MONEYLIFE FOUNDATION

THE RIGHT THING TO DO

Presents

KYC IS TORTURE:
RURAL REALITIES AND REFORMS

A Study for *Moneylife* Foundation by

Arjun Chahal

Preface

Moneylife Foundation has, for over a decade, consistently raised concerns about the arbitrary and often illegal freezing of bank accounts under the guise of Know Your Customer (KYC) compliance. Despite the clear regulatory framework laid down by the Reserve Bank of India (RBI), in practice, bank customers—particularly senior citizens, rural populations and economically vulnerable groups— are routinely denied access to their own money without due process. This is done without proper intimation, in violation of RBI's own master directions and in a manner that creates immense hardship for those least equipped to navigate such bureaucratic obstacles.

The Foundation's work on this issue began with the alarming experiences of individuals whose bank accounts were frozen without any wrongdoing, often simply because they had not been notified that a KYC update was due.[1] Such actions have had devastating consequences. Our past representations to the RBI have repeatedly emphasised that the absence of clear, enforceable Standard Operating Procedures (SOPs) across banks has led to widespread confusion, inconsistent practices, and ultimately, the marginalisation of the very citizens financial inclusion efforts were supposed to empower.[2]

The Kanungo Committee, constituted by the RBI in 2022—more than a decade after the Damodaran Committee on customer service (2010)—offered a long-overdue opportunity to bring coherence and empathy to the treatment of customers by regulated entities. Crucially, the Kanungo Committee report acknowledged a fact Moneylife Foundation has long asserted: that there is no regulatory basis for freezing accounts due to non-updation of KYC.[3] Paragraph 4.4.2 of the committee report states unambiguously that such actions are not permitted under RBI regulations, even though cheques have been dishonoured and operations blocked in many cases.[4]

Yet, despite this acknowledgement and the committee's well-considered recommendations—such as the call for SOPs or model operating procedures to be published by the Indian Banks' Association (IBA)—there has been no tangible progress. There is still no mandated, system-wide implementation of these SOPs.

[1] https://www.mlfoundation.in/memorandum/arbitrary-freezing-of-bank-accounts/130.html

[2] https://www.moneylife.in/article/moneylife-foundation-submits-concerns-and-key-issues-to-rbis-customer-services-committee/70230.html

[3] https://www.moneylife.in/article/kyc-banks-dont-have-the-right-to-freeze-accounts-its-illegal/71135.html

[4]https://rbidocs.rbi.org.in/rdocs/PublicationReport/Pdfs/REPORTCUSTOMERSERVICE0DC064A6613C40AB8343B94EF50DFA13.PDF

Banks continue to interpret and enforce KYC norms as they see fit, resulting in unpredictable, often punitive treatment of customers.

This disconnect between regulation and enforcement becomes especially damaging in rural India, where literacy, access to documents and physical banking infrastructure are limited.[5] The pages of this report document, in painstaking detail, how ordinary villagers—small farmers, pensioners, daily wage earners—have suffered "financial death" due to account freezes. In some districts of Jharkhand and Chhattisgarh, surveys have found over 60% of households had at least one bank account frozen due to KYC issues.[6] These freezes have blocked access to pensions, student scholarships, employment wages under National Rural Employment Guarantee Act (NREGA) and even life savings.

These are not isolated cases. They represent a systemic failure that stems from poor implementation, inadequate communication, lack of SOPs and misapplication of regulations meant to curb financial crime—not punish law-abiding citizens. As this report shows, there are countless examples of KYC updates being demanded far more frequently than the 2/8/10-year intervals prescribed, of accounts frozen without intimation, and of people with perfectly valid documentation being asked to appear at distant branches repeatedly. This not only violates customer rights, but also defeats the very purpose of financial inclusion.

The report also brings attention to how rigid KYC enforcement affects nomination and succession processes, with heirs and family members of deceased account holders unable to access funds due to arbitrary and unclear documentation requirements.[7] Once again, the lack of a uniform SOP has left banks to formulate their own checklists, often inconsistent and burdensome. Despite the Kanungo Committee recommending updates to the IBA's model SOPs to improve these processes, RBI has yet to take decisive action to institutionalise these across the sector.

In presenting this report, *KYC is Torture: Rural Realities and Reforms*, Moneylife Foundation hopes to push for long-overdue reform. The evidence gathered from various field surveys, case studies and interactions with affected customers shows that the harm caused by current KYC enforcement is not hypothetical or rare—it is persistent, widespread and avoidable. The report proposes practical solutions: video

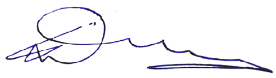
[5] https://www.moneylife.in/article/how-aadhaar-ekyc-is-causing-financial-death-of-poor-people/75385.html

[6] https://www.moneylife.in/article/aadhaar-ekyc-menace-75-percentage-village-households-have-at-least-1-bank-account-frozen/75441.html

[7] https://www.mlfoundation.in/memorandum/challenges-in-transmission-of-assets-to-nominees-and-legal-heirs/389.html

KYC facilitated by business correspondents, use of central KYC registries, clear risk-based tiering of compliance requirements and the need for a customer-first approach to identity verification.

The recommendations in this report are not merely academic or aspirational. They reflect lived realities and are designed to be immediately actionable. We urge the RBI, IBA and all financial regulators to finally bridge the gap between intention and implementation. With minimal effort, the system can be made more humane, effective and inclusive—without compromising on security.



Sucheta Dalal
(Trustee, Moneylife Foundation)
Mumbai
May 2025

Know Your Customer Regulations and Rural India: Barriers, Consequences, and Pathways to Inclusion

This study, authored by Arjun Chahal for the Moneylife Foundation, critically examines the impact of KYC regulations on rural India. Drawing from field data, stakeholder insights, and regulatory analysis, the report proposes actionable solutions to improve financial access, trust, and institutional accountability.

Know Your Customer (KYC) regulations have become a cornerstone of India's financial system, intended to prevent fraud, money laundering, and illicit financing by verifying customer identities. In theory, these norms should strengthen trust in financial institutions and broaden financial inclusion. In practice, however, India's current KYC system is presenting unforeseen challenges—especially for rural populations. Minor mismatches in names or personal details and lack of proper documentation are not mere inconveniences; they have led to **frozen bank accounts, denial of services, and even "financial death" of the poor**[8].[9] For rural Indians, the hurdles in complying with KYC requirements often translate into significant barriers in accessing basic financial services, inheriting property, and obtaining official documents. This paper critically examines how the KYC regime, while well-intentioned, has disproportionately negative effects on rural communities. It explores real-life case studies from rural India to illustrate the human impact of bureaucratic KYC hurdles and analyzes the regulatory framework's effectiveness and unintended consequences. Finally, the paper proposes innovative and practical solutions—spanning technological, policy, institutional, and legal reforms—to make the KYC system more inclusive and user-friendly, restoring trust among marginalized populations without compromising on financial integrity.

Background: KYC Framework in India and Its Objectives

Under Indian law and regulation, KYC norms are mandated for banks and other financial institutions primarily by the Reserve Bank of India (RBI) through its Master Direction on KYC (first issued in 2016) and by the Prevention of Money Laundering Act (PMLA) rules. The **core objective of KYC is to verify customers' identities and ensure that accounts are not used for illicit activities.**[10] Customers typically must

[8] https://www.moneylife.in/article/how-aadhaar-ekyc-is-causing-financial-death-of-poor-people/75385.html#%3A~%3Atext%3DJharkhand%2CKYC

[9] https://www.moneylife.in/article/aadhaar-ekyc-menace-75-percentage-village-households-have-at-least-1-bank-account-frozen/75441.html#%3A~%3Atext%3Dcompleted%20and%20her%20account%20would%2Cbe%20unfrozen

[10] https://www.dglegacy.com/understanding-kyc-policy-and-its-impact-on-the-heirs-of-deceased-users-assets/#%3A~%3Atext%3DKnow%20Your%20Customer%20%2Cfinancial%20position%2C%20and%20financial%20

provide proof of identity and address (such as Aadhaar card, voter ID, PAN card, passport, etc.), a recent photograph, and other contact details. Over the past decade, India's push for digital financial inclusion via the Jan Dhan–Aadhaar–Mobile (JAM) trinity has further entwined KYC with biometric identification, especially the Aadhaar system. Aadhaar-based e-KYC allows instant identity verification using fingerprints or iris scans against a national database, and it was advertised as a rapid route to open millions of bank accounts for the poor.

RBI's guidelines stipulate a **risk-based approach to KYC updates**: high-risk customers are to be re-verified every two years, medium-risk every eight years, and low-risk every ten years.[11] Most rural account holders, such as small farmers, laborers, or pensioners with modest balances, qualify as low-risk customers, implying that once their account is opened with proper KYC, they should only need to update KYC once a decade. Furthermore, **if there is no change in a customer's KYC information, RBI permits a simple self-declaration to suffice for re-KYC** (which can even be submitted via registered email, mobile, ATM, or online banking). A change of address can similarly be updated by submitting new address details through these channels, to be verified by the bank within two months. In theory, these regulations mean that **for most rural customers with stable information, KYC compliance should be neither frequent nor onerous**.

However, the reality on the ground diverges sharply from these principles. In practice, banks often demand fresh KYC documents and in-person verification even when no details have changed, sometimes as frequently as every 2–3 years regardless of risk category. Many banks have not provided easily accessible online or remote re-KYC options and instead insist that customers visit home branches and resubmit identity proofs, photographs, PAN cards, and even information beyond what regulations require his gap between policy and practice— compounded by the central role of Aadhaar—has set the stage for serious compliance difficulties, especially in rural areas.

KYC's stated goals of financial security and integrity must be balanced with inclusion, yet India's current framework has struggled in this regard. The following sections examine how these KYC norms play out in rural India, often working against the very populations that financial inclusion policies sought to empower.

---

goals

[11] https://www.moneylife.in/article/kyc-nightmare-how-banks-are-asking-for-rekycs-illegally-and-in-the-process-collecting-additional-data-from-customers/75585.html#%3A~%3Atext%3DAs%20per%20RBI%20norms%2C%20banks%2Cof%20the%20last%20KYC%20update

KYC Compliance Challenges in Rural India

Rural populations in India face unique challenges in complying with KYC requirements, owing to socioeconomic factors, administrative capacity, and the design of the KYC system itself. Key hurdles include discrepancies in personal data (such as name spellings), lack of standard documentation, biometric verification failures, and strained banking infrastructure.

Documentation Discrepancies and Identity Mismatches

A pervasive issue is **minor mismatches in personal details across documents**, which can render a customer's KYC "invalid" in the eyes of a bank. In rural India, many individuals have only a few identity documents, and those often contain errors introduced during data entry or translation. For example, names transliterated from local languages into English can produce inconsistencies – one's name might appear slightly differently on the Aadhaar card versus the voter ID or bank records. In tribal regions of Jharkhand, a survey found numerous cases of accounts frozen due to such discrepancies. One villager, *Sarita Oraon*, had her bank account frozen for three years simply because **her Aadhaar card listed her name as "Archana" instead of the name on her account.** All attempts to rectify this mismatch failed, leaving her funds inaccessible. The surveyors noted that *"everyone knows that demographic details in the Aadhaar database are unreliable – then why insist on 100% consistency with Aadhaar in bank accounts?"* (Moneylife - Source 4 of the paper). Indeed, insisting that every spelling and date of birth perfectly align across documents—when errors are common—sets a trap that ensnares innocent customers.

Compounding the problem, **many rural Indians lack a complete set of officially valid documents**. Some do not have birth certificates or passports; others, especially women, might have changed names after marriage, leading to different surnames on different documents. When a poor farmer or laborer is told to produce proof of permanent address, they may not have anything beyond a ration card or a letter from the village head, which banks might not readily accept. Although RBI's norms allow use of alternative documents (and even allow a simple declaration for low-value "small accounts"), in practice bank officials often err on the side of strictness, demanding standardized documents that rural customers do not possess. A global study on KYC and inclusion notes that requiring formal **proof of address tends to exclude rural populations**, as many do not have utility bills or registered leases in their name.[12] In India, despite tiered KYC provisions for small accounts, "a

[12] https://www.afi-global.org/sites/default/files/publications/2019-03/KYC-Innovations-Financial-Inclusion-Integrity-Selected-AFI-Member-Countries.pdf#%3A~%3Atext%3D%E2%80%A2%20Proof%20of%20address%20continues%2C%E2%80%A2%20A

conservative compliance environment" leads bankers and auditors to continue insisting on documents like formal ID and address proof, undermining the flexibility intended by the rules

The outcome is that a **minor clerical error or an outdated document can effectively sever someone's access to their own bank account.** Instead of simple, prompt corrections, rural customers often face a bureaucratic maze to reconcile the data. They may be instructed to first update their Aadhaar details to match the bank records (which itself requires navigating the UIDAI update process and, sometimes, paying unofficial fees), or to obtain notarized affidavits confirming that "Person X and Y are the same." These extra steps are burdensome for anyone, let alone someone from a remote village with limited literacy or financial means. The situation of *Basnt Oraon* (whose Aadhaar misspelled his name as "Basnt" instead of **"Basant"**) exemplifies this ordeal—his account was frozen and remained so until he could get the error corrected in the Aadhaar database. Such instances illustrate how *trivial discrepancies can snowball into major barriers* for rural customers under a rigid KYC regime.

Biometric Authentication Failures

India's embrace of Aadhaar-based e-KYC was meant to simplify verification, but for many rural citizens it has introduced new complications. Biometric authentication (fingerprint or iris scan) is required in Aadhaar e-KYC to instantly pull one's data. Yet **for manual laborers, farmers, and the elderly—common demographics in rural areas—fingerprint authentication often fails**. Years of manual work can erode fingerprint patterns; rural workers with calloused hands frequently find that the scanner cannot read their prints reliably. The system's sensitivity issues are well documented, and Aadhaar's own authority has acknowledged a subset of the population faces biometric authentication problems. When the fingerprint match fails, the KYC process cannot proceed through the digital route, forcing the person into a manual paperwork process. In effect, the very people who could benefit from a quick e-KYC (to avoid paperwork they struggle with) are the ones most likely to be rejected by the biometric system, a cruel irony of technological "inclusion."

Moreover, if a person's biometric fails at the bank, they may be told to update their biometrics at an Aadhaar enrollment center. Such centers (e.g., *Pragya Kendras* or common service centers in villages) might be miles away, and appointments or queues can be long. In one example, *Rani Kondi*, a differently-abled woman in Jharkhand who cannot hear or speak, had to undertake a **50-kilometer journey to**

%20conservative%20compliance

the district headquarters just to complete a KYC update via biometric.[13] Until she did so, she was unable to withdraw her modest pension from her Jan Dhan account. These travel burdens and costs undermine the accessibility of financial services for vulnerable groups.

Banking Infrastructure and Administrative Capacity

The physical and administrative infrastructure in rural banking often cannot cope with the volume of KYC updates being demanded. Rural bank branches are typically understaffed and serve a wide catchment of villages. In recent years, banks (public sector banks in particular) have been instructed by regulators and headquarters to complete re-KYC of old accounts, leading to a sudden influx of customers at branches all trying to update paperwork. Reports from Jharkhand and other states indicate that **rural bank branches have been swamped by crowds of people attempting to comply with KYC**.[14] Villagers line up from morning to evening, and even then not everyone is attended to. Overwhelmed staff impose token systems and ask people to come back another day. For instance, a local survey found that in Latehar district, a branch manager had a backlog of 1,500 KYC applications while being able to process only about 30 per day. At that pace, even if no new requests came in, it would take two months or more to clear existing applications – a delay during which accounts remain frozen and customers remain cut off from their money.

Infrastructure issues further exacerbate delays. Many rural branches suffer from **frequent connectivity problems ("server down" or "no network")** that hinder online verification or updating of records. Power outages or slow internet can stall the Aadhaar authentication or the uploading of KYC documents. A KYC procedure that might take 15 minutes in a city (with stable internet and dedicated staff) can stretch over multiple attempts in a village branch. The cumulative effect is that a customer might travel to the branch repeatedly— incurring wage losses and transport costs—only to be told each time that the system is not working or the responsible officer is on leave. Indeed, rural customers often describe the KYC update process as a **Sisyphean task of "running around" with no certainty of resolution.**

[13] https://www.moneylife.in/article/how-aadhaar-ekyc-is-causing-financial-death-of-poor-people/75385.html#%3A~%3Atext%3DNational%20Rural%20Employment%20Guarantee%20Act%2Caccount%20due%20to%20KYC%20issues

[14] https://www.moneylife.in/article/kyc-epidemic-in-jharkhand-depriving-poor-people-of-their-own-money-in-banks-survey/75475.html#%3A~%3Atext%3Dbank%20for%20timely%20reactivation%20of%2CThis%20can%20take%20months

For example, *Somwati Devi*, a villager whose account was frozen, **visited her bank branch repeatedly over two years trying to complete an e-KYC** update. Each visit demanded time and money, and each time she left without success. Stories like hers are not isolated. They reveal a systemic administrative shortfall: rules were imposed requiring millions of accounts to be updated within a short span, without adequately scaling up the ground capacity to implement them efficiently.

Corruption and Informal Costs

An often unspoken aspect of the rural KYC ordeal is the opportunity it creates for petty corruption. When formal processes are convoluted, middlemen and some officials may exploit desperate customers. In some cases, agents or even bank/administration personnel have demanded **"fees" or bribes to facilitate KYC updates or documentation**. One case from Bihar involved *Sangeeta Devi*, who could not get Aadhaar cards made for her children because she lacked the money demanded as a bribe by officials. Her family's woes were compounded when her husband's bank account was simultaneously frozen due to pending e- KYC, depriving them of funds needed to pay anyone for help. Such extortion around identity documents is an additional barrier for the poorest, effectively pricing them out of compliance. It also breeds resentment and distrust towards institutions, as rural citizens come to view necessary services as contingent on their ability to "pay extra," which many cannot.

In summary, rural Indians face a **confluence of disadvantages** under the current KYC system: they are more likely to have data mismatches (due to lower literacy and bureaucratic errors in their documents), less likely to have multiple alternate IDs to satisfy requirements, more likely to encounter biometric failures (due to the nature of their work and life), and must rely on an understaffed infrastructure that struggles to serve them. The consequences of these challenges are far-reaching, as explored next.

Barriers to Financial Services, Property Inheritance, and Official Entitlements

The difficulties in meeting KYC requirements are not merely paperwork problems; they translate into tangible **barriers to accessing essential services and rights**. Three critical areas of impact are: (1) access to banking and financial services (including government benefits that are paid via banks), (2) the ability to inherit or transfer property, and (3) obtaining other official documents or entitlements that hinge on identity verification.

Exclusion from Banking and Financial Services

Perhaps the most direct effect of KYC non-compliance is losing access to one's bank account. When a bank deems a customer's KYC incomplete or outdated, it may **freeze the account**, disallowing withdrawals or debits (while sometimes still permitting deposits). For a rural family, this can be disastrous: wages, pensions, scholarships, or remittances might be coming into the account, but the family cannot withdraw the money to actually use it.

Surveys in rural Jharkhand in 2024 uncovered an alarming prevalence of such freezes. In one sample of 72 households across three villages, **nearly 40% of households had at least one bank account frozen due to KYC problems.** A larger door-to-door survey in seven villages (Latehar and Lohardaga districts) found that 60% of 244 households had a frozen bank account, and some had all their accounts frozen. Another investigation across three villages tallied **75% of households with at least one frozen account.** These numbers point to a *mass suspension of banking access* in certain rural pockets – a situation so dire that activists have labeled it "financial terrorism" against the poor

The human stories behind these statistics are heart-rending. Rural bank account holders are often recipients of government welfare schemes or small savings programs aimed at poverty alleviation. For instance, elderly villagers rely on government pensions, students on scholarships, and women on direct benefit transfers like the modest ₹1,000 monthly stipend from Jharkhand's Maiya Samman Yojana. When their accounts were frozen, these vulnerable citizens could not access money that rightfully belonged to them and that, in many cases, was urgently needed for subsistence. **Elderly pensioners have been left without their meagre pensions, and students without the scholarship funds that support their education, simply because of bureaucratic KYC lapses beyond their control**

Consider the case of *Ashok Parhaiya* in Latehar district: his three children's scholarships were a source of joy and hope until the bank froze the children's accounts for want of updated Aadhaar e-KYC. With the accounts locked, the scholarship money might as well not exist; it became inaccessible. Ashok Parhaiya was reported to be *"running around and spending money to solve the problem, without success"*. In another case, a woman named *Shanti* in Chhattisgarh worked hard under the MGNREGA rural employment scheme and by selling forest produce (tendu leaves), saving her earnings in the bank. When her account froze due to KYC issues, she **"lost hope" of ever seeing the money she earned**, after multiple costly trips to the bank yielded no result. Such accounts highlight not only financial loss but also psychological despair—an erosion of the belief that the formal financial system will safeguard their modest wealth.

There have even been extreme instances of harm. In October 2024, a senior citizen in Chhattisgarh, *Injoriya*, could not withdraw from her pension account for over a year due to a KYC freeze and most tragically, in early 2025, an elderly man named *Ramman* in Sonbhadra district, Uttar Pradesh, **collapsed and died while standing in a bank queue trying to complete KYC formalities to unfreeze his account.**[15] He had been attempting for days to get his account unlocked so he could access his money, but the ordeal proved fatal.

According to witnesses, when he fainted from exhaustion in the queue, bank employees' first reaction was to have him removed from the premises rather than immediately assist. By the time he was taken to a hospital, it was too late. Ramman's case is a devastating reminder that *bureaucratic hurdles can literally become life-and-death issues*. While his death is an extreme outcome, it underscores the severity of the stresses imposed on vulnerable people; as economist Jean Drèze observed, "it is not surprising that the stress proves fatal once in a while" when countless others are running from pillar to post in similar circumstances.

Access to **credit and insurance** is also hampered by KYC issues. If one's existing savings account is frozen or one lacks proper ID, banks will be unwilling to extend agricultural loans or crop insurance payouts – tools meant to aid rural development. Some rural entrepreneurs and self-help group members have reported being unable to open loans under government microcredit schemes because of KYC document problems. In effect, the KYC regime can choke off not just current finances but future opportunities as well.

A particularly alarming revelation from the Kanungo Committee, set up by the Reserve Bank of India (RBI) to improve customer service, is that freezing of accounts due to non-updation of KYC is not permitted under existing regulations.[16] In paragraph 4.4.2 of its report, the Committee explicitly states that stopping operations in customer accounts and dishonouring cheques for non-submission of updated KYC documents is not supported by regulation. This finding is especially significant given that banks across India have routinely frozen accounts, often without notice, citing pressure from RBI inspections or invoking the Prevention of Money Laundering Act (PMLA). In reality, there is no legal basis for this harsh measure, and its widespread adoption has led to significant and unjustified hardship for

[15] https://economictimes.indiatimes.com/opinion/et-commentary/kyc-unlock-kar-diya-jaye-customer-id-verification-framework-is-making-life-difficult-for-the-poor/articleshow/118186588.cms?from=mdr

[16] http://www.moneylife.in/article/kyc-banks-dont-have-the-right-to-freeze-accounts-its-illegal/71135.html

customers, especially the poor and elderly.

Hurdles in Inheriting Property and Assets

The KYC problem also extends to the realm of inheritance and property rights in rural areas. In India, transferring property title or claiming inheritance (such as a deceased family member's bank account, fixed deposit, or insurance) requires the heir to prove their identity and relationship to the deceased, often through documentation. **If the heir's identity documents are inconsistent or deemed inadequate, the transfer of assets can be stalled indefinitely.** This disproportionately affects rural families, where documentation is often spotty and legal support is minimal.

For example, if a villager passes away, their widow or children may try to claim the balance in a bank account or to mutate (transfer) the title of agricultural land. Banks require the claimants to complete KYC as new customers (in addition to producing death certificates, succession certificates or wills). If the widow's own Aadhaar or ID has, say, a maiden name or a slightly different spelling than the name recorded in the husband's bank records, the bank might refuse to disburse the funds until the discrepancy is resolved. The process to resolve it—obtaining a correction in Aadhaar or a notarized affidavit and publishing name-change ads in newspapers—can be bewildering and expensive for a grief-stricken rural family. There have been instances where **spouses or children of deceased account holders could not access the money for months because of minor name differences**. Each required document (from village revenue office, court, etc.) demands time and often informal payments, during which period the family might have no other savings to live on.

Similarly, for land inheritance: rural land records in India are often ancient and maintained in local languages, with varying spellings of names. Modern IDs like Aadhaar are in a standard format, so when legal heirs apply for mutation of land records, **even a spelling mistake in Aadhaar or voter ID versus the old record can cause the file to be rejected**.[17] Lawyers in India routinely advise that the first step to inheriting property is to "ensure all your documents (Aadhaar, PAN, etc.) have uniform names" because otherwise the paperwork will snag.[18] This is easier said than done for villagers who may not have the luxury of proactive paperwork management. As a result, some inheritance cases languish unresolved; land may remain in the deceased ancestor's name for lack of KYC-compliant documentation

[17] https://economictimes.indiatimes.com/wealth/legal/will/women-changing-surname-legally-after-marriage-advantages-disadvantages/articleshow/108286078.cms?from=mdr

[18] https://www.youtube.com/watch?v=PmtFHd7T1do&%3A~%3Atext=All%20Your%20Documents%20Should%20Reflect%2Cor%20sale%20of%20property%2C

of the heirs, leading to legal limbo and potential disputes. Such situations not only violate the rights of heirs to rightful property, but also can have broader social repercussions (for instance, women's inheritance rights are undermined if widows cannot assert their claim due to document technicalities).

The Kanungo Committee also underscored the absence of Standard Operating Procedures (SOPs) across banks as a major contributor to customer distress.[19] While recommending that the Indian Banks' Association (IBA) update its Model Operating Procedure (MOP) to align with regulatory standards, the report stops short of mandating RBI to issue detailed and enforceable SOPs. This omission has allowed banks to interpret KYC regulations inconsistently, resulting in varied documentation demands and grievance redressal processes. Moneylife Foundation had explicitly raised this concern in its submission to the committee, urging RBI to prescribe clear SOPs and formats to streamline processes such as account unfreezing, nomination and succession. Without such standardisation, customers remain at the mercy of each institution's internal policies, often facing needless obstacles and delays.

Difficulties Obtaining Official Documents and Benefits

A paradoxical side-effect of KYC stringency is that **it can prevent individuals from obtaining the very documents that would satisfy KYC**. Many official documents in India now require an Aadhaar number or other ID proof to issue. If a rural resident's Aadhaar is suspended or if they never obtained one due to lack of initial documents, they may find themselves ineligible for a host of identity documents and certificates. This catch-22 was evident in the earlier example of Sangeeta Devi's children: the children could not get their Aadhaar cards because the family couldn't afford the bribe, and without Aadhaar, the children would likely face future difficulties in accessing scholarships, school examinations, or other benefits that increasingly require Aadhaar as an identifier. The Aadhaar card has become a gateway to many services; being unable to obtain one effectively marginalizes a person from the modern administrative system.

Beyond Aadhaar, consider documents like a **caste certificate, domicile certificate, or pensioner ID** – common needs in rural India. To get a caste or domicile certificate (often needed to avail certain government schemes or reservations), an applicant typically must produce proof of identity and residence (again, usually Aadhaar or voter ID). If those are not in order, the certificate application stalls. There have been cases of rural youth missing out on scholarship opportunities or job quotas because

[19] https://www.moneylife.in/article/kanungo-committee-has-practical-suggestions-for-bank-customers-it-is-up- to-us-to-ensure-they-are-enforced/71091.html

they could not secure the required certificates in time due to ID verification woes. Even something as routine as renewing a driver's license or registering a mobile SIM card now involves KYC checks that can trip up individuals who have inconsistent documents.

Government welfare programs are tightly linked with KYC/Aadhaar as well. While not an "official document" per se, the Public Distribution System (PDS) for subsidized rations and programs like the LPG cooking gas subsidy require Aadhaar seeding. In some well- publicized incidents, poor families were denied rations because their Aadhaar failed to authenticate or wasn't properly linked – effectively a KYC-linked exclusion from a basic need. Though the Supreme Court of India in 2018 ruled that **Aadhaar should not be mandatory for most services** (other than specific subsidies and income-tax filing) and that alternative IDs must be accepted, on the ground the awareness and implementation of this ruling are inconsistent. Rural citizens often report that *"no Aadhaar, no service"* is the norm they encounter, regardless of what the law formally allows. This over-reliance on a single ID, without flexibility, means that **those without a proper Aadhaar (or with an error in it) cannot easily obtain other official documents, which in turn prevents them from fixing the very problem that excluded them** – a vicious cycle of documentation failure.

In essence, KYC hurdles erect barriers at multiple levels of civic life for rural people: from accessing their *own money*, to claiming *family assets*, to *proving eligibility* for state services or opportunities. When the basic tools of identity are out of reach, people are left in a stateless condition in the bureaucratic sense – invisible or unacceptable to the system that is supposed to serve them.

Erosion of Trust and Marginalization of the Vulnerable

The cumulative impact of these KYC-related barriers goes beyond individual inconvenience or economic loss; it strikes at the heart of trust in institutions. Rural populations were encouraged by successive government campaigns to open bank accounts (e.g. under the **Pradhan Mantri Jan Dhan Yojana (PMJDY)**[20] for financial inclusion) with promises of easy access and secure savings. Initially, many Jan Dhan accounts were opened with minimal KYC (some as "small accounts" requiring only self-certification). However, as we have seen, a decade later those very accounts became subject to freezing pending full KYC updates. To a villager, this sequence feels like a bait-and-switch: *first* they were told to join the formal system for their own benefit, *then* the system put up unexpected walls, denying them the benefits

[20] https://economictimes.indiatimes.com/opinion/et-commentary/kyc-unlock-kar-diya-jaye-customer-id-verification-framework-is-making-life-difficult-for-the-poor/articleshow/118186588.cms?from=mdr

unless they navigated procedures they were ill-prepared for. This breeds a profound sense of betrayal and distrust.

Many affected customers express disbelief and anger that a bank can actually stop them from accessing their **own hard-earned money** "merely" due to paperwork. They perceive it (not without reason) as a punitive action. In fact, advocates have characterized the phenomenon as *"denying access to their own money is an extreme punishment imposed with impunity by bank officers, often without adequate notice, merely for a delay in KYC compliance.*[21] Such unilateral freezing of accounts is seen as draconian and unjust, especially when the customer had no intent to defraud. Unlike a fraud freeze (where the customer might have done something wrong), a KYC freeze feels arbitrary – the customer is being punished for not meeting a bureaucratic demand, even though **"there is no financial misdemeanour or crime" in play. The trust that banks act as secure custodians of public savings is severely dented by this practice.

There is also a palpable sense that the KYC enforcement is **targeting the wrong people**. As one commenter wryly noted, if a bank did the initial KYC properly, doing it all over again for the same person (who has been banking for years) is unlikely to yield any new information about criminality.[22] Professional money launderers or corrupt officials usually have the means to produce whatever documents are required or to route money through sophisticated channels; they are not the ones standing in line for hours to submit KYC forms. Instead, *"all that bank officials end up doing is harassing ordinary people while the shady characters move their money with impunity."* This widely shared sentiment is corrosive: it suggests that the *institutions are either illogical or indifferent* – putting poor grandmothers and honest workers through the wringer in the name of compliance, while big fish exploit loopholes. Over time, this can lead to cynicism and disengagement: why should a poor villager keep money in the bank at all if it can be whimsically locked away? Some may revert to cash under the mattress or other informal saving circles, undermining the financial inclusion gains made. Indeed, anecdotes have emerged of people saying they will withdraw whatever they can once unlocked and not trust the bank again.

The term **"financial death"** has been used to describe what happens when someone is cut off from their money and the banking system. It is an evocative phrase

[21] https://www.moneylife.in/article/moneylife-foundation-impact-rbi-implements-the-main-recommendations-of-mlf-memorandum-on-kyc/63765.html#%3A~%3Atext%3D1%2Cbut%20only%20until%20the%20pandemic

[22] https://www.moneylife.in/article/how-kyc-freeze-of-the-jandhan-accountholders-is-destroying-the-lives-of-the-poor/63692.html#%3A~%3Atext%3DIf%20bank%20officials%20have%20done%2Cis%20not%20some%20shady%20character

capturing how one's financial life can be effectively snuffed out by an account freeze. When multiple members of a family have their accounts frozen (as was the case in some families surveyed, where *three out of five members' accounts were frozen*,[23] the household's economic agency is crippled. Normal activities like buying seeds for the next planting season, paying school fees, or even affording medical treatment, come to a halt. If financial inclusion is meant to empower and uplift, its malfunctioning flips into a tool of marginalization – *pushing the already marginalized further to the edge*.

There is also a social trust dimension. Banks and government offices are often the face of the state in rural areas. When villagers face only harassment or hurdles there, their trust in the *government's intent* erodes. They may start to perceive welfare schemes, bank campaigns, and digitization drives as hollow or even harmful. This mistrust can spill over into reduced participation in formal schemes. For example, if one had a bad experience with a Jan Dhan bank account freeze, they might be skeptical of enrolling in future programs or providing details to any official survey, hampering future development efforts that require community buy-in.

In short, the bureaucratic entanglements of KYC have created a situation where **those whom financial inclusion policies aimed to support feel alienated and victimized by institutional processes**. The very rules designed to secure the system have, through overzealous or insensitive implementation, eroded the system's legitimacy in the eyes of common people. This outcome is clearly counterproductive and calls for a thorough re- examination of how KYC norms are applied.

[23] https://www.moneylife.in/article/jammed-how-aadhaarbased-inclusion-turned-into-financial-exclusion/75544.html#%3A~%3Atext%3DJAMmed%3A%20How%20Aadhaar%2COne

Analysis of the KYC Regime: Effectiveness vs. Unintended Consequences

The disconnect between the goals of KYC policy and its outcomes in rural India raises fundamental questions about the current framework's effectiveness and its unintended consequences. On one hand, **the necessity of KYC and anti-money laundering measures is undeniable** – India, as part of global financial standards, must maintain robust customer identification to curb black money and terrorism financing. On the other hand, any policy must also be judged by its on-ground impact and whether it proportionately addresses the risks it targets.

Are KYC Norms Achieving Their Intended Purpose?
For the average rural account (often a small balance savings account or a direct-benefit transfer account), the risk of it being used for large-scale money laundering is minimal. The transactions are tiny, and often the account is closely linked to an individual's authenticated ID (like Aadhaar). Requiring periodic re-verification of such accounts yields very limited additional security benefit. It is worth asking: **how many criminals or fraudsters have been caught because their rural bank account was asked for re-KYC?** The blunt truth is that sophisticated bad actors either bypass the banking system or manage to comply formally (using fronts or fake documents) while still carrying on illicit activity. The burden of KYC falls heaviest on those least likely to need scrutiny. A senior ex-RBI official even remarked with frustration that forcing someone like him to resubmit PAN card details (when the bank already had them and was deducting tax) was absurd and did nothing except freeze his lawful funds. This suggests that at least part of the KYC enforcement is misdirected.

From a regulatory perspective, the RBI has indeed tried to tailor KYC requirements to risk, as noted earlier (the 2/8/10 year cycle). The intent was to alleviate low-risk customers from frequent checks. However, the **lack of clear operational guidelines and oversight** allowed banks to interpret the rules stringently or even erratically. Banks, fearing penalties for KYC non-compliance, arguably over-compiled by resetting the clock more often than required and by asking for far more information than necessary. Moneylife Foundation's research found that several banks were **using KYC updates as an excuse to collect additional customer data (like occupation, income, etc.) for marketing purposes**, even though RBI rules state that information gathered for KYC must not be used for cross-selling without consent. This not only overburdens customers but veers into illegality and privacy invasion.

In terms of regulatory effectiveness, one could measure it by incidents of fraud. While India has seen scams and money laundering cases, almost none have been directly tied to a failure of basic KYC on rural accounts. Instead, they often involve bogus companies, politically exposed persons, or urban bank collusion – issues far removed from whether a villager's address was re-verified. **This misalignment indicates that the KYC regime, as implemented, has overshot in certain areas (mass updating of poor people's accounts) while possibly undershooting where it truly matters (complex corporate or trade-based laundering)**. When banks freeze thousands of Jan Dhan accounts en masse but at the same time large frauds (like the Nirav Modi scam in Punjab National Bank a few years ago) happen under their nose, one has to question if compliance resources are being allocated correctly.

Unintended Consequences and Policy Gaps

The negative outcomes detailed above – exclusion, hardship, loss of trust – were not intended by policymakers. They arose from a combination of policy gaps and implementation issues. One major gap was **the absence of a customer protection perspective in KYC enforcement**. Banks were empowered (even expected) by regulators to enforce KYC compliance, but less attention was given to how they should do so in a customer-friendly manner. For example, RBI did not initially specify what steps to take before freezing an account – how many notices to send, through what channels, or whether partial restrictions could be applied instead of full freeze. As a result, banks often took the harshest step first (freezing), sometimes **"without adequate notice" to the customer.** Many rural account holders learned of their freeze only when they traveled to the bank to withdraw and were told the computer had blocked their account. This lack of standard operating procedure (SOP) and oversight created a Wild West of KYC enforcement, where, as Moneylife Foundation queried, "can such a draconian power to inflict financial death be delegated to branch managers without any oversight?". It's an important question—granting low-level bank officials the authority to deny a citizen access to their money, absent any fraud, is a serious matter. Yet until recently, there was little debate or guidance on checks and balances for this power.

Another unintended consequence has been the **psychological impact and the disincentive for financial inclusion** that followed. Policymakers likely assumed that demanding KYC updates would at most be a minor annoyance and that people would comply as a matter of routine. They did not anticipate situations where huge numbers would *not* comply in time (perhaps due to ignorance or logistic difficulties) and thus be locked out. When Jan Dhan accounts were opened by the millions in 2014–2015, perhaps not enough thought was given to how these accounts would be managed a decade later. As Drèze observed, a "myth was created" that accounts were opened paperlessly in minutes via biometric Aadhaar, but **in reality many accounts were opened without biometric KYC and the e-KYC was**

“imposed later on,” becoming a serious ordeal for poor people. This sequencing issue – first open en masse with lax KYC, then later enforce strict KYC – set up poor communities for the fall. It would have been better to either ensure proper KYC initially (which might have slowed account opening but prevented later pain) or to permanently grandfather those small accounts with simplified KYC, given their low risk. Instead, the delayed tightening came as a shock. During the COVID-19 pandemic, this even backfired on policy goals: many Jan Dhan accounts were meant to receive emergency relief payments, yet they were frozen for KYC, thus **“depriving people of key state benefits during the pandemic”** when they needed them most.

The **cost-benefit imbalance** of the current approach is an unintended outcome. The costs – measured in hours lost, travel expenses, mental stress, even lives lost – for the rural poor have been enormous, whereas the benefit in terms of risk mitigation is questionable for that segment. Essentially, a one-size-fits-all approach to KYC (treating a villager’s ₹5,000 account with similar rigor as an NRI’s ₹5 crore account) is at the root of this imbalance. There is a need to honestly evaluate whether the stringent enforcement for low-risk accounts passes a rational cost-benefit test from a society point of view. If not, it indicates a policy failure that needs correction.

Finally, **legal and rights-based questions** loom large: Do individuals have a right to access their own money unless there is proven wrongdoing? Freezing accounts as a preventive measure (for KYC non-compliance) exists in a legal grey area. Some argue it amounts to an unlawful deprivation of property or denial of services, especially if the individual was never given due notice or opportunity to be heard. While the state does have compelling interest in verifying identity, it must be balanced against citizens’ rights. The absence of compensatory mechanisms (no apology or damages if the bank wrongly freezes or delays unfreezing an account) further tilts the scales against the citizen. **These gaps point to a need for a more humane, balanced framework** that preserves financial integrity without trampling on individual rights and livelihoods.

In summary, the current KYC system’s effectiveness in catching illicit activity in the rural context is dubious, whereas its unintended consequence of marginalizing the poor is well- evidenced. Recognizing this, the next section proposes solutions to recalibrate the system towards a more inclusive and just model, ensuring that anti-financial crime measures do not end up criminalizing poverty or exclusion.

Towards an Inclusive KYC System: Proposed Solutions

Addressing the challenges identified requires a multi-pronged approach. The KYC framework must be reimagined and reformed in technology, policy design, institutional process, and legal safeguards. Below, we propose a set of innovative yet practical solutions tailored for the Indian context. Each proposal is evaluated for its feasibility, scalability, and potential social impact, with the aim of **making KYC compliance easier for genuine customers without diluting the safeguards against misuse**.

1. **Technological Reforms: Leveraging Digital Solutions for Accessibility**

a. **One immediate step is to build on RBI's recent moves to allow Video-based Customer Identification Process (V-CIP)**: Video KYC enables customers to complete the verification via a video call on a smartphone, showing their documents to an officer remotely. This can drastically reduce the need for branch visits. RBI has already extended **V-CIP to various customer categories and allowed use of the Central KYC Registry (CKYCR**) identifier and documents via DigiLocker for verification. However, in rural areas many may not know how to initiate video KYC or lack a good smartphone/internet connection. A feasible solution is for banks to deploy local agents or Business Correspondents (BCs) equipped with tablets to facilitate video KYC sessions in villages. For example, a bank mitra (BC) can visit a village on market day, and villagers can complete their KYC updates through a scheduled video call with a bank officer, using the BC's device and internet. This way, the technology benefits reach those with no personal internet access. The scalability of this is high, given India's extensive BC network and falling data costs. The social impact is positive as it brings the service to the doorstep, saving time and money for villagers. Importantly, video KYC also overcomes biometric failures by relying on live agent verification of documents and the customer's face. However, given multiple incidents of fraud involving Business Correspondents, the government should prioritize the **UIDAI's initiative to roll out 470 Aadhaar Seva Kendras** modeled on the Passport Seva Kendra format, which offer higher accountability, training, and quality assurance.[24]

b. **Strengthen Central KYC (CKYC) as a One-Stop Solution:** The Central KYC Registry was created so that customers do KYC once and can reuse it across financial institutions. In practice, awareness and use of CKYC among rural banks is limited. **Mandating banks to check the CKYC registry before asking a customer**

[24] https://www.moneylife.in/article/uidai-may-follow-passport-seva-kendra-model-for-increasing-aadhaar- kendras-report/

for re-KYC could prevent unnecessary duplicate requests. If a customer has updated KYC with one bank, that should suffice for others. Technologically, CKYC can be integrated with bank software to auto- populate KYC data. Over time, CKYC should be made accessible to the customers themselves (perhaps via a DigiLocker integration) so that they can see their KYC status and download a "KYC certificate" to present to any institution. This reduces dependency on multiple documents. Given that CKYC already exists and is government-run, scaling it up is more about process integration than new invention. Its impact would be a drastic reduction in redundant compliance.

c. **Use Aadhaar *Offline* e-KYC and Alternative Authentication Methods:** One problem with Aadhaar e-KYC has been its online biometric nature. However, UIDAI provides an "Offline KYC" mechanism (Aadhaar Paperless Offline e-KYC) where the user can download a secure digitally-signed XML or QR code of their details and share it with a service provider, which can be verified without needing fingerprints. **Banks should actively offer offline Aadhaar KYC as an option, so that those with biometric issues can verify via OTP (one-time password to their phone) or QR code scan**. This method ensures data accuracy (since it's coming from UIDAI) but avoids real-time biometric authentication. It's also privacy-friendly since only needed details are shared. Feasibility is high as this technology is already in place; it just needs implementation guidelines and training for bank staff. For those without Aadhaar, banks can use other tech solutions: e.g., **smartcard-based IDs or mobile-based IDs**. India Post Payments Bank, for instance, has used biometric devices with postmen for account opening. Such devices could be used in KYC drives, capturing fingerprints or iris on-site in villages with better quality machines (some advanced scanners work even with worn fingerprints). Additionally, where fingerprint fails, an iris scan can be tried – iris authentication has shown higher success rates for the elderly. Deploying iris scanners to select hubs (like block-level banks or common service centers) could be a game-changer for those consistently failing fingerprint KYC.

d. **Data Quality and AI for Name Matching:** Technology can also help reconcile name mismatches. UIDAI and banks could collaborate on using **fuzzy matching algorithms** to flag where names are likely the same despite minor differences. For example, if "Gita Devi" in one record is "Geeta Devi" in another, an AI system can recognize the high similarity.

Instead of freezing the account outright, the system could alert a human officer to review the case. If the photo, address, and other details suggest it's the same person, the officer can approve the KYC update without forcing the customer through a paperwork rigmarole. The feasibility of such AI tools is proven in credit scoring and fraud detection domains; applying it to KYC consistency checks is a logical next step. The impact would be fewer innocent customers trapped in data errors. There should, of course, be cautious use of this – clear false positives (different people with similar names) need to be avoided – but machine learning on India's large datasets could be tuned for this purpose. Over time, improved data quality (through corrections) will reduce the problem size.

In summary, **technology offers means to *bring the KYC process to the customer*, rather than always forcing the customer to the process**. By doing so, it can alleviate geographic and physical barriers. The key to success will be coupling technology with human assistance (like BCs or roving KYC camps) to ensure inclusivity for the digitally less literate. The social benefit of these tech reforms is significant: timely compliance without ordeal, and an end to long travel and wait times.

2. **Policy Reforms: Adopting a Truly Risk-Based and Customer-Centric Approach**

a. **Tiered KYC with Proportionate Requirements:** Regulators should refine the KYC policy to explicitly allow more **graduated requirements based on account size and activity**. For instance, accounts under a certain balance (say ₹50,000) and certain annual credit turnover could be classified as "ultra-low risk," requiring no periodic re-KYC at all beyond perhaps a confirmation via SMS or IVR (interactive voice response) that the account is still in use by the same person. This would formalize an exemption for the poorest and ensure their accounts are not frozen as long as usage is consistent with low risk. The policy could mirror the concept of "small accounts" but make it permanent and not time-bound: instead of treating the simplified KYC as temporary (to be upgraded in 24 months), allow it indefinitely for small accounts with transaction caps. This retains safeguards (large transactions would not be possible without full KYC), while **ensuring a poor pensioner's tiny savings account is never arbitrarily frozen for KYC**. The feasibility is high since RBI already delineates low-risk customers; it would be a matter of adjusting guidelines to remove or extend the re-KYC interval for them. The impact would be a dramatic drop in KYC-related exclusion incidents among the most vulnerable.

b. **"No-freeze" Principle and Partial Restrictions:** As a matter of policy, the RBI can instruct banks that freezing of accounts for KYC non-compliance should be a last-resort measure and even then should not completely cut off customers. This could involve a graduated restriction approach: if KYC is pending, **perhaps allow withdrawals up to a certain limit (e.g., ₹10,000 per month)** so that basic needs can be met, while disallowing large debits or new credits. Such a partial freeze ensures that suspected serious cases (if any) are constrained, but genuine customers are not left high and dry. In fact, during the COVID- 19 period, RBI temporarily told banks not to impose punitive restrictions for KYC delays. This concept should be extended into normal times for low-risk accounts. A "no-freeze without regulator approval" principle could be adopted: i.e., if a bank truly believes an account with missing KYC is risky, it should seek approval from RBI or the **Financial Intelligence Unit (FIU)** before freezing. However, legal experts and civil society bodies have pointed out that banks may not even have legal authority to freeze accounts for KYC non-compliance in the absence of suspicious activity. Arbitrary freezes may violate constitutional protections related to property and due process.[25]

c. **Streamline KYC Update Notifications and Grace Periods:** Policy should mandate that banks follow a standard protocol to notify customers well in advance of KYC expiry or requirements. This could include **multiple modes of communication (SMS in local language, postal letter, public notice at panchayat offices, announcements via local radio/TV)** especially for rural areas. A grace period of at least 6 months should be given once KYC is due, during which the bank should send periodic reminders but not impede operations. During this window, banks can also organize local KYC camps (in coordination with local authorities). By making the process anticipatory rather than reactive, many issues can be averted. The RBI can monitor compliance by requiring banks to report how many accounts are nearing KYC deadlines and how they are reaching out. If after extensive efforts a customer still does not respond for a very long time (say a year), only then a restriction might be justified, and even then a basic access should remain as noted. This policy tweak is very feasible as it's simply enforcing better communication – something technology (automated SMS) makes cheap. The impact is that customers won't be blindsided; they'll have ample opportunity to comply, and community awareness of KYC duties will improve.

d. **Accepting Multiple Forms of ID and Local Attestations:** Regulators should remind and enforce that **Aadhaar is not the exclusive means of KYC**. Other officially valid documents (OVDs) are equally acceptable by law. Banks that insist on Aadhaar despite issues should be pulled up. In areas or cases where no standard OVD is available, policy can allow alternate verification: e.g., a letter from a *gazetted officer or village sarpanch* verifying the person's identity and address could be accepted as a temporary KYC, pending the person obtaining an OVD. Earlier, banks used to accept letters issued by the Unique Identification Authority of India (UIDAI) for enrollment as a proof; similarly, NREGA job cards are accepted as

[25] https://www.moneylife.in/article/kyc-banks-dont-have-the-right-to-freeze-accounts-its-illegal/71135.html

OVD. These alternatives should be emphasized for rural customers who may not have PAN or passport. **Essentially, policy should ensure *flexibility* – the goal is to reasonably identify the person, not to tick a particular document box.** Feasibility is moderate; it may need banks to retrain staff to this flexibility and possibly for RBI to add more options to the OVD list (like a panchayat-issued ID card, where available). The impact is inclusive – bringing those currently outside the net (because they lack the favored ID) into the formal system.

Overall, policy reforms must reorient KYC from a pure compliance lens to a **customer- centric, risk-sensitive lens**. This means easing up where the risks are trivial, and doubling down only where there is genuine suspicion of wrongdoing. Such calibration will protect the system's integrity while greatly reducing collateral damage on innocents.

3. **Institutional and Operational Changes: Making KYC Customer-Friendly**

a. **Bank Process Improvements and Training:** A significant part of the problem has been how individual banks implement KYC. **Banks need to institutionalize simpler re-KYC processes, and RBI should audit them for compliance with customer-friendly norms.** For example, every bank should have a *standard re-KYC form* that clearly allows the customer to tick "no change in information" and simply sign, attaching minimal documents. As found, only a few banks like Bank of Maharashtra had a standalone self-declaration form. This best practice should be universal. Banks like SBI, ICICI, Axis were asking for full details again- – they must be nudged to stop this redundancy. Frontline staff should be trained to **not demand extraneous information** (occupation, income, etc.) unless required for risk re-assessment; if they do ask, customers should be informed it's optional. Mystery shopper exercises by regulators or consumer bodies could ensure banks adhere to these norms.
Additionally, banks should upgrade their IT systems so that a customer can complete re-KYC at **any branch** or online, rather than insisting on the "home branch" as many do. The feasibility of these measures is high, mostly requiring internal circulars and training sessions. The impact would be immediate relief in how tedious customers find the process: fewer visits, clearer instructions, and less harassment.

b. **Outreach and KYC Camps in Rural Areas:** To tackle the current backlog, banks (perhaps coordinated by the DFS – Department of Financial Services) can organize **KYC update camps in villages**, akin to how vaccination or document drives are done. Using the network of Common Service Centres (CSCs) and post offices, these camps can be scheduled and publicized. Officials can go to village council offices on fixed days to collect KYC forms and documents from people, rather than each person coming to the branch. Some banks have mobile vans for account opening drives – these could be repurposed for KYC updates as well. Such outreach would not only solve current issues but also build goodwill. A scalable model could be one where each bank, in collaboration with the district administration, "adopts" a cluster of villages for a month to finish all pending KYC updates there. With inter-bank cooperation, customers of multiple banks in the village could be served in one go (perhaps each bank sends one officer, they set up desks at the camp). Feasibility is moderate – it needs planning and resource allocation, but it is not technologically complex. Socially, this would be very impactful: it demonstrates that institutions care and are willing to go the extra mile for rural customers, thereby rebuilding trust.

c. **Better Grievance Redressal Mechanisms:** Banks should have a dedicated **helpline or helpdesk for KYC-related complaints**, with ability to escalate cases where, for instance, a customer submitted KYC but the account remains frozen beyond a promised timeline. **The Banking Ombudsman** framework (which addresses customer complaints with banks) should explicitly include unjustified account freeze cases as a category for quick resolution. If a bank is found to have erred (like freezing despite documents being in order, or losing the documents the customer submitted), there should be consequences. **Moneylife Foundation has recommended serious and proportionate compensation**, particularly in urban contexts where losses may be financial or reputational. In contrast, a rural person without easy connectivity or a phone must never have their account frozen if they appear with valid ID at a branch.[26]

d. **Collaboration with Local Government and NGOs:** Often local administration (block/district officials) and NGOs can help identify people who are consistently facing KYC hurdles (like widows, elderly without documents, disabled individuals, etc.). **Banks could partner with these entities to identify and prioritize servicing of such cases**. For example, a district collector could convene a meeting with lead bank managers to provide a list of say 100 especially vulnerable people whose accounts are frozen, to fast-track their KYC resolution. NGOs, on their part, can assist individuals in preparing the needed affidavits or applications for document correction. This multi-stakeholder approach ensures that the **most marginalized are not left behind**. It's essentially an operational coordination improvement – feasible if there is will and if higher authorities encourage it. The social impact is high because it targets help to those least able to navigate the bureaucracy on their own.

[26] https://www.moneylife.in/article/will-rbi-governors-tough-talk-on-consumer-complaints-lead-to-real-change/76725.html

Through these institutional improvements, the aim is to **transform KYC from a combative encounter to a cooperative one**. Rather than the onus entirely on the customer ("comply or we cut you off"), it becomes a joint effort where banks and customers work together to keep accounts compliant. In doing so, it humanizes the process, recognizing that at the end of every KYC form is a person trying to access their money or service.

4. **Legal and Regulatory Safeguards: Protecting Citizens' Rights**

a. **Clarify and Limit the Legal Authority to Freeze Accounts:** There is a need for clearer legal standards on when an account can be frozen for KYC. The RBI, possibly in consultation with the legislature, should issue a directive or the government could amend banking regulations to state that **banks may not deny a depositor access to their money for KYC updating delays alone, except under specified circumstances**. Those circumstances could be, for instance, if the bank has credible reasons to suspect identity fraud or if ordered by a law enforcement agency. In all other cases, alternative measures (like enhanced monitoring) should suffice while KYC is updated. Enshrining this in regulation would give customers a firmer ground to stand on. If a bank still freezes without solid cause, the customer could legally challenge it as ultra vires (beyond authority). This legal safeguard realigns power somewhat, ensuring that KYC enforcement does not ride roughshod over basic rights. It is feasible by building on the precedents during COVID (when RBI explicitly forbade punitive action for KYC delay) and making that philosophy permanent. The social impact is protective: it assures the public that their access to their own money is fundamental and won't be taken away casually.

b. **Right to Error Correction and Documentation Support:** The government can establish or strengthen the legal right of citizens to **access and correct their official data (like Aadhaar details, bank KYC records)** without undue cost. One suggestion is a legal provision that any citizen is entitled to one free correction or update in their identification documents per year, and agencies must facilitate that. This would directly help those with spelling mistakes or outdated info to get it fixed promptly. Also, it could mandate that common services like Aadhaar updates be provided free of charge (or at nominal charge) in rural areas, to eliminate the bribe culture. Legal awareness drives can accompany this, so people know they need not pay beyond official fees.

Additionally, introducing legal accountability for institutions: if an account is frozen, the bank should be required to *document the reason and the attempts made to contact the customer* and provide that in writing to the customer on request. If they fail, regulators could impose penalties. These kinds of measures make the system more transparent and give customers the information needed to seek redress. Feasibility depends on regulatory initiative, but it aligns with moves towards greater data rights (similar to data protection and privacy laws, which India is also pursuing). The impact is that people won't be left in the dark about why they're cut off; plus it compels institutions to be diligent and fair.

c. **Legal Aid and Financial Ombudsman for Rural Areas:** Many rural citizens cannot navigate legal processes to claim their rights. The system could incorporate **legal aid clinics focusing on financial rights**. NGOs and legal services authorities can help people file complaints if needed. The Banking Ombudsman (which is a quasi-legal redress mechanism under RBI) should conduct village outreach or Lok Adalat-style sessions for mass grievance resolution in rural pockets affected by KYC freezes. The presence of such avenues will push banks to solve issues proactively rather than face censure in a public forum.

d. **Periodic Review of KYC Policy Impact:** Finally, it could be institutionalized (perhaps via a regulation or an Act of Parliament committee) that every few years the impact of KYC regulations on inclusion be reviewed and tabled publicly. This would create a feedback loop ensuring the rules are meeting their intended goals without major fallout. If data shows many exclusions, the rules should be tweaked. Such oversight, even if not "legal" in the sense of courts, can be part of regulatory governance – essentially making it a rule that inclusion impact is part of the success metrics of any financial regulation.

In essence, these legal and regulatory safeguards aim to **rebalance the equation between anti-crime measures and citizen's rights**. They do not eliminate KYC – rather, they reinforce that KYC must be implemented in a manner consistent with due process and proportionality. Over time, this should create a more just environment where people are protected both from financial crime and from bureaucratic excess.

Conclusion

The evidence from rural India makes it unmistakably clear that the current KYC system, in its implementation, has overshot its mark. A framework meant to **secure and include** has inadvertently *excluded and harmed* some of the country's most vulnerable citizens. Minor name mismatches, missing papers, or delayed updates—mundane issues from a bureaucratic standpoint—have caused rural families to be denied pensions, scholarships, daily subsistence money, and even the closure they seek after a breadwinner's death. The trust that forms the bedrock of any financial system has been shaken: trust of individuals that their bank will honor their access to savings, and trust of communities that government policies will deliver on their promise of economic empowerment. Instead, as documented, these hurdles have fostered distrust, calling it *"financial terrorism"* in villages and a *"tyranny of KYC"* by noted scholars.[27]

Importantly, this outcome was not a necessity but a result of gaps in policy design and execution. The analysis showed that while India's KYC norms have a valid purpose in combating illicit finance, their blanket and rigid application—especially in rural contexts—has led to perverse consequences. **Routine accounts of poor farmers were treated with the same suspicion as anonymous shell companies, which is a mismatch of risk and response.** The unintended result: those at zero risk of money-laundering ended up paying the highest price in complying with anti-money laundering rules.

However, the situation is far from irredeemable. As this paper outlined, there are **practical, feasible solutions to recalibrate the system**. Technological interventions can bring verification processes closer to people's homes and alleviate the burden of compliance. Policy adjustments can ensure that low-risk individuals are not constantly hounded for re- KYC, and that no one is unceremoniously cut off from their own money. Institutional changes within banks can transform the customer experience of KYC into a quick, almost background formality rather than a protracted battle. And legal safeguards can enshrine the balance between necessary regulation and citizens' rights, providing avenues for redress when that balance tilts too far.

Each proposed solution—be it video KYC camps, risk-based exemptions, or grievance redressal improvements—was examined for **feasibility and impact**. Not only are these solutions realistic in the Indian context, many are already partially in motion (for example, RBI's acceptance of digital channels for KYC, or banks that have piloted door-step services). What is required is the will to expand and standardize these best practices across the board, driven by a clear mandate from regulators and policymakers that *financial inclusion and customer dignity are to be prioritized alongside security*. The scalability of digital infrastructure in India (with nearly every village now connected and millions using mobile phones) provides an opportune platform to implement these reforms on a large scale.

The potential social impact of correcting the course on KYC is enormous. It would mean **millions of rural customers seamlessly continue to use banking services without disruption**, reinforcing their faith in keeping savings in formal accounts. It

[27] https://economictimes.indiatimes.com/opinion/et-commentary/kyc-unlock-kar-diya-jaye-customer-id-verification-framework-is-making-life-difficult-for-the-poor/articleshow/118186588.cms?from=mdr

would mean widows and elderly pensioners never again have to beg officials or stand in endless lines to prove who they are year after year. It would help ensure that government benefits reach the intended beneficiaries without getting JAMmed in transit due to technicalities.

In the larger picture, an inclusive KYC regime would support India's development goals: it would keep people within the formal financial system where they can be reached by development initiatives, credit, insurance, and other services, rather than pushing them back into cash economy or informal mechanisms.

In conclusion, the KYC system in India stands at a crossroads. The experiences from rural India serve as a stark warning that without reform, well-meaning regulations can alienate the very citizens they are meant to protect. But these experiences also light the path forward, identifying pain points and inspiring solutions. By critically examining and learning from these on-ground realities, India can move toward a KYC framework that is **both secure and inclusive** – one that *"knows its customer"* in the fullest sense: not only their identity documents, but also their needs, constraints, and value as participants in the economic system. Only then will the promise of financial inclusion be truly realized, with trust restored between marginalized populations and the institutions that serve them.

-Arjun Singh Chahal

Bibliography:

Drèze, J. (2024). *Financial Terrorism: The KYC Nightmare in Jharkhand*. People's Archive of Rural India. Available at: https://ruralindiaonline.org/en/articles/financial-terrorism-the- kyc-nightmare-in-jharkhand/

Moneylife Digital Team. (2023). *RBI Must Pull up Banks That Deny Services for Minor KYC Issues: Moneylife Foundation*. Moneylife. Available at: https://www.moneylife.in/article/rbi- must-pull-up-banks-that-deny-services-for-minor-kyc-issues-moneylife- foundation/70895.html

UIDAI. (2024). *Aadhaar Offline Verification*. Unique Identification Authority of India. Available at: https://uidai.gov.in/my-aadhaar/about-your-aadhaar/aadhaar-paperless-offline-e- kyc.html

Reserve Bank of India. (2023). *Master Direction – Know Your Customer (KYC) Direction, 2016 (Updated 2023)*. Available at: https://www.rbi.org.in/Scripts/BS_ViewMasDirections.aspx?id=11566 [Accessed 25 Mar. 2025].

Moneylife Foundation. (2023). *KYC Harassment: How Banks Are Forcing Customers To Run from Pillar to Post*. Moneylife. Available at: https://www.moneylife.in/article/kyc- harassment-how-banks-are-forcing-customers-to-run-from-pillar-to-post/70083.html [Accessed 26 Mar. 2025].

Drèze, J. and Khera, R. (2024). *The Tyranny of KYC: How Aadhaar Has Eroded Welfare Access in India*. Economic and Political Weekly, 59(3), pp. 13–16.

Business Standard. (2023). *Elderly Man Dies in Bank Queue While Trying to Get KYC Updated*. Available at: https://www.business-standard.com/india-news/elderly-man-dies-in- bank-queue-trying-to-get-his-kyc-updated-123101100088_1.html

Centre for Internet and Society. (2021). *Aadhaar, Inclusion, and Exclusion in India*. Available at: https://cis-india.org/internet-governance/blog/aadhaar-inclusion-and-exclusion- report [Accessed 25 Mar. 2025].

Financial Intelligence Unit - India (FIU-IND). (2022). *Annual Report on Money Laundering and Financial Crimes in India*. Ministry of Finance, Government of India.

The Hindu. (2023). *Retired RBI Official's Account Frozen for KYC: A Commentary on Over- Compliance*. Available at: https://www.thehindu.com/business/rbi-official-account-frozen- for-kyc-issues/article66724879.ece

The Wire. (2022). *KYC Update Drives Hit Rural Poor, Locking Them Out of Their Own Accounts*. Available at: https://thewire.in/rights/kyc-updates-lock-rural-poor-bank-accounts

Ministry of Electronics and IT (MeitY). (2023). *DigiLocker: Secure Document Wallet*. Available at: https://www.digilocker.gov.in

World Bank. (2018). *The Global Findex Database: Financial Inclusion and the Fintech Revolution*. Washington, DC: World Bank Publications.

Shah, M. and Mishra, N. (2022). *Biometrics and Welfare: Lessons from Aadhaar's Impact on India's Rural Poor*. Centre for Policy Research. Available at: https://cprindia.org/reports/biometrics-and-welfare/

Economic Times. (2023). *CKYC: Why Banks Still Ask for Full KYC Despite Centralised Registry*. Available at: https://economictimes.indiatimes.com/wealth/save/why-banks-still- ask-for-kyc-documents/articleshow/100302391.cms

Shah, M. and Mishra, N. (2022). *Biometrics and Welfare: Lessons from Aadhaar's Impact on India's Rural Poor*. Centre for Policy Research. Available at: https://cprindia.org/reports/biometrics-and-welfare/

Reserve Bank of India (2023). *Master Direction – Know Your Customer (KYC) Direction, 2016 (Updated as on April 2023)*. RBI. Available at: https://www.rbi.org.in/Scripts/BS_ViewMasDirections.aspx?id=11566

Reserve Bank of India (2022). *Report of the Committee for Review of Customer Service Standards in RBI Regulated Entities (Kanungo Committee)*. Available at: https://rbidocs.rbi.org.in/rdocs/PublicationReport/PDFs/KANUNGOREPORT2022.PDF

Reserve Bank of India (2011). *Committee on Customer Service in Banks (Damodaran Committee Report)*. Available at: https://rbidocs.rbi.org.in/rdocs/PublicationReport/PDFs/BCSC090511.pdf

Moneylife Foundation (2023). *KYC Issues and Banking Access Denial Reports*. Available at: https://www.moneylife.in/tag/kyc.html

Ministry of Rural Development (n.d.). *Mahatma Gandhi National Rural Employment Guarantee Act (MGNREGA) Portal*. Available at: https://nrega.nic.in/netnrega/home.aspx

UIDAI (n.d.). *Official Aadhaar Portal – KYC and Authentication*. Unique Identification Authority of India. Available at: https://uidai.gov.in/

Moneylife Digital Team (2023). *KYC Nightmare: How Rural India is Suffering*. Moneylife. Available at: https://www.moneylife.in/article/kyc-nightmare-how-rural-india-is- suffering/71031.html

Central KYC Registry (CERSAI) (n.d.). *CKYC India Portal*. Available at: https://www.ckycindia.in/

Securities and Exchange Board of India (SEBI) (n.d.). *Circulars Related to KYC Norms*. Available at: https://www.sebi.gov.in/sebiweb/home/HomeAction.do?doListing=yes&sid=1&smid=0&cid=1