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EDITORIAL ANALYSIS

KYC as a Proportionality Problem: Why Uniform Documentation Is a Regressive Tax

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KYC as a Proportionality Problem: Why Uniform Documentation Is a Regressive Tax

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INTERVIEW ANGLE

"A daily-wage worker without a permanent address and a company with a layered ownership structure across three jurisdictions both walk into a bank. Present rules ask both for documents. Which of the two is the money-laundering risk, which one bears the higher relative cost of compliance, and what does the answer tell you about how the rulebook should be designed?"

Source: Original editorial ↗ Business Standard

Every fact web-verified against primary sources

THE LIFT LINE

A rule that costs everyone the same rupee is not a neutral rule. It is a tax on the smallest customer, collected in documents.

WHY THIS EDITORIAL MATTERS FOR YOUR EXAM

KYC appears in answers as a compliance detail. It is in fact a rare topic that sits on three examinable axes at once: the **economy** axis of financial-system integrity and anti-money-laundering architecture, the **governance** axis of proportionality and administrative burden, and the **rights** axis of privacy, identity and the Aadhaar jurisprudence. Very few GS3 topics carry a Supreme Court judgment, a statute, a Financial Action Task Force evaluation and a flagship inclusion scheme in the same frame.

It also connects directly to the day's news on the Reserve Bank's tightening of the recovery-agent framework: both are instances of the same underlying question, namely how far a regulator should prescribe conduct rather than merely prescribe outcomes when the burden of an intermediary's behaviour falls on the least powerful customer.

GS Paper 3: Indian economy, mobilisation of resources, banking and financial sector; money laundering and its prevention; security challenges and their management, including linkages of organised crime with terrorism. **GS Paper 2:** Government policies and interventions for development in various sectors; issues relating to the transparency and accountability of institutions; important aspects of governance; welfare schemes for vulnerable sections.

CONCEPT	MEANING	WHY IT IS TESTABLE
KYC	Know Your Customer, the set of procedures by which a regulated entity identifies and verifies a customer and understands the nature of the relationship	The entry control of the entire anti-money-laundering framework
CDD and EDD	Customer Due Diligence is the baseline process; Enhanced Due Diligence applies to higher-risk relationships such as politically exposed persons and complex ownership structures	The risk-based principle in operational form
Placement, layering, integration	The three classical stages of money laundering: introducing illicit funds, disguising their trail through transactions, then reintroducing them as legitimate wealth	KYC targets placement; transaction monitoring targets layering
Reporting entity	Under Section 2(wa) of the PMLA, a banking company, financial institution, intermediary or person carrying on a designated business or profession	Defines who owes the obligation, and it is broader than banks
Beneficial owner	The natural person who ultimately owns or controls a client, identified under Rule 9 of the PML (Maintenance of Records) Rules, 2005	The provision that pierces shell structures; thresholds are examinable
CKYCR	Central KYC Records Registry, maintained by CERSAI, holding a single verified KYC record reusable across financial institutions with customer consent	The interoperability answer to repeated verification
V-CIP	Video-based Customer Identification Process, a remote alternative to in-person verification	The last-mile technology, now extendable through business correspondents
Small account	A simplified-KYC account for customers without officially valid documents, subject to balance and transaction caps	The explicit proportionality provision already inside the rulebook

BACKGROUND AND CONTEXT

India’s anti-money-laundering architecture was built in response to an international obligation and matured into a domestic one.

ELEMENT	DETAIL
Prevention of Money Laundering Act, 2002	Enacted 2003; the Act and its Rules came into force from **1 July 2005**
PML (Maintenance of Records) Rules, 2005	Prescribe record-keeping, reporting and, under **Rule 9**, Customer Due Diligence and beneficial-ownership identification
Financial Intelligence Unit-India (FIU-IND)	Set up by office memorandum of **18 November 2004**, in the **Department of Revenue, Ministry of Finance**; the central national agency receiving, processing and disseminating information on suspicious transactions
RBI Master Direction on KYC	Dated **25 February 2016**, updated repeatedly; the operative rulebook for banks and other regulated entities
CKYCR	Operated by **CERSAI**; **CKYCR 2.0** began rolling out for banks and insurers in **August 2026**

The external anchor is the **Financial Action Task Force (FATF)**, an inter-governmental standard-setting body whose 40 Recommendations define the global anti-money-laundering and counter-terror-financing standard, and whose **mutual evaluation** process assesses both technical compliance and, more demandingly, effectiveness. India's Mutual Evaluation Report was adopted at the FATF plenary in **Singapore in June 2024** and released in September 2024. India was placed in the **regular follow-up** category, the most favourable of the follow-up outcomes, joining a small group of G20 members, and was assessed as compliant or largely compliant with **37 of the 40 Recommendations**. This is not a ceremonial distinction: a poor rating raises the cost and friction of cross-border transactions for every Indian institution.

Running alongside is the inclusion story. **Pradhan Mantri Jan Dhan Yojana** accounts stood at roughly **58.63 crore** with deposits above **Rs 3.08 lakh crore** as of **1 July 2026**, with about **55.7 per cent** held by women and about **77.8 per cent** opened in rural and semi-urban areas. The two policies met at the same counter, and the meeting is where the friction is.

THE ANALYSIS

1. KYC is a control, not a formality, and the case for it is a public-goods case. The value of establishing identity is not that any single verification catches a criminal. It is that identity is the spine on which every subsequent control hangs: transaction monitoring, suspicious-transaction reporting, sanctions screening, and eventually attribution. Without it, the financial system either admits everyone, which makes it a laundering channel, or admits no one, which destroys its purpose. The author's framing, that KYC safeguards the customer as much as the system, is correct in a specific sense: the customer whose identity is the only thing standing between them and an impersonated account has a direct interest in the control.

2. But compliance cost is fixed per customer, which makes uniform rules regressive. Assembling documents, travelling to a branch, obtaining an address proof, losing a day's wage: these costs barely scale with account size. As a share of the value at stake, they are trivial for a large customer and prohibitive for a small one.

A uniform documentation requirement therefore does not treat customers equally; it imposes a much heavier real burden on the poorest, and it does so in exactly the segment that poses the least money-laundering risk, while the layered corporate structures that pose the most risk are the ones best equipped to satisfy a documentary standard.

3. The rulebook already contains the answer; the practice does not apply it. India's framework is risk-based in design. Enhanced Due Diligence for higher-risk relationships, simplified due diligence and small accounts at the bottom, and periodic updation staggered by risk category, at least once every two years for high-risk, eight years for medium-risk and ten years for low-risk, are all proportionality devices. What is missing is judgement in application. When branch-level practice replaces risk assessment with a standard document checklist applied to everyone, the regime keeps its costs and loses its intelligence. The Reserve Bank's own senior leadership has criticised the reduction of KYC to a periodic ritual, which is a regulator conceding that the failure is behavioural rather than textual.

4. The sharpest injustice is not refusal, it is freezing. An account refused at onboarding is a visible exclusion that the customer can respond to. An account frozen years later for want of a re-verified document is exclusion by administrative default, and it typically strikes a customer who has already been included, who may be receiving a direct benefit transfer through that account, and who discovers the problem at the moment of need. Graduated restriction, adequate prior notice through channels the customer actually uses, and a measured time to restoration are the minimum design requirements, and they are a governance question as much as a banking one.

5. Technology can make rigour cheaper without making it lighter, and that is the real frontier. V-CIP removes the branch visit. Permitting business correspondents to assist with video-based identification and with self-declaration of unchanged particulars pushes the capability to the last mile. CKYCR converts verification from a repeated per-institution event into a single record reused with consent, and the **CKYCR 2.0** migration, from batch document uploads to consent-based real-time interfaces with Aadhaar masking and a customer self-service portal, is the most consequential inclusion measure in this space precisely because it is invisible to the customer. The strategic point is that interoperability, not relaxation, is what lowers the burden without lowering the standard.

6. The constitutional boundary is settled and must be respected in the design. In **Justice K.S. Puttaswamy v. Union of India**, decided on **26 September 2018**, the Supreme Court upheld the Aadhaar Act while striking down **Section 57**, which had permitted body corporates and private persons to require Aadhaar authentication. The **Aadhaar and Other Laws (Amendment) Act, 2019**, in force from **24 July 2019**, omitted Section 57 and inserted **Section 11A** into the PMLA, under which the Central Government may, on the recommendation of the sector regulator and UIDAI and subject to privacy and security standards, notify a reporting entity to use Aadhaar e-KYC authentication on a **voluntary** basis. The practical implication for an answer is precise: Aadhaar e-KYC is available, but as a notified and consent-based route, not as a default demand, and any KYC reform must be built inside that constraint rather than around it.

DATA AND INSTITUTIONS VAULT

PRELIMS-GRADE FACTS:

PMLA, 2002 enacted in 2003; the Act and Rules came into force from 1 July 2005

PML (Maintenance of Records) Rules, 2005; Rule 9 governs Customer Due Diligence and beneficial-owner identification

FIU-IND established 18 November 2004, under the Department of Revenue, Ministry of Finance; it is the central national agency for suspicious-transaction information, and it reports to the Economic Intelligence Council

RBI Master Direction, Know Your Customer (KYC) Direction, 2016, dated 25 February 2016

Periodic updation intervals: at least once every 2 years (high risk), 8 years (medium risk), 10 years (low risk)

Small account limits: balance not above Rs 50,000 at any time, aggregate credits not above Rs 1 lakh in a year, withdrawals and transfers not above Rs 10,000 in a month; ordinarily valid for 12 months, extendable by another 12 on proof of having applied for an officially valid document

V-CIP: Video-based Customer Identification Process; data and recordings must be stored on systems located in India; the 12 June 2025 amendment allowed business correspondents to assist with V-CIP and with self-declaration of unchanged particulars

CKYCR: Central KYC Records Registry, operated by CERSAI; CKYCR 2.0 rollout for banks and insurers began August 2026, replacing batch uploads with consent-based real-time interfaces, Aadhaar masking and a customer self-service portal

FATF: 40 Recommendations; India’s Mutual Evaluation Report adopted at the June 2024 plenary in Singapore, India placed in the regular follow-up category, compliant or largely compliant on 37 of 40 Recommendations

PMJDY: about 58.63 crore accounts, deposits above Rs 3.08 lakh crore, as of 1 July 2026; about 55.7 per cent women, about 77.8 per cent rural and semi-urban

Puttaswamy (Aadhaar), 26 September 2018: Section 57 of the Aadhaar Act struck down; Aadhaar and Other Laws (Amendment) Act, 2019, in force 24 July 2019, omitted Section 57 and inserted Section 11A in the PMLA for voluntary, notified Aadhaar e-KYC

Author: Swaminathan J, Deputy Governor, Reserve Bank of India, writing in Business Standard, 6 August 2026

WATCH THE TRAP: FIU-IND SITS UNDER THE MINISTRY OF FINANCE (DEPARTMENT OF REVENUE), NOT UNDER THE RESERVE BANK, AND IT IS AN INTELLIGENCE BODY, NOT AN INVESTIGATING AGENCY: THE ENFORCEMENT DIRECTORATE INVESTIGATES PMLA OFFENCES. FATF IS AN INTER-GOVERNMENTAL TASK FORCE, NOT A UNITED NATIONS BODY AND NOT AN ARM OF THE IMF, AND ITS LISTS ARE THE GREY AND BLACK LISTS, WHICH ARE DISTINCT FROM THE FOLLOW-UP CATEGORIES USED IN MUTUAL EVALUATIONS. DO NOT WRITE THAT AADHAAR E-KYC WAS BANNED FOR PRIVATE ENTITIES AFTER 2018; SECTION 57 WAS STRUCK DOWN, AND A NOTIFIED, VOLUNTARY ROUTE WAS THEN CREATED UNDER SECTION 11A OF THE PMLA. FINALLY, DO NOT CONFLATE A SMALL ACCOUNT WITH A BASIC SAVINGS BANK DEPOSIT ACCOUNT: EVERY SMALL ACCOUNT IS SUBJECT TO BSBDA-TYPE FEATURES, BUT A BSBDA OPENED WITH FULL KYC IS NOT A SMALL ACCOUNT.

THE DEBATE

Argument FOR uniform and rigorous KYC. Money laundering does not announce itself, and risk is least observable at exactly the moment the risk tier must be assigned. The entire technique of layering consists of making illicit funds look like ordinary retail activity, and mule-account networks are built out of precisely the small, low-value, individually unremarkable accounts that a tiered regime would wave through. Terror financing frequently moves in amounts small enough to fall below any sensible threshold. A regime that relaxes the front door invites its own circumvention, and the cost of an intelligence failure falls on the public, not on the institution that eased the check. India's favourable FATF outcome is an asset with a measurable value in the cost of cross-border finance, and it was earned by rigour, not by discretion.

Argument AGAINST uniformity. Rigour applied uniformly is not rigour; it is volume. Compliance capacity is finite, and spending it on re-collecting an address proof from a rural customer with a Rs 4,000 balance is capacity not spent on the layered beneficial-ownership structures where laundering risk is actually concentrated. Uniform demands are regressive in incidence and exclusionary in effect, and their sharpest expression is the frozen account, which withdraws access from someone already banked and often already dependent on that account for a benefit transfer. This is not a hypothetical trade-off in a country that spent a decade opening 58 crore accounts to reach the unbanked. And much of the burden is self-inflicted: banks routinely demand more than the Master Direction requires, because over-collection carries no supervisory penalty while under-collection does.

Balanced verdict. The two positions are reconciled by separating what is currently bundled. **Identification** should be universal, since knowing who holds an account is not negotiable. **Verification intensity** should be proportionate, scaling with assessed risk, transaction profile and product, which is what the rulebook already provides for and what practice largely ignores. **Monitoring** should carry the analytical load, because behaviour over time is a far better signal of laundering than a document collected once, and continuous monitoring is where technology genuinely substitutes for paper. The binding constraint today is not the text of the Master Direction but the incentive structure inside banks, where over-collection is costless and under-collection is punished. Correcting that requires supervision to look at both errors: not only accounts that should have been scrutinised and were not, but accounts that were restricted and should not have been. Until the second is measured and published, KYC will keep being experienced as a barrier by the people it was never aimed at.

HOW TO THINK ABOUT THIS

The transferable pattern is: **when a compliance cost is fixed per person, a uniform rule is a regressive tax.**

Three questions follow whenever a regulation imposes a procedural requirement.

Does the cost of compliance scale with the size of the transaction or the person? If it does not, uniformity is not neutrality. It is a flat levy, and flat levies are regressive in incidence whatever their intent.

Is the burden falling where the risk is? A control is efficient only if its intensity correlates with the hazard it addresses. When the heaviest documentary burden sits on the lowest-risk segment, the regulation is not merely unfair, it is misallocating scarce enforcement attention.

Which error is punished by the supervisor? Wherever over-compliance is free and under-compliance is penalised, institutions will over-comply, and the excess burden will be pushed onto whoever has the least power to object. The fix is usually to make the neglected error visible and measurable rather than to rewrite the rule.

The same structure appears in environmental clearance requirements applied identically to a small unit and a large one, in documentation demanded for welfare eligibility, in compliance obligations under company law falling on micro enterprises, and in land-record requirements for agricultural credit. In each case, the reform is proportionality, not abolition.

DIAGRAM-IN-WORDS

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THE OBJECTIVE                          THE INSTRUMENT
Keep proceeds of crime out       ◄──   KYC at onboarding
of the legitimate system               (identification + verification)
                                              │
                                              ▼
                              STATUTORY SPINE
      PMLA, 2002  +  PML (Maintenance of Records) Rules, 2005
                    │                        │
             RBI Master Direction      FIU-IND (Dept of Revenue)
             on KYC, 25 Feb 2016       receives STRs / CTRs
                    │                        │
                    ▼                        ▼
             Regulated entities        Analysis, dissemination
                                       to ED / intelligence agencies
                                              │
                                              ▼
                              EXTERNAL VALIDATION
                    FATF mutual evaluation (June 2024 plenary)
                    India: regular follow-up, 37 of 40 Recommendations

THE COLLISION
Compliance cost is roughly FIXED per customer
        │
        ├─ Large customer, large balance  ──► cost is trivial, risk may be high
        │
        └─ Small customer, Rs 4,000 balance ─► cost is prohibitive, risk is low
                    │
                    ▼
        Uniform rule = REGRESSIVE burden + MISALLOCATED scrutiny
        Sharpest form: the FROZEN account (exclusion after inclusion)

THE RESOLUTION: unbundle
   IDENTIFICATION  ──► universal, non-negotiable
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VERIFICATION    ──► proportionate (risk-based CDD / EDD / small accounts)
MONITORING      ──► continuous, behaviour-based, carries the analytical load

ENABLERS: V-CIP · business-correspondent assistance · CKYCR 2.0
          (verify once, reuse with consent)
BOUNDARY: Puttaswamy 2018 struck Section 57; Aadhaar e-KYC runs
          through the voluntary, notified Section 11A PMLA route
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TAKEAWAY BOX

The question was never whether to know the customer. It was how much proof to demand from the customer least able to supply it, and least likely to need watching.

PMLA, 2002 *in force* **1 July 2005**; **PML (Maintenance of Records) Rules, 2005**, **Rule 9** *on CDD and beneficial ownership;* **FIU-IND** *set up* **18 November 2004** *under the* **Department of Revenue**; **RBI Master Direction on KYC, 25 February 2016**; *periodic updation at* **2 / 8 / 10 years** *by risk;* **small account** *caps* **Rs 50,000** *balance,* **Rs 1 lakh** *annual credits,* **Rs 10,000** *monthly withdrawals;* **V-CIP** *data stored in India, business correspondents permitted from* **12 June 2025**; **CKYCR** *run by* **CERSAI**, **CKYCR 2.0** *from* **August 2026**; **FATF** *40 Recommendations, India in* **regular follow-up** *after the* **June 2024 Singapore plenary**, **37 of 40** *compliant or largely compliant;* **PMJDY 58.63 crore** *accounts,* **Rs 3.08 lakh crore** *deposits (1 July 2026);* **Puttaswamy, 26 September 2018**, *struck down* **Section 57**; **Section 11A PMLA** *inserted by the* **2019 Amendment Act**.

a bank official freezes an account because a document was not refiled. The rule permitted a lesser restriction and the customer was low-risk, but freezing is safer for the official, since no supervisor ever penalised excess caution. This is the classic problem of asymmetric accountability in public-facing administration: where one error is visible and punished and the other is invisible and costless, the burden migrates to the powerless. What does an ethic of public service require of the individual officer when the institutional incentive points the other way, and what does it require of the institution that created the asymmetry? Link to empathy in public service, to the citizen as a rights-holder rather than a supplicant, and to the Second Administrative Reforms Commission emphasis on citizen-centric administration.

UPSC has repeatedly examined money laundering and its linkage with organised crime and terrorism under GS3 internal security, the working of the PMLA and its enforcement, and separately the right to privacy after the Puttaswamy judgments and the Aadhaar architecture under GS2. It has also asked about financial inclusion and the reach of Jan Dhan. This editorial is unusual in that it lets you connect all three in a single answer, which is precisely the kind of synthesis that distinguishes a high-scoring script.

"Uniform Know Your Customer requirements impose their heaviest burden on the customers who pose the least risk." Critically examine, and suggest a design that reconciles financial-system integrity with financial inclusion.

Sources: Business Standard, Reserve Bank of India, FIU-IND, Department of Revenue, FATF, PMJDY

KEY ARGUMENTS AT A GLANCE

KYC is neither bureaucratic obstruction nor an unqualified good; it is a proportionality problem. Establishing customer identity is the foundational control in India's anti-money-laundering and counter-terror-financing architecture and is what allows the financial system to be defended without shutting it, but because documentation and verification impose a broadly fixed cost, a uniform requirement is regressive: it falls hardest on the smallest customer, and therefore excludes precisely the population that financial inclusion was designed to reach.
The answer is genuine risk-based tiering, applied with judgement rather than as a periodic ritual, not a choice between rigour and access.

✓ SUPPORTING

- The framework has statutory teeth and international consequence. KYC obligations flow from the Prevention of Money Laundering Act, 2002, and the Prevention of Money-laundering (Maintenance of Records) Rules, 2005, both operative from 1 July 2005, with the Reserve Bank of India's Master Direction on Know Your Customer dated 25 February 2016 translating them for regulated entities and the Financial Intelligence Unit-India, established on 18 November 2004 in the Department of Revenue, receiving and analysing the resulting reports.
- The design is already risk-based in principle. Customer Due Diligence is calibrated to assessed risk, with Enhanced Due Diligence for higher-risk relationships including politically exposed persons and complex ownership structures, and simplified due diligence with small accounts for those lacking officially valid documents.
  Periodic updation follows the same logic: at least once every two years for high-risk customers, eight years for medium-risk and ten years for low-risk.
- The inclusion tension is empirically real, not theoretical. Pradhan Mantri Jan Dhan Yojana accounts had reached about 58.63 crore with deposits over Rs 3.08 lakh crore by 1 July 2026, with roughly 78 per cent of accounts in rural and semi-urban areas.
  Documentation demands that are trivial for a salaried urban customer are a serious barrier for a migrant worker without a permanent address, and an account frozen for want of a re-verified document delivers exclusion by administrative default.
- The technology stack is converging on making rigour cheaper rather than lighter. Video-based Customer Identification Process removes the branch visit, business correspondents have been permitted to assist with V-CIP and self-declaration of unchanged particulars, and the Central KYC Records Registry maintained by CERSAI allows a verified record to be reused across institutions with customer consent.

CKYCR 2.0, moving from batch document uploads to consent-based real-time interfaces with Aadhaar masking, began rolling out for banks and insurers in August 2026.

⚠ COUNTER

The strongest case against tiering is that risk is not observable at onboarding, which is exactly when the tier must be assigned. Layering works by disguising illicit funds as low-risk retail activity, and mule-account networks operate through precisely the small, low-value, apparently benign accounts that a tiered regime would treat lightly.

Every relaxation is therefore also a mapped attack surface, and the cost of an intelligence failure is borne by the public rather than by the bank that eased the check. There is a second objection from the opposite direction: much of the customer's pain comes not from the rules but from their mechanical implementation, banks demanding documents the Master Direction does not require, freezing accounts rather than restricting them, and treating periodic updation as a form-collection exercise.

If the operational failure is the binding problem, loosening the rulebook treats the wrong variable.

→ WAY FORWARD

Separate the three things now bundled together: identification, verification and monitoring. Keep identification universal, make verification proportionate to assessed risk and transaction profile, and shift the analytical weight onto continuous transaction monitoring, which detects behaviour rather than checking paper.

Operationally: complete the CKYCR 2.0 migration so a verified record travels with the customer and re-verification becomes a consent event rather than a fresh submission; hold banks to the RBI position that periodic updation must not become an account-freeze mechanism, and prefer graduated restriction to suspension; expand business-correspondent-assisted and video-based updation so the last mile is served without a branch visit; publish, as a supervisory metric, the number of accounts restricted for KYC reasons and the median time to restoration, since what is not measured is not managed; and anchor Aadhaar-based e-KYC firmly in the consent and proportionality framework the Puttaswamy judgment requires, using the Section 11A route under the PMLA rather than informal mandates.

MAINS ANSWER FRAMEWORK

QUESTION

Know Your Customer norms sit at the intersection of financial-system integrity and financial inclusion. Examine the architecture of India's KYC framework and critically assess whether a uniform documentation standard is compatible with the objective of universal banking access. (250 words)

INTRODUCTION

Know Your Customer norms are experienced by the customer as documentation and by the regulator as the foundational control of financial integrity. Both descriptions are accurate, and the tension between them is the policy question.

India's framework rests on the Prevention of Money Laundering Act, 2002, and the Prevention of Money-laundering (Maintenance of Records) Rules, 2005, operationalised for banks by the Reserve Bank of India's Master Direction on KYC of 25 February 2016, with the Financial Intelligence Unit-India as the receiving and analytical node. The question is not whether identity should be established, but how the cost of establishing it should be distributed.

BODY

The case for rigour is strong and has been externally validated. KYC is the entry control that prevents proceeds of crime from being introduced into the legitimate financial system at the placement stage, and it supplies the identity spine without which suspicious-transaction reporting is meaningless.

India's Mutual Evaluation Report, adopted at the Financial Action Task Force plenary in Singapore in June 2024, placed the country in the regular follow-up category, the most favourable outcome, with compliance or large compliance on 37 of the 40 Recommendations, an outcome that materially affects the cost at which Indian entities access cross-border finance. Against this stands the inclusion problem.

Compliance cost is largely fixed per customer, so it is regressive in incidence: the same documentation demand that is a minor inconvenience for a salaried urban customer can be prohibitive for a migrant worker without stable address proof. With Jan Dhan accounts at about 58.63 crore by mid-2026 and roughly 78 per cent of them rural or semi-urban, a re-verification requirement applied uniformly can undo inclusion administratively, through accounts frozen rather than accounts refused.

The framework already contains the answer in principle: risk-based Customer Due Diligence, Enhanced Due Diligence for higher-risk relationships, simplified due diligence and small accounts at the bottom, and periodic updation at two, eight and ten years by risk category. The failure is largely in implementation, where risk-based judgement is replaced by uniform document collection, a tendency the Reserve Bank has itself criticised in describing KYC as having become a periodic ritual.

Technology narrows the gap rather than closing it: V-CIP removes the branch visit, business correspondents can now assist, and the Central KYC Records Registry, moving to a consent-based real-time architecture as CKYCR 2.0 from August 2026, allows a verified record to be reused instead of recreated. The constitutional constraint runs alongside: after the Aadhaar judgment of 26 September 2018 struck down Section 57, private entities cannot compel Aadhaar authentication, and its use now runs through the voluntary route created by Section 11A of the PMLA, inserted in 2019.

CONCLUSION

KYC is best understood as a proportionality problem rather than a paperwork problem. Uniform documentation buys the appearance of rigour while imposing its heaviest real cost on the customers who pose the least risk, and it diverts compliance capacity away from the layered corporate structures where laundering risk actually concentrates.

The reform direction is therefore to keep identification universal, scale verification to assessed risk, shift analytical weight to continuous transaction monitoring, complete the interoperable CKYCR migration so that verification travels with the customer, and treat account restriction as a supervised and measured event rather than a routine consequence of an unfiled form.

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