

Central Depository Services (India) Limited



Disclosures on Compliance with Principles for Financial Market Infrastructures

**Committee on Payments and Market Infrastructures
Board of the International Organization of Securities
Commissions**

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Responding Institution : Central Depository Services (India) Limited

Jurisdiction in which the FMI operates : India

Authority(ies) regulating, supervising or overseeing the FMI : Securities and Exchange Board of India

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This disclosure is made available at www.cdslindia.com

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1. EXECUTIVE SUMMARY

The Central Securities Depository (India) Ltd. (CDSL) was incorporated in December 1997 and commenced its operations as a depository under SEBI (Depositories and Participants) Regulations, 1996 on February 8, 1999. As a depository, CDSL facilitates holding of securities in electronic form and enables securities transactions to be processed by book entry. The services offered by depository are available for the general public and are instrumental for bringing about the change in settlement systems of securities market to make the same short, transparent and efficient. Thus, along with stock exchanges which provide electronic platform for nation-wide trading in securities, depositories which enable settlement of electronic balances of securities are considered as one of the systemically important market infrastructure institutions.

CDSL is the leading securities depository in India by incremental growth of Beneficial Owner (BO) accounts over the last three Fiscals and by the total number of registered Depository Participants as at the end of Fiscal 2017.

CDSL presently maintains and services more than 13.16 million Beneficial Owner accounts in the country. CDSL today has established a huge network of business partners – 590 Depository Participants (DPs) servicing BOs through more than 17,300 locations.

2. GENERAL BACKGROUND

CDSL offers depository services to investors and other intermediaries like Exchanges, Clearing Corporations, Stock Brokers, Custodians, Issuer companies, Registrar and Transfer Agents (RTAs), other depository, etc. The investors open demat accounts in CDSL system through Depository Participants (DPs) who are pre-specified registered intermediaries and act as agents of CDSL.

Following are some of the important services being offered by CDSL:

- a. **Dematerialization of securities:** – A wide range of securities including equity shares, preference shares, mutual fund units, debt instruments, government securities, commercial papers, etc. can be held in electronic form in demat accounts maintained with CDSL. Existing physical certificates can also be converted into electronic balances and vice versa.
- b. **Transfer of securities:** – The beneficial ownership can be transferred by execution of transaction in the depository system. CDSL offers facility to record transfer of securities pursuant to market or off-market transactions.
- c. **Processing of Corporate Actions and allotment of securities:** –
 - The non-cash corporate actions such as rights issue, bonus issue, split / consolidation, conversion, effecting scheme of merger or amalgamation, etc. on securities held in demat accounts are processed by CDSL and appropriate effect in applicable ratio is given in the demat accounts of eligible beneficial owners.
 - In case of cash corporate actions, the information about beneficial owners eligible to receive such cash corporate action is given to the RTA of the Issuer Company which in turn distributes the cash corporate action.

- In an Initial Public offering (IPO) or further issue of securities (FPO) , the allotment of securities in demat form is processed by CDSL on the basis of information received from the Issuer Company.
 - CDSL also provides facility of pre-verification of BO details as received by the Issuer Company in application for IPO / FPO to ensure seamless processing of allotments.
- d. Pledging of securities: CDSL enables it's demat account holders to pledge the securities balances held in his/her demat account in favour of a pledgee demat account holder. After creation of pledge in the depository system, although the beneficial ownership remains with the pledger demat account holder, the control vests with the pledgee demat account holder. CDSL also enables unpledge or invocation of pledge.
- e. Other services: CDSL also offers other ancillary services like e-voting, e-Locker, easi (Electronic Access to Security Information), easiest (Electronic Access to Security Information and Execution of Secured Transaction), assistance in drafting and preparation of wills for succession (myeasiwill). It has mobile Applications for CSD and E voting.
- f. CDSL also regularly conducts investor meetings and other awareness programs as a knowledge enhancement initiative.

2.1 Legal and Regulatory Framework

CDSL is a public limited company incorporated under the Companies Act, 1956. CDSL is listed on National Stock Exchange Ltd. and is required to be compliant with listing requirements. The depository operations of CDSL are mainly governed under Depositories Act, 1996 and SEBI (Depositories and Participants) Regulations, 1996 (Regulations) as amended from time to time. The Regulations and CDSL's bye laws and Operating Instructions for DPs and RTAs provides the legal basis for its operations.

2.2 System Design and Operations

The CDSL DP operating instructions and CDSL RTA operating instructions provide an insight into processing of various types of transactions. These operating instructions are available on the following links

<https://www.cdslindia.com/dp/DP-RTA-operating-instructions.html>

<https://www.cdslindia.com/rta/RTA-operating-instructions.html>

Overall system design description is available on:

<https://www.cdslindia.com/aboutcdsl/technology.html>

3. PRINCIPLES RELATED TO CSD

The CPSS-IOSCO report on Principles for financial market infrastructures (FMIs) recognizes that although most principles are applicable to all types of FMIs covered by the report, a few principles are relevant to specific types of FMIs. Accordingly, the principles which are generally applicable to Central Securities Depositories (CSDs) are listed below.

The Indian legal framework governing CSDs has some unique features like provision for multiple depositories for same type of securities. Indian CSDs do not perform functions of a CCP and only facilitate securities settlement. Hence, certain principles related to CSDs are not applicable in case of Indian CSD. The table below provides a summary of the applicability of the principles related to CSD.

Sr. no	Principles	Observance
1	Principle 1 Legal Basis	Observed
2	Principle 2 Governance	Observed
3	Principle 3 Framework for comprehensive management of risk	Observed
4	Principle 10 Physical Deliveries	Not Applicable
5	Principle 11 Central Securities Depositories	Observed
6	Principle 13 Participant default rules and procedures	Observed
7	Principle 15 General business risk	Observed
8	Principle 16 Custody and investment risk	Observed
9	Principle 17 Operational risk	Observed
10	Principle 18 Access and participation requirements	Observed
11	Principle 19 Tiered participation requirements	Not Applicable
12	Principle 20 FMI Links	Observed
13	Principle 21 Efficiency and effectiveness	Observed
14	Principle 22 Communication procedures and std.	Observed
15	Principle 23 Disclosure of rules, key procedures and market data	Observed

- *Although CDSL also acts as a trade repository for corporate bonds, the 24th principle is not applicable to CSDs, the same has not been considered.*

PRINCIPLE 1: Legal Basis

An FMI should have a well-founded, clear, transparent, and enforceable legal basis for each material aspect of its activities in all relevant jurisdictions

KC 1.1: *The legal basis should provide a high degree of certainty for each material aspect of an FMI's activities in all relevant jurisdictions.*

The activities of Central Depository Services Ltd (CDSL) can be identified as any service connected with the recording of allotment of securities or transfer of ownership of securities in the record of a depository. The principle jurisdiction for regulating the activities of the depositories is with Securities and Exchange Board of India (SEBI). However in order to facilitate the activities of the depositories, in addition to the provisions specified in the Depositories Act, 1996, certain provisions have also been incorporated in the Companies Act 2013 which is under the purview of Ministry of Corporate Affairs.

Legal framework governing securities consists of Companies Act, 2013, Depositories Act, 1996, SEBI (Depositories & Participants) Regulations 1996, which are passed by the Parliament of India. The Courts in India are bound to give verdict on the matters relating to securities within the scope of these Acts. The legal provisions to provide certainty to the activities of the depositories is as under:–

Section 2(m) of the Depositories Act 1996, inter-alia defines the service rendered by the depository as service connected with recording of allotment of securities or transfer of ownership of securities in the record of a depository.

Section 10 of the Depositories Act 1996, which deals with the rights of depositories and beneficial owner inter-alia states that, a depository shall be deemed to be the registered owner for the purposes of effecting transfer of ownership of security on behalf of a beneficial owner.

Section 10(3) of Depositories Act, 1996 states that the beneficial owner shall be entitled to all the rights and benefits in respect of his securities held by a depository.

Section 2(55) of Companies Act, 2013 states that every person holding equity shares of company and whose name is entered as beneficial owner in the records of the depository shall mean a member of the concerned company.

Section 46(4) states that where a share is held in depository form, the record of the depository is the prima facie evidence of the interest of the beneficial owner.

Section 59(4) of Companies Act 2013, states that where the transfer of securities is in contravention of any of the provisions of the Securities Contracts (Regulation) Act, 1956, the Securities and Exchange Board of India Act, 1992 or this Act or any other law for the time being in force, the Tribunal may, on an application made by the depository, company, depository participant, the holder of the securities or the Securities and Exchange Board, direct any company or a depository to set right the contravention and rectify its register or records concerned

Section 88(3) of the Companies Act, 2013 states that the register and index of beneficial owners maintained by a depository under section 11 of the Depositories Act, 1996, shall be deemed to be the corresponding register and index for the purposes of this Act.

KC 1.2: An FMI should have rules, procedures, and contracts that are clear, understandable, and consistent with relevant laws and regulations.

The Bye-laws of CDSL and any subsequent amendments are approved by SEBI. Further, CDSL needs to intimate SEBI of any proposed instructions, specifications and guidelines, to be known as “Operating Instructions”, relating to the functioning and operation of CDSL seven days prior to releasing such instructions. In case SEBI has no observations or does not communicate any observation within seven working days from the date of filing, CDSL can issue the operating instructions.

KC 1.3: An FMI should be able to articulate the legal basis for its activities to relevant authorities, participants, and, where relevant, participants' customers, in a clear and understandable way.

CDSL shall inform SEBI for any repeal, delete, amend and/or alter of the Bye Laws and Operating Instructions or any part thereof or issue new or fresh Operating Instructions from time to time and submit a copy of the Operating Instructions or the amendment to or modification thereof, as the case may be, at least seven days before the same are given effect to by CDSL.

KC 1.4: An FMI should have rules, procedures, and contracts that are enforceable in all relevant jurisdictions. There should be a high degree of certainty that actions taken by the FMI under such rules and procedures will not be voided, reversed, or subject to stays.

The Bye-laws of CDSL emanate from the Depositories Act 1996, which are approved by SEBI. Further, operating instructions issued by CDSL are also intimated to SEBI prior to issuance. Further, there is no legal precedence where CDSL's actions under its rules, procedures, and contracts were held void.

KC 1.5: An FMI conducting business in multiple jurisdictions should identify and mitigate the risks arising from any potential conflict of laws across jurisdictions.

CDSL does not operate in multiple jurisdictions and therefore the key consideration is not applicable to CDSL.

PRINCIPLE 2: Governance

An FMI should have governance arrangements that are clear and transparent, promote the safety and efficiency of the FMI, and support the stability of the broader financial system, other relevant public interest considerations, and the objectives of relevant stakeholders.

KC 2.1: An FMI should have objectives that place a high priority on the safety and efficiency of the FMI and explicitly support financial stability and other relevant public interest considerations.

The main objective of CDSL is to be a dependable, secured and convenient depository for the participants, investors, RTAs and clearing corporations. It has a net worth of ₹ 395.94 crores as on 31st March, 2017 as against the required minimum of ₹ 100 crores. It has received ISO22301:2012 Certification for its Business Continuity Management Systems as well as ISO 27001:2013 for its Information Security Management System. Its DRS where all transactions are replicated almost on real time basis, is tested regularly to ensure its capability to handle any emergent situation.

Every year system audit is done by an outside agency, the report of which is placed before the governing board of CDSL as well as sent to SEBI. Its financial transactions are audited by internal as well as external auditors. The critical operational activities are under concurrent audit. The internal and concurrent audit is conducted by an independent Chartered Accountant Firm. The auditors' reports are placed before the audit committee for review and minutes of audit committee are placed before the governing board. The adequacy of internal controls is also reviewed periodically.

CDSL places high priority on the safety and efficiency of its operations. Some of the measures are investment in IT Infrastructure, Advanced Data Security and Claims on Depository Participant (DP) i.e. If any DP of CDSL goes into liquidation, the creditors of the DP will have no access to

the holdings of the BO. CDSL has obtained an insurance to cover loss to a BO due to system failure or the negligence or fraud by the employees of CDSL or its DPs.

The financial stability of participants of CDSL is ensured through continuous eligibility requirements. Insurance cover has been obtained for any claims arising from negligence / errors / frauds of officials of CDSL and / or its participants.

CDSL has several advisory committees like Business Advisory Committee, IT Strategy Committee, IT Steering Committee, Disciplinary Action Committee, Risk Management Committee etc. with representatives of participants / eminent persons from the field of finance, accounting, law or other disciplines related to capital market.

KC 2.2: An FMI should have documented governance arrangements that provide clear and direct lines of responsibility and accountability. These arrangements should be disclosed to owners, relevant authorities, participants, and, at a more general level, the public.

CDSL is governed by various Acts and Regulations laid down by SEBI, MCA etc.

Managing Director and CEO is delegated with substantial powers of management and he operates under overall supervision and guidance of the Board of Directors and reports the performance to the Board. Compliance Officer for depository Operations and Principal Officer under Prevention of Money Laundering Act have been appointed. CDSL has also appointed a Chief Risk Officer who is responsible, accountable, accessible and answerable to the Regulator on overall risk management issues.

Managing Director and CEO has the overall responsibility of Depository Operations. Different functional heads report to him each being responsible for his functional area. Compliance Officer reports to the MD & CEO, the Board and the Regulator.

A mix of shareholder directors who represent the interest of the owners and public interest directors who represent the interest of the investors in general have constituted the governing board of CDSL. The number of public interest directors is not less than the number of shareholder directors.

CDSL complies with Governance requirements as laid down by the Regulator under SEBI (Depositories and Participants) Regulations and SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015. There are various committees viz. audit committee, risk management committee, Nomination and Remuneration / Compensation Committee, Stakeholders Relationship Committee, whose work is depicted in Corporate Governance Report.

Annual Report which contains a report on corporate governance is placed before all shareholders in the Annual General Meeting. The Board reviews financial and operational performance of the company at least once in a quarter. Information relating to the ownership, management, financial performance and investors' Grievances are published on the website.

The disclosure is made through Annual Reports which is approved by the Board of Directors and the same is uploaded on the website.

KC 2.3: The roles and responsibilities of an FMI's board of directors (or equivalent) should be clearly specified, and there should be documented procedures for its functioning, including procedures to identify, address, and manage member conflicts of interest. The board should review both its overall performance and the performance of its individual board members regularly.

The Board is responsible for achievement of objectives of CDSL and it reviews the performance of CDSL. The primary responsibility of the board of directors is to ensure that the depository operations are carried out as per the Act, Regulations and Bye Laws. The board of directors is the highest governing authority with a responsibility to review the risk profile of the business and to evaluate effectiveness of internal controls. It also approves the capital and revenue budget and reviews operational and financial performance against the budget. It selects and evaluates performance of company's chief executive officer (CEO) and Key Management Personnel. The Board of Directors meets at least 4 times during the year and reviews the financial and operational performance of the company quarterly.

Various committees consisting of Board members and of eminent personalities viz: Audit Committee, Risk Management Committee, Nomination and Remuneration / Compensation

Committee, Finance and Committee , Disciplinary Action Committee etc. have been formed to facilitate smooth functioning of the company, corporate governance and in order to take such decision for which Board of Directors cannot meet frequently. The powers and functions of these committees have been outlined.

Every Director is required to disclose his interest and shareholding including that of his close relatives in other companies every year and as and when he becomes interested in other companies. The directors and the Key Management Personnel are also required to give a declaration every year that they continue to be a “fit and proper” person.

CDSL has a documented policy for evaluation of the performance of the individual directors, the Board and its committees. The stakeholders review performance of the board through Annual General Meeting.

KC 2.4: The board should contain suitable members with the appropriate skills and incentives to fulfill its multiple roles. This typically requires the inclusion of non-executive board member(s).

The Board comprises of:

- (a) Shareholder Directors
- (b) Public Interest Directors; and
- (c) Managing Director

In terms of SEBI Regulations, the number of public interest directors on the board of directors of a depository cannot be less than the number of shareholder directors. The public interest directors are nominated by SEBI for a term of three years, or for such extended period, as may be approved by SEBI. The appointment and re-appointment of all shareholder directors is with the prior approval of SEBI.

Nomination and Remuneration / Compensation Committee consisting of majority of public interest directors recommends to the Board suitable candidates for various director positions.

The Candidates evaluated by it are not aligned with any particular promoter group. Experience and expertise of the candidates in the capital market and other related areas are taken into consideration for this purpose. They are experts with requisite experience in the capital market or other related areas. Except sitting fees within the ceiling limits provided under the Companies Act, no other incentive is paid to the non-executive directors.

The appointment, renewal of appointment and termination of service of the Managing Director is also subject to the prior approval of the Regulator. The compensation payable to the managing director or any change in the terms and conditions of the compensation is also required to be approved by SEBI.

The information on shareholder directors and public interest directors is disclosed on CDSL website.

KC 2.5: The roles and responsibilities of management should be clearly specified. An FMI's management should have the appropriate experience, a mix of skills, and the integrity necessary to discharge their responsibilities for the operation and risk management of the FMI.

The management has the delegated responsibility of development of capital market, framing business strategies in furtherance of the objectives of CDSL. Management is responsible for carrying out business / day to day operations within the legal framework and by complying with all applicable laws. It is also responsible to ensure continuity of business / operations /services so that no client or stakeholder is put to loss or inconvenienced. The management also plays crucial role in motivating employees by defining clear goals for the team and providing training and development opportunities for overall growth of employees.

Senior management personnel are responsible for achieving their targeted goals. Their performance is assessed every year on behavioral and functional parameters. While according performance ratings emphasis is given to achievement of goals and rightful behavior. Incentives are linked to the ratings. Quantitative as well as qualitative parameters are used for evaluation of performance.

Service Rules provide the procedure for removal of a senior management person. Principles of natural justice are followed in the procedure for removal.

KC 2.6: The board should establish a clear, documented risk-management framework that includes the FMI's risk-tolerance policy, assigns responsibilities and accountability for risk decisions, and addresses decision making in crises and emergencies. Governance arrangements should ensure that the risk-management and internal control functions have sufficient authority, independence, resources, and access to the board.

SEBI has prescribed the risk management framework for depositories. CDSL has complied with SEBI directions in this regard and has also developed it further. CDSL has a well documented risk management policy and the same is reviewed periodically. CDSL has designated a senior management person as its Chief Risk Officer.

Functional and Operational Risks are reviewed and assessed by the Risk Management committee which is a committee of the Board. CDSL has also formed a Risk Management Council which is headed by the Chief Risk Officer to review the function wise identified risks and mitigation controls.

Finance and Investment Committee ensures that the surplus funds are invested in good quality liquid assets.

Financial Risks, Functional and Operational Risks - Audit, Inspection and Compliance Department is headed by Vice President who reports to Managing Director & CEO. All critical functional areas of CDSL have been brought under concurrent audit, which is carried out by an independent auditor on daily basis. The internal and concurrent audit reports by an independent Chartered Accountant Firm are placed before the Audit Committee at the end of every quarter along with action taken thereon and minutes of the Audit Committee are placed before the Board of Directors.

System Risks – are reviewed and assessed by an external system auditor. Actions to be taken are monitored by the IT Department. IT Strategy Committee reviews the same. Minutes of the Committee are placed before the Board.

As a depository, CDSL does not undertake clearing and settlement functions of CCP. Hence, risk decisions such as limits on risk exposures are not required to be taken. CDSL has laid down clear lines of responsibility and authority which helps in accountability for decisions. The risks posed by CDSL's depository participant are managed inter alia by net worth restrictions and annual submission of net worth, inspections, internal audits etc.

KC 2.7: The board should ensure that the FMI's design, rules, overall strategy, and major decisions reflect appropriately the legitimate interests of its direct and indirect participants and other relevant stakeholders. Major decisions should be clearly disclosed to relevant stakeholders and, where there is a broad market impact, the public.

The Business Advisory Committee headed by public interest director advises the Management on the matters of business strategies. IT Strategy Committee advises on the system requirements and suitability of the hardware and software required for meeting challenging and dynamic business requirements. Disciplinary Action Committee which inter-alia consists of representatives of the participants and persons of eminence from the field of law, finance and accounts ensures appropriate actions against erring DPs and RTAs. Interested member / director does not participate in the discussion and decision on the matter in which he is interested.

Communiqués are issued on all important operational matters for the benefit of stakeholders. They are also posted on the website. Major decisions of the Board are disclosed in the Annual Report. The same is uploaded on the website.

PRINCIPLE 3: Framework for the Comprehensive Management of Risks

An FMI should have a sound risk-management framework for comprehensively managing legal, credit, liquidity, operational, and other risks.

KC 3.1: An FMI should have risk-management policies, procedures, and systems that enable it to identify, measure, monitor, and manage the range of risks that arise in or are borne by the FMI. Risk-management frameworks should be subject to periodic review.

CDSL being a depository does not undertake function of clearing and settlement and has identified financial, system and operational risks applicable to it. To continuously identify and assess risks that arise in depositories business, CDSL has constituted a Risk Management Committee and Risk Management Council. The Risk Management committee directly reports to the Board. The Risk Management Council is headed by the Chief Risk Officer who is a senior management person. These Committees review the operational procedures and their adequacy taking into account fluctuation in risk intensity, changing environments, and market practices. CDSL also has in place Risk management policy and Fraud risk management Policy. Further, various risk prone operational activities of CDSL are periodically reviewed for effectiveness through system and risk audits and the observations are used to further improve the processes. CDSL has also appointed an independent Chartered Accountant who conducts daily concurrent audit of risk prone operational activities of CDSL. The report of such audit is placed before the Audit Committee of CDSL.

The policies are analyzed and reviewed annually for their effectiveness.

KC 3.2: An FMI should provide incentives to participants and, where relevant, their customers to manage and contain the risks they pose to the FMI.

CDSL conducts training programmes for compliance officers and Internal / Concurrent Auditors of participants with special focus on risks and procedures / systems to be followed to contain such

risks. Further, effectiveness of risk management by participants is periodically reviewed by inspection and audit. Whenever aggregate value of portfolio of securities (AVPS) held with a stockbroker DP exceeds 75 times of its networth, CDSL cautions that DP. CDSL restrains new account opening by a stock broker DP when the ratio of AVPS to networth reaches 90. Also, CDSL incentivizes compliant DPs by charging less insurance premium for liability insurance policy and levying monetary penalties on non-compliant DPs.

KC 3.3: An FMI should regularly review the material risks it bears from and poses to other entities (such as other FMIs, settlement banks, liquidity providers, and service providers) as a result of interdependencies and develop appropriate risk-management tools to address these risks.

CDSL has identified operational risk due to failure of systems and connectivity as the major risk which it may pose to another FMI. The said risk is mitigated by providing for alternative system and ensuring that there is no single point of failure in systems.

KC 4.4: An FMI should identify scenarios that may potentially prevent it from being able to provide its critical operations and services as a going concern and assess the effectiveness of a full range of options for recovery or orderly wind-down. An FMI should prepare appropriate plans for its recovery or orderly wind-down based on the results of that assessment. Where applicable, an FMI should also provide relevant authorities with the information needed for purposes of resolution planning.

CDSL has identified the following scenarios that may disrupt its critical operations:–

- External and environmental threats
- Damage from fire, flood, earthquake, explosion, civil unrest, and other forms of natural or man-made disaster
- Loss of Information
- Breach of information security
- Events that can cause interruptions to business processes
- Frauds or errors / delays by CDSL employees

- Frauds or errors / delays by employees of Depository Participants
- Risks associated with physical security
- Non-availability of services on account of problems associated with systems, human resources, infrastructure, vendors, etc.

To mitigate the risks, CDSL has established an ISO22301:2012 certified Business Continuity Management System (BCMS). An Executive Management Team looks after the overall governance of the BCMS which reviews the BCMS once a year and whenever there are significant changes to Business Operations / Technology / Infrastructure / Legal or Regulatory requirements and takes adequate corrective and preventive actions for identified areas of improvement in the BCMS and documents changes in BCMS.

PRINCIPLE 10: Physical Deliveries

An FMI should clearly state its obligations with respect to the delivery of physical instruments or commodities and should identify, monitor, and manage the risks associated with such physical deliveries.

KC 10.1: An FMI's rules should clearly state its obligations with respect to the delivery of physical instruments or commodities.

KC 10.2: An FMI should identify, monitor, and manage the risks and costs associated with the storage and delivery of physical instruments or commodities.

CDSL does not settle transactions using physical delivery (delivery of an asset, such as an instrument or a commodity, in physical form). Hence, this principle is not applicable to CDSL.

PRINCIPLE 11: Central Securities Depositories

A CSD should have appropriate rules and procedures to help ensure the integrity of securities issues and minimize and manage the risks associated with the safekeeping and transfer of securities. A CSD should maintain securities in an immobilized or dematerialized form for their transfer by book entry.

KC 11.1: A CSD should have appropriate rules, procedures, and controls, including robust accounting practices, to safeguard the rights of securities issuers and holders, prevent the unauthorized creation or deletion of securities, and conduct periodic and at least daily reconciliation of securities issues it maintains.

The Issuer or its agent Registrar and Share Transfer Agent (RTA) maintains the records of total securities issued (i.e. securities held in physical form and securities held in dematerialized form with the depositories.)

As per the Regulation 55 of SEBI (Depositories and Participants) Regulations 1996, the responsibility of reconciliation of records of dematerialized securities with all the securities issued by the issuer, on a daily basis, is assigned to issuer or its agent. However where the State or the Central Government is the issuer of Government securities, the depository on a daily basis, reconcile the records of the dematerialized securities.

Further, Section 88(3) of the Companies Act 2013 states that, the register and index of beneficial owners maintained by a depository under section 11 of the Depositories Act, 1996, shall be deemed to be the corresponding register and index for the purpose of this Act. The issuer is required to record the name of the depository as a registered owner in respect of physical securities converted into dematerialized form or securities allotted in dematerialized form. Thus, the issuer or its agent (RTA) maintain record of the securities held in physical form and maintain the balances of securities held in dematerialized form in the name of registered owner i.e. depositories.

Depositories maintain the record of beneficial ownership of securities held in dematerialized form and maintains the register and index of the beneficial owners.

CDSL provides a system whereby the Issuer can check the securities balance for each ISIN on daily basis. CDSL has also directed maintenance of reconciliation register by Issuer / RTA to reconcile CDSL balance against their back office balance on a daily basis. CDSL inspects maintenance of this register during its inspection of Issuer / RTA.

CDSL has implemented systems to handle creation and deletion of scrips. CDSL has prescribed documentation requirements such as Memorandum and Articles of Association, Balance sheet for last three years, Board resolution, in-principle approval from stock exchanges etc. which are obtained and checked. CDSL follows a maker-checker principle for creation and deletion of securities. The system entries are checked against the documents submitted by the Issuer / RTA. The creation and deletion of securities is subjected to concurrent audit by an independent Chartered Accountant firm. Further depositories have created a Distinctive Number Range (DNR) database which would aid in keeping track of the distinctive number assigned to issue shares and help prevent the unauthorized creation of shares. The DNR database is database of distinctive numbers of equity shares of listed companies with details of distinctive numbers in respect of physical shares and overall range for dematerialized shares.

With respect to the rights of holders, corporate actions where no option needs to be exercised by the beneficial owner (BO), are processed through 'auto corporate action' wherein on the basis of information like ratio and benefit, ISIN entered by the RTA / Issuer and checked by CDSL with documents submitted by the Issuer / RTA, the corporate action is executed. Other corporate actions are executed on the basis of information about allotment and supporting documents submitted by the RTA and Issuer.

CDSL also provides the issuers / RTAs the beneficial owner position (BO Name, ID, address, quantity of securities held, etc.) on periodic basis (weekly and at every month end) free of charge. If any Issuer / RTA requires the information on ad-hoc basis, the same is also provided by CDSL. Depositories and Depository Participants (DPs) are subject to audit. Further the DPs and Issuers / RTAs are inspected by CDSL on annual basis.

Additionally CDSL makes the rules and procedures available to participants and Issuer / RTA through its website.

KC 11.2: A CSD should prohibit overdrafts and debit balances in securities accounts.

CDSL system does not allow overdraft or debit balances in securities account. Debit from securities account is only allowed to the extent of credit balance of securities available in the account.

KC 11.3: A CSD should maintain securities in an immobilized or dematerialized form for their transfer by book entry. Where appropriate, a CSD should provide incentives to immobilize or dematerialize securities.

Depositories Act 1996 provides for dematerialization of securities. Further, SEBI has prescribed that settlement of transactions which have taken place on an exchange should take place in dematerialized form.

As an incentive, the transfer of ownership in electronic form has been exempted from stamp duty reducing the transaction cost for transfer in electronic form. SEBI has introduced a 'Basic Services Demat Account' whereby a small investor having value of holdings below specified limit is exempted from paying Annual Maintenance Charge (AMC) or required to pay minimal AMC. Further, CDSL also conducts nation-wide investor awareness programmes in English, Hindi (National language) and regional languages whereby general investors are informed about benefits of dematerialization which include safety of securities, request to only one entity (DP) for update of change in investor details as compared to each Issuer, ease of transmission, quicker corporate action benefits, etc.

CDSL also provides a 'free of charge' facility to demat account holders whereby using internet, the demat account holder can view its account details and transaction details online.

CDSL also provides a ‘Consolidated Account Statement’ to enable a single consolidated view of all the investments of an investor in Mutual Funds (MF) and securities held in demat form with the Depositories.

KC 11.4: A CSD should protect assets against custody risk through appropriate rules and procedures consistent with its legal framework.

Section 16 of Depositories Act 1996, mandate that any loss caused to the beneficial owner due to the negligence of the depository or the participant (Depository Participant) has to be indemnified by the depository. In case the loss due to the negligence of the Depository Participant (DP) is indemnified by the depository, the depository shall have the right to recover the same from such (DP).

CDSL Bye-laws empowers CDSL to require the DP to replenish the relevant securities / pay cash to enable CDSL to replenish. Further, CDSL obtains Comprehensive Package insurance policy for ₹ 100 crores (any one incident and any one year) covering losses incurred due to system failure, negligence, errors, and frauds by employees of CDSL and DPs.

Operationally, CDSL has established various procedures through which the beneficial owners are informed about transactions or modifications in their demat account. E.g. SMS alerts for transactions and account modifications, free internet access to account information, transaction statements to dormant accounts etc. This is in addition to the transaction statements being sent by the Depository Participants to their demat account holders on monthly basis (if there is any transaction in that month) or half yearly basis (if there is no transactions during the half year). The DPs also inform the demat account holders if there is any modification in the demat account details like change in address, change in nomination, etc.

KC 11.5: A CSD should employ a robust system that ensures segregation between the CSD’s own assets and the securities of its participants and segregation among the securities of participants. Where supported by the legal framework, the CSD should also support operationally the segregation of securities belonging to a participant’s customers on the participants’ books and facilitate the transfer of customer holdings.

CDSL Bye law 5.4.6 requires a Depository Participant (DP) to maintain a separate account for each Beneficial Owner and ensure that the securities of the Beneficial Owner are not mixed with its own securities. CDSL maintains demat accounts at beneficial owner level in its systems. Due to the beneficial owner level accounting system adopted, the segregation of securities is ensured. The Beneficial Owner can decide to close its demat account with a Depository Participant and open another account with other Depository Participant and transfer securities to such an account. CDSL as well as the Depository Participant does not levy any charge on closure of an account or such transfer instructions as directed by SEBI.

KC 11.6: A CSD should identify, measure, monitor, and manage its risks from other activities that it may perform; additional tools may be necessary in order to address these risks.

As per regulation 7 (c) of SEBI (Depository and Participants) Regulation 1996, CDSL is only permitted to carry activities of depository or activities incidental to depository, provided that CDSL may carry out an activity which is not incidental to its activities as a depository, as may be assigned to the depository by the Central Government or by a regulator in the financial sector, through the establishment of Strategic Business Unit(s) specific to each activity with the prior approval of SEBI and subject to such conditions as may be prescribed by SEBI.

SEBI has approved providing of e-voting service and service to dispatch annual reports through e-mail by CDSL. These services may not pose any credit or liquidity risks to the depository. The limited operational risks have been mitigated through agreements entered into with clients.

CDSL has incorporated subsidiaries / Special Purpose Vehicles to perform activities other than depository activities or activities incidental to depository like KYC Registration Agency, National Academic Depository, Commodities Repository, etc. This structure ensures that risks, if any, arising from carrying out of such activities do not affect the depository.

PRINCIPLE 13: Participant-Default Rules and Procedures

An FMI should have effective and clearly defined rules and procedures to manage a participant default. These rules and procedures should be designed to ensure that the FMI can take timely action to contain losses and liquidity pressures and continue to meet its obligations.

CDSL acts as a depository and does not act as a CCP. Further, the depository structure requires maintenance of beneficial owner-wise accounts. Separate accounts are to be maintained by every DP in the name of each beneficial owner and segregate securities of each beneficial owner so that it is not mixed with the securities of other beneficial owners or with the DP's own securities. Thus, even in case of a participant becoming insolvent, the securities of beneficial owners are not affected as the same are maintained separately in separate beneficial owner-wise accounts.

***K.C 13.1:** An FMI should have default rules and procedures that enable the FMI to continue to meet its obligations in the event of a participant default and that address the replenishment of resources following a default.*

***KC 13.2:** An FMI should be well prepared to implement its default rules and procedures, including any appropriate discretionary procedures provided for in its rules.*

CDSL Bye laws and the agreement between CDSL and DP clearly define the procedure to be followed in case of termination or suspension of a DP. The Bye Laws require that in the event of default / insolvency of the DP, it shall forthwith inform CDSL. CDSL will then evaluate and follow the procedure for termination of the DP and arrange for transfer of investors' accounts from the concerned DP to another DP.

CDSL does not carry out clearing and settlement of securities. Further, as securities balances are maintained at beneficial owner level and are segregated from securities balances of participants, the default or insolvency of a participant does not affect the investors whose assets are held in a

depository system. On the insolvency of a participant a depository can terminate the agreement with the participant and arrange for transfer of investors' accounts to another participant.

SEBI has laid down the eligibility criteria for Depository Participants which specifies the type of entity which can become a Depository Participant. SEBI and depositories have also laid down net worth criteria for some types of entities which is monitored annually. The Depository Participant has to satisfy "fit and proper person" criteria.

As a risk management measure, lest the participant may default, at the time of admission of a participant, depository takes security deposit and it can ask for additional security deposit whenever it deems fit.

As regards the use and sequencing of financial resources (to use promptly any financial resources that CDSL maintains for covering losses and containing liquidity pressures arising from default, including liquidity facilities and the order in which the financial resources can be used) the same is "Not applicable" to CDSL as it does not carry out clearing and settlement function.

KC 13.3: An FMI should publicly disclose key aspects of its default rules and procedures.

The procedure for termination and withdrawal of a Depository Participant has been laid down in CDSL Bye laws. The Bye-laws have been made available on CDSL website.

PRINCIPLE 15: General Business Risk

An FMI should identify, monitor, and manage its general business risk and hold sufficient liquid net assets funded by equity to cover potential general business losses so that it can continue operations and services as a going concern if those losses materialize. Further, liquid net assets should at all times be sufficient to ensure a recovery or orderly wind-down of critical operations and services.

KC 15.1: An FMI should have robust management and control systems to identify, monitor, and manage general business risks, including losses from poor execution of business strategy, negative cash flows, or unexpected and excessively large operating expenses.

Risk is managed under a comprehensive risk framework, with policies related to each of the relevant risks. All critical functional areas of the company are under concurrent audit, which is carried out by an independent firm of Chartered Accountants. The scope of the internal and concurrent audit is determined by the Audit Committee and the audit reports are reviewed by this Committee on regular basis. CDSL has adopted the policy of preparing budget for revenue as well capital expenses which is approved by the Board. All the expenses are incurred within the limits of approved Budget

The business risk can arise due to system failure, an error / fraud by an employee of the depository. CDSL has obtained Insurance Policy covering losses arising out of such risks. The employees are adequately trained. Maker-checker principle has been implemented to reduce chances of errors and frauds. CDSL has broad based its business by inducting large number of depository participants having wide spread reach in the country.

CDSL has an investment policy which ensures safety of the corpus with good returns. The costs / expenses are monitored and controlled.

KC 15.2: An FMI should hold liquid net assets funded by equity (such as common stock, disclosed reserves, or other retained earnings) so that it can continue operations and services as a going concern if it incurs general business losses. The amount of liquid net assets funded by equity an FMI should hold should be determined by its general business risk profile and the length of time required to achieve a recovery or orderly wind-down, as appropriate, of its critical operations and services if such action is taken.

As per SEBI (D&P) Regulations, a depository is required to have net worth of ₹ 100 crores. Further, it may also be noted that as per SEBI Regulations, the sponsors cannot reduce their shareholding below 51%.

CDSL has taken operational insurance policy which is sufficient to cover unforeseen losses. In addition to this, investments of approximately ₹ 300 Crores are held in the form of liquid assets as well as for long term.

The experience confirms that the operational insurance policy taken is sufficient to cover unforeseen losses. Hence, exact amount of liquid assets to be maintained is not determined. As per our policy, investments are into securities having highest credit rating and hence they can be liquidated at short notice. Therefore the possibility of equity capital falling below minimum requirement is remote.

KC 15.3: An FMI should maintain a viable recovery or orderly wind-down plan and should hold sufficient liquid net assets funded by equity to implement this plan. At a minimum, an FMI should hold liquid net assets funded by equity equal to at least six months of current operating expenses. These assets are in addition to resources held to cover participant defaults or other risks covered under the financial resources principles. However, equity held under international risk-based capital standards can be included where relevant and appropriate to avoid duplicate capital requirements.

SEBI has prescribed a minimum net worth of ₹ 100 crores for a depository. CDSL has net worth of ₹ 395.94 crores as on 31st March, 2017. Liquid Net Assets are large enough to take care of defaults, if any. Liquid net Assets are more than current operating expenses of the entire year.

KC 15.4: Assets held to cover general business risk should be of high quality and sufficiently liquid in order to allow the FMI to meet its current and projected operating expenses under a range of scenarios, including in adverse market conditions.

Investment of Funds is done as per the investment policy laid down by the Finance and Investment Committee and Board of Directors. The investment policy is reviewed periodically. The policy stipulates that funds can be invested only with those entities which are on the list approved by the Finance & Investment Committee. The entities are approved by the committee after considering various factors such as a) Background of Promoters b) Track Record of the entity 3) Size of the entity 4) Financial strength of the entity etc. This list is reviewed periodically for additions / deletions as the case may be. These entities are supervised and regulated by RBI / SEBI. CDSL invests in instruments such as Fixed Deposits of Banks, Non-Convertible Debentures / Bonds of top rated AAA Central Public sector undertakings and AAA private sector companies, Central Government Securities and various schemes floated by Mutual Fund.

As substantial portion of investments of CDSL are into debt securities having duration of short to medium term, adverse price effects due to market conditions are limited. These assets are fairly liquid and can be liquidated at short notice of 1 day to 7 days.

KC 15.5: An FMI should maintain a viable plan for raising additional equity should its equity fall close to or below the amount needed. This plan should be approved by the board of directors and updated regularly.

CDSL has reserves to the tune of ₹ 357.79 crores and net worth of ₹ 395.94 crores as on 31st March, 2017. As per Regulation 7(d) of SEBI (D&P) Regulations, sponsors have to hold at least 51% of the capital of CDSL. The SEBI (D&P) Regulations also specify other criteria for shareholding pattern of the depository. CDSL is now a listed entity.

Any capital raising plan will require approval of the Board of Directors and shareholders.

PRINCIPLE 16: Custody and Investment Risks

An FMI should safeguard its own and its participants' assets and minimize the risk of loss on and delay in access to these assets. An FMI's investments should be in instruments with minimal credit, market, and liquidity risks.

***KC 16.1:** An FMI should hold its own and its participants' assets at supervised and regulated entities that have robust accounting practices, safekeeping procedures, and internal controls that fully protect these assets.*

The only asset CDSL receives from its participants (DPs) is an interest free refundable security deposit of ₹ 5,00,000/-. CDSL has policy of investing only with those entities which are approved by its Finance and Investment Committee after considering various factors such as a) Background of Promoters b) Track Record of the entity 3) Size of the entity 4) Financial strength of the entity. Accordingly, CDSL invests in liquid instruments carrying minimal credit risk –securities in demat form, Bank FDs, Non-convertible Debentures / Bonds of AAA rated Central Public Sector Undertakings and AAA rated private sector companies, Central Government Securities and various schemes floated by Mutual Fund.

These entities are supervised and regulated by RBI / SEBI – system and accounts audit of Banks is carried out by RBI while that of Mutual Funds by SEBI. Top rated AAA Central Public sector undertakings and AAA private sector companies in the list are those having good track record, established internal system / processes, following accounting practices as issued by the ICAI and are listed on the exchanges.

***KC 16.2:** An FMI should have prompt access to its assets and the assets provided by participants, when required.*

CDSL keeps its investments in securities, mutual fund units, NCDs / Bonds in demat form in a demat account opened with one of its DPs ensuring prompt access. The securities kept in demat account with DP are protected against claims of DP's creditors.

Bank FDs and mutual fund units can be accessed at short notice. Non-convertible Debentures / Bonds are secured instruments carrying 1st charge on the assets of the issuing firm. Further, CDSL has a policy to keep its investment in short term / medium term instruments.

KC 16.3: An FMI should evaluate and understand its exposures to its custodian banks, taking into account the full scope of its relationships with each.

Not applicable to CDSL.

KC 16.4: An FMI's investment strategy should be consistent with its overall risk-management strategy and fully disclosed to its participants, and investments should be secured by, or be claims on, high-quality obligors. These investments should allow for quick liquidation with little, if any, adverse price effect.

CDSL's investment strategy ensures that investments are with entities with proven track record and good financial strength and having high credit rating which are assigned by independent credit rating agencies. Further, the investments are in liquid instruments (short term / medium term) carrying minimal credit risk. The investments in securities, NCDs and Bonds is kept in demat form ensuring easy access and liquidation. CDSL does not disclose its investment strategy to its participants.

PRINCIPLE 17: Operational Risk

An FMI should identify the plausible sources of operational risk, both internal and external, and mitigate their impact through the use of appropriate systems, policies, procedures, and controls. Systems should be designed to ensure a high degree of security and operational reliability and should have adequate, scalable capacity. Business continuity management should aim for timely recovery of operations and fulfillment of the FMI's obligations, including in the event of a wide-scale or major disruption.

KC 17.1: *An FMI should establish a robust operational risk-management framework with appropriate systems, policies, procedures, and controls to identify, monitor, and manage operational risks.*

The Board of Directors of CDSL has constituted a Risk Management Committee to identify, assess and mitigate risks involved in depository business. CDSL has appointed a Chief Risk Officer who has overall responsibility for the development and implementation of risk control principles, frameworks, limits and processes across all categories of risks faced by CDSL. CDSL has constituted a Risk Management Council headed by Chief Risk Officer with Heads of Departments like Information Technology, Operations, Audit and Inspection, etc. as its members. CDSL had also conducted a 'Risk audit' by an independent Chartered Accountant firm.

System audit is conducted on annual basis to identify the risks, if any.

The internal and concurrent auditors of CDSL (an independent Chartered Accountant firm) check efficacy of procedures on an on-going basis.

CDSL has identified the following sources of operational risks which include internal sources, external sources as well as its participants -

- External and environmental threats
- Damage from fire, flood, earthquake, explosion, civil unrest, and other forms of natural or man-made disaster
- Loss of Information
- Breach of information security
- Events that can cause interruptions to business processes
- Frauds or errors / delays by CDSL employees
- Frauds or errors / delays by employees of Depository Participants
- Risks associated with physical security
- Non-availability of services on account of problems associated with systems, human resources, infrastructure, vendors, etc.

Checking for potential single point of failure is included in the scope of annual system audit of CDSL. There is no single point of failure at system level as all systems are backed up by alternatives. It also has a ISO22301:2012 certified Business Continuity Management System and is ISO 27001:2013 certified for Information Security Management System. CDSL has hosted DR Site in a different seismic zone. CDSL also conducts Vulnerability Assessment and Penetration Testing (VAPT) to ensure information security. CDSL complies with broad guidelines laid down by SEBI for Business Continuity Plan and Disaster Recovery for Depositories. CDSL also carries System Audit through renowned System Auditors as per guidelines issued by SEBI for System Audit on annual basis.

To ensure proper implementation of procedures, policies and controls, activities of each department are monitored through Departmental Reports. Further, it has appropriate HR policies of hiring, training, retention and compensation.

For fraud prevention, CDSL has adopted maker-checker principle for performing all important activities. Two factor authentication is required to access systems. The operational activities having impact on market are subjected to concurrent audit.

Major changes / projects are implemented after consultation with participants in the IT steering committee and plans are reviewed by the IT Strategy Committee.

KC 17.2: An FMI's board of directors should clearly define the roles and responsibilities for addressing operational risk and should endorse the FMI's operational risk-management framework. Systems, operational policies, procedures, and controls should be reviewed, audited, and tested periodically and after significant changes.

CDSL Board of Directors has given the responsibility to assess, monitor and review risks in depository and depository participant operations to the Risk Management Committee. CDSL has appointed a Chief Risk Officer who has overall responsibility for the development and implementation of risk control principles, frameworks, limits and processes across all categories of risks faced by CDSL. CDSL has constituted a Risk Management Council headed by Chief Risk Officer with Heads of Departments like Information Technology, Operations, Audit and Inspection, etc. as its members.

The responsibility to review CDSL's controls, systems, procedures and safeguards has been placed with the internal auditor. The task of reviewing the adequacy of internal control system and internal audit function including structure of the internal audit department, staffing, coverage etc. is assigned to the Audit Committee.

The Board has also constituted IT Strategy Committee to advise the Board on expansion or modification of processing / storage capacities, fine tuning, introduction of new features, steps to be taken to enhance performance and adoption of new technology to meet the requirement of Users.

CDSL carries out system audit on an annual basis. It also conducts internal and concurrent audit by an independent Chartered Accountant Firm. Statutory Auditors of CDSL review the internal and concurrent audit reports. The Statutory Auditors are required to certify regarding the internal audit system being commensurate with the nature of CDSL's business. The reports are placed before the Audit Committee which meets at least 4 times in a year.

Any major change in the systems is tested with select participants in controlled environment. Before implementation of any change, adequate notice is given to the participants to incorporate the change in their systems / procedures. Similarly, test / mock system which is similar to the production system is provided to new participants initially. The operations are shifted to DRS once in a quarter.

The Board reviews the minutes of the Risk Management Committee, IT Strategy Committee and Audit Committee. The Board also reviews System audit report and the action taken on it

KC 17.3: An FMI should have clearly defined operational reliability objectives and should have policies in place that are designed to achieve those objectives.

Regarding operational reliability, CDSL's objective is to ensure uninterrupted system availability with operational efficiency. Performance standards have been laid down for each operational activity and the same is monitored through MIS reports which are reviewed by MD & CEO at periodic intervals. CDSL has established RTO of 4 hours and RPO of near zero data loss.

KC 17.4: An FMI should ensure that it has scalable capacity adequate to handle increasing stress volumes and to achieve its service-level objectives.

The capacity utilization (Disk space, CPU utilization, memory utilization) including maximum utilization is monitored on daily basis. If the capacity utilization touches prescribed limit frequently, the same is reported to IT Strategy Committee for review and action as prescribed by IT Strategy Committee is taken. The utilization reports are also part of System Audit.

KC 17.5: An FMI should have comprehensive physical and information security policies that address all potential vulnerabilities and threats.

CDSL office is housed in a building having multi layered physical security. Further, CDSL office regulates physical access through access control systems. The access to data centers, console room and network room is restricted and the entire office premises and data centers are under CCTV

surveillance. The ISO 27001 certification has physical security too under its scope and International standards as embedded in ISO standards have been implemented.

Regarding information security, Vulnerability Assessment and Penetration Testing (VAPT) is carried out on half yearly basis while System audit is carried out on annual basis. CDSL has also complied with ISO 27001 Standards and has been awarded ISO 27001 certificate by leading certification body.

While drawing the project management plan for changes and major projects, Information security and physical security are among the aspects considered.

KC 17.6: An FMI should have a business continuity plan that addresses events posing a significant risk of disrupting operations, including events that could cause a wide-scale or major disruption. The plan should incorporate the use of a secondary site and should be designed to ensure that critical information technology (IT) systems can resume operations within two hours following disruptive events. The plan should be designed to enable the FMI to complete settlement by the end of the day of the disruption, even in case of extreme circumstances. The FMI should regularly test these arrangements.

Under its Business Continuity Plan, CDSL has implemented various processes to ensure RTO of 4 hours as per SEBI guidelines. CDSL has established RPO of near zero data loss by implementing Data Guard Facility for archiving data base logs to DR site and have implemented Recovery Point for automated replication of file system to DR site. Further, to enable participants to reconcile and to ensure that there is no data loss, in case users are disconnected from CDSL system due to technical reason, they are shown the last 20 files uploaded on the day and last 20 online transactions done.

For effective communications internally and with key external stakeholders and authorities in crisis situations, CDSL has documented Communication list which is published to all employees. Different stakeholders have been identified and specific responsibilities are assigned for communication.

CDSL has established a fully operational DRS at a different seismic zone and have deployed systems with capacity as that of primary site. CDSL has also established Business Continuity site at a safe distance from the main office site which can access both primary site and DRS. Participants can upload transactions on CDSL system using “easiest” the web enabled facility in case of failure of primary and alternate or back-up connectivity. . Additionally, CDAS the main application the participants use is also made available through Internet connection with proper controls and authentication mechanism. CDSL has also made available its main system over internet after implementation of two factor authentication. BCP is reviewed annually and whenever there is a significant change. CDSL conducts services from DRS on a quarterly basis.

KC 17.7: An FMI should identify, monitor, and manage the risks that key participants, other FMIs, and service and utility providers might pose to its operations. In addition, an FMI should identify, monitor, and manage the risks its operations might pose to other FMIs.

CDSL requires all its participants to maintain an alternate means of connectivity and allows its participants to upload transactions by using its web based application. Additionally CDSL can also set up contingency terminal for the concerned participant for execution of transactions. CDSL also accepts transactions from participants through established procedure of accepting files through registered e-mail ids.

CDSL has identified operational risk due to failure of systems and connectivity as the major risk which it may pose to another FMI. The said risk is mitigated by providing for alternative system and ensuring that there is no single point of failure in systems.

PRINCIPLE 18: Access and Participation Requirements

An FMI should have objective, risk-based, and publicly disclosed criteria for participation, which permit fair and open access.

KC 18.1: An FMI should allow for fair and open access to its services, including by direct and, where relevant, indirect participants and other FMIs, based on reasonable risk-related participation requirements.

Criteria to access depository (i.e. CSDL) has been prescribed in the Depository and Participant (D & P) Regulations 1996 as well as the Bye-Laws of CDSL. The D & P Regulations provide broad categories for entities who may be eligible to become a Depository Participant (DP). The broad categories are:–

- i) a public financial institution as defined in section 4A of the Companies Act, 1956 (1 of 1956);
- ii) a bank included for the time being in the Second Schedule to the Reserve Bank of India Act, 1934 (2 of 1934);
- iii) a foreign bank operating in India with the approval of the Reserve Bank of India;
- iv) a State Financial Corporation established under the provisions of section 3 of the State Financial Corporations Act, 1951 (63 of 1951);
- v) an institution engaged in providing financial services, promoted by any of the institutions mentioned in sub-clauses (i), (ii), (iii) and (iv), jointly or severally;
- vi) a custodian of securities who has been granted a certificate of registration by the Board under sub-section (1A) of section 12 of the Act;
- vii) a clearing corporation or a clearing house of a stock exchange;
- viii) a stock broker who has been granted a certificate of registration by the Board under sub-section (1) of section 12 of the Act :

Provided that the stock broker shall have a minimum net worth of rupees 50 lakhs and the aggregate value of portfolio of securities of the beneficial owners held in dematerialized form in a depository through him, shall not exceed 100 times of the net worth of the stock broker:

Provided further that if the stock broker seeks to act as a participant in more than one depository, he shall comply with the criteria specified in the first proviso separately for each such depository:

Provided further that where the stock broker has a minimum net worth of rupees ten crore, the limits on the aggregate value of the portfolio of securities of the beneficial owners held in dematerialized form in a depository through him shall not be applicable;

- ix) a non-banking finance company, having a net worth of not less than rupees fifty lakhs (to act as participant only on behalf of itself).

Provided further that a non-banking finance company may act as a participant on behalf of any other person, if it has a net worth of ₹ 50 crore in addition to the net worth specified by any other authority.

Further CDSL Bye-laws also provides for additional criteria:–

- i) For participation the applicant should furnish information and details pertaining to its business and equity holding relating to a minimum period of 3 years immediately preceding the date of the application or from the date of its inception, if less than 3 years.
- ii) The applicant or its key officials holding substantial interest or otherwise in a position to control the affairs of the applicant should not have been convicted in any of the 5 years immediately preceding the filing of the application in any matter involving misappropriation of funds and securities, theft, embezzlement of funds, fraudulent conversion, forgery or any other offence involving moral turpitude
- iii) The applicant or its key officials holding substantial interest or otherwise in a position to control the affairs of the applicant should not have been expelled, barred or suspended by the regulator or any recognized stock exchange.
- iv) The applicant should have a net worth as specified by CDSL / SEBI whichever is higher.
- v) The applicant should furnish details of directors, key personnel responsible for conduct of business
- vi) Applicant should have trained staff who have sufficient skill and knowledge relating to operational, functional and technical aspects.

vii) Applicant should have adequate office space and arrangements for conducting effective and safe operations including software and hardware requirements, risk containment and insurance requirements

All eligible participants, meeting the above criteria are provided fair and equitable access to the CDSL systems.

KC 18.2 An FMI's participation requirements should be justified in terms of the safety and efficiency of the FMI and the markets it serves, be tailored to and commensurate with the FMI's specific risks, and be publicly disclosed. Subject to maintaining acceptable risk control standards, an FMI should endeavor to set requirements that have the least-restrictive impact on access that circumstances permit.

The eligibility criteria prescribed by SEBI and CDSL, allows for screening of entities, so that only fit and proper persons are permitted to act as participants. It also enables limiting access to participants who are systemically essential.

It may be highlighted that SEBI has prescribed Networth requirements for stock brokers acting as DPs e.g. stock broker DPs as ₹ 50 lakhs. Stock broker DPs having net-worth less than ₹ 10 crores can hold portfolio of securities to the extent of 100 times of its net-worth, a non-banking finance company needs to have net worth of at least ₹ 50 lakhs but if the net worth is less than ₹ 50 crores it cannot act as a participant on behalf of any other person. Further, CDSL has laid down higher net worth criteria for stock broker DPs in its bye laws. Therefore, it is observed that all classes are not subject to the same access criteria. The participation criteria, including restrictions in participation are disclosed and explained in bye-laws for the information of all the participants. The Bye laws are available on CDSL website

The eligibility requirements specified under CDSL Bye Laws are reviewed in the normal course of risk management.

CDSL has formed a Membership Committee to scrutinize, process, evaluate, accept or reject applications for admission to CDSL of intending participants. Further, the Membership Committee constituted by the Board also reviews the criteria as per market conditions and risk environment

KC 18.3: An FMI should monitor compliance with its participation requirements on an ongoing basis and have clearly defined and publicly disclosed procedures for facilitating the suspension and orderly exit of a participant that breaches, or no longer meets, the participation requirements.

CDSL has implemented a mechanism wherein the net worth of the participant is checked every year based on the net worth certificate and audited financial statements submitted by it. In respect of stock broker participant its exposure to business in relation to its net worth is monitored on daily basis and restraint is imposed on undertaking new business until exposure is brought down within permissible limits. If a participant is not able to raise the net worth within a reasonable period, its operations are terminated and the accounts held with it are transferred to another participant with the consent of / by giving notice to the investors.

Further, the participants are required to fulfill participation requirements, i.e. for the stock broker DP -providing net worth certificate, average value of portfolio of securities held in relation to the net worth of all the beneficial owners held in dematerialized form.

The above requirements are monitored by CDSL and for any deviations observed during inspection or internal / concurrent audit, appropriate penalty is imposed. The matter is also referred to the Disciplinary Action Committee if wrong compliance is reported and appropriate action including issuance of warning / show cause notice is taken. Further CDSL Bye laws have detailed provisions regarding suspension of a participant which includes reporting to the Disciplinary Action Committee (DAC), personal hearing before the DAC, show-cause notice and passing of final order by DAC which has power to terminate the agreement

PRINCIPLE 19- Tiered Participation Arrangements

An FMI should identify, monitor, and manage the material risks to the FMI arising from tiered participation arrangements.

KC 19.1: An FMI should ensure that its rules, procedures, and agreements allow it to gather basic information about indirect participation in order to identify, monitor, and manage any material risks to the FMI arising from such tiered participation arrangements.

KC 19.2: An FMI should identify material dependencies between direct and indirect participants that might affect the FMI.

KC 19.3: An FMI should identify indirect participants responsible for a significant proportion of transactions processed by the FMI and indirect participants whose transaction volumes or values are large relative to the capacity of the direct participants through which they access the FMI in order to manage the risks arising from these transactions.

The Depository structure as mandated by the legal framework provides only for direct participation. The beneficial owners hold their demat accounts with Depository Participants who act as agents of the Depository.

Hence, this principle is not applicable to CDSL.

PRINCIPLE 20: FMI Links

An FMI that establishes a link with one or more FMIs should identify, monitor, and manage link-related risks.

KC 20.1: *Before entering into a link arrangement and on an ongoing basis once the link is established, an FMI should identify, monitor, and manage all potential sources of risk arising from the link arrangement. Link arrangements should be designed such that each FMI is able to observe the other principles in this report.*

CDSL has established links with other depository and CCPs. CDSL has prescribed the software and hardware requirements for links between CCP and CDSL. Further the requirements for links between CDSL and other depository has been mutually decided upon. CDSL continuously monitors the links with the other depository and CCPs.

KC 20.2: *A link should have a well-founded legal basis, in all relevant jurisdictions, that supports its design and provides adequate protection to the FMIs involved in the link.*

The Regulation 31 of SEBI (Depositories and Participants) Regulations, 1996, mandates the depository to maintain continuous electronic means of communication with all its participants, issuers or issuers' agents, as the case may be, clearing houses and clearing corporations of the stock exchanges and with other depositories.

KC 20.3: *Linked CSDs should measure, monitor, and manage the credit and liquidity risks arising from each other, any credit extensions between CSDs should be covered fully with high quality collateral and be subject to limits.*

The depository system does not allow for overdraft or credit facilities. Debit is allowed only when the total of securities for debit is less than or equal to the shares available in the account.

KC 20.4: Provisional transfers of securities between linked CSDs should be prohibited or, at a minimum, the retransfer of provisionally transferred securities should be prohibited prior to the transfer becoming final.

To ensure finality of transactions, in case of a debit transaction, CDSL earmarks the balance and then sends the transaction to the other depository. The other depository will send the response after checking details. If positive response is received then the earmarked balance is debited and nostro account is credited along with confirmation of response sent to the other depository. Similarly, in case of credit transaction, the BO account will be credited only on receipt of 'confirmation of response' from the other depository. The transfer between the linked CSDs is final.

KC 20.5: An Investor CSD should only establish a link with an issuer CSD if the arrangement provides a high level of protection for the rights of the investor CSD's participants.

CDSL maintains data about securities holding at the beneficial owner level. Thus, securities are segregated at each beneficial owner level. Further, the SEBI (D&P) Regulations prescribe for reconciliation of records on a daily basis, by the Issuers / RTA, of dematerialized securities with all the securities issued by the Issuer.

KC 20.6: An investor CSD that uses an intermediary to operate a link with an issuer CSD should measure, monitor, and manage the additional risks (including custody, credit, legal and operational risks) arising from the use of the intermediary.

Not applicable to CDSL.

KC 20.7: Before entering into a link with another CCP, a CCP should identify and manage the potential spill-over effects from the default of the linked CCP. If a link has three or more CCPs, each CCP should identify, assess, and manage the risks of the collective link arrangement.

Not applicable to CDSL.

KC 20.8: *Each CCP in a CCP link arrangement should be able to cover, at least on a daily basis, its current and potential future exposures to the linked CCP and its participants, if any, fully with a high degree of confidence without reducing the CCP's ability to fulfill its obligations to its own participants at any time.*

Not applicable to CDSL.

KC 20.9: *A TR should carefully assess the additional operational risks related to its links to ensure the scalability and reliability of IT and related resources.*

CDSL's Trade Repository provides consolidated information on primary issuance across depositories and secondary market trades reported on stock exchanges with respect to corporate bonds. The information is obtained electronically without any manual intervention.

PRINCIPLE 21: Efficiency and Effectiveness

An FMI should be efficient and effective in meeting the requirements of its participants and the markets it serves.

***KC 21.1:** An FMI should be designed to meet the needs of its participants and the markets it serves, in particular, with regard to choice of a clearing and settlement arrangement; operating structure; scope of products cleared, settled, or recorded; and use of technology and procedures.*

CDSL has constituted advisory committees viz. IT Strategy Committee, and Business Development Committee and Risk Management Committee, with participant representation to enable a feedback process from the different stakeholders while formulating policies / enhancing or changing systems. Further, in case of any major change or upgrade, in the systems / technologies, relevant participant groups are formed for consultation and inputs. Feedback on one-to-one basis from its participants through on-site visits, are also available.

Such multiple channels for engaging the participants help in assessing effectiveness and efficiency of existing systems and procedures and understand requirements of the markets.

***KC 21.2:** An FMI should have clearly defined goals and objectives that are measurable and achievable, such as in the areas of minimum service levels, risk-management expectations, and business priorities.*

Performance standards for CDSL's activities and systems are reviewed by MD & CEO periodically and deviations in processing time of critical system processes (e.g. settlement processing, EOD processing, etc.) are monitored on daily basis.

***KC 21.3:** An FMI should have established mechanisms for the regular review of its efficiency and effectiveness.*

CDSL appoints an independent Chartered Accountant firm to conduct internal audit of its operations on monthly basis and concurrent audit of its activities having impact on market on daily basis. The auditors also review compliance with laid down SLAs and report non-compliance, if any. Regular review meets are also held with each department by the MD & CEO.

PRINCIPLE 22: Communication Procedure and Standards

An FMI should use, or at a minimum accommodate, relevant internationally accepted communication procedures and standards in order to facilitate efficient payment, clearing, settlement, and recording.

KC 22.1: An FMI should use, or at a minimum accommodate, internationally accepted communication procedures and standards.

CDSL uses multi-factor authentication system at the user login of depository application. The said system is accessible through a private network (point to point connectivity) as well as the Internet. Once the user is authenticated successfully using simultaneous mutual authentication between user terminal and CDSL, users get connected to depository application through the secure encrypted channel. It enables protocol-level authentication of both the user and his access device before providing access to the Depository application. The RMAK (Relative-Identity Mutual Authentication and Key Exchange) protocol ensures that only the authorized user connects to the depository application and nobody else, much like an on-demand private network.

The data communication between CSD and DP through Internet is through secure HTTPS protocol. The user also uses digital signature for non-repudiation of transactions over the Internet. Data exchange between depositories for inter-depository transaction happens using message based communication through point to point IPsec encrypted tunnel. Messages are also appended by hardware based digital signatures.

PRINCIPLE 23: Disclosure of Rules, Key Procedures, and Market Data

An FMI should have clear and comprehensive rules and procedures and should provide sufficient information to enable participants to have an accurate understanding of the risks, fees, and other material costs they incur by participating in the FMI. All relevant rules and key procedures should be publicly disclosed.

***KC 23.1:** An FMI should adopt clear and comprehensive rules and procedures that are fully disclosed to participants. Relevant rules and key procedures should also be publicly disclosed.*

For Depository Participants (DPs) and Issuers / RTAs, Bye Laws, Operating Instructions, Compliance Manual, Communiqués comprise the CDSL's rules and procedures. They are also governed by the Depositories Act, 1996, SEBI (D & P) Regulations, 1996 and SEBI circulars issued from time to time. The Bye Laws are approved by the regulator (SEBI). The Operating Instructions or the amendment to or modification thereof is submitted to SEBI at least seven days before the same are given effect to by CDSL. The Bye Laws and Operating instruction lay down procedures to be followed, rights and obligations of entities, information to be submitted to CDSL, penalty provisions etc.

The above mentioned documents are also available on website of CDSL. Non routine matters are generally handled on case to case basis after taking appropriate approvals from the concerned authority. Procedure approved for a particular non routine matter is followed for similar matter in future.

***KC 23.2:** An FMI should disclose clear descriptions of the system's design and operations, as well as the FMI's and participants' rights and obligations, so that participants can assess the risks they would incur by participating in the FMI.*

System's design and operations is provided in CDSL Bye laws and Operating Instructions available on the CDSL website. The process of intimating SEBI the change / amendment in Operating Instructions at least seven days before giving effect to the same is specified in CDSL Bye Laws. The Depositories Act provides that a depository shall make byelaws with the previous approval of SEBI. The CDSL bye laws specifically provide for instances where CDSL can have discretion over operation of the relevant clause.

Bye Laws contain information regarding Rights and Obligations of Participants and Rights and Obligations of Beneficial Owners. It also contains procedure to be followed for redressal of investors' grievance.

KC 23.3: An FMI should provide all necessary and appropriate documentation and training to facilitate participants' understanding of the FMI's rules and procedures and the risks they face from participating in the FMI.

Training programs are conducted for employees / Compliance Officers of DPs and internal / concurrent auditors of DPs. Two employees of each DP are mandatorily required to undergo training.

The same is evidenced by following:

- a. Exams are conducted at the end of every DP training programme and certificates are issued to successful candidates.
- b. The amount of penalty imposed on DPs is steadily coming down, evidencing improved level of compliance.

SEBI has also specified that associated persons conducting specified activities in DP operations should have certification from National Institute of Securities Markets (NISM) by passing the NISM-Series-VI: Depository Operations Certification Examination (DOCE) and Compliance Officer of a participant should have certification from National Institute of Securities Markets

(NISM) by passing the NISM Series – III A: Securities Intermediaries Compliance (Non-Fund Certification Examination).

The first inspection of the DP is conducted within three months of its operations. This inspection helps DP to understand the various compliance requirements. Any queries of the DP are promptly replied. During annual inspection if it is found that a DP is lacking in understanding of procedures in any particular area, guidance is provided to the DP by inspectors.

KC 23.4: An FMI should publicly disclose its fees at the level of individual services it offers as well as its policies on any available discounts. The FMI should provide clear descriptions of priced services for comparability purposes.

Charges payable by the participants, issuers, RTAs and discounts given as a policy are part of Operating Instructions which are available on the website. Any revision thereof is advised to all concerned 30 days in advance by way of a communiqué. The same is displayed on website.

Nomenclatures used for various services offered by CDSL are commonly used in the industry and easily understandable by the users and therefore offers easy comparability. The glossary of commonly used abbreviations is available on CDSL website for easy reference.

KC 23.5: An FMI should complete regularly and disclose publicly, responses to the CPSS-IOSCO Disclosure framework for financial market infrastructures. An FMI also should, at a minimum, disclose basic data on transaction volumes and values.

CDSL discloses responses to the CPSS-IOSCO Disclosure framework for financial market infrastructures on its website

CDSL website also discloses basic data on volumes and values by providing information on various important parameters like number of investor accounts, number of admitted issuers, Value and volume of securities held in demat form, etc.