

(Know Your Customer Series – 01)

2021

# KNOW YOUR CUSTOMER – WHY?



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01-Jan-2021

‘Know Your Customer’ or ‘Know Your Client’ (KYC)  
has become the most talked about pain point across the country!  
Read the Article to address Customer Pain Points!

## WHAT IS KYC?

KYC in the simplest terms is –

- Identifying a person or an entity,
- Verifying the identity/address of the person or an entity,
- Obtaining information on the purpose and intended nature of the business relationship, and
- Identifying beneficial owner, if any, in case of entities.



## WHY KNOW YOUR CUSTOMER (KYC)?



- ☒ KYC is a significant preventive element in the global fight against money laundering and combating financial terrorism
- ☒ KYC is a **mandatory statutory** requirement. It is the global requirement mandated by Financial Action Task Force (FATF), a global watchdog and policy making body, responsible for prevention of money laundering and terrorist financing.
- ☒ Look at the [library of recommendation](#) made by FATF in their [Report](#). A mere glance at the titles of recommendations reveals the need for Anti Money Laundering (AML) / Combating Financial Terrorism (CFT) / Know Your Customer/Client (KYC) Policies and global co-operation required in the prevention of money laundering and terrorist financing activities. A reading of the recommendations (attached) will enlighten every citizen and even a banker, and all the questions about the need for KYC will vanish.
- ☒ *In India, it is Prevention of Money Laundering Act, 2002 and Rules framed thereunder, based on a mandate from the FATF, to which more than 200 countries have subscribed their allegiance and agreed to take all necessary steps to prevent money laundering and terrorist financing.*

Indian requirements are no different from  
other countries across the globe!

## IS STATUTORY REQUIREMENT, THE ONLY REASON FOR KYC?

- ✘ Risk mitigation is another reason for 'Know Your Customer (KYC)'
- ✘ If you desire to do any business with any person, that person would like to know **you**, to **minimize risks** in doing business with an unknown person. Right!
- ✘ Does this explain 'Why KYC is required?'
- ✘ Let us make another attempt to explain it further?
- ✘ If you place an order with anyone, for supply of certain goods at your office, should the supplier not have your correct address so that the goods sent to you do not get returned? If you are not making advance payment and would make cash payment on delivery, should the supplier not know more about you and your paying capacity, your activities to be able to take the risk of sending goods to you, particularly when the 'to and fro' cost of transportation may exceed the profit margin?



It is therefore, a responsibility  
of every law-abiding citizen  
to understand the genesis of KYC requirements  
and co-operate with the service providing entities!

## WHO MUST DO KYC?



financial intermediaries

- ✘ All reporting entities are required to do KYC.
- ✘ As per statutory provisions, reporting entities include banks, financial institutions, intermediaries and persons carrying on a designated business or profession.
- ✘ A detailed list of reporting entities is given in the [Appendix](#).
- ✘ In addition to the reporting entities detailed in the [Appendix](#), under the directions of Supreme Court of India issued in February, 2017, telecom service providers are also required to verify the identity of all mobile phone users.

In this Article, we shall describe  
Banking KYC Processes

## WHAT BANKS ARE SUPPOSED TO DO?

- ✠ Banks must verify the identity of their clients, and beneficial owners.



- “Client” means a person who is engaged in a financial transaction or activity with a reporting entity and includes a person on whose behalf the person who engaged in the transaction or activity, is acting.
- “Beneficial Owner” means an individual who ultimately owns or controls a client of a bank or the person on whose behalf a transaction is being conducted and includes a person who exercises ultimate effective control over a juridical person.
- “Person” includes an individual, a Hindu undivided family, a company, a firm, an association of persons or a body of individuals whether incorporated or not, any artificial judicial person, any agency, office or branch owned or controlled by any of these persons mentioned here.

## IN WHICH CASES BANKS SHOULD DO KYC?

- ✠ At the time of commencement of an account-based relationship, a bank must –
- identify its clients,
  - verify their identity,
  - obtain information on the purpose and intended nature of the business relationship; and
  - determine whether a client is acting on behalf of a beneficial owner, and identify the beneficial owner and take all steps to verify the identity of the beneficial owner.
- ✠ In addition, a bank must verify the identity –
- while carrying out any ‘*transaction*’ of an amount equal to or exceeding Rs.50,000/-, whether conducted as a single transaction or broken into several smaller value transactions that appear to be connected, or carrying out any international money transfer operations.
- "Transaction" referred above means a purchase, sale, loan, pledge, gift, transfer, delivery or the arrangement thereof and includes –
- Opening of an account;
  - Deposits, withdrawal, exchange or transfer of funds in whatever currency, whether in cash or by cheque, payment order or other instruments or by electronic or other non-physical means,

- The use of a safety deposit box (Locker) or any other form of safe deposit;
- Entering into any fiduciary relationship (representative like Advocate, Chartered Accountant, Portfolio Manager);
- Any payment made or received in whole or in part of any contractual or other legal obligation;
- Any payment made in respect of playing games of chance for cash or kind including such activities associated with casino, and
- Establishing or creating a legal person or legal arrangement.

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## WHAT NEXT?

Having understood why KYC needs to be done,  
let us move on to How KYC must be done

**Read our Know Your Customer Series -02**

## International Standards on Combating Money Laundering and the Financing of Terrorism & Proliferation The FATF Recommendations

( [www.fatf-gafi.org/recommendations](http://www.fatf-gafi.org/recommendations) )



[Download pdf \(1,717kb\)](#)

*Paris, 16 February 2012*

Money laundering, terrorist financing, and the financing of the proliferation of weapons of mass destruction are serious threats to security and the integrity of the financial system.

The FATF Standards have been revised to strengthen global safeguards and further protect the integrity of the financial system by providing governments with stronger tools to take action against financial crime. At the same time, these new standards will address new priority areas such as corruption and tax crimes.

The revision of the Recommendations aims at achieving a balance:

- On the one hand, the requirements have been specifically strengthened in areas which are higher risk or where implementation could be enhanced. They have been expanded to deal with new threats such as the financing of proliferation of weapons of mass destruction, and to be clearer on transparency and tougher on corruption.
- On the other, they are also better targeted – there is more flexibility for simplified measures to be applied in low risk areas. This risk-based approach will allow financial institutions and other designated sectors to apply their resources to higher risk areas.

The FATF Recommendations are the basis on which all countries should meet the shared objective of tackling money laundering, terrorist financing and the financing of proliferation. The FATF calls upon all countries to effectively implement these measures in their national systems.

FATF Recommendations 2012				
<b>A</b>	<b>AML/CFT POLICIES AND COORDINATION</b>		<b>E</b>	<b>TRANSPARENCY AND BENEFICIAL OWNERSHIP OF LEGAL PERSONS AND ARRANGEMENTS</b>
1	Assessing risks & applying a risk-based approach		24	Transparency and beneficial ownership of legal persons
2	National cooperation and coordination		25	Transparency and beneficial ownership of legal arrangements
<b>B</b>	<b>MONEY LAUNDERING AND CONFISCATION</b>		<b>F</b>	<b>POWERS AND RESPONSIBILITIES OF COMPETENT AUTHORITIES AND OTHER INSTITUTIONAL MEASURES</b>
3	Money laundering offence		<i>Regulation and Supervision</i>	
4	Confiscation and provisional measures		26	Regulation and supervision of financial institutions
<b>C</b>	<b>TERRORIST FINANCING AND FINANCING OF PROLIFERATION</b>		27	Powers of supervisors
5	SRII Terrorist financing offence		28	Regulation and supervision of DNFBPs
6	SRIII Targeted financial sanctions related to terrorism & terrorist financing		<i>Operational and Law Enforcement</i>	
7	Targeted financial sanctions related to proliferation		29	Financial intelligence units
8	Non-profit organisations		30	Responsibilities of law enforcement and investigative authorities
<b>D</b>	<b>PREVENTIVE MEASURES</b>		31	Powers of law enforcement and investigative authorities
9	Financial institution secrecy laws		32	Cash couriers
<i>Customer due diligence and record keeping</i>			<i>General Requirements</i>	
10	Customer due diligence		33	Statistics
11	Record keeping		34	Guidance and feedback
<i>Additional measures for specific customers and activities</i>			<i>Sanctions</i>	
12	Politically exposed persons		35	Sanctions
13	Correspondent banking		<b>G</b>	<b>INTERNATIONAL COOPERATION</b>
14	Money or value transfer services		36	International instruments
15	New technologies		37	Mutual legal assistance

16	Wire transfers		38	Mutual legal assistance: freezing and confiscation
<i>Reliance, Controls and Financial Groups</i>			39	Extradition
17	Reliance on third parties		40	Other forms of international cooperation
18	Internal controls and foreign branches and subsidiaries			
19	Higher-risk countries			
	<i>Reporting of suspicious transactions</i>			
20	Reporting of suspicious transactions			
21	Tipping-off and confidentiality			
	<i>Designated non-financial Businesses and Professions (DNFBPs)</i>			
22	DNFBPs: Customer due diligence			
23	DNFBPs: Other measures			



Appendix 1

Reporting Entities			
1	Banking Companies	(i)	All Banks including State Bank of India
		(ii)	Co-operative Banks ( <i>State Co-operative Banks, Central Co-operative Banks and Primary Co-operative Banks</i> )
		(iii)	Regional Rural Banks
2	Financial Institutions	(i)	<p>Financial Institution: A Non-Banking Institution carrying on as its business or part of its business any of the following activities:</p> <ul style="list-style-type: none"> <li>(a) Financing, whether by way of making loans or advances or otherwise, of any activity other than its own;</li> <li>(b) Acquisition of shares, stock, bonds, debentures or securities issued by a Government or local authority or other marketable securities of a like nature;</li> <li>(c) Letting or delivering of any goods to a hirer under a hire-purchase agreement as defined in clause (c) of Section 2 of the Hire-Purchase Act, 1972;</li> <li>(d) Carrying on any class of Insurance business;</li> <li>(e) Managing, conducting or supervising, as foreman, agent or in any other capacity, or chits or kuries as defined in any law which is for the time being in force in any State, or any business, which is similar thereto;</li> <li>(f) Collecting, for any purpose or under any scheme or arrangement by whatever name called, monies in lumpsum or otherwise, by way of subscriptions or by sale of units, or other instruments or in any other manner and awarding prizes or gifts, whether in cash or kind, or disbursing monies in any other way, to persons from whom monies are collected or to any other person,</li> </ul>
		(ii)	Chit Fund Companies
		(iii)	Housing Financing Institutions
		(iv)	<p>Authorised Persons:</p> <ul style="list-style-type: none"> <li>(a) Authorised dealers,</li> <li>(b) Money changers,</li> <li>(c) Off-Shore Banking Unit (OBUs), or</li> <li>(d) Any other person for the time being authorised under sub-section (1) of section 10 to deal in foreign exchange or foreign securities</li> </ul>
		(v)	<p>Payment System Operators:</p> <ul style="list-style-type: none"> <li>(a) Providers of Systems enabling Credit Card Operations,</li> <li>(b) Providers of Systems enabling debit card operations,</li> <li>(c) Providers of Systems enabling smart card operations,</li> <li>(d) Providers of Systems enabling money transfer operations or similar operations.</li> </ul> <p>Notes:</p> <ul style="list-style-type: none"> <li>(i) 'Payment System Operator' means a person who operates a payment system and such person includes his overseas principal;</li> <li>(ii) The 'Overseas Principal' is the one who owns or controls or manages, directly or indirectly, the activities or functions of payment system in India, be it an Individual or HUF or a Company, a Firm, an Association of Persons, a Body of Individuals, an Artificial Juridical Person, whether incorporated or not, such company, firm, association of persons, body of individuals, artificial juridical person incorporated or registered outside India.</li> <li>(iii) "Payment System" means a system that enables payment to be effected between a payer and a beneficiary, involving clearing, payment or settlement service or all of them, and includes the systems enabling credit card operations, debit card operations, smart card operations, money transfer operations or similar operations;</li> </ul>
		(vi)	<p>Non-Banking Finance Companies:</p> <ul style="list-style-type: none"> <li>(a) Financial Institution which is a company;</li> <li>(b) Non-banking institution receiving deposits or lending; or</li> </ul>

Reporting Entities		
		(c) Such other non-banking institution or class of such institutions, as RBI may specify.
		(vii) Department of Posts
3	Intermediaries	(i) (a) Stock-broker, (b) Share Transfer Agent, (c) Banker to an Issue, (d) Trustee to a Trust Deed, (e) Registrar to an Issue, (f) Merchant Banker, (g) Underwriter, (h) Portfolio Manager, (i) Investment Adviser, or (j) Any other Intermediary associated with securities market and registered under section 12 of the SEBI Act, 1992
		(ii) (a) Association recognised or registered under the Forward Contracts (Regulation) Act, 1952, or (b) Any Member of such association; or
		(iii) Intermediary registered by PFRDA
		(iv) Recognised stock exchanges
	Persons carrying on a designated business or profession and such other activities as the Central Government may, by notification, so designate, from time to time	(i) Person carrying on activities for playing games of chance for cash or kind, and includes such activities associated with casino;
		(ii) Inspector-General of Registration (Registration of Properties)
		(iii) Real Estate Agent
		(iv) Dealer in precious metals, precious stones and other high value goods, as may be notified by the Central Government; <i>(Precious Metal means gold, silver, platinum, palladium or rhodium or such other metal as may be notified by the Central Government)</i>
		(v) Person engaged in safekeeping and administration of cash and liquid securities on behalf of other persons, as may be notified by the Central Government; or
		(vi) Multi-State Co-operative Society registered under the Multi-State Co-operative Societies Act, 2002
<p>Note: 'Person', wherever mentioned, includes:</p> <ul style="list-style-type: none"> <li>(a) an individual,</li> <li>(b) a Hindu undivided family,</li> <li>(c) a company,</li> <li>(d) a firm,</li> <li>(e) an association of persons or a body of individuals, whether incorporated or not,</li> <li>(f) every artificial juridical person, not falling within any of the preceding sub-clauses, and any agency, office or branch owned or controlled by any of the above persons mentioned in the preceding sub-clauses</li> </ul>		