Newsletter

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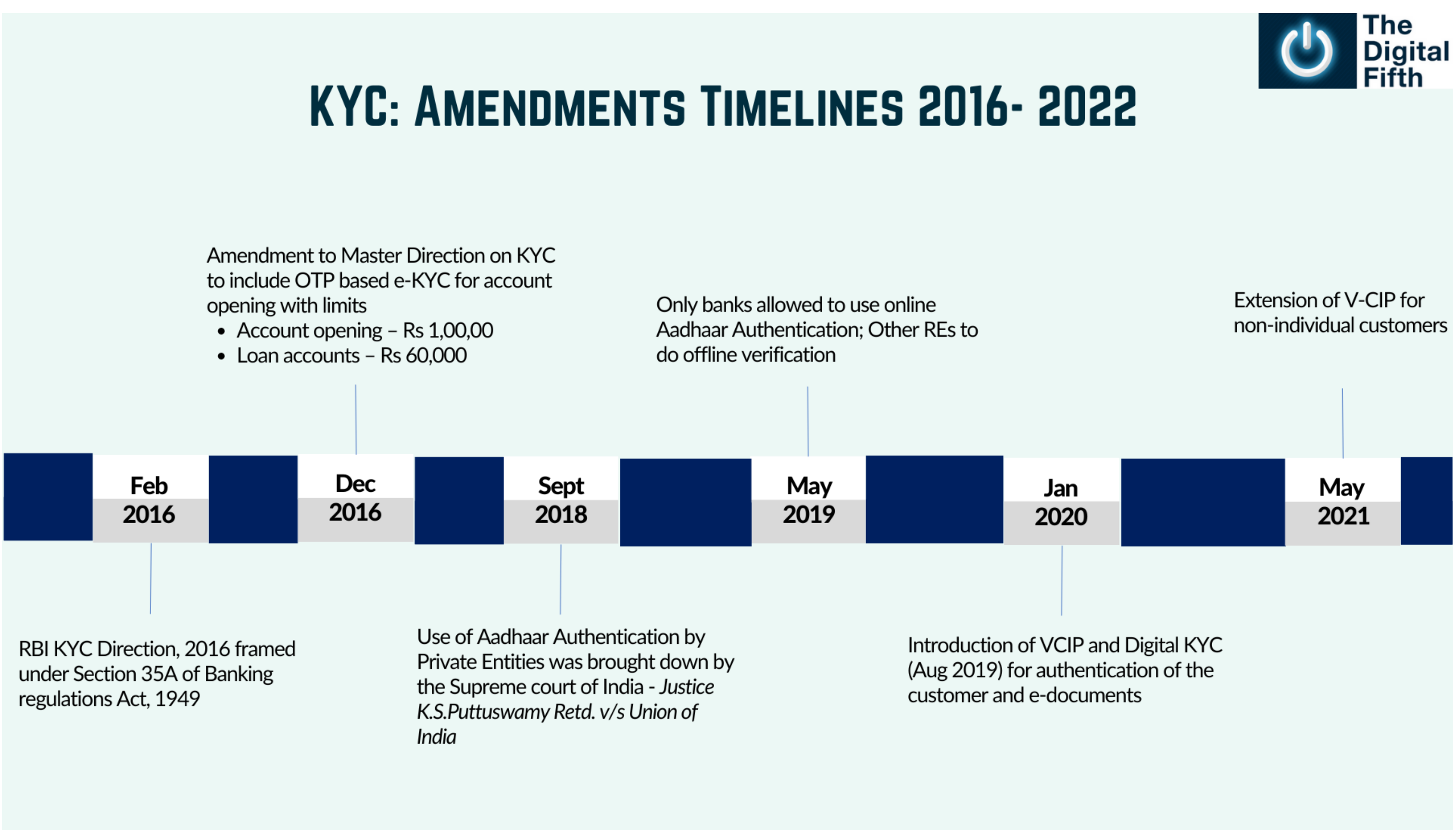
The Digital Fifth

Changes to the Master Directions
Know Your Customer (KYC) Directions from RBI

Background of KYC Directives from RBI

In India, the Reserve Bank of India (RBI) is looking after issuing guidelines and directives related to financial institutions. One such important directive is the KYC Circular of 2016. The circular provides guidelines and instructions to reporting entities on the implementation of KYC procedures. The KYC directive has undergone some changes in April 2023 & some minor corrections in May 2023.



Highlights from the change to Master Direction of KYC 2023

The changes in the policies and procedures of the Master Direction - Know Your Customer (KYC) Directions from RBI are aimed at enhancing the effectiveness of KYC procedures in identifying and mitigating money laundering and terrorist financing risks. These changes were needed to align with evolving regulatory standards and address potential vulnerabilities in the existing KYC framework. Here's why changing the policies and procedures was necessary to impact the directive:

1. **Expanded Scope**: In the recent circular it is directed that individuals shall have to hold a controlling ownership interest of more than 10% in companies to be the Beneficial Owner (BO) of a company or a Non-profit organization (NPO).

a. The scope of PEPs has been expanded to include individuals entrusted with prominent public functions by foreign countries, the revised guidelines ensure a thorough risk assessment.

2. **Wire Transfer Transparency**: The recent circular has introduced new terms and information requirements for wire transfers strengthens transparency and traceability, reducing loopholes and vulnerabilities in the KYC process. Registered Entities (REs) are required to ensure complete wire transfer information flow when engaging or involving unregulated entities in wire transfers.

3. **Video-based Customer Identification Process (V-CIP)**: With the improvements in V-CIP which can be subjective to veracity (indicates a lot of inconsistency) & the REs are requested to validate the customer data & maintain the audit trail of the verification of customer data. V-CIP scope now permits for the customer to be identified through facial recognition and audio-visual interaction, treating it on par with face-to-face customer identification. This technological advancement streamlines the KYC process and enables remote customer verification.

4. **Correspondent Banking**: Correspondent banking has been introduced in the KYC Master Directive which involves one bank (correspondent bank) providing services to another bank (respondent bank), including cash management, wire transfers, cheque clearing, and foreign exchange services.

a. The term payable-through accounts refers to correspondent accounts that are used directly by third parties to transact business on their own behalf has been specified in the Master Directive.

5. **Ongoing Due Diligence and Risk Management**: REs are required to categorize customers based on various risk parameters which has been expanded to include geographical risks covering customers, transactions, products, services, delivery channels, payment instruments wire transfers and forex trade to implement suitable systems to prevent customer identities from matching with names on sanctions lists. It has been specified that AI & ML technologies can be utilized for effective monitoring and enhancing ongoing due diligence practices.

6. **Role of Designated Director and Principal Officer**: It has been communicated that REs are required to communicate the details of the Designated Director and Principal Officer to the RBI. The Designated Director ensures overall compliance, while the Designated Principal Officer monitors transactions, shares information, and handles reporting.

7. **Technological Investments**: The Master Directive also specifies the adoption of V-CIP and compliance with wire transfer obligations require REs to invest in technological solutions such as facial recognition technology and secure customer interaction channels.

8. **Record Management**: REs must maintain registration records of non-profit organizations for five years after the business relationship ends. Details of non-profit organizations should be registered on the DARPAN Portal of NITI Aayog.

9. **Periodic Updating of KYC**: The updated guidelines allow for Aadhaar OTP-based e-KYC for periodic updating of KYC in non-face-to-face mode. Customers are required to submit updated documents within 30 days of any changes.

a. Declaration of current address, if the current address is different from the address in Aadhaar, shall not require positive confirmation.

b. REs shall ensure that the mobile number for Aadhaar authentication is the same as the one available with them in the customer's profile.

10. **Obligations under International Agreements**: REs are required to refer to FATF, UNSC Sanctions Lists and lists under the Prevention and Suppression of Terrorism Order for compliance with relevant acts. Daily verification of designated lists is required.

Impact of these KYC changes

Some of the changes to the Policies implemented by the REs as directed by the changes to the Master Directive of RBI are:

- KYC Policy: Reporting Entities (REs) must have a board-approved KYC policy. Group-wide policy implementation is required to comply with anti-money laundering regulations.
- Customer Acceptance Policy: REs must obtain additional information with explicit customer consent. Suitable systems should prevent customers' identities from matching with names on sanctions lists.
- Suspicion of Money Laundering or Terrorist Financing: If REs suspect money laundering or terrorist financing, they should file a suspicious transaction report.
- Risk Management: REs should categorize customers based on various risk parameters. Customer risk categorization and reasons for categorization must remain confidential.
- Customer Identification Procedure (CIP): International money transfers require customer identification even for non-account holders.
- V-CIP Infrastructure and Procedure: REs must comply with RBI guidelines on cybersecurity and have a secure V-CIP infrastructure.
- Small Accounts: Small accounts are monitored for suspicious activities, and foreign remittances require full customer identification.

Change in Roles & Responsibilities of Stakeholders:

Some of the changes to the Roles & responsibilities through the master directive of the KYC are:

- Designated Director and Principal Officer: Details of the Designated Director and Principal Officer must be communicated to the RBI.
- The Designated Director is expected to ensure overall compliance with the obligations imposed under Chapter IV of the PML Act
- The Designated Principal Officer is expected to ensure compliance, monitor transactions, share and report information

Change in Compliance, Due Diligence, Enhanced Due Diligence & Record Management:

Some of the changes to the Compliance, Due Diligence, Enhanced Due Diligence & Record Management through the master directive of the KYC are:

- Customer Due Diligence (CDD) Procedure: Aadhaar number or KYC Identifier with explicit consent can be used for CDD. Accounts opened using Aadhaar OTP-based e-KYC are subject to specific conditions.

- Simplified Procedure for NBFCs: NBFCs may open accounts based on discretion, subject to subsequent CDD.
- CDD Measures for Legal Entities: Documents and information required for opening accounts of partnerships, trusts, and other juridical persons.
- Ongoing Due Diligence: REs can utilize AI & ML technologies for effective monitoring.
- Enhanced Due Diligence (EDD) for non-face-to-face customer onboarding: EDD measures for remote onboarding include the option of a video-based Customer Identification Process (V-CIP).
- Record Management: Details of non-profit organizations should be registered on the DARPAN Portal of NITI Aayog, and registration records should be maintained for five years after the business relationship ends.

Changes in Updating the KYC of the customer:

Some of the changes in updating the KYC of the Customer through the master directive of the KYC are:

- Updating / Periodic Updating of KYC: Aadhaar OTP-based e-KYC is allowed for periodic KYC updating with specific conditions.
- Additional measures for updating documents: Customers must submit updated documents within 30 days of any changes to the documents submitted at the time of establishing the business relationship or account-based relationship.
- Obligations under International Agreements: REs should refer to UNSC Sanctions Lists and lists under the Prevention and Suppression of Terrorism Order for compliance with relevant acts. Daily verification of designated lists is required.
- Other Instructions: REs should upload KYC records onto the Central KYC Records Registry (CKYCR) within 10 days of establishing an account-based relationship.

The changes to KYC shall enhance the effectiveness of the procedures in identifying and mitigating money laundering and terrorist financing risks. By expanding the definition of Beneficial Owner, Non-profit Organizations, and Politically Exposed Persons, the revised guidelines ensure a more comprehensive assessment of potential risks. The inclusion of new terms and information requirements for wire transfers strengthens transparency and traceability, reducing loopholes and vulnerabilities in the KYC process. These changes enable RE's to gather more detailed and accurate customer information, improving their ability to identify and prevent illicit activities along with:

- Enhanced Risk Assessment: The broadened Beneficial Owner definition, Non-profit Organizations inclusion, and widened Politically Exposed Persons (PEPs) range enables a thorough risk assessment, mitigating potential illicit activities.
- Strengthened Transparency: Additional wire transfer information requirements boost transaction transparency, tracing funds effectively, curbing anonymous transactions, and facilitating a transparent financial environment.
- Technological Advancements: Video-based Customer Identification Process (V-CIP) adoption provides a streamlined KYC process and remote customer verification, demanding technological investment and standard compliance.
- Operational Adjustments: The updated KYC guidelines require procedural adjustments, such as policy updates, staff training, and enhanced due diligence, necessitating additional resources for compliance.

Implications of these changes:

The changes have significant implications for reporting entities (REs) and the financial industry. REs will need to update their KYC policies and procedures to align with the revised guidelines, ensuring compliance with anti-money laundering regulations and reducing the risk of penalties or reputational damage. The expanded requirements for identifying beneficial owners, non-profit organizations, and politically exposed persons will require enhanced due diligence efforts and more thorough record-keeping. Some more implications of the updated KYC directions from RBI are:

- Compliance Obligations: Reporting entities must align their practices with the new guidelines to meet anti-money laundering regulations, mitigating potential penalties and reputational harm.
- Technological Investments: Implementing V-CIP and wire transfer obligations requires investment in technological solutions, including facial recognition tech and secure customer interaction channels.
- Enhanced Due Diligence: Extended identification requirements necessitate more detailed due diligence, demanding additional information collection, identity verification, and risk scrutiny.
- Industry Collaboration: Revised KYC guidelines call for increased information-sharing among industry players, enhancing efforts against illicit activities, while adhering to data privacy regulations.

The revised KYC directions serve as a crucial framework for preventing money laundering and terrorist financing. By expanding the scope of identification and implementing stricter requirements for wire transfers, the changes enhance the effectiveness of KYC procedures and reduce potential vulnerabilities. It is imperative for reporting entities to update their policies and procedures, accordingly, ensuring compliance and reinforcing their commitment to financial integrity. These changes play a vital role in strengthening the global fight against illicit activities, ultimately safeguarding the stability and security of the financial system.

Market News

Launch of account aggregator services by PhonePe

The Account Aggregator (AA) services have been made available by PhonePe Group through its wholly-owned subsidiary PhonePe Technology Services Pvt Ltd (PTSPL), which recently got the NBFC-AA licence from the RBI. With the help of PTSPL's Account Aggregator service, Indian consumers will be able to give regulated Financial Institutions or FIUs (Financial Information Users) permission to access and use all of their financial data, including bank statements, insurance policies, and tax filings, for a variety of purposes, including loan applications, new insurance purchases, investment advice, etc. Any ongoing data consent can be requested, paused, or revoked by users directly through aa.phonepe.com or the PhonePe app.

RBI Expands RuPay's Purpose And Enables Banks To Issue Prepaid Foreign Currency Cards

In order to expand payment options for Indians travelling abroad, the Reserve Bank of India on Thursday decided to allow issuance of RuPay Prepaid Forex cards by banks in India for use at ATMs, PoS machines and online merchants overseas. Further, RuPay Debit, Credit, and Prepaid Cards will be enabled for issuance in foreign jurisdictions, which can be used internationally, including in India, Reserve Bank Governor Shaktikanta Das said, while unveiling the second bi-monthly monetary policy of this fiscal.

Weekly Funding

Company	Round	Amount	Description
lentra	**Series B**	**$ 60 Million**	**AI-enabled loan life cycle management solution for banks and lenders**
Sentra.world	**Seed**	**$ 2 Million**	**Provider of a technology platform offering ESG solutions**

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