



KYC: From Compliance Ritual to Strategic Imperative

As fraud evolves and digital transformation accelerates, financial institutions in India must stop treating KYC as a checkbox—and start treating it as the foundation of trust and governance.

India's financial sector has long been admired for its ambition and over the past decade, it has embraced technology, welcomed fintech disruption, and significantly expanded financial inclusion, and the pace has intensified with the arrival of AI and machine learning. In addition, the traditional brick-and-mortar setup has become increasingly redundant, especially in retail space.

This document offers a point of view for institutions to embed compliance culture, enhance technological oversight, and adopt continuous verification models that integrate AI responsibly with human judgement.

Technology has been a powerful enabler of innovation across the product and customer life cycle. Yet, despite the advancements, many institutions still struggle to get the basics right- compliance, to be specific. Some have not even started their tech transformation journeys, while others are overwhelmed mid-course. The result? Legacy challenges persist— albeit in new, half-baked tech-powered form. A glaring example is the state of Know Your Customer (KYC) program. A requirements critical to the financial services world and on the priority list of regulators world over.

KYC is not new. KYC processes are fundamental to any financial ecosystem and lay the foundation for responsible banking, designed to verify customer identity, monitor transactions, and, prevent fraud, money laundering, and terrorist financing. They are the very first touch point with the customer and hence have significance not just from compliance perspective but also from a business stand point.

In India, these norms are enforced through the RBI's master directives and Prevention of Money Laundering Act (PMLA), regulated by the Reserve Bank of India (RBI) and other financial authorities. The RBI's November 2024 updates to its Master Directions aimed to streamline processes further—introducing UCIC-based due diligence, enhancing integrations with centralized registries like CKYCR, and emphasizing real-time updates. These changes were meant to future-proof compliance mechanisms and align Indian practices with global standards.



On the surface, India's KYC regime is one of the most evolved in the world but the reality on the ground paints a different picture. Many institutions still treat KYC as a compliance checkbox rather than a critical business process. Inconsistent application, weak enforcement, and a mindset that prioritizes

customer acquisition over due diligence continue to expose deep systemic risks. Even now, financial institutions—both large and small—frequently onboard customers using outdated documentation, skip periodic updates, and fail to flag suspicious transactions in a timely manner.

The reality: cost vs compliance

As India's financial ecosystem embraces rapid digitization, the foundational practice of Know Your Customer (KYC) remains unevenly implemented, often treated as a regulatory formality rather than a strategic pillar of trust and fraud prevention. Institutions face regulatory penalties, reputational risks, and increasing post-onboarding fraud. Moreover, synthetic identities, document forgery, and deepfake threats are testing the limits of current verification processes and systems.

While on paper, these frameworks are robust, their execution however across India's diverse financial landscape is still patchy—and at times, disturbingly casual. For a country that has had regulated financial institutions for decades, it shows that KYC remains an area riddled with gaps.

Building and maintaining a robust KYC program is not cheap. With the huge workforce and disconnected technology this becomes a barrier for thorough verification. Larger players, on the other hand, often look to cut corners to improve turnaround times. This cost-pressure environment results in shortcuts—outsourcing KYC to undertrained third parties, over-relying

on automated tools without human oversight, or simply neglecting re-verification protocols. Unfortunately, the price of these shortcuts is often paid later—in the form of fraud, regulatory penalties, and reputational damage and/or business disruption.

The RBI's actions in the last year should be on every board's radar. Some recent statistics suggest that regulatory interventions have become more frequent and stringent. With 412 enforcement actions and over ₹68 crore in penalties, it's clear that regulatory risk is no longer a theoretical discussion—it's a balance-sheet event. And the pattern is striking: 72 of these cases involve KYC or AML lapses, exposing weaknesses not just in operations, but in oversight and governance. These are not just statistics these are signs of systemic failures. Interestingly the penalized aren't rookies—they're institutions with established governance mechanisms. Which would make

you ask and possibly put the compliance officer in the spotlight: are compliance risks being escalated effectively? Are Board committees engaging deeply with these matters? Are they giving compliance officers the mandate—and resources—they need? Let's be honest, regulatory compliance has only recently come top of the charts as a focused agenda with the RBI tightening the noose and thereby putting greater emphasis on Boards involvement and responsibilities for monitoring compliance. As the role of the board in shaping a culture of regulatory adherence is under greater scrutiny, boards must take an active role in setting the tone from the top. Compliance should be part

of strategy discussions, not just audit reviews. Routine checks won't cut it. You need real-time KYC updates, automated monitoring tools, and cross-functional alignment to catch issues before the regulator does. Because today, when the RBI calls out a lapse, it isn't about that one transaction—it's a comment on YOUR culture.

KYC must evolve from a static check to a dynamic, enterprise-wide risk and governance framework. It's not the quantum of regulations but the institutions belief and conviction in them to adapt to the digitizing world – because taking the basics for granted is no longer an option.

Beyond Onboarding

Another element of the customer identification program is the periodic monitoring of customers risk profile post customer onboarding... this is when fraud begins. This points to a serious breakdown in ongoing monitoring. Dormant accounts get reactivated and misused, synthetic identities and deepfakes – once the stuff of science fiction and considered as one of the top risks by financial institutions – are now commonplace in fraud attempts and even biometric verification, once heralded as a silver bullet, is being spoofed by tech-savvy criminals.

In addition, customer information is dynamic and DOES change frequently, be that the source of income, residential address, assets, credit profile etc. Interestingly, this indicates that some of the data that the financial institutions hold, becomes inaccurate or outdated if not properly maintained.

Hence, unless KYC is treated as a living process, the initial verification means little.

The Culture Problem: KYC as a “process”, Not Belief

One reason these challenges persist is ...cultural. Despite the availability of technology, the institutional belief in KYC as a **strategic risk function** is still lacking. Too often, KYC is viewed as a bottleneck to growth, a regulatory hurdle to clear, or a task best outsourced. This perception shapes the way institutions build their systems: minimal oversight, broken integration, and inconsistent follow-up.

This issue further elevates when automation is layered on top. AI-based transaction monitoring and OCR-driven document verification tools are only as effective as the

governance and accountability that accompany them. In one illustrative case, an AI alert system flagged high-risk transactions, but due to a lack of trained staff, no one reviewed the alerts for months. The flagged accounts remained active, continuing to move funds—including high-risk remittances. Institutions often misunderstand technology as all knowing all doing beast, assuming implementation of technology will release them of the accountability, whereas in reality technology is just a means to an end.

This is the crux of the issue: technology does not replace responsibility—it magnifies it.

Rebuilding KYC

If India's financial institutions are serious about building real resilience—not just adding buzzwords to annual reports—it's time to move past doing compliance for compliance's sake. KYC shouldn't be a perfunctory checkbox on someone's dashboard; it should be a strategic, enterprise-wide responsibility embedded into the culture of the institution.

And no, that doesn't just mean buying more software and calling it a day. This shift requires genuine, across-the-board action:

- **Leadership accountability:** Let's start at the top. Boards and senior management need to stop viewing KYC as a box-ticking exercise for the regulator's benefit and start treating it as a serious business risk—because that's exactly what it is.
- **Cultural integration:** Compliance isn't something you delegate to “those guys on the 2nd floor.” It's everyone's job. Whether you're writing code, handling customer queries, or approving loans, understanding why KYC matters is non-negotiable.

- **Continuous verification:** If your KYC process stops at onboarding, you're essentially locking the front door and leaving the back wide open. Real-time behavioural analytics, ongoing identity checks, and dynamic risk scoring aren't futuristic luxuries—they're baseline expectations now.
- **Smart tech, smarter humans:** Yes, AI and machine learning are great. But if you think they'll fix your compliance culture

while you look the other way, think again. Tools should amplify good intent, not hide negligence. That means proper training, oversight, and timely response mechanisms must go hand in hand.

- **Customer engagement:** And let's not forget the customer. Educating users on why accurate KYC information matters isn't just a courtesy—it's a critical piece of the ecosystem. If they don't get it, your risk increases.

Conclusion: The Integrity Test India Cannot Afford to Fail

The growing use of APIs and digital onboarding has certainly improved turnaround times, but it has also introduced new vulnerabilities. For instance, biometric verification, once considered highly secure, is now increasingly being challenged by sophisticated deepfakes and spoofing attacks, a concern highlighted in cybersecurity reports throughout 2024. And while India has a relatively centralized regulatory approach, the sheer scale and diversity of the financial ecosystem—from rural co-ops to digital-first fintech—makes uniform compliance a continuing challenge. This is not about the regulations, but rather the execution across varied business models and maturity levels.

So where does that leave us?

The answer is not transformational, it's foundational. KYC must evolve from being a customary check to becoming a living, responsive process. Institutions must invest in smarter, adaptive technologies—not just for onboarding, but for continuous verification. AI, ML, and behavioral analytics can play a major role in identifying unusual patterns in real time. Based on the RBI penalties there is also a strong case for strengthening internal governance, upskilling frontline staff, and fostering a culture of zero tolerance toward lapses.

A proactive approach to KYC doesn't just mitigate fraud. It builds customer trust, improves operational efficiency, and protects the brand in the long run. At a time when customer data is the new currency and cybercrime is becoming more sophisticated by the day, the cost of taking the basics for granted is simply too high.

The battle to “know your customer” never really ends. It requires constant vigilance, reinvention, and above all, accountability.



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