

Know your customer

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Know your customer (KYC) is the process of a business identifying and verifying the identity of its clients.^[1] The term is also used to refer to the bank and anti-money laundering regulations which governs these activities. Know your customer processes are also employed by companies of all sizes for the purpose of ensuring their proposed agents, consultants, or distributors are anti-bribery compliant. Banks, insurers and export creditors are increasingly demanding that customers provide detailed anti-corruption due diligence information.

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Standards

The objectives of KYC guidelines is to prevent banks from being used, intentionally or unintentionally, by criminal elements for money laundering activities. Related procedures also enable banks to better understand their customers and their financial dealings. This helps them manage their risks prudently. Banks usually frame their KYC policies incorporating the following four key elements:

- Customer Acceptance Policy;
- Customer Identification Procedures;
- Monitoring of Transactions; and

- Risk management.

For the purposes of a KYC policy, a *Customer/user* may be defined as:

- a person or entity that maintains an account and/or has a business relationship with the bank;
- one on whose behalf the account is maintained (i.e. the beneficial owner);
- beneficiaries of transactions conducted by professional intermediaries such as stockbrokers, Chartered Accountants, or solicitors, as permitted under the law; or
- any person or entity connected with a financial transaction which can pose significant reputational or other risks to the bank, for example, a wire transfer or issue of a high-value demand draft as a single transaction

Typical controls

KYC controls typically include the following:

- Collection and analysis of basic identity information such as Identity documents (referred to in US regulations and practice as a "Customer Identification Program" or CIP)
- Name matching against lists of known parties (such as "politically exposed person" or PEP)
- Determination of the customer's risk in terms of propensity to commit money laundering, terrorist finance, or identity theft
- Creation of an expectation of a customer's transactional behavior
- Monitoring of a customer's transactions against expected behavior and recorded profile as well as that of the customer's peers

Laws by country

- **Australia:** The Anti-Money Laundering and Counter-Terrorism Financing Act 2006 (AML/CTF Act) gives effect to KYC laws.^[2] The Anti-Money Laundering and Counter-Terrorism Financing Rules Instrument 2007 provides guidance for applying the powers and requirements of the Act.^[3] Compliance is governed by the Australian Government agency, Australian Transaction Reports and Analysis Centre, established in 1989, known as AUSTRAC.^[4]
- **Canada:** The Financial Transactions Reports Analysis Centre of Canada, also known as FINTRAC, was created in 2000 as Canada's financial intelligence unit. FINTRAC updated its regulations in June 2016 regarding acceptable methods

to determine the identity of individual clients to ensure compliance with AML and KYC regulations.

- **India:** The Reserve Bank of India introduced KYC guidelines^[5] for all banks in 2002. In 2004, RBI directed all banks to ensure that they are fully compliant with the KYC provisions before December 31, 2005.^[6]
- **Italy:** the country's Central Bank (Banca d'Italia), which also exercises regulation power for the financial industry, has enacted in 2007 the KYC requirements and rules that financial institutions have to comply with on the Italian territory.^[7]
- **Namibia:** Financial Intelligence Act, 2012 (Act No. 13 of 2012) published as Government Notice 299 in Gazette 5096 of 14 December 2012.^[8]
- **New Zealand:** Updated KYC laws were enacted in late 2009 and entered into force in 2010. KYC is mandatory for all registered banks and financial institutions (the latter has an extremely wide meaning).^[9]
- **South Africa:** The Financial Intelligence Centre Act 38 of 2001 (FICA)
- **United Kingdom:** The Money Laundering Regulations 2007 are the underlying rules that govern KYC in the UK. Many UK businesses use the guidance provided by the European Joint Money Laundering Steering Group as a guide to compliance.
- **United States:** Pursuant to the USA Patriot Act of 2001, the Secretary of the Treasury was required to finalize regulations before October 26, 2002 making KYC mandatory for all US banks. The related processes are required to conform to a customer identification program (CIP)
- **Luxembourg:** KYC is governed in the Anti-Money Laundering (AML) laws and regulations, which became effective in 1993 and were amended for the last time in 2015.

Enhanced due diligence

Enhanced due diligence (EDD) is a more detailed standard required for larger customers and transactions. The USA PATRIOT Act dictates that institutions "shall establish appropriate, specific, and, where necessary, enhanced, due diligence policies, procedures, and controls that are reasonably designed to detect and report instances of money laundering through those accounts."^[10] US regulations require that EDD measures are applied to account types such as Private banking, Correspondent account, and Offshore banking institutions. Because regulatory definitions are neither globally consistent nor prescriptive, financial institutions are at risk of being held to differing standards dependent upon their jurisdiction and regulatory environment. An article published by Peter Warrack in the July 2006 edition of ACAMS Today (Association of Certified Anti-Money Laundering

Specialists) suggests the following: "A rigorous and robust process of investigation over and above (KYC) procedures, that seeks with reasonable assurance to verify and validate the customer's identity; understand and test the customer's profile, business and account activity; identify relevant adverse information and risk; assess the potential for money laundering and / or terrorist financing to support actionable decisions to mitigate against financial, regulatory and reputational risk and ensure regulatory compliance."

Characteristics of EDD

Rigorous and robust

Generally this means consistent, thorough and accurate. The process must be documented and available for inspection by regulators. The process must be SMART (Specific, Measurable, Achievable, Relevant and Timebound),^[11] scalable and proportionate to the risk and resources.

Over and above KYC procedures

EDD files rely upon initial client screening. EDD processes should use a tiered approach dependent upon the risk. Crucial to the integrity of any EDD process is the reliability of information and information sources, the type and quality of information sources used, properly trained analysts who know where to look for information, how to look and how to corroborate, interpret and decide the results. Commercial intelligence companies aggregate this information and compile it daily into a comprehensive database. Many of these commercial intelligence companies are serviced by in-country providers with researchers on the ground who can obtain information that is not otherwise easily accessible.

Reasonable assurance

What is reasonable depends upon factors including jurisdiction, risk, resources, and technology state of the art. For sanction matches it depends upon information provided by regulators. In all cases the suggested standard is to the civil standard of proof i.e. on the balance of probability.

Relevant adverse information

Information obtained from any source, including the Internet, free and subscription databases and the media, which is directly or indirectly indicative of involvement in money laundering, terrorist financing or predicate offenses. Examples include fraud and other dishonesty, drug trafficking, smuggling or other proscribed offenses, references to money laundering, or conducting business, residing in or frequenting countries deemed by the Financial Action Task Force and/or (institution) as being countries under sanction or countries with which (institution) does not do business; to official sanctions or watch lists; and to investigations, convictions or disciplinary findings by authorized regulatory bodies.

See also

- Financial Action Task Force on Money Laundering
- Anti-money laundering
- Anti-money laundering software
- Anti-bribery
- Anti-corruption
- Politically exposed person
- Certified copy

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