KYC-AML Compliance for Strengthening the Institutions and the Financial System[1]

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Good Morning to all.

Shri. V.G Sekar, Principal, College of Agricultural Banking, Principal Officers of Commercial Banks, SFBs and UCBs, and faculty members of College of Agricultural Banking, my warm greetings to all of you.

At the outset, I wish to thank the College of Agricultural Banking for organising this very important Seminar on KYC-AML compliance and inviting me to deliver the keynote address on **'**KYC-AML Compliance for Strengthening the Institutions and the Financial System'**.**

I am happy to note that this one-day seminar is being organized with an objective to update and strengthen the understanding of KYC/ AML guidelines of Principal Officers and to provide a platform for deliberations and sharing of best practices on KYC/ AML compliance

Importance of KYC-AML Compliance

2. Let me begin by emphasizing on the importance of KYC-AML compliance. In today's competitive and dynamically changing business environment, it is important that financial institutions are not only focussed on providing better services to their customers, but also ensure that systems of financial institutions are not being misused, intentionally or otherwise, by the criminal elements for fraudulent, money laundering and terrorist financing activities. The innovative and complex products being offered by banks today, the competition in the financial sector, and increasing expectations from customers, have exposed financial institutions to elevated KYC-AML risks. The interconnectedness of financial institutions, not only nationally but also globally, means that laxity on this front by even one player may have a system-wide bearing. As a result, KYC-AML risk mitigation and management are given immense importance globally, across most jurisdictions.

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[1] Address by Shri Rohit Jain, Executive Director, Reserve bank of India, at the Seminar for Principal Officers of Banks on KYC-AML Compliance (online mode)

Historical and International Perspective

3. Though the terms KYC and AML are often mistakenly used interchangeably, KYC is primarily a documentation procedure for the purpose of customer due diligence (CDD) and AML is a complete framework deployed by the banks and other regulated entities, which *inter alia* encompasses CDD for customer onboarding.

4. The anti-money laundering (AML) policy across the globe is considered to have originated at the summit meeting of the Heads of State of the G-7 in Paris in July 1989, when laundering of proceeds originating from drug trafficking was a matter of grave concern. The major international level organizations involved in framing policies for AML / CFT are the Financial Action Task Force (FATF) and various other Regional Bodies like Asia-Pacific Group (APG), Eurasia Group (EAG), etc., the Egmont Group of FIUs, United Nations Office on Drugs and Crime (UNODC), International Money Laundering Information Network (IMoLIN), etc. In July 2020, Basel Committee on Banking Supervision (BCBS) also revised its guidelines on 'Sound management of risks related to money laundering and financing of terrorism'.

5. Of these, FATF is of particular relevance for India, as the Mutual Evaluation (ME) of India by FATF is scheduled in the coming years. The FATF is an intergovernmental body which develop policies to combat money laundering and terrorist financing. The FATF focuses on three main areas such as (a) setting anti-money laundering (AML) and countering the financing of terrorism (CFT) standards through regularly updated FATF Recommendations, (b) evaluating progress through "mutual evaluations" of member countries by other member countries, and (c) identifying trends and engaging with high-risk, non-cooperative jurisdictions.

6. Further the BCBS guidelines require that every bank should have the following four essential elements as part of their sound AML / CFT risk management:

a) Assessment and Understanding of Risk
b) Proper Governance Arrangements
c) The Three Lines of Defence and
d) Adequate Transaction Monitoring System

Domestic Framework and RBI Guidelines

7. In India, the primary legal framework for combating Money Laundering is Prevention of Money Laundering Act (PMLA), 2002 and PML Rules 2005. The main objectives of PMLA are to prevent money laundering, to confiscate and seize the property obtained from the laundered money and to deal with any other issues connected with money laundering in India. PML Rules 2005 require every reporting entity to designate a Principal Officer, who shall furnish the various reports such as CTR, STR, etc. to FIU IND.

8. Building upon the international best policies and practices, RBI has framed comprehensive guidelines vide **‘**Master Direction on KYC’, which aim to serve as a foundation for prudent and safe banking practices. The Master Direction also encompasses the various provisions mentioned in the PMLA Act, 2002 and the PML Rules, 2005. The Master Direction on KYC inter alia requires the banks and other RBI regulated entities, to have a Know Your Customer policy (KYC policy) duly approved by the Board, which should include four key elements namely customer acceptance policy, risk management, customer identification procedures and monitoring of transactions. The other major requirements for the banks as per the said MD are as under:

a. Carry out ‘Money Laundering (ML) and Terrorist Financing (TF) Risk Assessment’ exercises periodically to identify, assess and take effective measures to mitigate their money laundering and terrorist financing risk.
b. Apply a risk-based approach for the mitigation and management of identified risks
c. Record-keeping and reporting, which are integral elements of the KYC compliance.
d. Ensure that there is no tipping off at any level to the customer the fact that a suspicious transaction report or related information is being reported or provided to the FIU.

Increased focus on KYC-AML Compliance at DoS, RBI

9. To give special focus to KYC / AML supervision of the banks, UCBs and NBFCs, distinct from their existing prudential supervision, Department of Supervision, RBI has created a separate and specialised structure for KYC/AML risk-based supervision. On the lines of FATF recommendations, RBI has developed Risk Based Approach (RBA) for KYC AML supervision of banks through development of an analytical model. RBA

facilitates better risk-discovery, improved risk-assessment and brings objectivity in the supervisory process leading to consistency in assessment across the banks.

RBI is also in the process of developing and adopting the RBA for the select large NBFCs and UCBs and an analytical model, on similar lines developed for the banks, will be developed for them.

Role of other agencies / regulators like FIU, LEA, SEBI, etc.

10. In the overall sphere of AML and CFT framework envisaged for India, various segments of the Government like FIU IND, Law Enforcement Agencies (LEA), Income Tax Department and other sectoral regulators like SEBI, IRDA, etc. also have critical to play. While FIU IND is the central national agency responsible for receiving, processing, analyzing and disseminating information relating to suspect financial transactions, other Law Enforcement Agencies and regulators are working on various roles applicable to them.

Role of Principal Officers and Supervisory Expectations from them

11. The Principal Officers have a very important role to play in the overall sphere of KYC-AML compliance. AS per PML Act and the PML Rules, Principal Officer is responsible for supplying information specified to the FIU-IND. The Principal Officer is required to co-ordinate and support Top Management's/Senior Management's focus on managing the money laundering/ terrorist financing risk in the bank. The Principal Officer should be independent and report directly to senior management or to the Board. It is also expected that Principal Officer has sufficient level of seniority and has sufficient resources. The level of resources should be commensurate with the size, complexity, and geographical spread of the bank's customer/product base.

The Principal Officers are expected to be proactive rather than being reactive, and exercise adequate authority in line with the responsibility and regulatory expectations from them to manage various risks. Therefore, the Principal Officer should have access to customer identification data and other CDD information, transaction records and other relevant information. Though the Principal Officer has a role to play in all the four key elements of KYC policy, the role of Principal Officer with respect to monitoring of transactions is very significant. The broad responsibilities of a Principal Officer are:

a) Reporting Requirements: Ensuring compliance to reporting obligations under PML Act / Rules.
b) Reviewing the adequacy of AML systems and controls: To have an oversight of the implementation of the bank's AML/ CFT system, policies, and procedures to ensure that the risks of money laundering and funding of terrorism are effectively managed. The Principal Officer must ensure that risk-based approach in the assessment of KYC/AML risks is followed in the bank.
c) Liaison with various stakeholders/ parties: To maintain liaison with various stakeholders/parties, such as regulators (internal and external), FIU-IND, IBA and other member banks, and ensure that queries raised by the regulators/supervisors are responded within the timeline.
d) Staff awareness – provision of relevant information to staff: Principal Officer is also responsible to keep a track of developments in the AML environment at the national and international level and disseminate relevant information to the business heads and staff in a timely manner.

Concluding Remarks

12. As mentioned earlier, the menace of money-laundering is global in character that not only threatens the security, but also compromises the stability, transparency, and efficiency of the financial systems. Money-laundering techniques are becoming more sophisticated and complex with each passing day. It is being recognised as a problem worldwide, which is threatening the stability of various regions by actively supporting and strengthening terrorist networks and criminal organizations. Money laundering also poses significant reputational risks to the banks. In such a dynamically changing scenario, it is essential that the banks are on their toes and align their operations with good international practice in KYC/AML/CFT/sanction procedures through a risk-based and proportionate approach for risk management.

I once again thank the College of Agricultural Banking (CAB) for having organised this very important seminar. I am sure that all of you will make the best use of it.

Thank You!!

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