Regd. No. MH/MR/South-30/2004-05

Volume I ◆ Issue 4

January 2005

MONETARY AND CREDIT INFORMATION REVIEW

POLICY

KYC Guidelines and AML Standards

The 'Know Your Customer' (KYC) guidelines have been revisited in the context of the recommendations made by the Financial Action Task Force on Anti Money Laundering Standards and on Combating Financing of Terrorism. These standards have become the international benchmark for framing anti money laundering and combating financing of terrorism policies by the regulatory authorities. Detailed guidelines based on the recommendations of the Financial Action Task Force and the paper issued on Customer Due Diligence for banks by the Basel Committee on Banking Supervision are indicated below. Banks have been advised to ensure that a proper policy framework on 'Know Your Customer' and anti-money laundering measures is formulated and put in place with the approval of their board.

Objective

The objective of KYC guidelines is to prevent banks from being used, intentionally or unintentionally, by criminal elements for money laundering activities. KYC procedures also enable banks to know/ understand their customers and their financial dealings better which in turn help them manage their risks prudently. Banks should frame their KYC policies incorporating the following four key elements - Customer Acceptance Policy, Customer Identification Procedures, Monitoring of Transactions and Risk Management.

Customer Acceptance Policy

The customer acceptance policy must ensure that explicit guidelines are in place on the following aspects of customer relationship -

(i) No account is opened in anonymous or fictitious/benami name(s).

(ii) Parameters of risk perception are clearly defined 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., to enable categorisation of customers into low, medium and high risk (banks may choose any suitable nomenclature viz., level I, level II and level III). Customers requiring very high level of monitoring, e.g. politically exposed persons may, if considered necessary, be categorized even higher.

(iii) Documents and other information should be collected in respect of different categories of customers depending on perceived risk and keeping in mind the requirements of PML Act, 2002 and guidelines issued by the Reserve Bank from time to time.

(iv) Not to open an account or close an existing account where the bank is unable to apply appropriate customer due diligence measures i.e., bank is unable to verify the identity and/or obtain documents required as per the risk categorization due to non-cooperation of the customer or non-reliability of the data/ information furnished to the bank. It may, however, be necessary to have suitable built in safeguards to avoid harassment of the customer. For example, decision to close an account may be taken at a reasonably high level after giving due notice to the customer explaining the reasons for such a decision.

(v) Circumstances in which a customer is permitted to act on behalf of another person/entity, should be clearly spelt out in conformity with the established law and practice of banking as there could be occasions when an account is operated by a mandate holder or where an account may be opened by an intermediary in the fiduciary capacity.

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(vi) Necessary checks should be carried out before opening a new account to ensure that the identity of the customer does not match with any person with known criminal background or with banned entities such as individual terrorists or terrorist organizations, etc.

Customer Identification Procedure

The policy approved by the bank's board should clearly spell out the customer identification procedure to be carried out at different stages i.e., while establishing a banking relationship, carrying out a financial transaction or when the bank has a doubt about the authenticity/veracity or the adequacy of the previously obtained customer identification data. Customer identification means identifying the customer and verifying his/her identity by using reliable, independent source documents, data or information. For customers that are natural persons, banks should obtain sufficient identification data to verify the identity of the customer, his address/location, and also his recent photograph. For customers that are legal persons or entities, banks should (i) verify the legal status of the legal person/entity through proper and relevant documents (ii) verify that any person purporting to act on behalf of the legal person/entity is so authorized and identify and verify the identity of that person, (iii) understand the ownership and control structure of the customer and determine who are the natural persons who ultimately control the legal person.

Monitoring of Transactions

Ongoing monitoring is an essential element of effective KYC procedures. Banks can effectively control and reduce their risk if they have an understanding of the normal and reasonable activity of the customer so that they have the means of identifying transactions that fall outside the regular pattern of activity. Banks should pay special attention to all complex, unusually large transactions and all unusual patterns which have no apparent economic or visible lawful purpose. Banks should prescribe threshold limits for a particular category of accounts and pay particular attention to the transactions which exceed these limits. Transactions that involve large amounts of cash inconsistent with the normal and expected activity of the customer should particularly attract the attention of the bank. Very high account turnover inconsistent with the size of the balance maintained may indicate that funds are being 'washed' through the account. High-risk accounts should be subjected to intensified monitoring. Banks should set key indicators for such accounts, taking note of the background of the customer, such as the country of origin, sources of funds, the type of transactions involved and other risk factors. A record of transactions in the accounts should be maintained and preserved. Transactions of suspicious nature should be reported to the appropriate law enforcement authority.

Banks should ensure that their branches continue to maintain proper record of all cash transactions (deposits and withdrawals) of Rs.5 lakh and above. The internal monitoring system should have an inbuilt procedure for reporting of such transactions and those of suspicious nature to controlling/head office on a fortnightly basis.

Risk Management

Banks should, in consultation with their boards, devise procedures for creating risk profiles of their existing and new customers and apply various anti money laundering measures keeping in view the risks involved in a transaction, account or banking/business relationship. Banks should ensure that their audit machinery is staffed adequately with individuals who are well-versed with the banks' policies and procedures. Concurrent/internal auditors should specifically check and verify the application of KYC procedures at the branches and comment on the lapses observed in this regard. The compliance in this regard may be put up before their board's audit committee at quarterly intervals.

Banks should have an ongoing employee-training programme so that staff members are adequately trained in KYC procedures. Training requirements should have different focuses for frontline staff, compliance staff and staff dealing with new customers.

Customer Education

Implementation of KYC procedures requires banks to demand certain information from customers which may be of personal nature or which was hitherto never called for. This can sometimes lead to a lot of questioning by the customer as to the motive and purpose of collecting such information. There is, therefore, a need for banks to prepare specific literature/ pamphlets etc., so as to educate the customer of the objectives of the KYC programme. The front desk staff needs to be specially trained to handle such situations while dealing with customers.

Credit/Debit/Smart/Gift Cards

Many banks are engaged in the business of issuing a variety of electronic cards that are used by customers for buying goods and services, drawing cash from ATMs, and can be used for electronic transfer of funds. Banks should ensure that appropriate KYC procedures are applied before issuing the cards to the customers. Agents marketing the cards should also be subjected to KYC measures.

Existing Accounts

While the revised guidelines would apply to all new customers, banks should also apply them to existing customers on the basis of materiality and risk. Transactions in existing accounts should, however, be continuously monitored and any unusual pattern in the operation of the account should trigger a review of the customer due diligence measures. Banks may consider applying monetary limits to such accounts based on the nature and type of the account. Banks should, however, ensure that all the existing accounts of companies, firms, trusts, charities, religious organizations and other institutions are subjected to minimum KYC standards which would establish the identity of the natural/legal person and those of the 'beneficial owners'. Banks may also ensure that term/recurring deposit accounts or accounts of similar nature are treated as new accounts at the time of renewal and subjected to revised KYC procedures. Where the bank is unable to apply appropriate KYC measures due to non-furnishing of information and/or non-cooperation by the customer, the bank may consider closing the account or terminating the banking/business relationship after issuing due notice to the customer explaining the reasons for taking such a decision. Such decisions should be taken at a reasonably senior level.

Monetary And Credit Information Review on Personal E-mail ID

Press Relations Division proposes to make available the Monetary And Credit Information Review through email. Interested readers may kindly send their e-mail ID to helpprd@rbi.org.in or gmprd@rbi.org.in. Readers within the Bank can also access the Monetary And Credit Information Review on intranet by following the path : Microsoft Outlook>public folders>all public folders>Press Relations Division>Monetary And Credit Information Review.

Appointment of Principal Officer

Banks should appoint a senior management officer to be designated as Principal Officer. The Principal Officer should be located at the head/corporate office of the bank and would be responsible for monitoring and reporting all transactions and sharing information as required under the law. He should maintain close liaison with enforcement agencies, banks and any other institutions which are involved in the fight against money laundering and combating financing of terrorism.

Risk Weight on Housing Loans and Consumer Credit

The Reserve Bank has advised banks that the risk weight for capital adequacy purposes, on housing loans extended by them to individuals, which are fully secured by mortgage of residential properties and investments in mortgage backed securities (MBS) of housing finance companies recognised and supervised by the National Housing Bank has been increased to 75 per cent. The Reserve Bank has also advised that for MBS of housing finance companies to be eligible for 75 per cent risk weight, securities issued by the special purpose vehicle (SPV) should be backed only by assets qualifying for 75 per cent risk weight. In all other cases, it would be 100 per cent.

The Reserve Bank has also increased the risk weight on consumer credit including personal loans and credit cards receivables from 100 per cent to 125 per cent.

As the capital to risk-weighted assets ratio (CRAR) is to be maintained on an on-going basis, risk weights as indicated above would be applicable on all outstanding exposures.

Graded Interest Rates on Deposits with SIDBI

Pursuant to the recommendation of the Ganguly Working Group regarding restructuring the scheme of placement of deposits with the Small Industries Development Bank of India (SIDBI) by foreign banks in *lieu* of shortfall in their priority sector obligations, the Reserve Bank has advised all foreign banks that -

Shortfall in overall target (32 per cent of net bank credit) or aggregate shortfall in sub-targets SSI (10 per cent) and export credit (12 per cent), whichever is higher	**Rate of interest on the entire deposit to be made with SIDBI** (per cent per annum)
Less than 2 percentage points	Bank rate (6 per cent at present)
2 per cent and above, but less than 5 percentage points	Bank rate minus 1 percentage point
5 per cent and above, but less than 9 percentage points	Bank rate minus 2 percentage points
9 percentage points and above	Bank rate minus 3 percentage points

(i) The amount of shortfall in priority sector obligation should be placed with SIDBI for a tenor of three years.

(ii) The funds placed with SIDBI would have a graded interest rate structure linked to the bank rate as indicated in the box above.

The scheme would be made effective from the financial year 2005-06 so that foreign banks have adequate time to plan deployment of their resources. SIDBI would pass on the lower interest rates to the borrowers.

Margins on Advances against Shares increased

The Reserve Bank, on a review, has decided to increase with immediate effect, margins on all advances against shares/initial public offerings (IPOs)/issue of guarantees from 40 per cent to 50 per cent and the minimum cash margin from 20 per cent to 25 per cent.

It may be recalled that the margin on all advances against shares/financing of IPOs/issue of guarantees was reduced from 50 per cent to 40 per cent and the minimum cash margin from 25 per cent to 20 per cent in May 2004.

TSUNAMI RELIEF

Banks to provide Relief to Tsunami affected

The Reserve Bank has issued an advisory to banks on being proactive in providing relief to the Tsunami affected. It has, in the advisory, advised banks that their branch managers should, on the basis of their experience and in consultation with other agencies operating in the areas, identify the victims who are in need of assistance and provide them necessary relief and that they need not wait for any list of victims to be formally made available by any authority before providing relief to the affected persons. This would include taking help of good non-government organisations (NGOs) working in the areas to identify borrowers as also increase the limit of consumption loan to be provided to the affected persons up to Rs 5,000 without any collateral. The limit of consumption loan may be enhanced to Rs 10,000 at the discretion of the branch manager, depending on the repaying capacity of the borrower.

Further, banks may allow opening of savings bank accounts with a nominal balance of say, Rs 10, so that victims can receive relief cheques in their accounts. In the case of loss of passbooks/ cheque books, fresh ones should be immediately issued. The Reserve Bank has also advised banks to provide education loans to the affected persons to enable them to purchase books,

Nodal Bank Branches to Centrally receive Funds and remit them to the PMNRF

(i) Central Bank of India, 70, Janpath, New Delhi.

(ii) State Bank of India, Institutional Division, Parliament Street, New Delhi.

(iii) Union Bank of India, 14/15F, Connaught Place, New Delhi

(iv) Dena Bank, Mangal Bhawan, Arya Samaj Road, Karol Bagh, New Delhi.

(v) Syndicate Bank, South Block, New Delhi.

(vi) Corporation Bank, M-41, Connaught Circus, New Delhi.

(vii) Bank of India, 54, Janpath, New Delhi.

(viii) Indian Overseas Bank, Parliament Street, New Delhi.

(ix) Punjab National Bank, Parliament Street, New Delhi.

(x) Indian Bank, P45/90, Connaught Circus, New Delhi.

(xi) Allahabad Bank, Parliament Street, New Delhi.

(xii) Citi Bank, 3rd Floor, Jeewan Bharti Building, 124, Connaught Circus, New Delhi.

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Posted on 29th and 31st January 2005 at PATRIKA CHANNEL SORTING OFFICE MUMBAI - GPO

clothes, etc., for children studying in educational institutions. As regards financing of defaulting fishermen and other types of borrowers, banks have been asked to formulate a scheme on the lines of the scheme for financing 'farmers in arrears' as announced by the Union Finance Minister on June 18, 2004. The scheme for financing 'farmers in arrears' was communicated to banks by the Indian Banks' Association on July 7, 2004.

Tsunami Relief : Contributions to PMNRF

In consultation with the Prime Minister's Office and the Indian Banks' Association it has been decided that all the branches of commercial banks should receive donations and nominate a nodal branch in New Delhi for collecting contributions to the Prime Minister's National Relief Fund (PMNRF).

Each collecting branch should send the collection to the respective nodal branch of its bank in New Delhi each day along with the details of the donor, his address, cheque/draft number and the amount of contribution. The nodal branches should in turn remit the funds to any of the 12 designated branches, which are maintaining PMNRF account (see box on page 3). Banks which do not have any branch in New Delhi should collect the donations and remit through a single demand draft or by using the electronic funds transfer facility to any of the 12 designated branches along with the details of the donor, his address, cheque/draft number and the amount of contribution.

Banks offering on line remittance services have been advised to offer the service for remitting donations and to prominently display the facility of on line payment of donations on their website. Banks have been advised to offer all these services free of charge.

Contributions to the PMNRF are eligible for 100 per cent deduction from taxable income under Section 80(G) of the Income-tax Act. The Prime Minister's Office would issue an official receipt to the donor as per the current practice.

Relief Measures by the Banking System : A Backgrounder

The Tsunami tidal waves struck the coastal areas in the states of Andhra Pradesh, Tamil Nadu and Kerala and Union Territories of Pondicherry and Andaman and Nicobar Islands on December 26, 2004.

- On December 27, 2004, the Reserve Bank activated the relief package for the states/union territories affected by the Tsunami. Further, feedback was obtained from the convenor banks of the state level bankers' committee (SLBC) in these states/union territories. A Task Force was formed under the Chairmanship of the Deputy Governor, Shri V. Leeladhar to monitor the progress of relief and rehabilitation measures through banks and to constantly review the situation to see if any further measures would be required.
- Special meetings of the SLBC were immediately convened in the three states and the union territory of Pondicherry. Banks adopted special measures to provide financial assistance to the persons, particularly under fisheries, in the affected areas.
- Based on the suggestion received from a few SLBCs, the consumption loan limit was enhanced from the existing Rs. 1000 to Rs. 3000 in the case of persons affected by the Tsunami.
- A circular dated December 29, 2004 was issued to all scheduled commercial banks to receive donations to the Prime Minister's Relief Fund at all branches and nominate a nodal branch at New Delhi for the purpose of collection. The name, account number and MICR codes of the designated branches to facilitate online remittance of donations by bank customers have been placed in public domain. Banks offering online remittance services to its customers should permit remittance of donations. All such services are to be provided free of charge.
- The Government of India exempted, with immediate effect and up to March 31, 2005, all associations (other than political parties), having a definite cultural, economic, educational, religious or social programme from the provisions of the Foreign Contributions (Regulation) Act, 1976 enabling them to accept foreign contributions in cash and kind for providing relief to the Tsunami victims, without obtaining formal approval from the central government. This exemption is, however, subject to certain conditions. All scheduled commercial banks have been advised to issue necessary instructions to their branches in this regard.
- The National Housing Bank has formulated a concessional scheme for financial assistance to banks and housing finance companies for providing finance for construction/repair/renovation of houses.
- The National Bank for Agricultural and Rural Development (NABARD) has proposed to provide refinance at concessional rate to banks for financing the affected persons. NABARD has also been requested to advise banks that the unit costs (presently being circulated among banks by NABARD) for providing term loans for purchase of boats, fishing nets, etc., were only indicative rates and as such, should be flexible and should be decided by banks depending on the local conditions.

Edited and published by **Alpana Killawala** for the **Reserve Bank of India,** Press Relations Division, Central Office, Shahid Bhagat Singh Marg, Mumbai-400 001 and printed by her at **Alco Corporation**, A-2, 72, Shah & Nahar Ind. Estate, Lower Parel (West), Mumbai - 400 013. **Readers desirous of subscribing may remit the subscription, by way of cheque/DD payable at Mumbai to the Director, DRRP (Sales Section), DEAP, Reserve Bank of India, Amar Building, Sir P. M. Road, P. B. No. 1036, Mumbai - 400 001. Also available on Internet at www.cir.rbi.org.in**