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The Journey of CKYC In India – Origin, Implementation And The Challenges Faced.

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Abstract: *The 'know your customer' (KYC) policy has emerged as an important strategy for a proactive war against money laundering both nationally and internationally. In terms of this policy, financial institutions in most countries are required to identify their clients and the legitimacy of their financial transactions. The main purposes of this policy are profiling the originators of this potentially anti-economic crime as well as tracking the audit trail of any money that flows into our banking system. The question that needs to be asked is whether the buck of KYC policy can effectively stop with financial institutions profiling who their customers are rather than also tracking the trails of money through all the banking systems that money flows into. Also, the boon in technology brings further light to the policy in the form of E-KYC, which eliminates the paper work and makes the process easy. However, to battle against the war against money laundering would be made possible with the implementation of CKYC. This article intends to provide a historical background of KYC, the policies on KYC in India and the implementation of CKYC, importance and the way forward to support banks and other financial institutions.*

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I. Introduction

Money is the key support for any criminal activity. Banks and Financial Institutions, which are dealing in public money by providing a variety of services and instruments, are vulnerable to receive criminal money in the form of genuine business. The absence of any preventive mechanism to scan such criminal money would shun these institutions in reputational risk. In addition, they face stringent action for violation of relevant laws and regulatory guidelines for failure to check and weed out the criminal money from their system. Therefore, their integrity, safety and soundness depend heavily on their functioning within a framework of high legal, professional, and ethical standards. The globalisation of banking and finance, technological advancement in the payment system have provided wider scope for concealing criminal money and easy mobility of funds across borders. The need of the hour is a trained and committed staff in every financial institution, and building sophisticated technology platforms/software for monitoring transactions.

The KYC process is meant to weed the undesirable customers out and to protect the good ones and the banks. It is, therefore, important that the banks continue to stay focused on business, on good customer relationship, get to know more about client needs and preferences.

The KYC processes are only to ensure that our banking operations are safe and clean to help clients and bank personnel to conduct business, with comfort and confidence. It is essential to emphasise this point here, so that this basic banking principle is never undermined.

KYC – THE ORIGIN

The Basel Committee Reports of 1997 and 1998 adopted a statement of principles concerning anti-money laundering. The statement carried the first international mention of KYC procedures and encouraged banks management and their central banks, internationally, to draw guidelines for the full identification of customers, to map their transactions. Among other national controllers, the Federal Reserve of the US has initiated, almost immediately, proposals relating to the monitoring of customer transactions, and the reporting of suspicious transactions. It required banks to draw up customer and transaction profiles, record sources of funds, determine normal and expected transactions, and identify those which are inconsistent and report suspicious ones to a central monitoring authority. These are being followed, by all the banks in the US, with quick punishments being imposed by the regulators when serious aberrations are observed.

In India, the approach to KYC as it merges in the RBI guidelines is, basically,

- To prevent banks from being used, intentionally or unintentionally, by criminal elements for their money laundering activities; and
- To help banks to know their customer and their financial transactions better, This, in turn, will help them to manage their risks prudently.

KYC processes are to be laid down at the corporate level and should be followed by the operating units/branches. RBI expects all banks to have comprehensive KYC policies.

Deficient in KYC Policies

An internal Basel Committee survey, in 1999, identified several deficiencies in a large number of countries in the KYC policies and processes of banks. In some banks they were non-existent. This, despite the fact that serious thought had already been given to the subject as early as 1997, and there were growing incidents of adverse impact of money laundering, for example, the BCCI Bank (1991); European Union Bank (1997).

KYC deficiencies can lead to various business, operational, legal and concentrating risks. Even when a bank's services are unknowingly used for money laundering, such "involvement" can lead to substantial risk, and also loss of reputation. Eventually it might even lead to the loss of business.

RBI has taken strong, stage-wise steps to prevent money laundering. The guidelines issued by them in 2002 have been refined continuously. The guidelines relate to the identification of customers, and the systems and procedures that all banks should have in place for early detection and prevention of financial frauds, money laundering, scrutiny and monitoring of large value cash transaction etc. under Section 35 of the Banking Regulation Act, 1949.

The guidelines were further refined in 2004 in the light of the recommendations made by the Financial Action Task Force (FATF) on Anti-Money Laundering (AML) standards and on combating the Financing of Terrorists (CFT). These standards are the international benchmarks for AML and CFT policies by the regulatory authorities in all countries. The RBI had stipulated deadlines for all banks in India to have clear policies on AML and CFT.

RBI further simplified KYC norms in 2005 to facilitate financial inclusion of low-income group. In 2007, RBI came up with anti-money laundering guidelines on wire transfers, cross-border and domestic. With year on year updates, new indicative actions, norms and guidelines are issued and implemented. And recently in Feb 2019, KYC compliance norms implementation has been extended for 6 months to the e-wallet firms emerging enormously in the recent days.

Non-compliance of KYC is a major challenge faced by the banks in India – causes and consequences

Indian banks, once admired for their sound and safe conduct, are now increasingly getting caught breaking the rules. In 2018, RBI has slapped a hefty fine of Rs 58.9 crore on the country's second largest private bank, ICICI Bank Ltd, for the failure to follow the maturity guidelines for securities portfolio. Imagine a new bank, Airtel Payment Bank, just starting its operations, has been caught for violating the KYC guidelines, which is the most basic requirement in the banking industry.

The Reserve Bank of India (RBI) has imposed, by orders dated January 31, 2019, monetary penalty for non-compliance with various directions issued by RBI on monitoring of end use of funds, exchange of information with other banks, classification and reporting of frauds, and on restructuring of accounts, on four banks – Allahabad Bank with 1.5 crore, Andhra Bank with 1 crore, Bank of Maharashtra with 1.5 crore and Indian Overseas Bank with 1.5 crore.

In less than a year, the private banks, which are perceived to be well-managed, have often received the wrath of the banking regulator.

The Reserve Bank of India (RBI) has imposed, by orders dated February 04, 2019, monetary penalty for non-compliance with various directions issued by RBI on Know Your Customer (KYC) norms / Anti-Money Laundering (AML) standards, more specifically those contained in circulars dated November 29, 2004 and May 22, 2008, on three banks namely HDFC Bank Limited, IDBI Bank Limited and Kotak Mahindra Bank Limited with 20 lakhs each as penalty.

Recently, the Reserve Bank of India (RBI) has imposed, by order dated June 13, 2019, monetary penalty of ₹10 million on HDFC Bank Limited (the bank) for non-compliance with directions issued by RBI on 'Know Your Customer (KYC/ Anti-Money Laundering (AML) norms' and on reporting of frauds. The penalty has been imposed in exercise of powers vested in RBI under the provisions of Section 47A(1)(c) read with Section 46(4)(i) of the Banking Regulation Act, 1949, taking into account failure of the bank to adhere to the aforesaid directions issued by RBI.

The responsibility lies in the top management and the board to take these compliance violation issues seriously. The hurdles and causes are listed below for non-compliance of KYC in banks:

- The seriousness of the issue is taken very light and the consequences faced by the bank in case of KYC deficient accounts is very dangerous and damages the image and there is reputational risk. Ethical standards of the organisation is lost and indirectly the business integrity is lost.

- Proven breaches of non-compliance could be even more harmful. This is subject to fines and penalties and even prohibited from selling specific products or services. At the extreme end of the scale, those responsible for fraud or money laundering could be imprisoned. Reputational and Financial loss.
- The incapable and inadequate technology in following the process remains a cumbersome process even after a decade is passed.
- The process is very lengthy and time- consuming study of internal documentation, archiving and procedures – risking disruption to business as usual.
- There are still duplicate accounts of customers in same bank and the search for identity proof of customers still remains a cumbersome process leading to face challenges like fraudulent transactions, evasion of tax, default in loan repayment, money laundering etc.
- There are two aspects of KYC compliance that banks need to monitor. The first aspect that they need to check is whether the employees are following the KYC guidelines properly or not. The second, but not less important, is the co-operation of customers, when the account is opened as well as in the ongoing process of KYC submission. The customers get agitated and frustrated in repeated submission of KYC, without help from customers, it is difficult for a bank to build a robust KYC process.

CKYC – the need and the way forward

As per directives of the Ministry of Finance, the Central Registry if Securitisation Asset Reconstruction and Security Interest of India (CERSAI) is to perform the functions of the CKYC Records Registry (CKYCR). The CERSAI will receive, store, safeguard and retrieve KYC records in digital form for a client. Central KYC or CKYC is a government initiative to bring KYC process of all financial sector entities under a single window. The main objective of CKYC is to provide a platform which enables investors to complete their KYC only once before interacting with various entities in the financial services sector. CKYC is the latest addition to the various types of KYC already available. However, the other types of KYC will be rendered redundant once CKYC, is fully implemented.

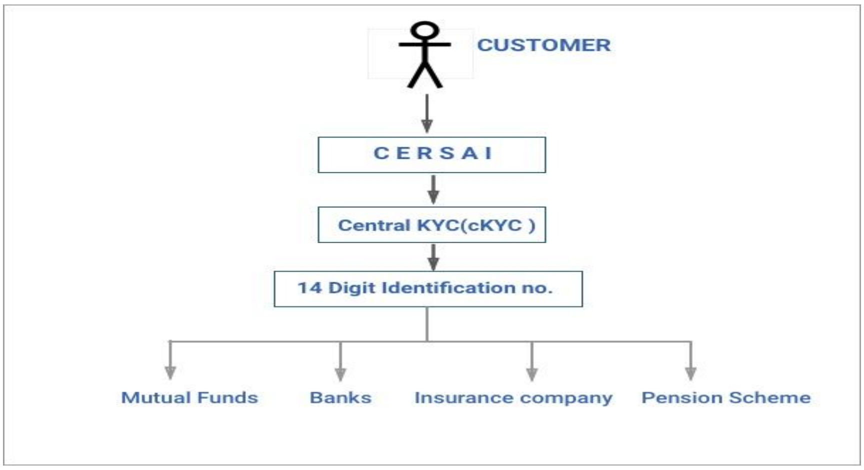
Benefits of CKYC

FI conveniences and User experience:

- Cost optimisation, as CKYC introduces mutualisation of costs across multiple FIs.
- FIs can stay focussed on their core business of serving their customers.
- Inter-usability of KYC records across the financial sector.
- Convenient for customers to upload their documents in one place.
- Reduced burdened of constantly producing and verifying KYC for new FI or existing FI.

HOW CKYC WORKS

CKYC collects and verifies information only once and distributes it to specific client-chosen FIs.



Difference between KYC, eKYC and CKYC

KYC – The identity of an investor is verified based on written details submitted by him on a form, supplemented by an in-person verification (IPV) process. Once the verification is carried out successfully, the relevant investor data is entered into the KRA system and subsequently uploaded to the KRA system database.

eKYC – It is carried out with the help of an investor's Aadhar number. While completing the eKYC process, the authentication of the investor's identity can be done either via one-time password or biometrics. This data is uploaded into the records of the KRA.

CKYC – It allows investors to carry out their KYC only once. CKYC compliance will allow an investor to transact/deal with all entities governed/regulated by the Government of India/different regulators (RBI, SEBI, IRDA and PFRDA) without the need to complete multiple KYC formalities.

CKYC – an introspection

CKYC will store all the customer information at one central server that is accessible to all the financial institutions. After opening a KYC account, a 14-digit identification number is generated. This will be helpful to the customers and investors as it eliminates the tedious process of KYC submission over and again for all new financial transactions in the same institute or other financial institutes.

The CKYC system unveiled by the government last year to unify KYC data across all financial regulators (RBI, SEBI, IRDA and PFRDA) seems a distant reality as it is being implemented at a slower-than-envisaged rate due to issues related to automation, process gaps and resolution queries.

Mandated to be maintained by the CERSAI, the lack of an application programming interface with C-KYC system is making life difficult for SEBI – registered KYC registration agencies to upload data manually. Unless full KYC details from the customer is collected, it would not be able to finish the process and it will defeat the purpose of creating duplication of data for same customer.

The unavailability of a link between CERSAI's CKYC system and SEBI – registered KRAs is perceived as the main reason for complications and a slower than envisaged rate of implementation. The data about non-individuals.

II. Conclusion

1) This is the most powerful and effective tool, which helps the financial sectors and the nation especially for a long run. If this tool is applied with lethargy – the results faced will be very dangerous and will affect in large – as the risk involved is very high and it includes both financial loss and reputational loss of a financial institute.
2) Now CKYC is a step forward to KYC, but the same will be unflagged soon if it isn't helpful in meeting the necessary goals. The technology used in framing the software should be updated, reliable and monitored time to time, which only pave the desired way. There should not be duplication of records.
3) The C-KYC system is not fully understood yet as it is new to the market/investors and hence, the transition is not very smooth. Data about non-individuals still rests with SEBI and there are no guidelines yet on how this data is to be included in the CKYC repository.
4) In PSU, the banks may be in a position to upload 'current' KYC data/ new account's KYC by the stipulated date, whereas they will need a little long time to upload information on legacy accounts. The bankers will be in difficult phase to contact the existing customers and getting their updated KYC data, including legacy data.
5) The real challenge will arise for banks, who will need to frequently update their records in the CKYC repository once there is a change in the demographic details of the client. If the changes are not immediate, other banks may open an account based on the existing CKYC records and will face a bona fide challenge with respect to the client's KYC details, thus posing a threat to the entire banking system.

Financial Institutes will have to implement this new regime, which will require a significant investment of time, money and resources. Cost wise this tool is slightly expensive, but if eventually utilised, will turn fruitful in defeating the crime of anti-money laundering.

I hereby declare that the paper is the original work of myself and that the paper has not been submitted for publication anywhere else.

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