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KYC – THE JOURNEY TO DIGITALIZATION

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Theme No: 349: **KYC – THE JOURNEY TO DIGITALIZATION**

"When learning is purposeful, creativity blossoms. When creativity blossoms, thinking emanates. When thinking emanates, knowledge is fully lit. When knowledge is lit, economy flourishes."
- Dr. A.P.J. Abdul Kalam

The "SIB Students' Economic forum" is designed to kindle interest in the minds of younger generation. We highlight one theme in every monthly publication. Topic of discussion for this month is **"KYC – THE JOURNEY TO DIGITALIZATION".**

Let's start with a definition of KYC and eKYC, and discover how advanced ID verification systems can better support KYC processes.

KYC – Definition

KYC is 'Know Your Customer' which refers to the process of identity and address verification of all customers and clients by banks, insurance companies and other institutions either during customer on-boarding, before or while they conduct transactions. Essentially, the purpose of KYC is to establish an individual's identity and address through relevant supporting documents (OVDs) and In-Person Verification (IPV).

Importance of KYC

The Reserve Bank of India (RBI) has made KYC mandatory for all banks and other financial institutions that carry out financial transactions. In other words, they must make sure that their clients are genuinely who they claim to be. They usually frame their KYC policies incorporating the following four key elements.

Customer Acceptance Policy No account shall be opened if: * The account to be opened is either Fictitious or in Benami names * The customer is Non-cooperative * The documents / information are Un-reliable * Name appears in UN / Sanctions list	**Customer Identification Procedures** Identifying the customer and verifying his/her identity using reliable, independent source document.
Monitoring of Transactions Regular monitoring of transactions is vital for preventing Money Laundering and Terrorist Financing.	**Risk Management** Customers shall be categorized, at least once every six months, into: High risk, Medium risk and Low risk KYC Periodic Updation every 2 / 8 / 10 years, for High / Medium / Low risk.

The regulatory environment establishes KYC as a mandatory and crucial procedure for financial institutions as well as non-financial institutions. It minimizes the risk of fraud, by identifying suspicious elements earlier on in the client-business relationship. Banks may refuse to open an account or may halt business relationship if the client fails to meet minimum KYC requirements. The KYC rules have also been adopted by the insurance and commodity trading sectors. The Securities and Exchange Board of India (SEBI) has made KYC compliance mandatory for mutual fund and broking accounts. Such norms were introduced to curb practices like money laundering, fraud, and financing of terrorist activities which are sometimes routed through banks and other financial institutions. With the KYC norms in place, banks and other financial institutions find it easier to track their customers and transaction trails.

<u>KYC Documents</u>

Each client is required to provide credentials to prove identity and address. As per the guidelines issued by the Government of India, 6 documents serve as 'Officially Valid Documents (OVDs)' and can be considered for the verification of identity.

<u>Officially Valid Documents (OVDs)</u>

1. Passport
2. Driving Licence
3. Proof of possession of Aadhaar number
4. Voter's Identity card issued by Election Commission of India
5. Job card issued by NREGA duly signed by an officer of the State Government
6. Letter issued by National Population Register, containing details of name and address

Even if you have already submitted the KYC documents to an institution, they may ask again for the documentary proof to periodically update the KYC records.

<u>e-KYC</u>

The e-KYC process, often called paperless KYC, is the process of electronically verifying the credentials of a customer. In India, e-KYC is also called Aadhaar-based e-KYC as your identity is verified electronically via Aadhaar-based authentication. This means that the service provider will cross verify the details of your Aadhaar, like name, address, gender, date of birth, mobile number, email address etc. with the database of the Unique Identification Authority of India (UIDAI). Thus, Aadhaar-based e-KYC provides your proof of identity and address to the service provider instantly, dispensing the need for the tedious in-person verification.

<u>Digital KYC & V- CIP</u>

Earlier this Year, the RBI amended the KYC norms allowing banks and other lending institutions regulated by it to use Digital KYC and Video based Customer Identification Process (V-CIP), a move which will help to onboard remote customers.

As per the RBI Circular, Digital KYC has been defined as capturing live photo of the customer and officially valid document or the proof of possession of Aadhaar, where offline verification cannot be carried out, along with the latitude and longitude of the location where such live photo is being taken by an authorized officer of the Reporting entity (RE) as per the provisions contained in the Act. Banks are to develop an application for digital KYC process which shall be made available at customer touch points for undertaking KYC of customers and the KYC process shall be undertaken only through this authenticated application of the bank. Banks may use the service of Business Correspondent (BC) for this process.

Financial service providers now have the option to adopt V-CIP solutions as an alternative to in-person KYC identification. Several banks in the country have started offering V-CIP service to sign up new customers. This method allows banks and other Financial Institutions to verify customers through video interviews and biometric authentication, which are checked against physical documents. Under the V-CIP process, people are contacted by a bank officer through a live video call and they have to submit identity proof digitally. What they have to do is, visit the bank's website, share personal details and enable access to the phone's location for V-CIP. This is to prevent people outside India from opening a bank account. The V-CIP is carried out through a bank's website or its mobile application. It does not take place via third party apps like Zoom, WhatsApp, Google Duo and Skype.

The results of using V-CIP indicate the reduction of the turnaround time, better people management, and an increase in the number of new accounts. Be its facial recognition, liveness detection, or geo-tagging, V-CIP detects the authenticity of profiles in a matter of minutes. The overall scope, scalability, and cost-effectiveness of mainstreaming V-CIP in the financial sector are clearly evident.

Bottom Line

The challenges faced by traditional KYC in a digitizing economy go beyond identification of fraudulent practices by applicants. Banks and other lending companies often invest heavily in conducting customer verification. It involves professionals, documentation costs, and hiring third-party agents who organize in-person visits to verify the identity of applicants.

Banks and other lending institutions often find it challenging to reach out to a wider customer base, possibly in rural and remote areas. In this scenario, a solution that saves time, effort and manpower in the verification process was needed to increase customer inclusion. Video KYC is likely to radically alter this landscape, making it easier for service providers and banks to complete procedures. Not to mention, the additional inclusion of those who have so far remained outside the financial system without access to credit, due to lack of credible documentation and availability of services in their area. The policy changes are not just beneficial to lending institutions, but also lay the foundations for the next generation of FinTech startups in the country, leading to the development of state-of-the-art technology-driven solutions. Adding on to this, Video-KYC is also set to give a fillip to the financial inclusion agenda of India.

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