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Theme 205
KNOW YOUR CUSTOMER (KYC), ANTI- MONEY LAUNDERING (AML) & COMBATING FINANCING OF TERRORISM (CFT)

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17th Year of Publication

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DECEMBER 2008

Experience Next Generation Banking

The South Indian Bank Ltd., H.O. : 'S.I.B. House', Thrissur, Kerala

Theme No. 205 : KNOW YOUR CUSTOMER (KYC), ANTI- MONEY LAUNDERING (AML) & COMBATING FINANCING OF TERRORISM (CFT)

Know Your Customer (KYC), Standards and Measures for Anti-Money Laundering (AML) and Combating Financing of Terrorism (CFT)

The objective of KYC/AML/CFT guidelines is to prevent banks from being used by criminals for money laundering or terrorist financing activities. KYC procedures enable banks to collect detailed information about their customers and their financial dealings, which in turn help the banks in managing risks prudently. Know Your Customer (KYC) enjoins on the basic minimum requirements that the financial institutions and banks must necessarily perform to identify their customers and ascertain relevant information pertinent to doing financial business with them. In the USA, KYC is typically a policy implemented to conform to a customer identification programme mandated under the Bank Secrecy Act and USA PATRIOT Act. Know Your Customer policies have become increasingly important globally to prevent money laundering, terrorist financing and frauds and the Central Banks of almost all countries have enforced the KYC guidelines.

What are basic requirements under the KYC Standards?

In India, according to the RBI guidelines, the KYC policies should incorporate the following four key elements:

a) Customer Acceptance Policy
b) Customer Identification Procedures
c) Monitoring of Transactions and
d) Risk Management.

The banks should adopt customer acceptance criteria and based on the customer profile, in terms of the nature of business activity, location of customer and his clients, mode of payments, volume of turnover, social and financial status etc. risk categorization of customers should be done.

Banks are required to follow certain customer identification procedure for opening of accounts. For individuals, Bank will obtain identification data to verify the identity of the customer, his address/location and also his recent photograph. This will be done for the joint holders and mandate holders, as well. For non-individuals, Bank will obtain identification data to:

1) verify the legal status of the legal person/entity
2) verify identity of the authorized signatories and
3) verify identity of the beneficial owners/controllers of the account

Transactions which exceed the normal parameters depending on the status of the account should be continuously monitored and reports should be generated and reported to statutory authorities and these reports should be preserved for a longer period also.

Thus, one aspect of KYC checking is to verify that the customer is not on any list of known fraudsters, terrorists or money launderers. Another key aspect of KYC controls is to monitor transactions of a customer against recorded profile and history on the customer's accounts.

How do banks practically address the monitoring of transactions?
Banks doing KYC monitoring for anti-money laundering (AML) and Counter-Terrorism Financing (CTF) purposes increasingly use specialized transaction monitoring software, particularly names analysis software and trend monitoring software. The generated alerts identify unusual activity which is then subject to due diligence processes. This helps determine whether a transaction or activity is suspicious and requires reporting to the authorities. In the US it would require Suspicious Activity Reporting (SAR) filing to Financial Crimes Enforcement Network (FinCEN). In the UK it would require a report to Serious Organized Crime Agency (SOCA). In India, such reports are to be sent by the banks to the FIU-IND (Financial Intelligence Unit – India), New Delhi for further processing and the required action. In India, RBI has directed all banks to be fully compliant with the KYC standards.

Are KYC requirements new?
No. KYC requirements have always been in place and Banks have been taking KYC documents in accordance with the guidelines issued by RBI

from time to time. RBI has revisited the KYC guidelines in the context of the recommendations made by the Financial Action Task Force (FATF), an international organization under the auspices of OECD, on Anti Money Laundering Measures and Combating Financing of Terrorism and enhanced the KYC Standards in line with international benchmarks.

Is KYC mandatory?
Yes. It is a regulatory and legal requirement.

Regulatory: In terms of the guidelines issued by the Reserve Bank of India (RBI) on 29^{th} November, 2004 on Know Your Customer (KYC) Standards and Anti Money Laundering (AML) Measures, all banks are required to put in place a comprehensive policy framework covering KYC Standards and AML Measures.

Legal: The Prevention of Money Laundering Act, 2002 (PMLA) which came into force from 1^{st} July, 2005 (later 'rules' under the Act were formulated and published in the Official Gazette) requires Banks, Financial Institutions and Intermediaries to ensure that they follow certain minimum standards of KYC and AML, as laid down in the Act and the 'rules' framed there under.

What is Money Laundering?
Money Laundering is the process by which criminals attempt to hide and disguise the true origin and ownership of the proceeds of their criminal activities, thereby avoiding prosecution, conviction and confiscation of the criminal funds. The term 'Money Laundering' is also used when the funds are used for terrorist financing, though the origin of the funds may be legitimate.

What are the obligations of Banks under PMLA, 2002?
Section 12 of PML Act 2002, places certain obligations on every banking company, financial institution and intermediary, which include:

i) Maintaining a record of prescribed transactions.
ii) Furnishing information of prescribed transactions to the specified authority.
iii) Verifying and maintaining records of the identity of its clients.
iv) Preserving records in respect of i, ii, iii above, for a period of 10 years from the date of cessation of transactions with the clients.

What are the transactions to be reported by Banks to Financial Intelligence Unit-India (FIU-IND)?

a) All cash transactions of the value of more than Rs.10 lakhs or its equivalent in foreign currency.
b) All series of cash transactions integrally connected to each other, which have been valued below Rs.10 lakhs or its equivalent in foreign currency (excluding individual transactions below Rs.50,000/- in the reporting) where such series of transactions have taken place within a month and the aggregate value of such transactions exceeds Rs.10 lakhs.
c) Counterfeit currency transactions.
d) Suspicious transactions.

When does KYC apply?

KYC will be carried out at the following stages:

- Opening a new account.
- Opening a subsequent account where documents as per current KYC standards have not been submitted while opening the initial account.
- Opening a Locker facility
- When the bank feels it necessary to obtain additional information from existing customers based on conduct of the account.
- When there are changes to signatories, mandate holders, beneficial owners etc. KYC will also be carried out in respect of non-account holders approaching the bank for high value one-off transactions.

Who is the contact person in the Bank for KYC purposes?

The contact person in the Bank will be the Branch Manager or the Officer who opens the account and who is in touch with the customer for the transactions in the account.

What will happen if the required KYC information/documents are not provided to the Bank?

The Bank will be entitled to refuse the opening of the account in the case of a prospective customer or discontinue the relationship with the customer in the case of an existing customer, if the required KYC information/documents are not provided. However, for certain categories of customers who are not able to provide the necessary documents, the Bank will open the account as per the flexibility provided for routing normal transactions for the customers profiled under low risk category.