# 📌 KYC (Know Your Customer) - Genesis & Policy Framework

## KYC/AML Chapter 1 Module B

### 🔍 1.1 GENESIS OF KYC

**1.1.1 Practice of Introduction**

✔ Banking primarily involves **accepting deposits and lending**.

✔ **Customer Introduction**: Traditionally, customers needed an introduction before opening a bank account.

✔ **Restrictions on Non-Introduced Customers**: No cheque facility if introduction was not provided.

✔ **Due Diligence for Borrowers**: Always mandatory for assessing **credit risk**.

📌 **Example:** In earlier banking systems, customers needed recommendations from existing account holders to open a new account.

### 1.1.2 Customer Due Diligence (CDD)

**Why CDD?**

✔ Rising **money laundering (ML)** & **terrorist financing (TF)** forced banks to adopt strict due diligence.

✔ **FATF (Financial Action Task Force)**, established after the **1988 Vienna Convention**, mandated banks to implement **CDD measures**.

✔ **2001 Basel Committee (BCBS)** published guidance on customer due diligence.

📌 **Purpose of KYC: Filter out high-risk customers** & ensure **safe banking transactions**.

## 📌 1.2 NEED FOR KYC POLICY

🔹 **Regulatory Framework:**

✔ **PMLA (Prevention of Money Laundering Act)** mandates strict KYC compliance.

✔ **Master Direction - KYC (2016)** issued by **RBI**, updated periodically.

✔ Every bank must have a **Board-approved KYC Policy**.

📌 **Example: Banks must verify customer identity before onboarding them**, ensuring the **legitimacy of funds**.

### 1.2.1 Periodical Review of KYC Policy

✔ **KYC/AML regulations are dynamic** and updated regularly by **FATF, RBI, and PMLA**.

✔ Banks must **revise their KYC policies at least once a year**.

✔ **Any changes in law must be promptly implemented & communicated within the bank.**

📌 **Example: A revised FATF guideline may require banks to collect additional details for high-risk customers.**

## 📌 1.3 ELEMENTS OF KYC POLICY

### 1.3.1 RBI Guidelines

💡 **RBI's 4 Key Elements of KYC Policy:**

1 **Customer Acceptance Policy (CAP)** – Define **who can be a customer**.

2 Risk **Management** – Classify customers into **low, medium, and high risk**.

3 **Customer Identification Procedures (CIP)** – Verification of **identity & address**.

4 **Monitoring of Transactions** – Identify **suspicious transactions**.

📌 **Example:** A **high-risk customer (e.g., Politically Exposed Person - PEP)** may need **enhanced due diligence (EDD)**.

### 1.3.2 Customization of KYC Policy

✔ KYC Policy should be **tailored** to each bank's **business operations & geographical presence**.

✔ **Domestic banks:** Focus on **local AML/CFT rules**.

✔ **International banks:** Consider **host country regulations & RBI directives**.

✔ **Banks with para-banking services:** Must comply with **SEBI (mutual funds) & IRDA (insurance sales)** regulations.

📌 **Example:** A **cooperative bank in India** doesn't need to cover **correspondent banking rules**, but **an international bank must**.

### 1.3.3 Compliance with KYC Policy

✔ **KYC Policy compliance is crucial** at **all levels** of a bank.

✔ Responsibilities of **Senior Management & Compliance Teams**:

- Assign **KYC responsibilities** to a designated **Senior Official**.
- Implement **internal control mechanisms** to monitor **policy execution**.
- Conduct **regular independent audits & risk evaluations**.
- Submit **quarterly compliance reports to the Audit Committee**.

✔ **Decision-making on KYC compliance cannot be outsourced**.

📌 **Example: Internal audit teams must verify KYC processes quarterly** to ensure compliance with AML norms.

## 🔍 Summary: Why KYC Matters?

✔ **Prevents financial crimes** (Money Laundering, Terrorist Financing).

✔ **Ensures customer identity verification** before providing banking services.

✔ **Reduces credit risk** by understanding customer background.

✔ **Mandated by RBI & international agencies (FATF, Basel Committee).**

✔ **Improves transparency & strengthens banking security.**

📌 **Final Thought:** KYC is **not just a regulatory requirement** but a **vital tool for a secure banking ecosystem.**

📌 **KYC (Know Your Customer) - Process Manuals & Customer Acceptance Policy**

## 📍 1.3.4 Process Manuals

### 💡 Why are Process Manuals needed?

✔ The **KYC Policy** is a broad regulatory framework.

✔ **Process Manuals** define the **operational steps** to implement **AML/CFT measures**.

✔ Manuals should clearly outline actions for different **business lines, functional units, and levels of banking operations**.

📌 **Example:**

A **bank branch** dealing with **retail customers** may have a separate KYC manual compared to a branch handling **corporate clients or high-net-worth individuals (HNIs)**.

🔹 **Manuals should cover:**

✔ **Customer onboarding** (from sourcing to account opening).

✔ **Risk assessment** based on the **customer profile**.

✔ **Monitoring and reporting suspicious transactions**.

✔ **Periodic review of customer relationships**.

## 📍 1.4 CUSTOMER ACCEPTANCE POLICY (CAP)

💡 **Objective:**

✔ To **mitigate ML/TF risks** by accepting only **genuine customers**.

✔ To **avoid relationships** with customers involved in **illegal or fraudulent activities**.

📌 **Example:** Banks **must refuse customers linked to money laundering, terrorism, or financial frauds**.

### 📍 1.4.1 Prohibitions (Accounts That Banks Cannot Open)

🔹 **As per Rule 9(11) of PML Rules, banks must NOT open:**

❌ **Anonymous accounts** (without identity details).

❌ **Accounts with fictitious names** (e.g., fake identities).

❌ **Accounts on behalf of unidentified persons**.

📌 **Example:** A bank cannot open an account for a customer named "John Doe" with **unverified or forged KYC documents**.

## 📍 1.4.2 RBI Guidelines on Account Opening

✔ **Benami accounts (held by a proxy for someone else) are prohibited**.

✔ **If a customer refuses to provide proper KYC documents**, banks must reject the account opening request.

✔ **CDD (Customer Due Diligence) is mandatory for ALL accounts**.

### 📌 Mandatory Customer Information:

✔ Basic KYC details **must be collected at onboarding**.

✔ Additional data **can be collected later with customer consent**.

✔ **One-time CDD is sufficient for an existing customer opening multiple accounts**.

✔ **Joint Accounts** – **KYC of all account holders is required**.

✔ **Acting on Behalf of Others** – A customer must **clearly declare authority to act for another entity**.

### 📍 1.4.3 Prohibited Accounts

**Banks MUST NOT open accounts for customers/entities appearing in**:

❌ **Unlawful Activities (Prevention) Act, 1967 (UAPA) list**.

❌ **FIU (Financial Intelligence Unit) Alert Lists**.

❌ **RBI Caution Advices**.

❌ **Criminal lists of CBI, Interpol, Enforcement Directorate (ED), DRI, etc.**.

❌ **ECGC Caution List** (for export credit risk).

❌ **Sanctions Lists of foreign governments (USA, UK, EU, etc.)**.

❌ **Entities under International Sanctions (OFAC, UN, EU, etc.)**.

📌 **Example:** A bank **cannot open an account** for a company that appears in the **US Office of Foreign Assets Control (OFAC) sanctions list**.

### 📍 1.4.4 KYC Documents & Customer Due Diligence

✔ **Banks must collect different levels of KYC documents based on customer risk.**

✔ **Risk-Based Approach**: Low-risk customers require **basic due diligence**, while high-risk customers need **enhanced due diligence (EDD)**.

📌 **Required KYC Documents for Individuals:**

✔ **Identity Proof** – Aadhaar, Passport, Voter ID, PAN Card.

✔ **Address Proof** – Utility Bill, Rent Agreement, Bank Statement.

✔ **Photograph** – Recent passport-size.

✔ **PAN Card** – Mandatory for tax-related transactions.

✔ **e-KYC (Digital Verification)** – Aadhaar-based authentication.

📌 **Online PAN verification should be done via the Income Tax Department portal**.

## 📍 1.4.5 Customer Risk Categorization

✔ **Banks must classify customers as:**

🟢 **Low Risk** – Salaried individuals, pensioners, government employees.

🟡 **Medium Risk** – Self-employed professionals, business owners.

🔴 **High Risk** – Politically Exposed Persons (PEPs), foreign nationals, cash-intensive businesses, NPOs/NGOs, shell companies.

📌 **Example:**

✔ A **retired teacher** may be categorized as **Low Risk**.

✔ A **casino owner dealing in high cash transactions** would be **High Risk**.

📍 **1.4.6 Approval Authority**

✔ **For High-Risk Customers**, **senior management approval is required** before establishing a banking relationship.

✔ **Complex business structures or offshore entities** should be subject to **enhanced scrutiny**.

📌 **Example:** A company registered in **Cayman Islands (a tax haven)** may need **Board-level approval** before opening an account.

📍 **1.4.7 Not to be Restrictive**

✔ The KYC Policy **should not deny banking access to genuine customers**.

✔ **Financial Inclusion:** Special provisions for **low-income customers & marginalized groups**.

📌 **Example:**

✔ **Small farmers, daily wage workers, or students** should not be denied banking services due to complex documentation requirements.

✔ **Basic Savings Bank Deposit Accounts (BSBDAs)** allow low-income customers to open accounts with **minimum KYC requirements**.

## 🔍 Summary: Key Takeaways

✔ **KYC Process Manuals** should provide **detailed operational guidelines**.

✔ Banks **CANNOT open anonymous, fictitious, or benami accounts**.

✔ **Risk-Based Approach:** Customers should be categorized into **Low, Medium, and High-Risk**.

✔ **Senior Management Approval** is needed for **high-risk customers**.

✔ **Prohibited Customers:** No accounts for individuals/entities on **sanctions lists** or under **money laundering investigations**.

✔ KYC should not be **overly restrictive**, ensuring **financial inclusion** for the economically weaker sections.