



**CIRCULAR**

CIR/MRD/DMS / 05 /2014

February 07, 2014

To

All Depositories.

Dear Sir / Madam,

**Subject: Guidelines for inspection of Depository Participants (DPs) by Depositories**

1. Depository System Review Committee (DSRC) was constituted by SEBI to undertake a comprehensive review of the depository system of Indian Securities market.
2. As a first measure, DSRC has reviewed framework adopted by the depositories with regard to the inspection of depository participants (DPs). Considering the recommendations of the committee, it has been decided that depositories shall ensure the following while inspecting their DPs.

**Inspection Areas and Sample Size**

3. For conducting inspection of DPs, depositories shall inspect the areas as mentioned in **Annexure - I**. During inspection, depositories shall cover implementation of circulars / guidelines issued by SEBI and guidelines / operating instructions / directions by depositories in respect of these areas. In addition, Depositories may include such other areas as felt appropriate.
4. For the purpose of determining the size of sample, depositories shall be guided by 'Adaptive Sample Size determination methodology' as mentioned at **Annexure - II**.

**Categorization / Risk Rating of DPs**

5. For the purpose of computing total risk score of DPs, depositories shall be guided by "DP Rating Model / Categorization" as mentioned at **Annexure – III**.
6. Depositories should periodically undertake risk - impact analysis for each of the inspection areas, assign appropriate risk weightage, calculate risk scores for each DPs in the lines mentioned below.
  - a) Risk Weightage: Depositories shall assign risk weights for each of inspection areas after taking into consideration following factors:



1. Operational risks in each of the inspection areas.
  2. Category of DPs (such as stock broker DPs, bank DP, etc)
  3. Size of Operation
  4. Repetitive violations
  5. IT Security and BCP
  6. Complaints received and redressed
- b) Quantitative Score Calculation: Depositories shall arrive at a Quantitative Risk Score for each inspection area by multiplying percentage of non-compliance to the sample size with the corresponding assigned risk weight.
- c) Qualitative Score Calculation: Depositories shall arrive at a Qualitative Risk Score for each qualitative area by multiplying the score assigned by inspection team to DP with corresponding assigned risk weight.
- d) Total DP Risk Score shall be the summation of quantitative and qualitative scores assigned to the DP.
- e) Depositories shall suitably normalize the scales of the qualitative and quantitative scores in arriving at the Total DP risk score.
7. Depositories shall categorize their DPs as 'High Risk', 'Medium to High Risk', 'Medium Risk', and 'Low Risk' DPs based on the percentile of risk score.

<b>DP Risk Rating / Categorization</b>	<b>Percentile of Risk Score</b>
High	≥ 80
Medium-High	46-79
Medium	21-45
Low	≤ 20

#### **Other requirements**

8. After arriving at the risk rating / categorization as mentioned above, for subsequent inspections, depositories shall use the DP risk rating / categorization to decide on the frequency of inspection of DPs.
9. Apart from the above, depositories may undertake specific purpose inspections for DPs which score high in the specific inspection areas as mentioned at Annexure - I.



10. Depositories shall jointly inspect DPs which are registered with both depositories to have better control over DPs, avoid duplicity of manpower, time and cost and also to reduce the possibility of regulatory arbitrage, if any. Depositories shall share the risk rating / categorization of common DPs with each other. For the purpose of determining sample size and frequency of the joint inspection of such common DPs, the higher risk categorization assigned by any of the Depository shall prevail.
11. Depositories shall put in place appropriate technological tools to undertake off-site inspections of DPs in order to reduce time and manpower resources. Depositories are directed to:
- take necessary steps and put in place necessary systems for implementation of the above.
  - make necessary amendments to the relevant bye-laws, rules and regulations for the implementation of the above decision, wherever applicable.
  - bring the provisions of this circular to the notice of their DPs and also disseminate the same on their website.
12. This circular is being issued in exercise of powers conferred under Section 11 (1) of the Securities and Exchange Board of India Act, 1992 read with Section 19 of the Depositories Act, 1996 to protect the interests of investors in securities and to promote the development of, and to regulate the securities market.

Yours faithfully,

**DILIP B. J.**  
**Deputy General Manager**  
**email: dilipbj@sebi.gov.in**

**Enclosures:**

- Annexure – I : List of inspection areas
- Annexure – II: Adaptive sample size determination methodology
- Annexure – III: DP Rating / Categorization Model



**Annexure –I**

**List of Inspection Areas**

1. Depositories shall inspect the areas mentioned at para 2 below during inspection of DPs with regards to any
  - 1.1. Circulars / Guidelines issued by SEBI on the areas mentioned below.
  - 1.2. Guidelines / Operating Instructions / Directions from depositories on the areas mentioned below.
2. In case there are built in system checks at the depository that ensure compliance of any of the inspection areas / sub –areas with regard to point 1.1 and 1.2 above, the depository may decide on the including the same during the inspection of DPs

**Inspection Areas**

**A. Account Opening / KYC Documents**

- A.1. Account Opening forms
- A.2. KYC Documents
  - A.2.1. PAN Verification
  - A.2.2. In-person verification
  - A.2.3. Forwarding of Documents to KYC Registration Agency (KRA)
- A.3. Proof of Identity (POI)
- A.4. Proof of Address
- A.5. Correspondence Address
- A.6. Authorized Signatories
- A.7. Completeness / Validation of data entered into DPM with data provided in the Account Opening forms
- A.8. Minor BO / Joint / HUF accounts
- A.9. Account Activation
- A.10. PMS Accounts
- A.11. Nomination
- A.12. Any other area as may be specified by the depository

**B. Basic Service Demat Account (BSDA)**

- B.1. Procedures and Checks pertaining to BSDA
- B.2. Any other area as may be specified by the depository

**C. Client Data Modification (CDM)**



- C.1. Procedure for CDM
- C.2. Any other area as may be specified by the depository
  
- D. Demat / Remat / Conversion /Reconversion request
  - D.1. Procedure for receiving/processing requests pertaining to Demat / Remat / Conversion /Reconversion request
  - D.2. Procedure for forwarding requests pertaining to Demat / Remat / Conversion /Reconversion request to RTA / issuer
  - D.3. Arrangement for Safekeeping of Security / Share Certificates
  - D.4. Tracking of demat requests
  - D.5. Rejection of above requests attributable to DPs
  - D.6. Checks pertaining to processing of Demat / Remat / Conversion / Reconversion request
  - D.7. Any other area as may be specified by the depository
  
- E. Delivery Instruction Slip (DIS)
  - E.1. Issuance of DIS
  - E.2. Inventory Control of DIS
  - E.3. First Instruction Slip Booklet
  - E.4. Requisition Slip
  - E.5. Procedure for Loose DIS
  - E.6. Depository specific areas
  - E.7. Verification of DIS
  - E.8. Procedure for accepting DIS
  - E.9. Time Stamping and related Areas
  - E.10. Accepting DIS by Fax
  - E.11. Accepting DIS in form of Annexure
  - E.12. Completeness of DIS
  - E.13. Accepting DIS in electronic form
  - E.14. Procedure for Verification of DIS
  - E.15. Signature Verification
  - E.16. Corrections / Cancellations to DIS
  - E.17. Blocking of used / executed / lost / misplaced / Stolen DIS
  - E.18. Procedure for processing of DIS



E.19. Any other area as may be specified by the depository

F. Transaction

- F.1. Checks pertaining to setting up / processing of transactions
- F.2. Future dated transactions
- F.3. Transfer of all ISINs of BO account having 5 or more ISINs
- F.4. Any other area as may be specified by the depository

G. Transaction Statement (TS)

- G.1. Validation of TS
- G.2. Maintenance of records of TS
- G.3. Issuance of TS to BOs
- G.4. Any other area as may be specified by the depository

H. Compliance under Prevention of Money Laundering Act, 2002 (PMLA)

- H.1. Compliance with PMLA Act, 2002 and SEBI Guidelines on areas such as Customer due diligence, suspicious transaction monitoring , reporting and record keeping
- H.2. Appointment of Principal officer as required under PMLA Act,2002
- H.3. Mechanism to deal with alerts provided by Depository
- H.4. Suspicious Transactions reports to FIU
- H.5. Any other area as may be specified by the depository

I. Maintenance of record and documents

- I.1. Information regarding place(s) of record keeping
- I.2. Outsourcing of record keeping activities
- I.3. Any other area as may be specified by the depository

J. Service Centre Opening and closing/ modification of service centers

- J.1. Procedure for Opening /Closure of Service centers
- J.2. Details of Service centre on Depository website
- J.3. Qualified persons at service centers
- J.4. Any other area as may be specified by the depository

K. Information Technology areas



- K.1. Hardware, Software and Network requirements / configurations
- K.2. Logical and Physical restrictions / safeguards
- K.3. IT Security
- K.4. Procedure for alteration of parameters / configurations
- K.5. Redundancy
- K.6. Any other area as may be specified by the depository
  
- L. Power of Attorney (POA)
  - L.1. Documents executed
  - L.2. Maintenance of POA Register
  - L.3. Clauses of POA
  - L.4. Registration of BO for SMS Alert facility for POA
  - L.5. Any other area as may be specified by the depository
  
- M. Inter Depository Transfers (IDT)
  - M.1. Processing of IDT
  - M.2. Checks pertaining to IDT
  - M.3. Any other area as may be specified by the depository
  
- N. Account Transfer
  - N.1. Procedure followed for account transfer
  - N.2. Checks pertaining to Account transfer
  - N.3. Waiver claimed for inter depository transfer
  - N.4. Any other area as may be specified by the depository
  
- O. Transmission
  - O.1. Procedure followed for transmission
  - O.2. Checks pertaining to Transmission
  - O.3. Waiver Claimed for inter depository transfer
  - O.4. Any other area as may be specified by the depository
  
- P. Pledge / Unpledge
  - P.1. Procedure followed for Pledge / Unpledge
  - P.2. Checks pertaining to Pledge / Unpledge



P.3. Any other area as may be specified by the depository

Q. Freeze / Unfreeze

- Q.1. Freeze facility
- Q.2. Procedure followed for Freeze
- Q.3. Checks pertaining to freeze
- Q.4. Any other area as may be specified by the depository

R. Miscellaneous areas

- R.1. Investor Grievance
- R.2. Forms for various activities
- R.3. Execution of any supplementary agreement/ Letter of Confirmation
- R.4. Submission of Internal Audit / Concurrent Audit / Net worth Certificate
- R.5. Submission of Annual Financial Statement
- R.6. Outsourcing of Activities
- R.7. Closure / transfer of Balances
- R.8. Submission of Information sought by Depositories specifically through Circulars / Letters.
- R.9. Half Yearly Compliance
- R.10. Any other area as may be specified by the depository

S. Status of compliance for deviations / observations noted in last inspection

T. Complaints

- T.1. Account Opening
- T.2. Demat / Remat
- T.3. Transaction Statement
- T.4. Improper Service
- T.5. Charges
- T.6. Delivery Instruction Related ( DIS )
- T.7. Closure
- T.8. Manipulation / Unauthorized Action
- T.9. Monthly report for client complaints
- T.10. Other Complaints



**Adaptive Sample Size Determination methodology**
**1. Sample Size for inspection area of 'Account Opening'**

- The sample selection for account opening shall cover all categories of clients such as individuals, HUF, Corporate, FII's etc.
- Base sample size: 5% of Account Opening Forms (AOFs) or 150 AOFs whichever is higher, with a maximum cap of 1000 accounts.
- Final Sample Size: The final sample size shall also be dependent on past rating / categorization of DP. The following multipliers shall be used to determine the final sample size for the current inspection. In case the total number of instances / cases is less than the final sample size, then 100% of the samples shall be verified.

<b>DP Rating / Categorization</b>	<b>Multiplier</b>
High risk	3
Medium High risk	2
Medium risk	1.5
Low risk	1

- The selected sample shall maintain the proportion of new accounts opened in each category, except for Account Opening Forms (AOF) relating to FII's where it shall be checked on a 100% basis.

**2. Sample Size for inspection area relating to DIS**

- Base sample size: 10% of total DIS processed or 200 processed DIS whichever is higher, with a maximum cap of 1000 DIS.
- Final Sample Size: The sample size shall also be dependent on rating / categorization of DP. The following multipliers shall be used to determine the final sample size for the current inspection. In case the total number of instances / cases is less than the final sample size, then 100% of the samples shall be verified.

<b>DP Rating / Categorization</b>	<b>Multiplier</b>
High risk	3
Medium High risk	2
Medium risk	1.5
Low risk	1

- Out of total intra depository instructions to be verified, the percentage of on and off market instructions would be in the ratio of 1/3 and 2/3.



- DIS issuance sample size shall be 5% of the total samples verified for DIS.
3. **Sample Sizes for inspection areas of 'Demat / Remat request' and 'Pledge / Unpledge'**
- 5% of Demat / Remat request processed or 100 requests whichever is higher with a maximum cap of 500 such requests.
  - 5% of Pledge / Unpledge request processed or 100 requests whichever is higher with a maximum cap of 500 such requests.
4. **Sample Size for inspection area of 'Client Data Modification', 'Miscellaneous areas' and 'Other depository specific requirements'**
- Base Sample Size
    - Address change = 50
      - Samples from Urban, Semi Urban and Rural Areas shall be equally represented if available.
    - Nomination Change = 25
    - Signature change = 100
    - Addition / Deletion / Modification of POA = 100
    - Freeze / Unfreeze = 50
    - Bank Details Change = 100
    - PAN modification = 100
    - Account closure initiated by clients = 25
    - Closure initiated by DPs = 25
    - Demat rejection = 30
    - Transactions = 25
    - Change in e-mail Id = 25
    - Change in mobile number = 25
    - Change in SMS flag = 50
    - Change in standing instruction flag = 50
    - Transmission = 50% of total transmission cases
    - Previous compliance = 100% of total samples
    - Final sample size shall be arrived at after multiplying with the respective multiplier corresponding to the DP Risk rating / categorization as given below. In case the total number of instances /



cases is less than the final sample size, then 100% of the samples shall be verified.

DP Rating/ Categorisation	Multiplier
High risk	3
Medium High risk	2
Medium risk	1.5
Low risk	1

#### 5. Other Aspects

- A uniform Base sample size of 100 shall be adopted in case of all other activities. In case the total number of samples is less than 100, then 100% of the samples shall be verified.



**DP Rating / Categorization Model**

- I. **Quantitative Score Calculation:** Specific weights shall be assigned to each area as decided by each depository. The Total Quantitative Score shall be the summation of all individual inspection scores.

**Table: Indicative Table for calculation of Quantitative Score**

Sr No	Inspection Areas	Weight (A)	B = No of Instances divided by Sample size	Inspection Score  IS = A*B
<b>A.</b>	<b>Inspection Area 1</b>			
A.1.	Inspection Sub Area A 1			
A.2.	Inspection Sub Area 2			
	Total Score for <b>Inspection Area 1</b>			
<b>B.</b>	<b>Inspection Area 2</b>			
B.1.	Inspection Sub Area B 1			
B.2.	Inspection Sub Area B 2			
B.3.	Inspection Sub Area B 3			
	Total Score for <b>Inspection Area 2</b>			

Depositories shall include all inspection areas and sub areas, as per Annexure –I (List of Inspection Areas) of this circular, in the above model to arrive at the Quantitative Score for a DP.

**Table: Indicative Table for calculation of Quantitative Score for Complaints Received**

Sr No	Type and Nature of Complaint	Weight (A)	(Number of Complaints redressed) / Number of Complaints received)	Inspection Score  IS = A*B
<b>T</b>	<b>Complaints</b>			
<b>T.1</b>	Complaint Sub Area 1			
<b>T.2</b>	Complaint Sub Area 2			
	Total Score for <b>Complaints</b>			



**Quantitative Score =  $\Sigma$  (Scores of Inspection Areas including Total score for Complaints)**

- II. Qualitative Score Calculation:** Specific weights shall be assigned to each area as decided by depository. The Total Qualitative Score shall be the summation of all area scores.

Sr. No	Qualitative Factors	Weight (A)	Point on the scale of 1 to 10. [10 being the Worst] (B)	Area score = (A) * (B)
1	Ownership and Governance			
2	IT security and Business Continuity			
3	Regulatory / procedural Compliance			
4	Automation of systems and processes for critical activities			
5	Quality of Management			
6	Financial Status / profitability of DPs			
7	Pending enquires / Penalties imposed by SEBI / Depositories on DP operations			
8	Complaints redressal			
9	Adverse findings of other activities (eg. Broking / custodian / banks etc)			
<b>Total Qualitative Score = <math>\Sigma</math> (Area Scores)</b>				

Following indicative factors shall be taken into account for arriving at above mentioned qualitative score:

**(a) Ownership and Governance**

1. Constitution of Board of DP – Number of promoter directors, Independent Directors etc.
2. Role of non-executive directors / Independent directors.

**(b) Quality of Management**

1. Experience, Fit and Proper and Qualification of Key Personnel.
2. Existence of Succession planning for top management especially in control functions.
3. Chinese walls between the activities in terms of manpower, resources etc.



4. Training and development of employees.
5. Adequacy of staff strength.
6. Compliance level of previous inspection observations/ directions of regulatory bodies

(c) **IT security and Business Continuity**

1. High Availability.
2. Appropriate Interconnected Architecture.
3. Appropriate Recovery Time Objective (RTO) and Recovery Point Objective (RPO) and near “Zero Data Loss”.
4. Periodic drills that simulate the real life disaster scenarios on a regular basis.
5. Technological glitches in the past period and remedies taken.
6. Information security.
7. Upgradation of technology

(d) **Financial Status / profitability of DPs**

1. The net-worth of the DPs (whether reducing or increasing from previous years)
2. Net Profits of DPs operations.

(e) **Complaints redressal**

1. Complaint redressal system
2. Percentage of complaints pending and resolved.

(f) **Other adverse findings**

1. Actions taken by Stock exchange and SEBI / RBI with respect to other activities
2. Actions taken by other depository.

**III. Total Score = Qualitative Score + Quantitative Score**