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B.Com Honours | Semester I | Calicut University

Foundations of Modern Banking

Course Code: COM1MN106 • Module 3 Notes

1. Banking Ethics, KYC, AML, and Artificial Intelligence

In the digital age, banking has transitioned from brick-and-mortar branch operations to algorithm-driven digital platforms. While technology increases operational efficiency and convenience, it introduces ethical and regulatory challenges regarding compliance, data security, and customer privacy. This module covers banking ethics, KYC/AML compliance, the role of Artificial Intelligence in banking, open banking, and the impact of technology on financial inclusion.

Banking Ethics and Professionalism

Banks operate on public trust. Professional banking ethics mandate absolute integrity, avoidance of conflicts of interest, fair treatment of customers, compliance with statutory laws, prevention of mis-selling financial products, and protecting client data confidentiality.

KYC and AML Regulations

- **KYC (Know Your Customer):** A mandatory customer identification process instituted by the RBI under the Prevention of Money Laundering Act (PMLA). It requires banks to verify the identity and address of customers using documents like Aadhaar, PAN, Passport, and Voter ID, preventing identity theft and financial fraud.
- **AML (Anti-Money Laundering):** A set of procedures and regulations designed to prevent criminals from disguising illegally obtained funds as legitimate income. Banks monitor transaction patterns, identify suspicious activity (e.g., massive cash deposits), and report them to the Financial Intelligence Unit - India (FIU-IND).

2. Artificial Intelligence in Banking Operations

Artificial Intelligence (AI) and Machine Learning (ML) are transforming daily banking operations, improving efficiency and customer personalization:

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Front-Office Applications

- **Conversational Chatbots:** Providing 24/7 customer support, resolving balance queries, and handling card blocks.
- **Personalized Financial Advice:** Recommending mutual funds, credit cards, or budget plans based on spending history.

Back-Office & Risk Management

- **Automated Credit Scoring:** Evaluating loan applications instantly by analyzing bank statements and credit histories.
- **Algorithmic Fraud Detection:** Monitoring card transactions in real-time, blocking cards if unusual spending patterns are detected.

Open Banking and API Integration

Open banking is a system that allows third-party financial service providers (Fintechs) open access to consumer banking, transaction, and other financial data through the use of **Application Programming Interfaces (APIs)**. This requires explicit customer consent. In India, this is facilitated by the **Account Aggregator (AA)** framework, enabling consumers to share their financial data securely across institutions in real-time.

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3. AI Challenges, Ethics, and Financial Inclusion

While AI offers major opportunities, its adoption in Indian banking is accompanied by structural challenges:

Challenges of AI Adoption

- **Data Silos & Legacy Systems:** Older public sector banks operate on legacy infrastructure, making integration with modern AI models difficult.
- **Lack of Skilled Talent:** High shortage of data scientists, machine learning engineers, and cybersecurity experts in public banking.
- **System Bias and Algorithmic Bias:** If historical data is biased, AI credit scoring models may discriminate against specific demographics or low-income segments.

Ethical Considerations

Ethics in technology banking mandate transparency (explainable AI), preventing algorithmic discrimination, securing customer data privacy, and managing the social impact of automated tasks on bank employee job security.

Promoting Financial Inclusion through Technology

Digital banking technologies have bridged the urban-rural divide in India:

- **Business Correspondents (BCs) & Micro-ATMs:** Handheld biometric devices allow rural citizens to withdraw cash and transfer funds in unbanked villages.
- **Aadhaar Enabled Payment System (AePS):** Enables secure transactions using biometric verification (thumbprint) linked to Aadhaar accounts.
- **UPI and PMJDY (Jan Dhan Accounts):** Zero-balance accounts integrated with mobile banking and UPI have democratized digital payments across rural India.

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