# Master Direction - Know Your Customer (KYC) Direction, 2016 and its applicability to ARCs



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# Know Your Customer (KYC) Direction, 2016

- The RBI's Master Directions on KYC, initially issued on February 25, 2016, lays out the framework for Customer Due Diligence (CDD) for Regulated Entities. These entities are mandated to follow the processes outlined in the MD to ensure the legitimacy of their customers.

- Directions updated from time to time- latest 4th January 2024

- Directions are applicable to every entity regulated by RBI, more specifically defined in 3(b)(xiv) of Section 2.

- Master Direction is divided in 11 Chapters with 4 annexures

# Existing Regulations

-Prevention of Money-Laundering Act, 2002 (PMLA 2002) and Rules (PMLR) thereunder

-WMD Act 2005.



<u>Regulated through RBI and SEBI</u>

RBI: KYC Direction 2016

SEBI: KYC requirements

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# Recent Amendments and its implications

a) **Compliance with Updated Laws:** The amendments align with changes to the Prevention of Money Laundering (PML) Rules as amended.

b) **Annex II and Annex III Updates:** to reflect changes in government orders related to Unlawful Activities (Prevention) Act, 1967, and Weapons of Mass Destruction and their Delivery Systems (Prohibition of Unlawful Activities) Act, 2005.

c) Modifications in accordance with recommendations from the Financial Action Task Force (FATF).

d) A new Section 55A on the Foreign Contribution (Regulation) Act (FCRA) has been incorporated into the MD.

e) **Miscellaneous Updates:** Several other instructions have been updated to enhance the regulatory framework.

# Implications

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- Appointment of Designated Director and Principal Officer
- Revised beneficial owner (BO) identification
- Periodic updation of KYC
- Monitoring Money Mules (S.59)
- Adoption of a risk-based approach to manage and mitigate the risks through appropriate Enhanced Due Diligence (EDD) measures and transaction monitoring, etc.
- REs to have comprehensive DD viz. Customer Due Diligence (CDD), On-going Due Diligence and as required by FATF ( Financial Action Task Force)
- Outsourcing of KYC to the extent it does not outsource decision making power
- Allot Unique Costumer Identification Code (UCIC) to existing as well as new customers (S.61)
- Record Management

# Major provisions in KYC Directions



- REs to have Board approved KYC policy
- Risk of ML and TF and its assessment should be part of the policy
- Outsourcing of KYC is possible, however responsibility of RE shall not cease
- Determination of BO
- Responsibility of Designated Director and Principal Officer
- Customer Acceptance Policy (chapter III)
- Risk Management and its parameters
- Periodic updation of KYC
- Record Management
- Secrecy Obligations

# Chapter I - Preliminary

Applicability to REs and its subsidiaries

## Definitions under 3a

- Beneficial Owner (BO)
- Designated Director
- Officially Valid Document (OVD)
- Principal Officer
- Suspicious Transaction
- Transaction

## Definitions under 3b

- Customer
- Customer Due Diligence (CDD)
- On-going Due Diligence
- Regulated Entities (RE)
- Video based Customer Identification Process (V-CIP)

# Chapter II- General

- KYC policy to be approved by the Board or the Committee thereof.

- **Policy should include 4 key elements**

a) Customer Acceptance Policy (Chapter III)

b) Risk Management (Chapter IV)

c) Customer Identification process (CIP) (Chapter V)

d) Monitoring of Transactions (On-going Due Diligence)



- RE which is part of the Group shall implement group-wide programmes against money laundering & terror financing

- REs policy framework should seek to ensure compliance with PMLA/ Rules, including regulatory instructions in this regard.

# 5A Money Laundering and Terrorist Financing Risk Assessment by RE

1. Periodic Risk Assessment shall be carried out to identify, assess and to mitigate ML and TF.

2. Consideration of Relevant Risk Factors

3. Risk assessment to be properly documented and be proportionate to nature, size and geographical presence.

4. The outcome exercise shall be put up to the Board and should be available to competent authorities.

While preparing the internal risk assessment REs shall take cognizance of the overall sector specific vulnerabilities, if any.

# 5B - Risk Based Approach

1. REs shall apply for mitigation and management of risks and should have board approved policies, controls and procedures.

2. To implement CDD programme. (Chapter VI)

# Designated Director and Principal Officer

| | Designated Director | Principal Officer |
|---|---|---|
| **Definition** | A person designated by the RE to ensure overall compliance with obligations under Chapter IV of the PML Act. | Responsible for ensuring compliance, monitoring transactions, and sharing and reporting information as required by law. |
| **Nomination** | Nominated by the Board of the RE and includes MD/WTD. | Officer at the management level. |
| **Prohibition** | Cannot be the same individual as the Principal Officer. | Cannot be the same individual as the Designated Director. |
| **Communication to FIU-IND** | Name, designation, and address must be communicated. | Name, designation, and address must be communicated. |
| **Communication to RBI** | Name, designation, address, and contact details must be communicated. | Name, designation, address, and contact details must be communicated. |
| **Primary Responsibilities** | To ensure overall compliance with the PML Act and Rules. | To oversee compliance, monitor transactions, and handle reporting and information sharing as per legal and regulatory norms pursuant to rule 8 of PMLA Rules. |

# Compliance of KYC Policy (Sec 8)

- Defining Senior Management
- Allocation of Responsibility
- Independent evaluation of Compliance functions
- Internal Audit System to verify the compliance with KYC/AML
- Submission of quarterly audit notes

REs to ensure decision-making functions of determining compliance with KYC norms are not outsourced.

# Chapter III- Customer Acceptance Policy

1. Terms that may be applicable to ARCs mentioned in section 10 to be considered.
2. Policy should not result in denial of financial facility to general public.

   (May not be applicable to ARCs)
3. Any suspicion of money laundering observed, RE to file Cash Transaction Report (CTR)/ Suspicious Transaction Report (STR) with FIU-IND.

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# Chapter IV - Risk Management

Categorization of customers as low, medium and high risk- category.

Categorization to be done on basis of different parameters i.e. nature of business activity, geographical risk covering customers as well as transactions, type of services offered, wire transfers, forex transactions etc.

Reasons for categorization to be kept confidential.

- REs can use FATF (Financial Action Task Force) public statement, reports and guidance notes on KYC/AML issued by IBA and other agencies for risk assessment.

# Chapter V- Customer Identification Procedure (CIP)

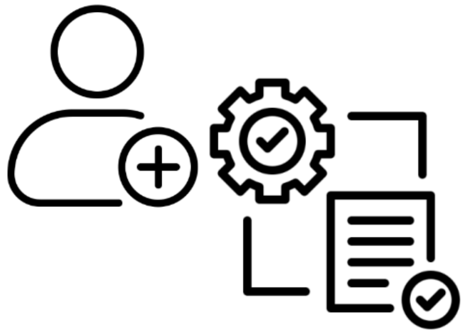
## (ARC shall take customer Identification Process in the following cases)

1. Commencement of account-based relation with customer by sending a notice to borrower after acquisition
2. International Money Transfers by Non-Account Holders (payment for borrowers by third party)
3. Doubts about customer Identification data
4. Suspicion of structuring Transactions into series of transactions



REs can rely on CDD done by third party or C-KYC records subject to certain conditions. (Sec 14)

# Chapter VI - Customer Due Diligence (CDD)

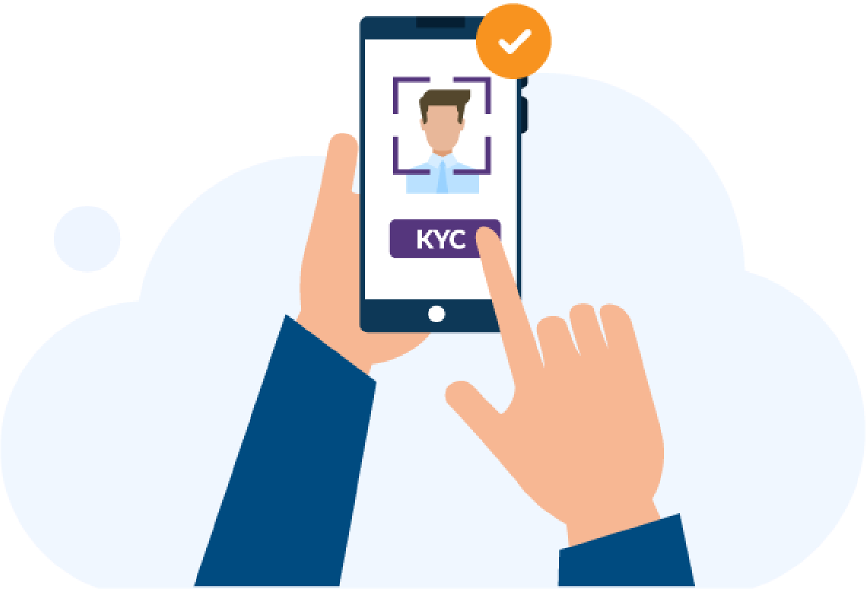


- Various CDD procedures (Aadhar, PAN and other relevant docs)
- CDD to be done at UCIC level.
- Ensure name of customer does not appear in UNSC/RBI sanction list/ willful defaulters list etc.
- CDD Measures for Legal Entities, Sole Proprietor, Company, Partnership and Trust.
- On going due diligence
- Up-dation of KYC/ CKYC

For high-risk customers: once in every 2 years

For Medium- risk customers: once in 8 years

For low-risk customers: once in every 10 years




# Modes of conducting CDD/ Types of KYC



- Physical
- Digital KYC
- V- CIP
- OTP Based E-KYC
- CKYCR

# Reasons to undertake V - CIP and its requirements

- CDD in case of new customer on-boarding for individual customers and other BOs.
- Define V- CIP process with SOP and only designated officials should conduct the same .
- Conversion of existing accounts opened in non-face to face mode.
- CDD measures for different legal entities.



## Standards to be adhered by REs opting V-CIP

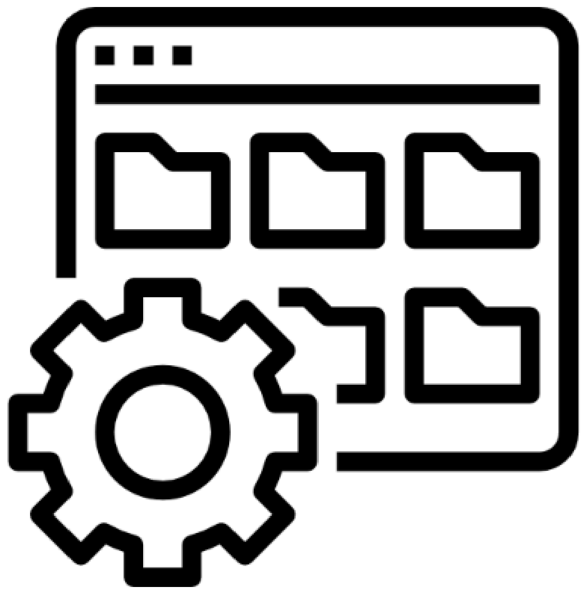
- V-CIP Infrastructure
- V-CIP Procedure
- V-CIP Records and Data Management.

# • Identification of Beneficial Owner (BO)

Individuals who exercise ultimate effective control over a legal person or arrangement.

| Customer Type | Who is a Beneficial Owner? |
|---|---|
| **Companies** | Natural person(s) who, directly or indirectly, control over 10% of the shares or capital or profits of the company, either through ownership or through other means like voting rights. |
| **Partnerships** | Natural person(s) who own more than 10% of the capital or profits of the partnership. |
| **Unincorporated Associations** | any natural person who owns more than 15% of the profits or capital. |
| **Trusts** | The trustee, settlor, beneficiaries holding more than 10% interest in the trust, or any other person with ultimate control over the trust through a chain of control or ownership |

# Chapter VII - Record Management



- Detailed transaction Record Management
- Preservation of Customer Identification Records
- Easy availability of records
- Record-keeping system
- Efficient Retrieval System
- Records to be maintained in both hard and soft formats

# Chapter VIII - Reporting Requirements

a) Information to be furnished to the director, FIU-IND by PO

b) Director of FIU-IND has authority to issue guidelines for detecting transactions.

c) Use of reporting formats and guidelines provided by FIU-IND for filing STR.

d) Adoption of suitable technology to maintain proper records of transactions

e) Delay in report to be treated as separate violation.

f) Use of software for identifying suspicious transactions.



# Chapter X - Other Instructions

- Secrecy Obligations and sharing information subject and sharing information subject to applicable exceptions.
- Sharing KYC information with Central KYC Records registry (CERSAI)
- Reporting requirement under FATCA.
- REs to identify and assess the ML/TF risks that may arise in relation to development of new product.
- UCIC to be allotted before entering into new transaction.
- Further, the name of the purchaser shall be incorporated on the face of the demand draft, pay order, banker’s cheque etc, by the issuing bank.

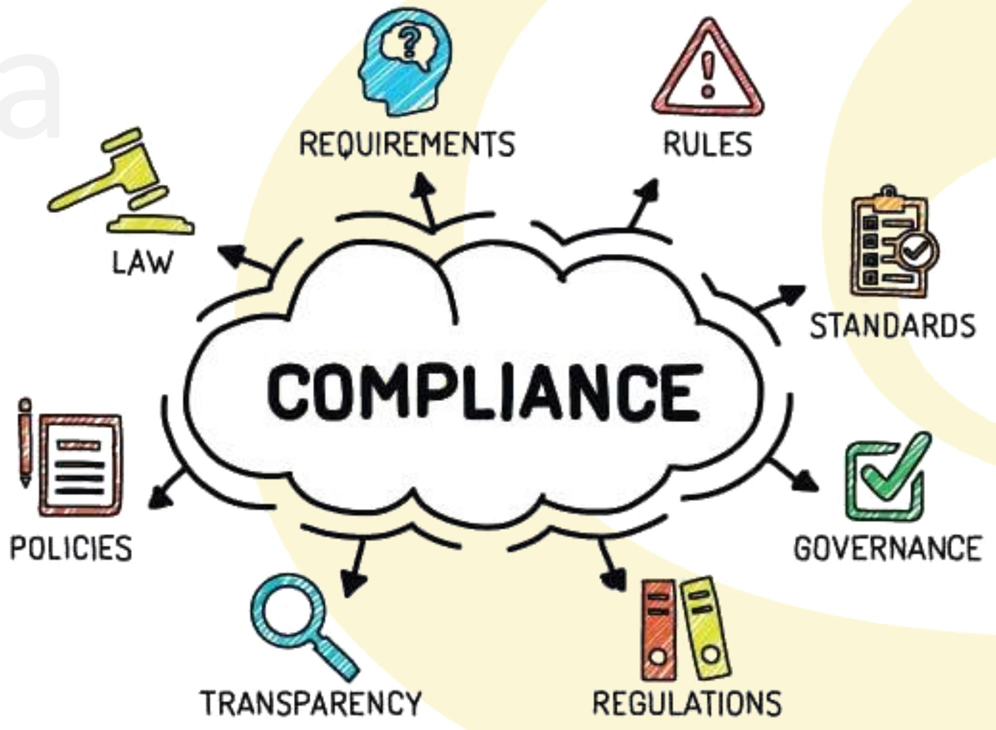
# Effects of Master Direction on ARCs


- ARC is neither a lender nor deposit accepting institution like Banks and NBFC.
- UCIC are created and monitored by the Banks alone.
- The space in which ARC operates is limited to restructuring or recovery of bad loans.
- Assignor Banks/ NBFC are reluctant to give covenant about KYC compliance and as per MD ultimate responsibility would be on ARC or Originator.
- KYC compliance being continuous it would be herculean task for the ARC to regularly update and maintain the data.
- Focus of resolution and recovery may affect due to increased compliance.

# Effects of Master Direction on ARCs

- Onus and additional responsibility  would be on ARC being categorized as RE
- Investment in latest technology with other additional costs like training, outsourcing and staffing
- Enhanced Compliance
- Risk Categorization for comprehensive Risk Management
- Board reporting as per Policy





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# Steps to be taken by ARCs

- ✓ ARC will buy only CKYC complied accounts from the banks. This can be mentioned while submitting the bid itself or in the Offer letter.
- ✓ In the Assignment Agreement Bank will give covenant to that effect.
- ✓ Updation of KYC can be outsourced by ARCs. Services of companies like CDSL, Karvy or CAMS can be tested. Originator help can be sought for such cases.
- ✓ Compliance as per section 65 while accepting DD from the borrowers.
- ✓ Quarterly review to be taken to check such compliance.
- ✓ Digital KYC wherever possible.
- ✓ Develop a software for compliance indicating CKYC reflected in each account.

# Thank You

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