhered to strictly. They shall desist from opening accounts in the name of banned organization and those without registration. In this connection branches shall be guided by the circulars issued from time to time.

Violation of KYC Norms

RBI is likely to adopt a zero tolerance policy on KYC and AML norms. The move follows a series of violation of norms by banks, which were identified by the RBI in the recent past.
The regulator also feels that the quantum of penalties for such violations is small. It is currently looking at a proposal to increase this.

Another proposal is to put operational curbs such as not allowing a bank to disburse loans for three months or not allowing them to take part in treasury operations for a limited period. Branch expansion is another area where restrictions could be imposed.

At present, a small violation of KYC / AML is overlooked by the central government during inspection. Now, they are saying even if a bank is 99% compliance, one percent non-compliance attracts penalties.

Banks could also see the monetary penalty rising sharply from the present Rs. 5 lacs per violation.

The Banking Regulation Act was amended and gave powers to RBI to impose a penalty of Rs. 1 crore for a single violation.

The RBI has penalized ICICI bank and BOB for violating norms governing KYC and AML. The fine was Rs. 50 lacs for ICICI bank and Rs. 25 lacs for BOB. Four banks – SBI, ICICI bank, BOB, & AXIS bank were scrutinized in January by the RBI for discrepancies and frauds by bank officials. The scrutiny was on the basis of a complaint by a reputed statutory organization.

This round of penalties for violation of KYC norms comes after a gap of 1 year. RBI also find six other banks – Allahabad bank, Bank of Maharashtra, Corporation bank, Dena bank, IDBI bank and Indian bank.

The RBI has slapped a penalty of Rs. 1.5 crore each on three public sector banks – Bank of Maharashtra, Dena Bank and Oriental Banks of Commerce for violating rules of KYC / AML.

RBI also asked eight other public sector banks – Bank of India, Punjab National Bank, and State Bank of Bikaner and Jaipur, Union Bank of India, Central Bank of India, UCO Bank, Vijaya Bank and Punjab and Sindh Bank to ensure strict compliance with KYC norms.

The RBI has asked banks to exercise full KYC procedure at least every two year for high risk individuals and entities, from earlier directive of not less than once in two years.

For low risk individuals and entities, KYC data updating has been relaxed to at least every 10 years from the requirement of not less than once in five years earlier.

For medium risk individuals and entities it has been relaxed to at least every eight years, from not less than once in two years.

Also, banks should closely examine transaction to ensure its consistency with their knowledge of the client, about their business and risk profile and, wherever necessary, the source of funds. Banks will be required to get fresh photographs from minor customer on becoming major.

**What Are The Valid Documents For ID Proof And Address Proof?**

Prospective customer can give self attested copy of one of the documents from following indicative list. The originals of these documents are, however required to be shown to the bank officials for verification.

**Proof of Identity**

1. Passport
2. Voter ID card
3. Driving license
4. PAN card
5. Photo credit card
6. Defense ID card
7. Any other valid proof as may be accepted by the bank

**Proof of Address**
1. Passport
2. Voter ID card
3. Driving license
4. Latest utility bill
5. Rent / Lease
6. Credit card
7. Employer’s authority’s address

**Note**
1. Address proof of close relatives (parents, son, daughter, etc.) may be provided with sufficient evidence in case prospective customer resides with relative and no valid address proof in his name available.
2. In case of joint holder, independent proof of identity and address for all the individuals are required.

**Key Elements of the KYC Policy**
Following are four key elements of KYC policy-

**Customer Acceptance Policy (CAP)**
Branch must ensure that no account is opened-

a) In anonymous or fictitious name(s)

b) In the names of person with a criminal background and / or having connection with terrorist organization.

**Risk Perception**-
No financial sector business is immune from the activities of criminal elements. The level of money laundering risk that bank is exposed to by customer relationships depends on:

- Type of the customer and nature of business.
- Type of product or service availed by the customer.
- Country where the customer is domiciled.

**Customer Identification Procedures**
The first requirement of knowing your customer for anti money laundering purposes is to be satisfied that a prospective customer is who he / she claims to be.

The second requirement of knowing your customer is to ensure that sufficient information is obtained on the nature of the business that the customer expect to undertake or any expected, or predictable pattern of transaction.

Customer identification means identifying the customer and verifying his / her identity by using reliable, independent, source documents, data or information to bank’s satisfaction. It is further clarified that ‘being satisfied’ means that the bank must be able to satisfy the competent authorities that due diligence was observed based on the risk profile of the customer in compliance with the extent guidelines in place.

**Monitoring Of Transaction**

Ongoing monitoring is an essential element of effective KYC procedure. Banks can effectively control and reduce their risk only if they have an understanding of the normal and reasonable activity of the customer so that they have the means of identifying transaction that fall outside the regular pattern of activity. However the extent of monitoring will depend on the risk sensitivity of the account. Bank should pay special attention to all complexes, unusually large transaction and all unusual pattern which have no apparent economic or visible lawful purpose. The bank may prescribe threshold limits for a particular attention to the transactions which exceed these limits. Transactions that involve large amounts of cash inconsistent with the normal and expected activity of the customer should particularly attract the attention of the bank very high account turnover inconsistent with the size of the balance maintained may indicate that funds are being “washed” through the account. High risk accounts have to be subjected to intensify monitoring. Every bank should set KYC indicators for such accounts, taking note of the background of the customer, such as the country of origin, sources of fund, type of transaction involved and other risk factors. Bank should put in place a system of periodical review of risk categorization of accounts and the need for applying enhanced due diligence measures. Banks should ensure that a record of transactions in the accounts is preserved and maintained as required in terms of section 12 of the PML Act, 2002. It may also be ensured that transactions of suspicious nature and / or any other type of transaction notified under section 12 of the PML Act, 2002, is reported appropriate Law enforcement authority.

Banks should ensure that its branches continue to maintain proper record of all cash transaction of Rs. 10 lacs and above. The internal monitoring system should have an in build procedure for reporting of such transactions and those of suspicious nature to controlling / head office on a fortnightly basis.

**Risk Management**

Bank may, in consultation with their boards, devise procedure for creating risk profiles of their existing and new customers and apply various Anti-Money Laundering measures keeping in view the risk involved in a transaction, account or banking business relationship. Banks internal audit and compliance functions have an important role in evaluating and ensuring adherence to the KYC policies and procedures. As a general rule, the compliance function should provide an independent evaluation of the bank’s own policies and procedure, including legal and regulatory requirements. Banks should ensure that their audit machinery is staffed adequately with individuals who are well versed in such policies and procedures. Concurrent / internal auditors should specifically check and verify the application of KYC procedures at the branches and comment on the lapses observed in this regard. The compliance in this regard may be put up before the audit committee of the board on quarterly intervals. Banks must have an ongoing employee training programme so that the members of the staff are adequately trained in KYC procedures. Training requirements should have different focuses for frontline staff, compliance staff and staff dealing with new customers. It is crucial that all those concerned fully understand the rationale behind the KYC policies and implement them consistently.
E – KYC through Aadhaar

The RBI has accepted an electronic KYC, based on the Aadhar or unique identification number (UDI), as a valid way to open a bank account. This could reduce the risk of identity fraud and document forgery, paving the way for a paperless way of fulfilling KYC norms.

An e-KYC norm was acceptable under prevention of money laundering rules, 2005. Banks may open a new account by taking a person’s Aadhar number and biometrics. Once matched, the demographic data, including identity and address proof stored in UID’s central registry, can be assessed by the bank concerned to complete the verification. A bank will need to take ‘explicit consent’ of the person concerned to “release his/her identity/address through biometric authentication to the bank branches / business correspondents.

A.P. Singh, Deputy Director General of the (UIDAI) said that move help the banking and telecom sector the most. These would save huge cost of storing and verifying the documents in question, along with the obvious advantage of establishing an audit trail and reducing document fraud.

CONCLUSION

The BOD of the bank should ensure that an effective KYC programme is put in place by establishing appropriate procedures and ensuring their effective implication. It should cover proper management oversight, system and controls, segregation of duties, training and other related method. Responsibility should be explicitly allocated within the bank for ensuring that the bank’s policies and procedures are implemented effectively.

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