Navigating KYC and AML Compliance for NBFCs: Key Insights from Mehta & Mehta Session

Know Your Customer (KYC) and Anti-Money Laundering (AML) compliance have become the cornerstone of financial integrity in India's regulatory framework. For NBFCs, these regulations go beyond customer onboarding—they are central to safeguarding the financial system from fraud, terrorism financing, and reputational risks.

In a recent session hosted by **Mehta & Mehta**, experts including **Ms. Hemanti Wadhwa (Chief Compliance Officer and Company Secretary, Jio BlackRock AMC Pvt Ltd)**, **Mr. Shanmugasundaram B (Senior Associate VP & Company Secretary, Coromandel International Ltd.)**, and **Ms. Tulna Shah (Associate Partner, Mehta & Mehta)** shared practical insights into RBI's Master Directions on KYC and AML norms, implementation challenges, and regulatory expectations.

The discussion underscored that for NBFCs, compliance is not merely a documentation exercise it is about accountability, transparency, and continuous vigilance.

Compliance Beyond Formality

• **Purpose over paperwork:** KYC is not just about collecting documents it's about identifying genuine customers and preventing illicit transactions.

• **Audit trail is everything:** During RBI inspections, undocumented processes are considered non-compliant even if practices exist in reality.

• **Continuous learning:** Frequent regulatory updates, FATF standards, and technology-driven processes demand ongoing training for compliance teams.

Regulatory Framework and Key Concepts

The legal foundation of KYC and AML lies in the **Prevention of Money Laundering Act, 2002 (PMLA)** and the **RBI Master Direction on KYC**.

Key definitions include:

• **Customer Due Diligence (CDD):** Verification of identity using reliable, independent sources.

• **Beneficial Owner:** The individual who ultimately owns or controls more than the prescribed percentage in an entity.

• **Suspicious Transactions:** Activities that appear unusual, complex, or inconsistent with a customer's profile.

• **Central KYC Registry (CKYCR):** A centralised digital repository of verified KYC records for financial institutions.

Governance and Oversight Roles

• **Designated Director:** A board-level member responsible for ensuring compliance with PMLA obligations and reporting requirements.

• **Principal Officer:** Manages day-to-day AML functions, monitors transactions, and reports to the **Financial Intelligence Unit (FIU-IND)**.

• **Segregation of roles:** Both positions must be held by separate individuals to ensure independence and oversight.

Four Pillars of KYC Framework
As explained in the session, RBI's KYC architecture rests on four fundamental pillars:

1. **Customer Acceptance Policy** – No anonymous accounts; onboarding must include screening against sanction lists.
2. **Customer Identification Procedure** – Verification at account opening and during high-value or cross-border transactions.
3. **Risk Management** – Classifying customers as low, medium, or high risk based on geography, business activity, and transaction patterns.
4. **Ongoing Monitoring** – Regular review of high-risk customers (every 2 years), medium-risk (every 8 years), and low-risk (every 10 years).

Aadhaar and Privacy Safeguards
The panel revisited the **Supreme Court's 2018 judgment** restricting mandatory Aadhaar usage by private entities.

• NBFCS **cannot mandate Aadhaar**, but may use **masked Aadhaar** (showing only the last four digits) with customer consent.

• Staff at branches must be trained to collect only masked Aadhaar to avoid regulatory breaches.

• Alternative documents such as PAN, Passport, or Voter ID remain valid for KYC verification.

Digital and Simplified KYC
• **Video-Based Customer Identification (VCIP):** RBI permits digital onboarding through secure, live video verification with geo-tagging and timestamping.

• **Simplified Accounts:** Allowed for customers lacking full documentation, with capped limits and validity for up to 12 months.

• **Concurrent Audits:** Every digital KYC case must undergo concurrent audit before account activation.

Reporting Obligations under PMLA
NBFCs are required to file the following with FIU-IND:

• **Cash Transaction Report (CTR):** Cash transactions of ₹10 lakh or above (single or aggregate).
• **Suspicious Transaction Report (STR):** Transactions that appear inconsistent, fraudulent, or suspicious.

• **No "nil reporting" required,** but RBI expects automated alert systems that flag reportable cases. Failure to file timely or accurate reports can attract **penalties and adverse supervisory observations** from both RBI and FIU-IND.

Vendor, Outsourcing, and Group Reliance

While third-party due diligence can be leveraged within a corporate group, NBFCs remain ultimately responsible for KYC accuracy.

• Cross-entity reliance is allowed only if immediate access to records is ensured.
• RBI discourages outsourcing of core KYC verification functions to protect data confidentiality and audit access.

Record Retention and Technology

• All transaction records must be preserved for **five years** from the date of transaction.
• Identity documents are to be retained for **five years after cessation of the relationship.**
• Institutions must adopt secure, automated systems for transaction monitoring and red-flag alerts.

Expert Insights and Practical Challenges

• **Complexity of regulation:** Fragmented updates across circulars demand constant monitoring.
• **Documentation fatigue:** Non-documented processes fail regulatory tests even when controls exist.
• **Behavioural risk:** STRs rely heavily on behavioural patterns making employee awareness vital.
• **Technology as a compliance enabler:** From digital onboarding to CKYC uploads, automation is crucial to reduce errors.

As **Mr. Shanmugasundaram B** aptly stated, "KYC is not a documentation exercise it is about protecting the integrity of the financial system."

Conclusion

The Mehta & Mehta Masterclass highlighted that **KYC and AML compliance is the new core of governance** for NBFCs. RBI's expectations go beyond procedural adherence—they require an integrated compliance culture built on transparency, technology, and ethical conduct.

In the words of **Ms. Hemanti Wadhwa**, "Every compliance professional must balance diligence with empathy—ensuring inclusion without compromising integrity."

The session concluded with a shared message:
"Compliance is not a cost—it's an investment in trust."

 To access the full webinar recording and related resources, visit: YouTube Channel: *"Decoding Corporate Laws with Mehta & Mehta"*