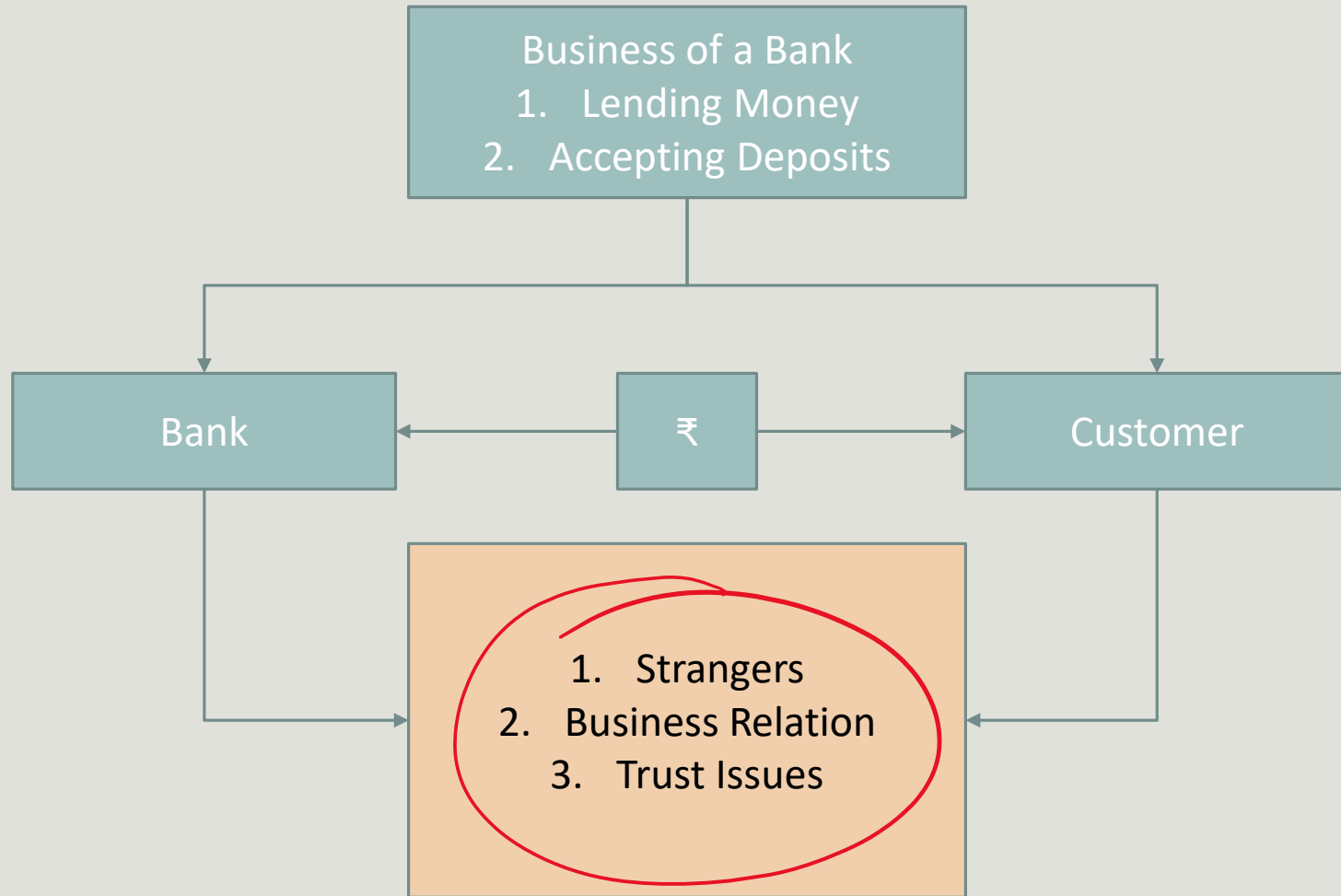


KYC Norms Scrutiny of Loan Cases

CA. PRANAV JOSHI

24.02.2020

Basics



Basics

Strangers

Introduction

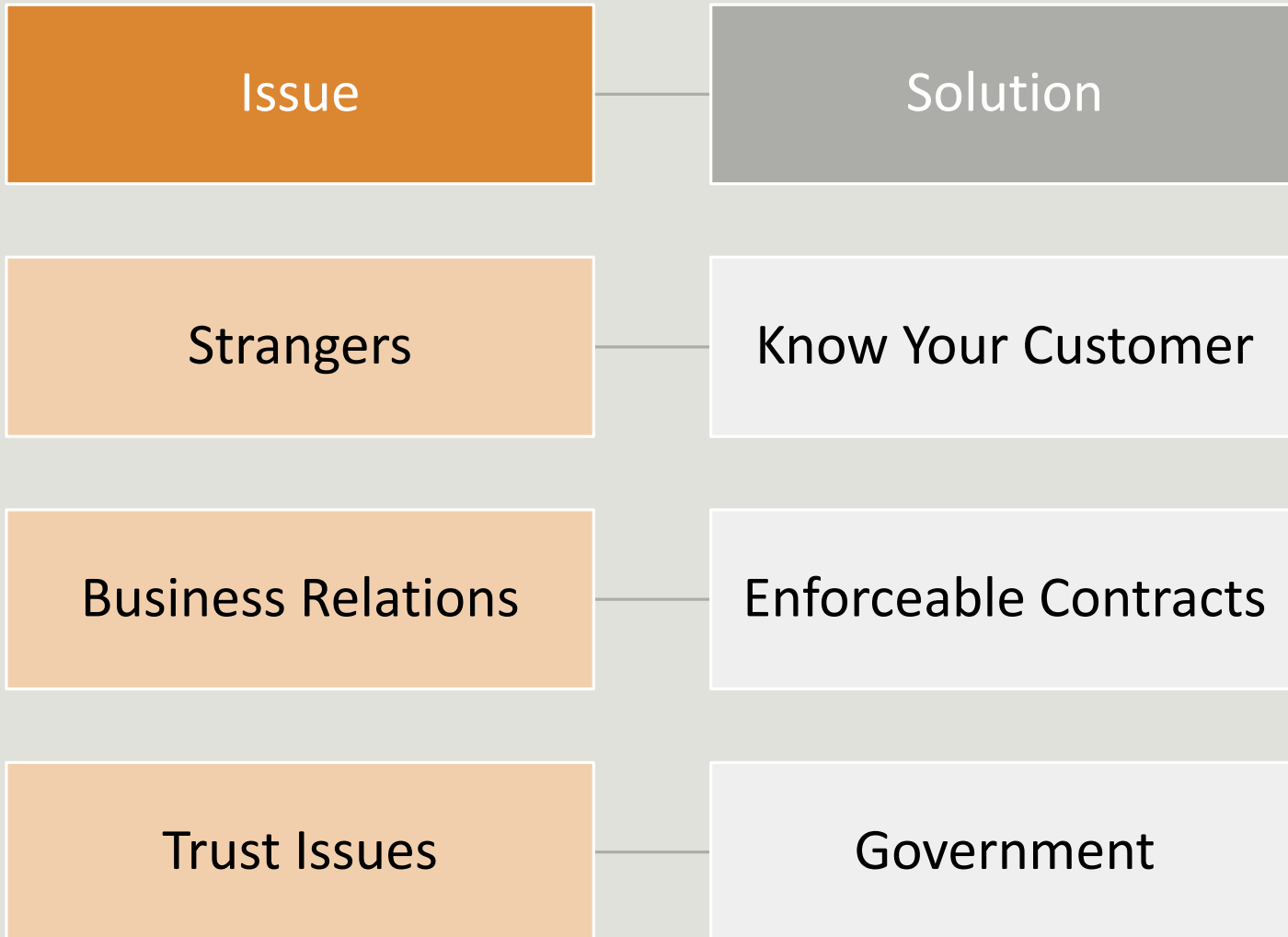
**Business
Relations**

Transparency

**Trust
Issues**

Comfort

How to do business?



Know Your Customer

Introduction – Know Your Customer (KYC)

How to know a person ‘Objectively’?

- Stems from Prevention of Money-Laundering Act, 2002 and the Prevention of Money-Laundering (Maintenance of Records) Rules, 2005 (As amended time to time)
- RBI has issued **Master Direction - Know Your Customer (KYC) Direction, 2016 - Every Bank to have its own KYC Policy**
- The objective of KYC/AML/CFT guidelines is to prevent banks/FIs from being used, intentionally or unintentionally, by criminal elements for money laundering or terrorist financing activities

KYC Policy to include:

Customer
Acceptance
Policy

Risk
Management

Customer
Identification
Procedures (CIP)

Monitoring of
Transactions

KYC Policy



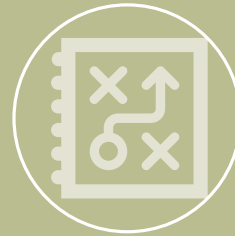
Customer Acceptance Policy

- Who not to work with
 - Terrorists
 - Black Listed Persons
 - Sector



Customer Identification Procedure

- Address Proof
- Identity Proof
- PAN Card
- Photo



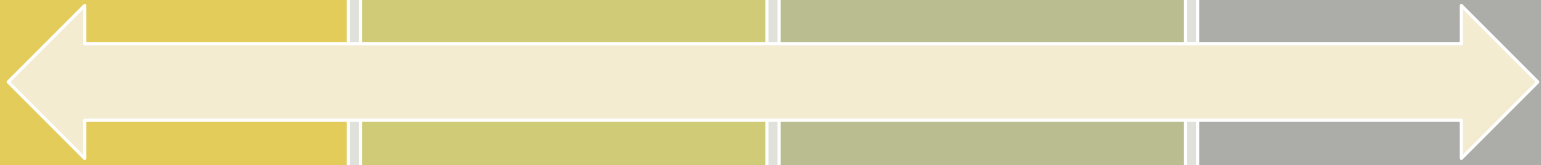
Risk Management

- Low, Medium , High Categorisation



Transaction Monitoring

- Post Sanction Appraisals
- Internal/Concurrent Audits



Customer Identification Procedure



**Commencement of
Account-based
Relationship**



**International
Transactions**
(Even if non-account
holder)



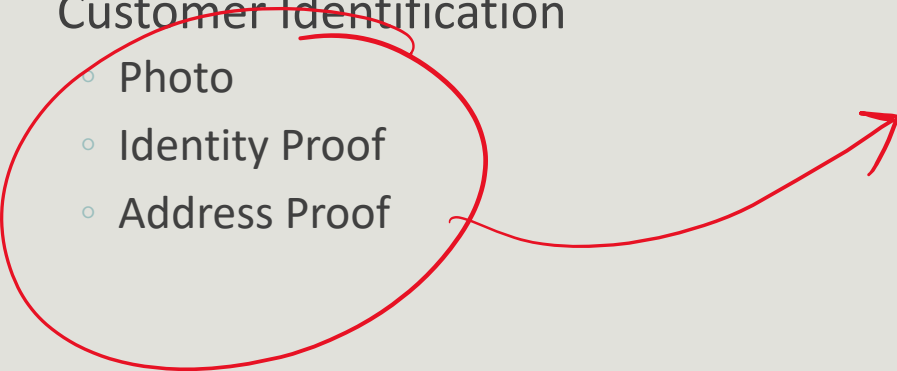
**Domestic
Transactions > Rs.
50,000**
(Even if non-account
holder)



A customer (account-based or walk-in) is **intentionally structuring a transaction into a series of transactions below the threshold of Rs. 50,000**

KYC – Audit Perspective

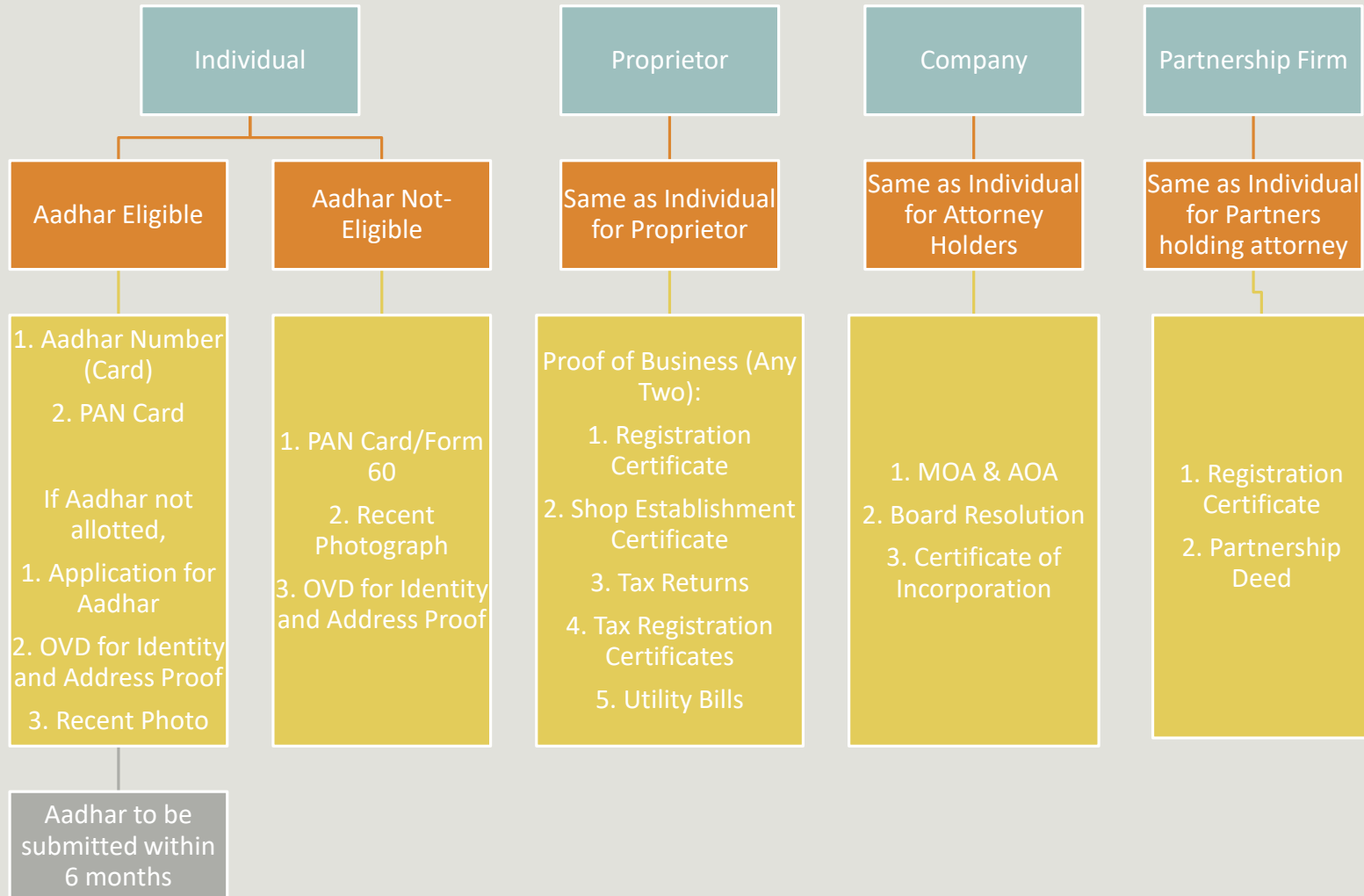
Customer Identification

- Photo
 - Identity Proof
 - Address Proof
- 

Officially Valid Documents (OVDs)

- the driving licence
- the Voter's Identity Card issued by the Election Commission of India
- job card issued by NREGA duly signed by an officer of the State Government
- letter issued by the National Population Register containing details of name and address.
- Utility Bills (Not less than 2 months old; For Address Proof Only)

Accepted Documents



RBI monitoring on KYC Compliance

RBI FINES HDFC BANK ₹1 CRORE FOR NON-COMPLIANCE OF KYC NORMS

*“This scrutiny, RBI said, revealed that the bank had failed to exercise **ongoing due diligence** in those accounts.”*

“It was observed that the transactions effected in these current accounts were disproportionate to the declared income and profile of the customers.”

RBI IMPOSES PENALTY ON FOUR BANKS FOR NON-COMPLIANCE OF KYC/AML RULES

“Punjab National Bank, Allahabad Bank and UCO Bank have been fined Rs 50 lakh each, Corporation Bank has been asked to pay Rs 25 lakh as penalty”

*“The Reserve Bank of India (RBI) has imposed a penalty on four public sector banks for **non-compliance with KYC requirement** and norms for opening of current accounts.”*

Observations to be Reported

1. Incomplete KYC Forms
2. Customer Signatures not available
3. Photos not cross-signed
4. Photocopies not “Verified with Originals” by competent authority
5. Photos not attached (Glued)
6. Rent Agreements (Address Proof) are expired
7. Absence of PAN card if transactions exceed Rs. 50,000 Limit
8. Transactions not suiting to customer profile
9. Whether KYC of non-Account holders was done in case of specified transactions?

Where to Report

1. Long Form Audit Report
2. Internal Audit Report

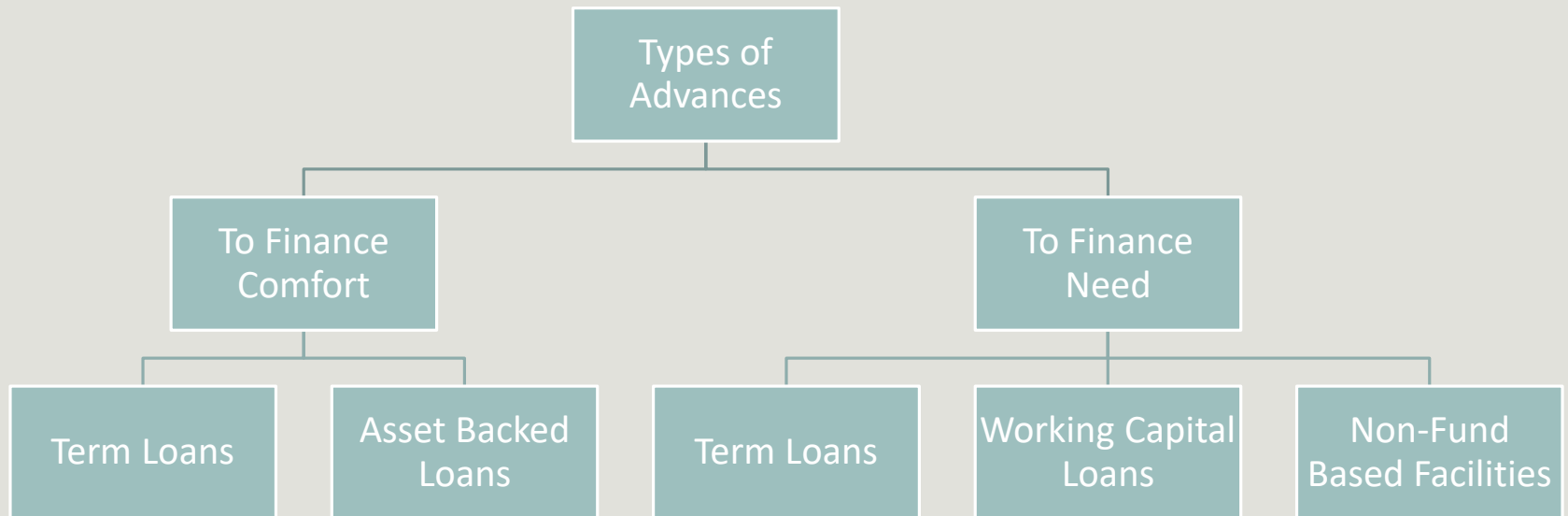
Scrutiny of Advances

APPROACH TO AUDIT OF LOAN FILES

Trust Issues

“How to ensure that the entire lent amount would be recovered in time with interest?”

Types of Advances



Type of Loans

Loan Category	Type of Loan	End Use of Loan	Primary Repayment Source
To Finance Need	Term Loan for P&M	Revenue Generating	Project
	Cash Credit for Business	Revenue Generating	Project
	LC/BG	Revenue Generating	Project
To Finance Comfort	Personal Loan	Non-Revenue Generating	Salary/Business Income
	Housing Loan	Non-Revenue Generating	Salary/Business Income
	Vehicle Loan	Non-Revenue Generating	Salary/Business Income
	Consumer Goods	Non-Revenue Generating	Salary/Business Income
Asset backed Loans	Gold Loan	Non-Revenue Generating	Salary/Business Income
	Loan against FD	Non-Revenue Generating	Salary/Business Income
	Loan Against Policy	Non-Revenue Generating	Salary/Business Income
	Loan against Property	Non-Revenue Generating	Salary/Business Income

Assessment of Credit Requirement

1. Revenue Generating Activity – Whether sufficient revenues are generated?
 1. Term Loans:
 1. Project Appraisal
 2. Validity of Assumptions
 3. Projected Cashflows
 4. DCSR
 2. Working Capital Loan:
 1. Working Capital Gap Assessment
 2. Treatment of Creditors
 3. Assessment of Stock Levels
 4. Debtor Ageing
 5. Margin
 3. Non-Fund Based Facility:
 1. Transaction Involved
 2. Margin
2. Non-Revenue Generating Activity – Whether income is sufficient?
 1. Cost of Expense/Asset
 2. Calculation of Repayment Capacity

Primary Source Verification

Revenue Generating Activity - These include Business Loans, Project Loans

- Project Drivers:
 - Promoter's Credibility – ITRs, Financials, Net Worth etc.
- Term Loan:
 - Cost of Project – CAPEX
 - Validity of Source of Cost
 - Propriety of the CAPEX as per project requirement
 - Cashflow Projects and underlying assumptions
 - Calculation of Repayment Capacity (DSCR)
 - Comparison of projections with actual financials
 - Benchmarking
- Working Capital:
 - How the Working Capital gap is ascertained
 - Treatment of Creditors
 - Stock Statements
 - Stock Audit Reports
 - Debtor Ageing

Primary Source Verification

Non-Revenue Generating Activity

- Borrower's Repayment Capacity:
 - ITR
 - Salary Slips
 - Repayment Capacity Calculation
 - Certified Financials
 - Subsequent ITRs
 - Transaction Monitoring
 - Secondary Source Verification (Rent, Interest) if considered while calculating repayment capacity

What if the Primary Source Fails?

Loan Category	Type of Loan	Primary Repayment Source	Fallback Mechanism
To Finance Need	Term Loan for P&M	Project/Business	<ol style="list-style-type: none"> 1. Mortgage of Assets/Pledging FD/Policies etc. 2. Hypothecation 3. Third Party Guarantees
	Cash Credit for Business	Project/Business	
	LC/BG	Project/Business	
To Finance Comfort	Personal Loan	Salary/Business Income	<ol style="list-style-type: none"> 1. Third Party Guarantees
	Housing Loan	Salary/Business Income	<ol style="list-style-type: none"> 1. Mortgage of Asset 2. Third Party Guarantee
	Vehicle Loan	Salary/Business Income	<ol style="list-style-type: none"> 1. Hypothecation 2. Third Party Guarantee
	Consumer Goods	Salary/Business Income	
Asset backed Loans	Gold Loan	Salary/Business Income	<ol style="list-style-type: none"> 1. Pledge of Asset 2. Third Party Guarantee
	Loan against FD	Salary/Business Income	
	Loan Against Policy	Salary/Business Income	
	Loan against Property	Salary/Business Income	

Verification of Fallback Arrangement

1. Mortgage of Asset (Primary or Collateral Security)
 1. Ownership of Asset
 2. Valuation of Asset
 3. Mortgage against amount of loan
 4. Mortgage Deed

2. Pledge of FD/Policies
 1. Ownership of FD
 2. Value of FD + Accrued interest (covering 100% of loan amount)
 3. Lien mark on FD – Physical + System
 4. Discharge by holder
 5. Pledge Deed

3. Pledge of Gold
 1. Ownership of Gold
 2. Declaration that gold is not *Stridhan*
 3. Value of Gold
 4. Pledge Deed

Verification of Fallback Arrangement

4. Hypothecation (Primary or Collateral Security)
 1. Ownership of Asset
 2. Valuation of Asset
 3. Hypothecation Deed
 4. Charge Creation with MCA (in case of Companies)
 5. Original Invoices (Vehicles, Consumer Good Loans)

5. Guarantees
 1. Net Worth of Guarantor
 2. KYC

6. Insurance
 1. Bank Charge
 2. Value of Insurance
 3. Validity
 4. Exclusions

Key Elements of Security

Ownership

Registered Sale Deed

Invoices directly
from seller

Certificate/
Instruments

Value

Valuation from
Empanelled Valuer

Income Proof – Rent
Agreements/ Royalty
Agreements

Invoices directly
from seller

Enforceability

Properly Executed

Registered

Notarised

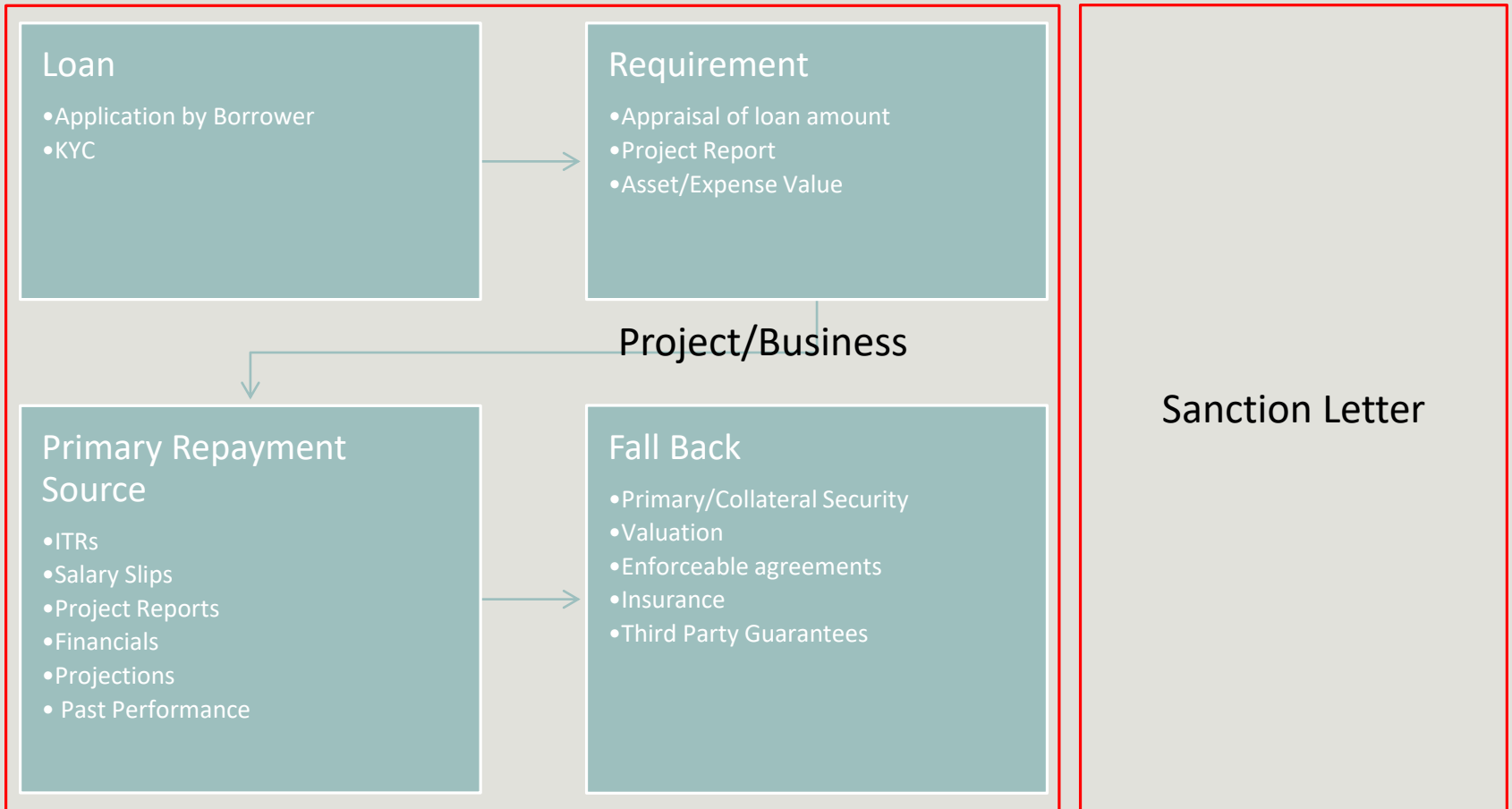
Adequately Stamped

Jurisdiction of Court

Credit Monitoring

1. Primary Source of Repayment:
 1. Borrower Returns – GST, Income Tax
 2. Latest Financial Statements
 3. Stock, Debtor & Creditor Statements
 4. Stock Audit Reports
 5. Renewals of Limits
 6. Credit & Debit Summation
 7. End Use of Loan
2. Fall-back Arrangement:
 1. Asset Verification Reports
 2. Insurance Renewals
 3. Site Visit Reports
 4. Inspection Reports

In a Nutshell



Audit Approach

1. Understand the Purpose of the Loan.
 1. Verify Propriety of the Loan
 2. Verify credit requirement
2. Identify the Primary Source of Repayment.
 1. Verify revenue sources
 2. Verify repayment capacity
 3. Verify Project assumptions and perform variance analysis
3. Identify Fall Back Arrangement.
 1. Ownership
 2. Valuation
 3. Enforceability
 4. Insurance

Thank You

CA PRANAV JOSHI
PARTNER,
P. G. JOSHI & CO.