STUDY NOTES · BASIC CONCEPT

What is KYC in Banks? Why and How is it done? What are the challenges?

Indian Economy

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KYC stands for Know Your Customer (or sometimes Know Your Client).

In banking (especially in India), KYC is a mandatory regulatory process where banks and other financial institutions verify and confirm the identity, address, and other key details of their customers. It is required when you open a bank account, apply for a loan, credit card, mutual funds, demat account, or even use certain digital wallets/payment services.

This process is governed by the Reserve Bank of India (RBI) under the Prevention of Money Laundering Act (PMLA), 2002, and RBI's Master Direction on KYC (updated regularly, latest major guidelines as of 2025-2026 include provisions for digital/e-KYC and periodic updates).

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Why is KYC Done? (Main Purposes)

KYC is not just paperwork — it serves several critical objectives:

1. Prevent Money Laundering & Terrorist Financing Banks ensure the account is not used for illegal activities like hiding black money, funding terrorism, or laundering proceeds of crime.
2. Combat Fraud & Identity Theft Verifies you are a real person (not using fake documents or someone else's identity) to protect both the bank and genuine customers from scams.
3. Risk Assessment & Customer Due Diligence Banks categorize customers as low-risk, medium-risk, or high-risk (e.g., Politically Exposed Persons or PEPs get extra checks). This helps monitor transactions and detect suspicious activity.
4. Regulatory Compliance Banks must follow global standards (like FATF recommendations) and Indian laws. Non-compliance can lead to heavy penalties from RBI or FIU-IND (Financial Intelligence Unit - India).
5. Build Trust & Protect the Financial System Creates a secure banking environment for everyone. It also helps banks understand your financial profile better for offering suitable products.

In short: KYC protects the bank, you (from identity misuse), and the entire economy from financial crimes.

How is KYC Done? (Basic Process in India)

There are different types/modes of KYC, but the core steps involve:

1. Customer Identification Program (CIP) Submit proof of identity (e.g., Aadhaar, PAN, Passport, Voter ID, Driving License) + proof of address (e.g., Aadhaar, utility bill, passport).
2. Verification
    - Offline — Physical documents checked at branch.
    - e-KYC — Using Aadhaar-based OTP or biometric (via UIDAI).
    - Video KYC (V-CIP) — Live video call with bank executive (popular for digital account opening).
    - Central KYC (CKYC) — One-time registration creates a 14-digit KYC Identification Number (KIN) stored centrally (CERSAI) — reusable across banks/NBFCs.
3. Ongoing Monitoring & Periodic Updation Banks review/update KYC every 2–10 years (depending on risk category; low-risk individuals often get relaxed timelines up to June 2026 in recent RBI relaxations). You may get reminders to re-submit if details change.

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Common KYC Documents (Officially Acceptable by RBI)

- Identity Proof: Aadhaar, PAN, Passport, Voter ID, Driving License.
- Address Proof: Aadhaar, Passport, Voter ID, recent utility bill, bank statement.
- Photograph (recent passport-size).
- PAN is mandatory for most accounts/transactions above certain limits.

KYC is now mostly digital/paperless in India (thanks to Aadhaar, DigiLocker, and V-CIP), making it quick — often completed in minutes for online account opening.

Challenges before the banks?

1. High Operational Costs: Implementing and maintaining robust KYC processes can be extremely expensive, especially for smaller institutions. These costs stem from the need for dedicated staff, advanced technology for data verification, ongoing monitoring, and training to keep up with evolving regulations.

Some reports indicate that KYC processes can cost an average bank tens of millions of dollars annually.

2. Resource Intensity: Many financial institutions dedicate a substantial number of full-time employees to KYC processes, and a significant portion of review tasks are still completed manually. This manual effort is time-consuming and prone to human error.
3. Evolving Regulations: Keeping pace with constantly changing regulations across different jurisdictions is a major hurdle. Regulatory changes, such as those under the Anti-Money Laundering Act (AMLA) of 2020 and updates in beneficial ownership reporting, add layers of complexity. Non-compliance can lead to substantial fines and reputational damage.
4. Data Quality and Management: Ensuring the accuracy, completeness, and standardization of customer data is critical but challenging due to inconsistencies and errors.
5. Lack of Standardization: The absence of common standards across the industry means different banks often request varying documents and information, increasing the administrative burden. Account holders also experience considerable strain due to KYC requirements.
6. Customer Friction and Inconvenience: KYC processes can create friction and inconvenience, leading to a poor customer experience. Lengthy verification processes, excessive documentation requirements, and repeated requests for information can be frustrating and time-consuming.
7. Repeated Demands for Updates: Despite regulatory efforts to simplify the process, many customers face repeated requests for documentation and updates, sometimes even for "low-risk" accounts. This can lead to account restrictions and delays.
8. Perceived Intrusiveness: Customers may view extensive data collection as intrusive. The banking industry is under sustained regulatory scrutiny to ensure full KYC compliance, which has intensified the pressure on banks, especially those grappling with staff shortages. While the intent of KYC is to prevent financial crime, the current implementation often creates a cumbersome loop that impacts both the operational efficiency of banks and the satisfaction of their customers.

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