Amendment to the Master Direction on KYC dated 28 April 2023

Point of view

Background

The Reserve Bank of India ('RBI') has issued a master direction on Know Your Customer ('KYC') norms for banks, non- banking financial companies (NBFCs), and other entities regulated by the RBI. The master direction on KYC provides a comprehensive framework that seeks to promote transparency, accountability, and customer protection in the financial system.

RBI has issued an amendment to the Master Direction on KYC on 28-Apr-2023, which is aimed at aligning the instructions with the recent amendments carried out in the PML Rules, 2005, incorporate instructions in terms of the Government Order related to Weapons of Mass Destruction (WMD) and their Delivery Systems (Prohibition of Unlawful Activities) Act, 2005 ('WMD Act, 2005'), update instructions in accordance with FATF Recommendations, and refine certain instructions in the Master Direction on KYC.

For evaluating the amendments to the Master Direction on KYC, we have considered a comprehensive AML/CFT risk assessment framework. The framework is bucketed under four broad categories which are further detailed in 12 key elements of an effective AML/CFT program. The framework provides a systematic approach to identify, assess, and manage the money laundering and terrorist financing risks.

1 Governance and Strategy

1. Leadership and Governance
2. Policies and Procedures
3. Risk Assessment Approach

2 Specific AML/CFT Control Areas

4. Customer Due Diligence (KYC)
5. Sanction Compliance
6. Transaction Monitoring
7. Regulatory Reporting
8. Information Sharing

3 Demonstrating and Monitoring Compliance

9. Record keeping
10. Compliance Monitoring and Independent Testing

4 Underlying People Controls

11. Accountability
12. Employee training & awareness

© 2023 KPMG Assurance and Consulting Services LLP, an Indian Limited Liability Partnership and a member firm of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

Key amendments to the Master Directions on KYC

Key elements–AML/CFT	Focus areas of the Master Direction	Summary of detailed provisions
Leadership and Governance	Introduction of new technologies	a. **Use of new or developing technology:** REs shall be responsible for identifying and assessing the ML/TF risks associated with creation of new products and business practices including new delivery systems, and the usage of new/developing technologies for both new and existing products. b. **Risk assessments:** REs shall undertake the risk assessments prior to the launch or use of such products, practices, services and technologies; and take appropriate measures to manage and mitigate the risks. c. **Artificial intelligence and machine learning:** For ongoing due diligence, REs may consider adopting appropriate innovations including artificial intelligence and machine learning (AI & ML) to support effective monitoring. Further, REs to leverage most recent technological advancements and tools for effective implementation of name screening to meet the sanctions requirements.
Policie and Procedures	Group-wide policy (*Prevention of Money- laundering Act, 2002*)	a. **Group-wide policy**: REs shall ensure that a group-wide policy is implemented to discharge obligations under the provisions of Chapter IV of the Prevention of Money-laundering Act, 2002 b. **Communication to RBI**: In addition to communicating to the FIU-IND, REs shall communicate the name, designation, address and contact details of Designated Director and Principal Officer to the Reserve Bank.
Risk Assessment Approach	Risk categorization	**Broad principles for risk categorization**: Broad principles may be laid down by the REs for risk categorization of customers. The indicative list of parameters for risk categorization has been expanded to include geographical risk including both customers and transactions, type of products/services offered, delivery channel used for products/services delivery, types of transaction undertaken, etc. REs shall treat the risk categorization and reasons for risk categorization of customers as confidential.
Risk Assessment Approach	Correspondent Banking	a. **Alignment with international standards:** The instructions regarding correspondent banking relationships have been aligned with international standards. b. **Prior approval of the senior management**: Banks shall ensure that prior approval is obtained from the senior management for establishing new correspondent banking relationships. c. **Due diligence:** Banks shall use the publicly available information which, inter alia, should include the following: i. information relating to the reputation of the respondent institution ii. the quality of supervision in the concerned jurisdiction whether the respondent institution has been subjected to any investigation or regulatory action relating to Money Laundering / Terrorist Financing.

© 2023 KPMG Assurance and Consulting Services LLP, an Indian Limited Liability Partnership and a member firm of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

Key amendments to the Master Directions on KYC

Key elements–AML/CFT	Focus areas of the Master Direction	Summary of detailed provisions
Customer Due Diligence (KYC)	Identification of Beneficial Owner ('BO')	**Threshold of 'Controlling ownership interest' revised for Companies and Trusts:** The threshold for 'Controlling ownership interest' for determining BO has been reduced from an earlier threshold of 25 percent and 15 percent to 10 percent for both 'companies' and 'trusts', respectively. Further, compliance is required to the provisions w.r.t revised threshold for 'Controlling ownership interest' to identify the BO for legacy accounts.
Customer Due Diligence (KYC)	CD measure of non-individual customers	**a. CDD measures for 'Companies', 'Partnership Firms' and 'Trusts':** Regulated Entities ('REs') shall ensure that CDD measures for opening of accounts pertaining to the 'Companies', 'Partnership Firms' and 'Trust' (non-individual customers) shall be amended to include additional information / document requirements such as names of the relevant persons holding senior management position, details of registered office and the principal place of its business, in case it is different etc., as mentioned in 'Part III – CDD Measures for Legal Entities' of the Master Direction. **b. Applicability to the legacy accounts:** Further, it would be mandatory to comply with the provisions w.r.t CDD measures of non-individual customers for legacy accounts. **c. CDD measures for juridical person:** REs shall ensure that for opening account of a customer who is a juridical person such as societies, universities and local bodies like village panchayats, etc., or who purports to act on behalf of such juridical person or individual or trust then certified copies of the documents such as document containing details of person authorised to act on behalf of the entity, documents of the person holding an attorney to transact on its behalf specified etc., as specified in section 33B of the Master Direction shall be obtained and verified.
Customer Due Diligence (KYC)	Periodic updation of KYC	**a. Aadhaar OTP based e-KYC:** In case of periodic updation Aadhaar OTP based e-KYC in non-face to face mode has been permitted. However, REs shall implement de-duplication mechanism to ensure that the mobile number for Aadhaar authentication is same as the one available with them in the customer's profile, to prevent any fraud. **b. Customer obligation to comply with PML rules:** REs shall advise the customers that in order to comply with the PML Rules, 2005 in case of any update in the documents submitted by the customer at the time of establishment of business relationship / account-based relationship and thereafter, as necessary, customers shall submit to the REs the update of such documents.
Customer Due Diligence (KYC)	Enhanced due diligence	**Non-face to face customer onboarding:** With regard to enhanced due diligence for onboarding non-face to face customer, REs shall ensure the following: a. Verify the current address through positive confirmation before allowing operations in the account, b. PAN shall be obtained from the customer and shall be verified,

© 2023 KPMG Assurance and Consulting Services LLP, an Indian Limited Liability Partnership and a member firm of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

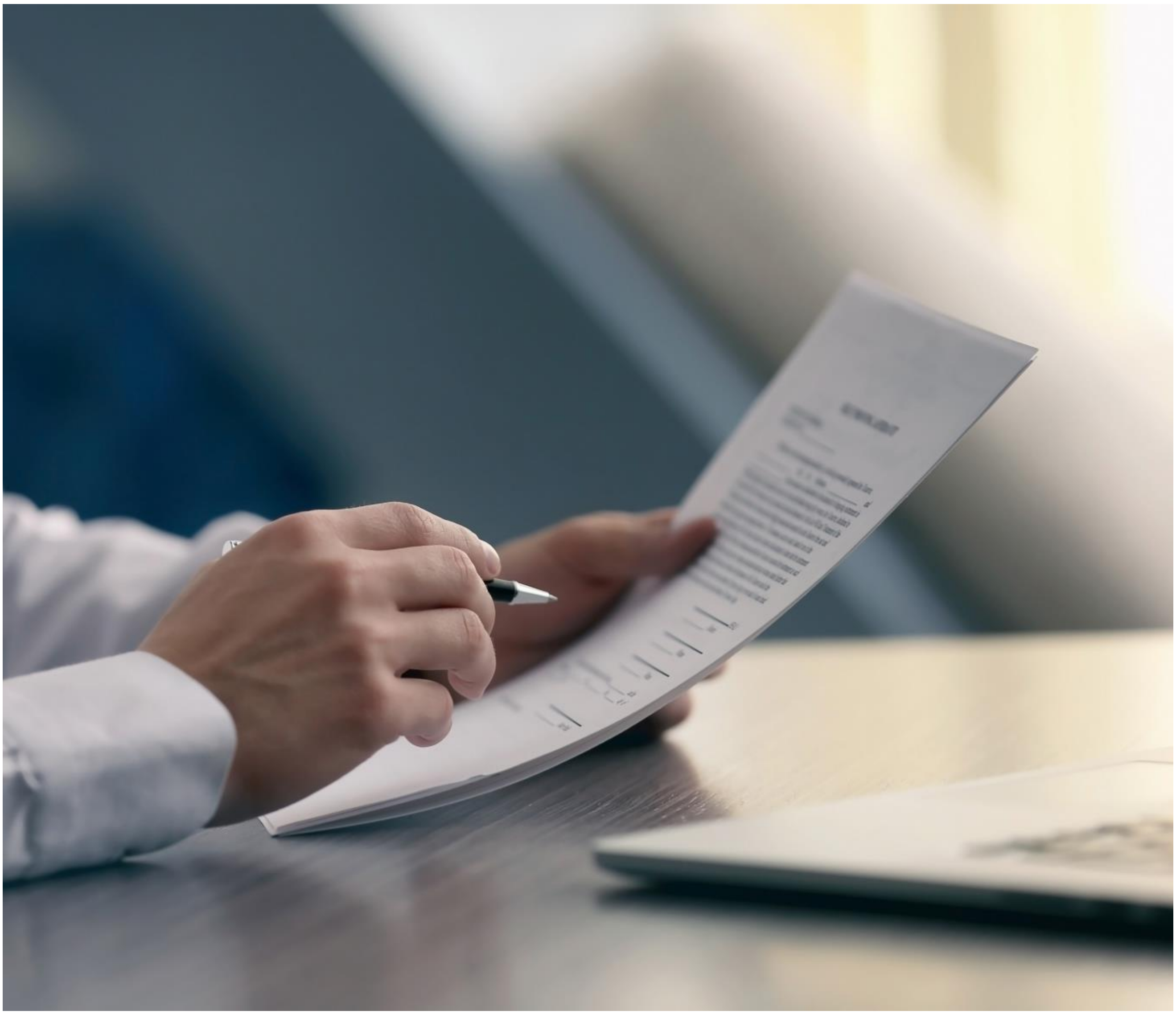
Key amendments to the Master Directions on KYC

Key elements–AML/CFT	Focus areas of the Master Direction	Summary of detailed provisions
Customer Due Diligence (KYC)	Enhanced due diligence	a. Customers shall be classified as high-risk customers and accounts opened in non-face to face mode shall be subjected to enhanced monitoring until the customer's identification is verified in face-to-face manner or through V-CIP, etc.
Sanction Compliance, Transaction Monitoring, Regulatory Reporting and Information Sharing	Requirements/ obligations under International Agreements – Communications from International Agencies	a. **/Obligations under the Unlawful Activities (Prevention) Act, 1967 ('UAPA'):** REs shall ensure that UNSC Sanctions Lists and lists as available in the Schedules to the Prevention and Suppression of Terrorism (Implementation of Security Council Resolutions) Order, 2007, shall be verified daily and any modifications to the lists in terms of additions, deletions or other changes shall be taken into account for meticulous compliance. b. **Obligations under Weapons of Mass Destruction (WMD) and their Delivery Systems (Prohibition of Unlawful Activities) Act, 2005 (WMD Act, 2005):** The guideline requires REs to ensure meticulous compliance with the order dated 30-Jan-2023 on implementation of section 12A of WMD Act, 2005, issued by the Ministry of Finance, Government of India. Key obligations casts upon REs have been summarized below: i. Ensure not to carry out transactions in case details of the individual / entity match with the details in the designated list ii. Ensure to run a check at the time of establishing relation with the customer and on a periodic basis to verify whether individuals and entities in the designated list are holding any funds, financial asset etc. iii. In case of identified match, immediately inform to the Central Nodal Officer, State Nodal Officer and file a STR with FIU-IND iv. In case of reasons to believe beyond doubt, REs shall prevent such individual/ entity from conducting financial transactions, under intimation to the CNO by email, FAX and by post, without delay. v. In case an order to freeze assets received by REs then without delay, take necessary action to comply with the Order. c. REs shall verify daily, the 'UNSCR 1718 Sanctions List of Designated Individuals and Entities', to take into account any modifications to the list and also ensure compliance with the 'Implementation of Security Council Resolution on Democratic People's Republic of Korea Order, 2017', as amended from time to time by the Central Government. d. In addition to the above, REs shall take into account other UNSCRs and lists in the first schedule and the fourth schedule of UAPA, 1967 and any amendments to the same for compliance with the Government orders on implementation of Section 51A of the UAPA and Section 12A of the WMD Act."

© 2023 KPMG Assurance and Consulting Services LLP, an Indian Limited Liability Partnership and a member firm of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

Key amendments to the Master Directions on KYC

Key elements– AML/CFT	Focus areas of the Master Direction	Summary of detailed provisions
Regulatory Reporting	Customer Acceptance Policy	**Reporting to FIU-IND:** Where RE is suspicious of ML/TF risks, and has a reason to believe that pursuing the CDD process will alert or tip-off the customer, it shall not pursue the CDD process, and instead submit a Suspicious Transaction Report ('STR').
Record keeping	Records Management	**a. Registration on DARPAN Portal of NITI Aayog:** REs needs to ensure that in case of customers who are non-profit organizations, the details of such customers are registered on the DARPAN Portal of NITI Aayog. In case such customers are not registered then RE shall register the details on DARPAN portal. As a result, obligation of compliance increases on REs as they need to ensure to comply with the Master Direction. **b. Maintenance of registration records:** REs shall also maintain such registration records for a period of five years after the business relationship between the customer and the RE has terminated or the account has been closed, whichever is later.



© 2023 KPMG Assurance and Consulting Services LLP, an Indian Limited Liability Partnership and a member firm of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

Point of view

Amendment to Master Direction on KYC encapsulate RBI's approach i.e. alignment with PML Act, 2002 and rules thereunder, incorporation of Government order w.r.t WMD Act, 2005, updation in accordance with FATF recommendations and prevention of money laundering, terrorist financing, and other forms of financial crime. These amendments have a significant impact on the REs. The amendment to the Master Direction on KYC reiterates that the ultimate responsibility to protect the integrity and stability of financial system against the threats arising from money laundering, terrorist financing, proliferation financing and other related risks lies with REs

Greater onus on REs

Through the amendment in Master Direction on KYC, RBI has reiterated that REs shall ensure meticulous compliance with the PML Act, 2002 and rules thereunder, UAPA Act, 1967, WMD Act, 2005, appropriate record management, periodic updation of KYC, appropriate due diligence of correspondent banking relationships, introduction of new technologies, enhanced due diligence etc. In this regard, REs needs to have effective oversight over AML/KYC activities. This would entail significant effort on the part of RE and senior management. The senior management and REs would need to be involved in setting the policies and procedures for compliance with these amendments and would need to monitor these transactions on a frequent basis.

Technological investment

With regard to these amendments, many of the REs may not be geared up with the most recent technological advancements and tools for effective implementation and monitoring of the compliance requirements. The amendment now requires the REs to consider adopting appropriate innovations including artificial intelligence and machine learning (AI & ML) to support effective monitoring. Further, REs to leverage the most recent technological advancements and tools for optimal, effective and daily implementation of name screening to meet the various sanctions requirements.

Enhanced compliance requirements

As per the amendments, REs need to include additional information / document requirements at the time of establishment of relationship with 'Companies', 'Partnership Firms' and 'Trusts'. REs can acquire KYC identifier of the customer only with specific consent from the customer to download their KYC records from CKYCR, for the purpose of performing CDD. The instructions regarding correspondent banking relationships have been aligned with international standards which requires due diligence on the Respondent Bank prior to establishment of correspondent banking relationship. Further, all the additional compliance requirements shall extend to legacy accounts as well.

Enhanced Parameters for Risk categorization

The amendments require REs to include broad principles which may be laid down for risk categorization of the customers for risk management. Further, parameters of such risk categorization have been expanded to include geographical risk including both customers and transactions, type of products/services offered, delivery channel used for products/services delivery, types of transaction undertaken – cash, cheque/monetary instruments, wire transfers, forex transactions, etc. REs would need to ensure that risk- based approach for risk management involves appropriate changes to meet the amendments specified by the RBI. Further, REs will have to revamp their customer experience journey to make it a seamless process. They will have to ensure minimal/no impact on business simultaneously while complying with regulatory requirements.

REs plays a significant role in establishment of robust systems and process for risk management, governance, and compliance. REs will now have to further invest in larger compliance teams, technology, data driven analytics, develop strategy to enhance customer experience and robust framework to address financial crime while meeting the regulatory requirements to mitigate the financial crime risks.

© 2023 KPMG Assurance and Consulting Services LLP, an Indian Limited Liability Partnership and a member firm of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

KPMG in India contacts:

Vijay Chawla
Partner and Head
Risk Advisory
T: +91 80 6833 5509
E: vschawla@kpmg.com

Jagvinder Brar
Partner and Head
Forensic and F-Tech
T: +91 97169 09339
E: jsbrar@kpmg.com

Suveer Khanna
Partner and Head
Forensic Investigations
T: +91 96196 32131
E: skhanna@kpmg.com

Sagrika Dani
Technical Director
Forensic Services
T: +91 88263 40896
E: sagrikadani@kpmg.com

kpmg.com/in

kpmg.com/in/socialmedia

The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavor to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act on such information without appropriate professional advice after a thorough examination of the particular situation.

KPMG Assurance and Consulting Services LLP, Lodha Excelus, Apollo Mills Compound, NM Joshi Marg, Mahalaxmi, Mumbai - 400 011 Phone: +91 22 3989 6000, Fax: +91 22 3983 6000.

© 2023 KPMG Assurance and Consulting Services LLP, an Indian Limited Liability Partnership and a member firm of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

The KPMG name and logo are trademarks used under license by the independent member firms of the KPMG global organization.

This document is for e-communication only. (004_THL_0523_SP)