



**BEFORE THE ADJUDICATING OFFICER
SECURITIES AND EXCHANGE BOARD OF INDIA
[ADJUDICATION ORDER NO. Order/JS/RJ/2026-27/32798]**

UNDER SECTION 15-I OF SECURITIES AND EXCHANGE BOARD OF INDIA ACT, 1992 READ WITH RULE 5 OF SECURITIES AND EXCHANGE BOARD OF INDIA (PROCEDURE FOR HOLDING INQUIRY AND IMPOSING PENALTIES) RULES, 1995 AND UNDER SECTION 19H OF DEPOSITORIES ACT, 1996 READ WITH RULE 5 OF DEPOSITORIES (PROCEDURE FOR HOLDING INQUIRY AND IMPOSING PENALTIES) RULES, 2005

In respect of:

**Central Depository Services (India) Limited
PAN: AAACC6233A**

**In the matter of inspection of Central Depository Services (India) Limited
conducted during FY 2023-24**

BACKGROUND OF THE CASE

1. Central Depository Services (India) Limited (hereinafter referred to as '**Noticee**'/ '**CDSL**') is a depository and a Market Infrastructure Institution (hereinafter referred to as '**MII**') registered with Securities and Exchange Board of India (hereinafter referred to as '**SEBI**').
2. An inspection of the Noticee was carried out for FY 2023-24(hereinafter referred to as '**inspection period**').
3. Post the culmination of the aforesaid inspection, the findings of the inspection were communicated to the Noticee vide email dated January 09, 2024. In response, Noticee made its submissions vide emails dated February 13, 2024 and March 20, 2024.
4. Thereafter, findings of the inspection vis-a-vis the responses of the Noticee were analysed by the concerned department of SEBI. Based on the said analysis, it was alleged that the Noticee had violated the following provision of law:



- (i) Regulation 79(5) of the Securities and Exchange Board of India (Depositories and Participants) Regulations, 2018 (hereinafter referred to as '**DP Regulations**');
- (ii) Clauses 4(d) and 8 of SEBI Circular CIR/MRD/DP/22/2012 dated August 27, 2012 (hereinafter referred to as '**SEBI Circular dated August 27, 2012**') read with clause 5 of SEBI Circular CIR/MRD/DP/21/2014 dated July 1, 2014 (hereinafter referred to as '**SEBI Circular dated July 1, 2014**') and clauses 3, 4 and 5 of SEBI Circular CIR/MRD/DP/20/2015 dated December 11, 2015 (hereinafter referred to as '**SEBI Circular dated December 11, 2015**');
- (iii) Clauses 3.4, 3.5 and 5 of SEBI Circular SEBI/HO/MIRSD/MIRSD-PoD-1/P/CIR/2022/153 dated November 11, 2022 (hereinafter referred to as '**SEBI Circular dated November 11, 2022**');
- (iv) Clauses 27, 28 and 31 of Annexure A of SEBI Circular CIR/MRD/DP/13/2015 dated July 06, 2015 (hereinafter referred to as '**SEBI Circular dated July 06, 2015**');
- (v) Clauses 3(d), 4(c) and (d), 5(c) and (h) of SEBI Circular SEBI/HO/MRD1/DTCS/CIR/P/2021/33 dated March 22, 2021 (hereinafter referred to as '**SEBI Circular dated March 22, 2021**'); and
- (vi) Clauses 2 (40) and (41) of the SEBI Circular SEBI/HO/MRD1/MRD1_DTCS/P/CIR/2022/68 dated May 20, 2022 (hereinafter referred to as '**SEBI Circular dated May 20, 2022**') read with Clauses 40 and 41 of the Annexure A of SEBI Circular dated July 06, 2015.

APPOINTMENT OF ADJUDICATING OFFICER

5. Pursuant to the superannuation of the earlier Adjudicating Officer (hereinafter referred to as '**AO**'), the undersigned was appointed as AO in this matter vide communique dated April 04, 2025 under section 15-I of SEBI Act read with rule 3 of SEBI (Procedure for Holding Inquiry and Imposing Penalties) Rules, 1995 (hereinafter referred to as '**Rules**') and under section 19H of the Depositories Act, 1996 read with rule 3 of Depositories (Procedure for Holding Inquiry and Imposing Penalties) Rules, 2005 (hereinafter referred to as '**Depositories Rules**'), to inquire into and adjudge the aforesaid alleged violations committed by the Noticee.



6. A Show Cause Notice dated August 27, 2024 (hereinafter referred to as '**SCN**') was issued to the Noticee to show cause as to why an inquiry should not be initiated against it and penalty, if any, should not be imposed upon it under the provisions of section 15HB of SEBI Act and sections 19FA and 19G of Depositories Act for the violations alleged to have been committed by the Noticee.
7. The SCN, *inter alia*, alleged the following:

Pledge Creation

- (i) Regulation 79(5) of the DP Regulations, *inter alia*, states as under:

"79. Manner of creating pledge or hypothecation

...

(5) If the depository does not create the pledge, it shall send along with the reasons an intimation to the participants of the pledger and the pledgee.

..."

- (ii) It was observed from the data provided by Noticee to SEBI regarding the pledges rejected by it during the inspection period that under the column "reason for rejection", Noticee was providing a common note which stated that "*Reason for rejection is known only to the Pledgee DP & the details can be verified during audit & inspection*" for all the cases. In this regard, Noticee further, submitted that the pledger and pledgee depository participants (hereinafter referred to as '**DPs**') were informed about the rejection of the pledge but the reason for the rejection was not captured in the system of the Noticee.
- (iii) Noticee, in its reply to the finding of inspection, stated that the pledge rejection reason was not mandatory to be captured in its system.
- (iv) In this regard, it is stated in the PIA that as per regulation 79(5) of the DP Regulations, if the depository does not create the pledge, it shall send, along with the reasons, an intimation to the DPs of the pledger and the pledgee. Hence, by not communicating the reason for the rejection of the pledge to the participants of the pledger and the pledgee, the Noticee was allegedly not in compliance with regulation 79(5) of the DP Regulations.
- (v) Therefore, it was alleged that the Noticee is in continuous violation of regulation 79(5) of the DP Regulations.

Basic Services Demat Accounts

- (i) It was observed that the Noticee provides a list of active beneficial owner identification numbers who are eligible for basic services demat accounts



(hereinafter referred to as '**BSDA**') to the DPs on a monthly basis as per the following criteria:

- (a) Demat accounts under individual category; and
 - (b) Value of securities held in demat account not exceeding Rs. 2 lakhs as on last working day of the month ;
 - (c) Demat accounts registered for SMART facility;
 - (d) One demat account of first holder across depository where verified PAN of the first holder is available.
- (ii) Based on the list provide by the depository, DPs have to either convert the eligible demat accounts in to BSDA or obtain the opting out confirmations from the respective beneficial owners (hereinafter referred to as '**BOs**').
- (iii) In this regard, it was observed during the SEBI inspection that:
- (a) A total of 71,89,934 beneficiary accounts (hereinafter referred to as '**BO A/Cs**') were converted to BSDA during inspection period. However, there were still 1,10,95,451 BO A/Cs that were eligible to be converted to BSDA but were not converted to BSDA till the end of the inspection period. Further, as per the data submitted by Noticee during the inspection, the number of BO A/Cs from which BSDA opting out confirmations were taken was only 8,321.
 - (b) During the DP inspection done by the Noticee, the Noticee was not checking whether BSDA eligibility intimations sent to eligible BOs. It was alleged that as a result of lack of effective supervision by the Noticee, the DPs were not taking/recording the opting out from the respective BOs in an effective manner. Further, it was alleged that the Noticee has failed to ensure that DPs are either converting the eligible demat accounts into BSDA or obtaining the BSDA opting out confirmations from the respective BOs in an effective and meaningful manner.
- (iv) In this regard, Noticee, in its response to the finding of the inspection, had submitted that the onus of conversion to the BSDA account was with the DP. The Noticee has, further, submitted that the role of the Noticee was only to facilitate the conversion by identifying and providing the data of eligible BO A/Cs for BSDA.
- (v) In this context, it is mentioned in the PIA that:

"....it is noted that at the end of inspection period 1,10,95,451 BO A/Cs were still eligible to be converted to BSDA. Further, it is also important to note here that as a part of incentive to maintain and open new demat accounts, Depositories on the basis of a prescribed criteria has to pay the cost of maintenance to all the DPs. In view of the above arrangement, it appears that depository are inclined to turn a blind eye towards the lackadaisical conversion of eligible demat accounts to BSDA.

Further, it is noted that penalty levied by CDSL on DPs for lackadaisical conversion of eligible demat accounts to BSDA has not effective. DPs



are taking the penalty as a cost of business as the performances of all the DPs has not improved subsequently.

In this regard, being a MII, CDSL is a first level regulator to all depository participants (DPs) and as result of this along with DPs, CDSL also is in violation of the spirit of SEBI circulars. Thus, submission of CDSL is not acceptable. CDSL has failed to ensure that eligible demat accounts are being converted to BSDA at the depository level."

- (vi) Therefore, the Noticee was alleged to have violated clauses 4(d) and 8 of the SEBI Circular dated August 27, 2012 read with clause 5 of SEBI Circular dated July 1, 2014 and clauses 3, 4 and 5 of the SEBI Circular dated December 11, 2015.

Client Unpaid Securities Pledge Account

Release of Securities

- (i) In terms of SEBI Circular dated November 11, 2022, the unpaid securities (i.e., the securities that have not been paid for in full by the clients) shall be transferred to the respective client's demat account, followed by creation of an auto-pledge (i.e., without any specific instruction from the client) with the reason "unpaid", in favor of a separate account titled – "client unpaid securities pledgee account", which shall be opened by trading members (hereinafter referred to as 'TM')/clearing members (hereinafter referred to as 'CM'). If the client fulfils its funds obligation within five trading days after the pay-out, TM/CM shall release the pledge so that the securities are available to the client as free balance.
- (ii) During the SEBI inspection, Noticee in response to Pre Inspection Query (hereinafter referred to as 'PIQ') "8.8 CUSPA details" provided details pertaining to top two settlement days during the inspection period on which the highest number of pledges were created towards the Client Unpaid Securities Pledge Account (hereinafter referred to as 'CUSPA'). It was observed from the analysis of the said data submitted by Noticee that TM/CM were releasing the securities to the client's account on the 6th and 7th trading days, which was not in compliance with the SEBI Circular dated November 11, 2022.
- (iii) In response, Noticee had, *inter alia*, submitted, as per clause 3.9 of the SEBI Circular dated November 11, 2022 that CUSPA pledge can be released at any time within seven trading days after the pay-out, until it gets auto released.
- (iv) It is stated in the PIA that the response of the Noticee cannot be accepted as it is clearly mentioned in clauses 3.4 to 3.6 of the SEBI Circular dated November 11, 2022, that if the client fulfils its fund obligation within five trading days after the pay-out, TM/CM shall release the pledge so that the securities are available to the client as free balance. Further, clauses 3.4 to 3.6 of the SEBI Circular dated November 11, 2022 provide that if the client does not fulfil its fund obligation, TM / CM shall dispose of such unpaid securities in the market within five trading days after the pay-out. In this background, it is stated in the PIA that the submission of the Noticee was factually incorrect.



- (v) In this background, Noticee was alleged to have violated clauses 3.4 and 3.5 of the SEBI Circular dated November 11, 2022.

Disposal of securities after the due date and lack of a system in place

- (i) As per the SEBI Circular dated November 11, 2022, if the client does not fulfil its fund obligation, TM / CM shall dispose of such unpaid securities in the market within five trading days after the pay-out. Further, if, pledge is neither invoked nor released within seven trading days after the pay-out, the pledge on securities shall be auto released and the securities shall be available to the client as a free balance without encumbrance.
- (ii) During the SEBI inspection, it was observed that the invocation of the pledge by TM/CM was taking place on 6th and 7th trading days from the pay-out date. Thereafter, vide email dated November 26, 2023, Noticee was asked to provide details, including the date and time stamp of the invocation of the pledge and the details mentioned in the 'Confiscation-cum-Early Pay-in' transaction in the Noticee's system, viz., EX ID, CC ID, SEGMENT ID, ISIN, QUANTITY & SETTLEMENT ID and trade dates for settlement IDs against which the invocation of pledge had taken place for the trades under question. The Noticee vide its email dated November 29, 2023 provided its response, which was further analysed as tabulated below:

Table 1

PSN (Pledge Sequence No.)	Date of Invocation of Pledge	Time of Invocation of Pledge	Quantity	Settlement ID	Trade Date for Settlement ID	Trade day from Pay-out date (w.r.t CUSPA)
305386765	17/04/2023	19:40:36	1	1211232023070	17/04/2023	6 th trading day
305463823	17/04/2023	17:51:49	247	1211232023070	17/04/2023	6 th trading day
305482246	17/04/2023	17:21:21	1	1211232023070	17/04/2023	6 th trading day
305542880	17/04/2023	18:51:54	89	1211232023070	17/04/2023	6 th trading day
305655722	17/04/2023	20:12:01	5	1211232023070	17/04/2023	6 th trading day
305714388	17/04/2023	16:24:15	306	1211232023070	17/04/2023	6 th trading day
311663908	17/05/2023	17:42:07	6175	1211242023091	17/05/2023	7 th trading day
311596656	17/05/2023	12:34:33	25	1110232324530	17/05/2023	7 th trading day
311602690	17/05/2023	18:44:41	1007	1110232324530	17/05/2023	7 th trading day



PSN (Pledge Sequence No.)	Date of Invocation of Pledge	Time of Invocation of Pledge	Quantity	Settlement ID	Trade Date for Settlement ID	Trade day from Pay-out date (w.r.t CUSPA)
311611229	17/05/2023	16:23:08	500	1211232023091	17/05/2023	7 th trading day
311889052	17/05/2023	15:46:36	500	1211232023091	17/05/2023	7 th trading day
305482246	18/04/2023	08:10:29	1	1211232023070	17/04/2023	6 th trading day
305463391	18/04/2023	17:06:44	1	1211232023071	18/04/2023	7 th trading day
305463823	18/04/2023	17:30:00	84	1211232023071	18/04/2023	7 th trading day
305464036	18/04/2023	17:29:59	10	1211232023071	18/04/2023	7 th trading day
305516521	18/04/2023	19:15:19	1	1211232023071	18/04/2023	7 th trading day
305542880	18/04/2023	19:15:17	11	1211232023071	18/04/2023	7 th trading day
305714386	18/04/2023	16:04:45	2000	1211232023071	18/04/2023	7 th trading day
305714388	18/04/2023	16:04:45	1082	1211232023071	18/04/2023	7 th trading day

- (iii) In this background, it was observed that the TM/CM were disposing off unpaid securities in the market after five trading days from payout, i.e., on 6th and 7th trading days. Further, the TM/CM were invoking the securities for pay-in on the same date when the unpaid securities were disposed off. Thus, it was observed that the TM/CM were not in compliance with the SEBI Circular dated November 11, 2022.
- (iv) In response, Noticee has submitted that considering the T+2 settlement cycle, securities sold on 5th trading day are allowed to be delivered in pay-in till 7th trading day in terms of clause 3.9 of SEBI Circular. Hence, to honor the sell trade executed on T+5, system was allowing execution of confiscation transactions (which results in auto-creation of early-pay in transaction) till T+7.
- (v) It is mentioned in the PIA that the submission of Noticee was not acceptable as it was observed during the inspection that TM/CM were disposing off unpaid securities in the market after five trading days, i.e., on 6th and 7th trading days and invoking the securities for pay-in on the same day for the said trades. It is alleged in the PIA that it is not in compliance with the SEBI Circular dated November 11, 2022.



- (vi) It is further mentioned that the details mentioned in the 'Confiscation-cum-Early Pay-in' transaction in CDSL system viz. EX ID, CC ID, SEGMENT ID, ISIN, QUANTITY & SETTLEMENT ID and the trade dates for settlement IDs against which the invocation of pledge took place for the trades under question were available with Noticee. Despite that, Noticee has allowed invocation of pledge in cases where the TM/CM has disposed of such unpaid securities after five trading days from the pay-out, i.e., on 6th and 7th trading days.
- (vii) Further, vide its email dated March 20, 2024, Noticee has submitted that it has taken up the system level changes to restrict the release of pledges on 6th and 7th trading days after the payout date. Noticee, further, stated that the said changes were tentatively expected to be implemented by June 2024. In this regard, it was stated in the PIA that from the response of the Noticee, it was evident that it had not put in place an appropriate system to ensure that the said securities were released / disposed by TMs/CMs after the end of the 5th trading day from the pay-out date during the inspection period.
- (viii) In view of the same, Noticee was alleged to have violated clauses 3.4, 3.5 and 5 of the SEBI Circular dated November 11, 2022.

Client Unpaid Securities Accounts

Unfreezing

- (i) In terms of SEBI Circular dated November 11, 2022, all the existing "Client Unpaid Securities Accounts" (hereinafter referred to as '**CUSA**') were required to be wound up on or before April 15, 2023, *inter alia*, failing which such accounts shall be frozen for debit and credit. Further, the stock exchanges, depositories and clearing corporations were required to place appropriate systems in place to ensure compliance with the provisions of the said Circular. Further, the stock exchanges, depositories and clearing corporations were directed to communicate, the status of the implementation of the provisions of the Circular within 7 days of implementation and in their Monthly Development Reports, to SEBI.
- (ii) In this regard, there has been a joint process followed by exchanges and depositories to unfreeze client collateral accounts and clients beneficiary accounts of TM for transferring securities to client's demat accounts since May 22, 2023. As per the said process, on receipt of requests from TM with supporting information / documents to unfreeze the demat account to transfer the securities to the respective client's demat account, the exchange forwards the requests to designated email ids of depositories for processing.
- (iii) During onsite inspection, it was observed that on receipt of communication from the exchange for unfreezing the CUSA mentioned and ensuring that the specified list of securities was transferred to the specified demat accounts of clients only, Noticee was unfreezing the entire CUSA account of TM/CM. The Noticee was supposed to unfreeze only the securities and quantity which were specified in the email of exchanges.
- (iv) Noticee, in response to the inspection findings, submitted that:



“...In view of the above-mentioned point in SEBI circular, Exchanges and Depositories have jointly submitted the proposal to SEBI on May 22, 2023, regarding unfreezing and transferring the securities from CUSA account. As per the point (5) of the said joint proposal between Exchanges and Depository is quoted as “The accounts are unfrozen for the period of T+3 days by the depositories beyond which the DP account is frozen again”.

Based on intimation from SEBI on 22nd May 2023, CDSL is following the process as mentioned in the said joint proposal....”

- (v) In this regard, it is mentioned in the PIA that the submission of the Noticee cannot be accepted because, as per point (4) of the joint process dated May 22, 2023:

*“The Exchange forward the requests (from the designated email IDs only) received from the members along with the client master of the respective clients to depositories on a fortnightly/monthly basis for processing. Exchange provides client wise securities details along **with the details of Collateral Accounts/Client Beneficiary Account to the depositories to facilitate the transfer of securities to the respective clients only.**” (Emphasis supplied)*

- (vi) Thus, it is stated that as per the joint process, the onus was on depositories to ensure that the transfer of specified securities happens only to the respective clients.
- (vii) In this regard, it is stated in the PIA that on receipt of communication from the exchange for unfreezing the CUSA mentioned in the email and for ensuring that the specified list of securities was transferred to the specified demat accounts of clients only, Noticee was unfreezing the entire CUSA account, not limited to the specified securities and quantities as mentioned in the email of exchanges.
- (viii) In view of the same, Noticee is alleged to have violated clause 5 of the SEBI Circular dated November 11, 2022.

No Transaction Statement

- (i) During the SEBI inspection, it was observed that Noticee was asking for confirmation from TMs/CMs by seeking transaction statements, after the shares were transferred from CUSA to BO, since July 2023. However, it was observed that Noticee was unfreezing the entire demat account instead of ISIN and quantity level unfreeze as mentioned in the emails of stock exchange. Thus, it was observed that there was a risk of TM/CM transferring shares to other than the intended beneficiaries and/or transferring shares of other companies / excess shares to BOs/its own demat accounts.
- (ii) In response, the Noticee has submitted that it was following the process as mentioned in the joint process dated May 22, 2023.
- (iii) In the PIA, it is stated that the submission of the Noticee cannot be accepted as per point (4) of the joint process dated May 22, 2023 reads as follows:



“The Exchange forward the requests (from the designated email IDs only) received from the members along with the client master of the respective clients to depositories on a fortnightly/monthly basis for processing. Exchange provides client wise securities details along with the details of Collateral Accounts/Client Beneficiary Account to the depositories to facilitate the transfer of securities to the respective clients only.”

- (iv) Thus, it is stated that as per the joint process between exchanges and depositories, the onus is on depositories to ensure that transfer of specified securities happens only to the respective clients.
- (v) In this regard, it was noted that the Noticee vide its email dated March 20, 2024, has, *inter alia*, submitted that it had implemented necessary checks to strengthen the operational process as follows:
 - (a) The details of the transfer so carried out are checked by CDSL;
 - (b) This is done by verifying the transaction statement of the transferor broker;
 - (c) The transaction statement of the transferor brokers provides the details of the credit to the transferee client;
 - (d) The transferee client account details on the transaction statement are same as that provided in the exchange intimation;
 - (e) Based on the above, CDSL reports the completion of transfer to the exchanges.
- (vi) It is stated in the PIA that the aforesaid checks were not carried out by Noticee during the inspection period. It is stated that the Noticee has started seeking confirmation from TMs/CMs by seeking transaction statement after the shares were transferred from CUSA to BO, since July 2023. Further, it was alleged that by unfreezing the entire demat account instead of ISIN and quantity level unfreeze which could only be transferred to the beneficiary(ies) as mentioned in the emails of stock exchange, there was a risk of TM/CM transferring shares to other than the intended beneficiaries and/or transferring shares of other companies/ excess shares to BOs/its own demat accounts.
- (vii) In view of the same, Noticee was alleged to have violated clause 5 of the SEBI Circular dated November 11, 2022.

No system level check

- (i) During the SEBI inspection, it was observed that there was no system level check done by the Noticee to ensure that the DP transfers the shares from CUSA accounts to the same BO which was mentioned in the email forwarded by the exchange. Further, it was observed that the Noticee did not have a system in place to undertake ISIN level unfreeze subsequently in case BO level freeze was initiated in the system.
- (ii) In response, the Noticee has submitted that:

“...Number of transfer requests was not frequent. Opening of new CUSA accounts was already prohibited hence cases of transfer requests will



continue to reduce more and more in future. At present, we are handling this activity operationally and the same was found to be functioning well with no cases of erroneous transfer observed. ..."

- (iii) In this regard, it is stated that the joint process currently being followed by exchanges and depositories is the same as was earlier followed by them to unfreeze client collateral accounts and clients beneficiary accounts of TMs for transferring the securities to client's demat accounts on specific requests received from TMs. Hence, the submission of the Noticee has not been accepted in the PIA.
- (iv) Accordingly, Noticee was alleged to have violated clause 5 of the SEBI Circular dated November 11, 2022.

System put in place in terms of SEBI Circular dated November 11, 2022 was not followed

- (i) Vide email dated November 24, 2023, Noticee was requested to provide correspondence, including emails received from exchanges requesting the unfreeze of the mentioned accounts and all subsequent communication forwarded by Noticee to any entity (including exchanges, TM/CM, DP, etc.) until the account was frozen by them in respect of certain sample CUSA accounts.
- (ii) On perusal of the sample cases, it was observed that in the case of JM Financial (CUSA account – 1203330001090865), the account was unfrozen on June 23, 2025 and frozen again on July 05, 2023. However, as per the email of the stock exchange, JM Financial (CUSA account – 1203330001090865) was required to be frozen on the EOD of June 27, 2023. On seeking clarification, the Noticee vide its email dated December 18, 2023 stated that the said BO account was inadvertently marked for freeze on July 05, 2023 instead of the exchange specified date of June 27, 2023. The Noticee further mentioned that it was observed during the internal weekly review of CUSA transfer cases and was immediately acted upon by freezing the said CUSA account on July 05, 2023.
- (iii) Further, in the case of Bajaj Financial Securities Limited (CUSA account – 1208860000001371), a request to unfreeze the account of the TM was sent by the stock exchange vide email dated August 28, 2023 with a request to transfer a specified quantity of specified security in the respective client's demat account and to re-freeze the account on August 31, 2023. However, on perusal of the information submitted by Noticee, it was observed that the unfreezing of the account was not done by the Noticee. Further, when BSE sought reasons for not processing the request for the unfreezing of demat account vide email dated November 23, 2023, Noticee did not provide the reason for not unfreezing the said demat account and requested BSE to provide new unfreeze date.
- (iv) In this context, it is alleged that Noticee has failed to unfreeze the CUSA account on the date as required by the exchange under the joint process put in place by the exchanges and depositories. It is alleged that by not following the joint process as put in place by exchanges and depositories for CUSA accounts,



Noticee was alleged to have violated clause 5 of the SEBI Circular dated November 11, 2022.

Information Technology Related Issues/ matters

Preventing Unauthorized access

- (i) Clause 31 of Annexure A of the SEBI Circular dated July 06, 2015 states that MIs should implement measures to prevent unauthorised access or copying or transmission of data / information held in a contractual or fiduciary capacity. Further, it should be ensured that the confidentiality of information is not compromised during the process of exchanging and transferring information with external parties.
- (ii) As per the cyber audit report for the period from October 2022 to March 2023, 24 endpoints of Noticee were not integrated with the CDSL Data Loss Prevention (hereinafter referred to as 'DLP') solution. Further, as per the report on the Cyber Risk Assessment done by KPMG in August, 2023 and the status submitted by Noticee, it was observed that DLP implementation at all channels was still incomplete. Accordingly, it was observed that the measures to prevent unauthorized transmission of data were not completely implemented by the Noticee during the IP.
- (iii) In this regard, Noticee has stated that the necessary actions to close this observation have been implemented. It is stated in the PIA that such lapses had the potential to impact the security of data maintained with Noticee. Accordingly, it was alleged that the Noticee was non-compliant with clause 31 of Annexure A of the SEBI Circular dated July 06, 2015 from the period July 2015 to October 2023.

Cyber Security Aspects

- (i) Clauses 27 and 28 of Annexure A of the SEBI Circular dated July 06, 2015, *inter alia*, prescribe that MIs, including depositories, should establish baseline standards to facilitate the consistent application of security configurations to operating systems, databases, network devices and enterprise mobile devices within the IT environment. Further, the MIs, including depositories, should also conduct regular enforcement checks to ensure that the baseline standards are applied uniformly. Moreover, the MIs should install network security devices, such as firewalls, as well as intrusion detection and prevention systems, to protect its IT infrastructure from security exposures originating from internal and external sources.
- (ii) It was observed that the DLP implementation at all channels was still incomplete during the inspection period. Further, this issue was also highlighted in the Cyber Risk Assessment report furnished by KPMG in August, 2023. It was, further, observed that the implementation of block mode within force point technology was still in progress even after a cyber-incident. Hence, it was observed that the Noticee has not implemented the baseline standards uniformly.



- (iii) In this regard, it is stated that though Noticee has stated in its submission that the necessary actions to close this observation have been implemented, the Noticee was non-compliant with clauses 27 and 28 of Annexure A of the SEBI Circular dated July 06, 2015 from the period July 2015 till October 2023.

Recovery Time Objective and Recovery Point Objective

- (i) As per clauses 4 (c) and (d) of SEBI Circular dated March 22, 2021, in the event of disruption of any one or more of the 'Critical Systems', the MIs shall, within 30 minutes of the incident, declare that the incident as 'Disaster' and take measures to restore operations, including from Disaster Recovery Site (hereinafter referred to as '**DRS**') within 45 minutes of the declaration of 'Disaster'. Accordingly, the Recovery Time Objective (hereinafter referred to as '**RTO**') - the maximum time taken to restore operations of 'Critical Systems' from DR site after the declaration of Disaster shall be 45 minutes. 'Critical Systems' for an exchange/ clearing corporation shall include trading, risk management, collateral management, clearing and settlement and index computation. 'Critical Systems' for a depository shall include systems supporting settlement process and inter-depository transfer system. MIs have to ensure that the Recovery Point Objective (hereinafter referred to as '**RPO**') -the maximum tolerable period for which data might be lost due to a major incident-shall be 15 minutes.
- (ii) However, under clause 4.3 of the Cyber Crisis Management Plan (hereinafter referred to as '**CCMP**') of the Noticee, the lowest values as per the Business Impact Analysis exercise were considered as RTO and RPO. It was observed that the RTO and RPO in the CCMP were not aligned with the SEBI guidelines.
- (iii) In response, the Noticee stated that RTO for Critical systems and RPO have been mentioned in the CDSL Business Continuity and Recovery Strategy which were in compliance with the SEBI Circular. In this regard, Noticee has stated that their "Business Continuity and Recovery Strategy version 2.2" has the SEBI stipulated RTO and RPO. In this regard, it is mentioned in the PIA that the said document was not furnished to SEBI during the inspection. It was also stated that several versions of Business Continuity Management Plans were submitted during the inspection that did not mention RTO and RPO as stipulated by SEBI.
- (iv) Further, it is mentioned in the PIA that the CCMP of Noticee dated September 20, 2023, submitted during the inspection, was the latest document and the last modification in the said document was relating to changes in RTO and RPO. In this regard, it is noted in the PIA that the CCMP of Noticee did not align with the stipulated RTO and RPO prescribed vide SEBI Circular. It is stated that the CCMP Version 1.4 dated September 20, 2023 states that the lowest values among the various processes in the departments were considered for RTO and RPO and the same will be treated as RTO and RPO.
- (v) In this context, it was observed that there were discrepancies between the policies of Noticee and the same was not in alignment with SEBI Circular dated March 22, 2021.



- (vi) Accordingly, Noticee was alleged to have violated clauses 4 (c) and (d) of the SEBI Circular dated March 22, 2021.

Disaster Recovery infrastructure

- (i) Clause 5(h) of the SEBI Circular dated March 22, 2021 states that stock exchanges, clearing corporations and depositories shall perform Primary Data Centre (hereinafter referred to as 'PDC') to DR site shifting to demonstrate their preparedness to meet RTO at 45 minutes.
- (ii) As per the Disaster Recovery (hereinafter referred to as 'DR') drills summary submitted by Noticee as part of the PIQ, it is observed that the RTO for the following periodic drills was more than 45 minutes:

Table 2

Sr. No.	System	Date of DR drill	Primary Made down at time	DR made up at time	Total Time Taken (in hrs)/ RTO
1.	WEBCDAS	17 September 2022	09:38	10:38	01 hrs
2.	WEBCDAS	16 December 2022	21:15	22:42	01 Hrs 27 Mins
3.	WEBCDAS	17 March 2023	23:10	02:05	02 Hrs 55 Mins
4.	WEBCDAS	23 June 23	21:17	22:04	47 Mins

- (iii) Noticee, in its submission, has stated that these drills are not actual 'disaster event'. Further, the status of DR drills, reasons for deviations from prescribed timelines and action taken were updated with the CDSL Standing Committee on Technology (hereinafter referred to as 'SCOT').
- (iv) In this regard, it is mentioned in the PIA that DR drills are conducted to simulate fault scenarios, formulate recovery plans and verify whether the plans are applicable and effective. Based on the summary of the DR drills and BCP_Testing_Plan_17-Mar-23_CDAS, it is alleged in the PIA that there have been four instances where Noticee was not able to comply with the stipulated timelines prescribed under SEBI Circular dated March 22, 2021. It is, further, alleged that after a cyberattack during the inspection period, three DR drills had RTO more than the stipulated time.
- (v) Accordingly, it is stated in the PIA that the delay during DR drills was not acceptable and hence, the Noticee was, allegedly, non-compliant with clause 5(h) of the SEBI Circular dated March 22, 2021
- (vi) Thus, Noticee was alleged to be non-compliant with clause 5(h) of the SEBI Circular dated March 22, 2021.

Manpower

- (i) As per the PIQ submissions of the Noticee, it was observed that the manpower deployed at the DR site in Hyderabad was eight nos. However, no official of Noticee was deployed at the PDC or near the site of CDSL.
- (ii) From the submission made by Noticee in response to the findings of the inspection, it is observed that the PDC and DR site of CDSL were managed by third-party data centre service providers.



- (iii) In this regard, it is stated in the PIA that though the Noticee had deployed manpower at the DR site in Hyderabad, there was no manpower deployed at the PDC.
- (iv) Accordingly, Noticee was alleged to have violated clause 3(d) of the SEBI Circular dated March 22, 2021.

Data Recovery Site Drill

- (i) Clause 5(c) of the SEBI Circular dated March 22, 2021 states that the DR drill should include running all operations from DR site for at least one full trading day.
- (ii) However, during the visit of the DR site in Hyderabad on October 12, 2023, it was observed that during the DR drill, the Security information and event management logs (hereinafter referred to as '**SIEM**') were still being collected at the PDC. Therefore, it was observed that all the operations were not being carried out from the DR site during the drill.
- (iii) In response, the Noticee has submitted that it had taken note of the recommendations of Technical Advisory Committee of SEBI. Further, the re-architecting of SIEM solution was a work in progress and it would be completed by September, 2024.
- (iv) It is mentioned in the PIA that though the devices of SIEM were present at DR, but the logs were forwarded to the SIEM collectors present at DC for monitoring. Hence, it is alleged that a complete switchover of DC to DR was not occurring during DR drills.
- (v) Thus, the Noticee was alleged to be non-compliant with clause 5(c) of the SEBI Circular dated March 22, 2021.

Identical Vulnerabilities repeated

- (i) As per clause 41 of SEBI Circular dated May 20, 2022, any gaps/vulnerabilities detected have to be remedied on immediate basis and compliance of closure of findings identified during Vulnerability Assessment and Penetration Testing (hereinafter referred to as '**VAPT**') shall be submitted to SEBI within three months post the submission of the final VAPT report to SEBI.
- (ii) During the inspection, VAPT reports of 2021-22 and 2022-23 were compared on a sample basis. It was observed that there were repeat vulnerabilities. It was, *inter alia*, observed that TLS version 1.1 protocol deprecated was present in both reports on the same IPs 61.95.148.49 [Port 10443].
- (iii) Further, on cross verifying the closure of the vulnerabilities on a sample basis, it was observed that certain vulnerabilities were still open. This included using components¹ with known vulnerabilities:
 - <https://betamfr.cdslindia.com/Scripts/xxxxx-x.x.x.js>
 - <https://betamfr.cdslindia.com/Scripts/xxxxx-xx-x.xx.x.min.js>
 - <https://www.cdslindia.com/Includes/xxxxxxxxx-x.x.x/xx/xxxxxxxxxx.min.js>

¹ Details excised for privacy and security.



- (iv) On further analysis of the detailed revalidation reports, it was observed that certain vulnerabilities were still open.
- (v) In this context, it was observed that vulnerabilities have not been patched by the Noticee within the three months' time stipulated by SEBI.
- (vi) In this regard, it was alleged in the PIA that the justification provided by the Noticee does not pertain to the vulnerability – "Deprecation of the TLS v 1.1 protocol". Justification was rather provided for vulnerability pertaining to "Web Server Disclosure". Further, it is mentioned in the PIA that the TLS deprecation vulnerability was identified in the VAPT report of 2021-22 as well as in the VAPT activity of 2022-23.
- (vii) Further, it is alleged that the vulnerability – "Using Components with Known Vulnerabilities" was found open during the present inspection as well. It is mentioned in the PIA that the closure of the said vulnerability only occurred after SEBI reported the same through the inspection report. The VAPT had concluded in May, 2023.
- (viii) With regard to the submission of the Noticee that the old library has been removed after its attention was drawn during the inspection, it is noted that the vulnerability was closed after a significant delay of seven months. Thus, it is alleged that the Noticee has not closed the vulnerabilities within the stipulated period of three months. Accordingly, it is alleged that the Noticee has not adhered to the closure of vulnerabilities in a timely manner.
- (ix) Therefore, it was alleged that Noticee was non-compliant with clause 2(41) of SEBI Circular dated May 20, 2022 read with clause 41 of A of the SEBI Circular dated July 06, 2015.

VAPT activity

- (i) During the inspection, it was observed that the Noticee was not covering all domains as required under VAPT in terms of clause 4.1. (b) of the SEBI Circular dated December 7, 2018. Further, it was observed that no VAPT reports pertaining to their CII applications, such as Edis, AuditWeb was provided. Moreover, the source code review was not undertaken. Further, the following vulnerabilities were found to be open during cross verification on a sample basis:
 - Using Components² with known vulnerabilities:
 - <https://betamfr.cdslindia.com/Scripts/xxxxx-x.x.x.js>
 - <https://betamfr.cdslindia.com/Scripts/xxxxx-xx-x.xx.x.min.js>
 - <https://www.cdslindia.com/Includes/xxxxxxxxx-x.x.x/xx/xxxxxxxxx.min.js>
 - Detailed revalidation reports provide evidence that vulnerabilities are still open.
- (ii) It is stated in the PIA that the VAPT conducted by Noticee was not comprehensive. Further, all the VAPT reports which were sought from Noticee during the inspection were not provided by Noticee to the inspecting officer. It

² Details excised for privacy and security.



was mentioned in the PIA that the claim made by Noticee in ATR stating – “as sought by the inspection team, VAPT audit reports were shared on sample basis” was incorrect. Adding on, it is mentioned in the PIA that the VAPT report on Edis and Auditweb which were CII applications were not furnished to SEBI.

- (iii) Therefore, Noticee is alleged to be non-compliant with clause 2(40) of the SEBI Circular dated May 20, 2022 read with clause 40 of the Annexure A of the SEBI Circular dated July 06, 2015.

- 8. Noticee submitted its reply vide letter dated October 04, 2024. The relevant extracts of the reply of Noticee as follows:

A. Allegation relating to the Pledge Creation with respect to non-compliance of regulation 79 (5) of the DP Regulations

- (i) Noticee stated that there has been no violation of regulation 79(5) of the DP Regulations, as alleged in the SCN. It acknowledged that the reason for the rejection of the pledge was not captured in certain instances due to system limitations, but it has taken corrective actions to address this issue.
- (ii) The pledge creation process is initiated by the pledgor through its DP by submitting a request for pledge creation. This request is then recorded in the depository's system. Both the pledgor and pledgee agree upon the terms and conditions of the pledge through a bilateral, offline process that is conducted outside the purview of the depository. Noticee, as a depository, facilitates the pledge creation and rejection process by providing the technological infrastructure and system for recording and managing pledges. The system reflects the instructions provided by the DP of the pledgor and pledgee including the reason for rejection of the pledge, as may be the case.
- (iii) SEBI has alleged that Noticee did not communicate the reason for the rejection of the pledge to the DPs of the pledgor and pledgee, thus, violating regulation 79(5) of the DP Regulations. It was observed that the “*reason for rejection*” was not populated for certain pledge rejections and instead, a generic note was provided stating that the reason for rejection is known only to the pledgee DP and can be verified during audit and inspection. Noticee submitted that the pledge creation system was implemented in August 2001, and during that time, there was no specific field in the system to capture the reason for the rejection of pledges by the pledgee DP. Therefore, at the foremost, it is not accurate to state that this specific field was not populated for “*certain*” pledge creations. Although CDSL had introduced a separate “*Remarks*” field in the system for pledgee DPs wherein DPs could specify the reason for rejection, which was not a mandatory requirement at the time.
- (iv) CDSL undertook a review of its system and initiated necessary system changes to ensure compliance. CDSL submitted its Action Taken Report to SEBI on June



21, 2024, informing SEBI that it had begun implementing changes to make it mandatory for pledgee DPs to provide the reason for rejection of pledges in the system. These changes were successfully implemented in the system on July 13, 2024, before the issuance of the SCN 2024. The upgraded system of CDSL now mandates that the pledgee DP provides the reason for rejection and the same is communicated to the pledgor's DP as well. Also, adequate communiques and guidance were given to all market participants to familiarize them with the new system functionality before it was implemented.

- (v) Noticee admitted that in 27 records, no reason for rejection was captured in Remarks field, as highlighted by SEBI. This occurred due to the previous system limitations where capturing rejection reasons was not mandatory. However, CDSL has rectified this issue and ensured that such instances do not recur.
- (vi) Noticee stated that the pledge is a bilateral agreement between the pledgor BO and the pledgee BO, and CDSL acts solely as a platform provider for facilitating the recording of these transactions. While there has always been a provision in the system to record the reason for pledge rejections, it is significant to note that there have been no complaints or representations in any of the 27 cases cited, indicating that the pledgee BO was deprived of any pertinent information that could have impacted the transaction or caused any disadvantage to the client. CDSL, as part of its ongoing enhancement efforts, has since made it mandatory for DPs to record the reason for rejection, thereby addressing any ambiguity in this regard.
- (vii) It is pertinent to note that there was no adverse market impact or loss suffered by any market participant due to the historical non-capture of rejection reasons. Further, there have been no investor grievances or complaints received by CDSL related to this issue.
- (viii) It has taken the necessary actions to address SEBI's concerns regarding the communication of reasons for the rejection of pledges. The revised system, effective since July 13, 2024, ensures that the reason for rejection is captured and communicated to both the pledgor's and pledgee's DPs as required under regulation 79(5). CDSL has implemented SEBI's observation within the reasonable time after intimation of the said observation. The fact that there has been no adverse market impact or investor grievances, CDSL submitted that the allegations in the SCN are unwarranted and should be set aside and dropped by SEBI.

B. Allegation relating to Basic Service Demat Account with respect to non-compliance with certain provisions of SEBI Circulars dated August 27, 2012, July 1, 2014, and December 11, 2015

- (i) Noticee stated that the said SEBI Circulars prescribe that the depository (here, CDSL) to communicate the status of the implementation through the MDR submitted to SEBI. These are the statutory obligations placed on the depository



under the aforementioned SEBI Circulars. CDSL has duly abided by the statutory requirements and has been reporting the status of BSDA conversions and related activities in its MDRs during the Inspection Period. This demonstrated CDSL's compliance with the requirements of the said SEBI Circulars.

- (ii) It is pertinent to note that the primary responsibility for converting eligible BO accounts to BSDA rests with the DPs. The obligation to offer BSDA to eligible BOs lies with the DPs, as they have the direct interface and communication with the BOs. Moreover, the DPs are also responsible for obtaining confirmations from BOs opting out of BSDA. As a depository, CDSL's role is supervisory in nature, ensuring that DPs comply with SEBI's requirements through regular audits and inspections as per CDSL DP inspection process.
- (iii) CDSL has a comprehensive DP inspection process, wherein its auditor inspection team checks the compliance of DPs with SEBI's requirements, including the conversion of eligible BO accounts to BSDA. These inspections are conducted periodically, and any non-compliance observed is recorded and compliance is sought from DPs. CDSL's inspection team typically performs sample-based checks to verify whether DPs are converting eligible accounts to BSDA or obtaining opting-out confirmations. If any instance of non-compliance is found, compliance is sought from the DPs.
- (iv) Additionally, in response to the evolving regulatory requirements, CDSL has actively engaged with SEBI to refine the penal action framework for the non-conversion of eligible demat accounts to BSDA. SEBI vide letter dated January 08, 2024 addressed to CDSL is regarding amendments to CDSL's operating instructions for revised penal action, stated:

"[...] It is suggested that there should be no upper cap on the penalty to be levied on DPs if non-conversion of eligible demat accounts is observed for multiple accounts. Further, a slab can be introduced for DPs to ensure incremental penalty beyond a certain threshold of non-conversion of eligible accounts to BSDA. Accordingly, it is informed that the amendments proposed to CDSL's Operating Instruction vide the aforementioned letter are being returned."
- (v) Further, vide SEBI's letter dated July 01, 2024, SEBI provided the following recommendations to CDSL based on CDSL's submission dated May 10, 2024:

"[...] "You are advised to reduce the cumulative penalty limit for referring a DP to the member committee. Accordingly, the revised penal actions as proposed by CDSL to its Operating Instruction are being returned. Further, CDSL is advised the following:

 - *To carry out the periodic monitoring of DPs classified as low-risk DPs in respect of conversion of eligible demat accounts to BSDA. Such periodic monitoring may involve such DPs to periodically submit data regarding the conversion of eligible demat accounts to BSDA.*



- *To verify the data submitted by such DPs during on-site inspection. In case of any anomaly observed in the data, CDSL may refer the DP to its member committee.”*
- (vi) At present, CDSL has incorporated SEBI’s feedback and is revising its penal action framework in line with SEBI’s suggestions to ensure more stringent action against DPs for non-conversion of eligible accounts to BSDA.
- (vii) To further facilitate the conversion of eligible BOs to BSDA and ensure the practice of good governance, CDSL has developed a system of proactively sharing the list of eligible BOs with DPs on a monthly basis. This assists DPs in identifying eligible BOs at the end of each billing cycle and offering them the option to convert to BSDA or opt-out.
- (viii) Further, it is pertinent to draw attention that during the Inspection Period, CDSL observed an overall increase in the number of accounts converted to BSDA, which was reported to SEBI in the MDRs. As on 31st May 2024, 3.5 crore demat accounts of CDSL are classified as BSDA accounts accounting for 29% of the total demat accounts of CDSL. This indicates that CDSL’s efforts to ensure compliance were yielding positive results.
- (ix) SEBI has alleged that CDSL did not effectively supervise the DPs, which led to the non-conversion of 1,10,95,451 eligible BO accounts to BSDA and only 8,321 opting-out confirmations being recorded. CDSL submitted that it has discharged its obligations by implementing a robust supervision mechanism through its DP inspection process, sample-based checks, and with the proposal to amend the operating instructions for levying penalties for non-compliance which is under discussion with SEBI. The conversion of eligible BOs to BSDA is primarily the responsibility of DPs, and any lapses on their part should not be construed as a failure on CDSL’s part.
- (x) Moreover, during the inspection period, CDSL had multiple discussions with senior SEBI officials, regarding the BSDA framework. CDSL drafted a policy advocacy document and submitted it to SEBI, suggesting enhancements to the BSDA framework. SEBI subsequently issued a consultation paper on the BSDA framework, which incorporated some of CDSL’s suggestions. On June 28, 2024, SEBI issued a revised framework for BSDA, which included CDSL’s contributions. This demonstrates CDSL’s proactive approach and its efforts to improve the BSDA framework in consultation with SEBI.
- (xi) CDSL submitted that the overall increase in BSDA conversions, as evidenced by the MDRs submitted during the inspection period, is a clear indication that its efforts were effective and that it was discharging its supervisory responsibilities diligently. CDSL has taken appropriate actions in line with the inspection findings.
- (xii) With the issuance of the revised BSDA framework on June 28, 2024, CDSL has continued to engage with DPs to ensure smooth implementation of the new framework. This further reinforces CDSL’s commitment to maintaining a high standard of compliance and governance.



- (xiii) Thus, CDSL has adhered to all the obligations prescribed under the SEBI Circulars regarding the BSDA framework and has taken proactive measures to supervise and monitor DPs in their compliance. CDSL has shared the list of eligible BOs with DPs, conducted inspections and engaged in policy advocacy with SEBI. CDSL has engaged proactively with SEBI to revise its penal action framework and strengthen the supervision of DPs. CDSL has demonstrated continuous efforts to ensure compliance with SEBI's directives and improve the BSDA framework through policy advocacy and ongoing engagement with SEBI.
- (xiv) Therefore, SEBI's allegation that CDSL failed in its supervisory role is unfounded, as the depository has implemented a robust mechanism to ensure compliance. The responsibility for converting eligible BO accounts to BSDA and obtaining opting-out confirmations lies with the DPs, and CDSL has acted diligently in its supervisory role. Therefore, CDSL was not in violation of clauses 4(d) and 8 of SEBI Circular dated August 27, 2012, read with clause 5 of SEBI Circular dated July 1, 2014, and clauses 3, 4, and 5 of SEBI Circular dated December 11, 2015, as stated in the SCN and therefore, the allegation ought not to have been alleged and ought to be dropped by SEBI.

C. Allegation relating to Client Unpaid Securities Pledgee Account with respect to non-compliance of clauses 3.4, 3.5, and 5 of the SEBI Circular dated November 11, 2022

- (i) Clauses 3.4. and 3.5. of the SEBI Circular dated November 11, 2022, respectively, clearly outlines the obligation of the trading member/ clearing members (TM/CM) with respect to releasing the pledge and disposing off the securities. As reiterated by SEBI in the SCN, clause 3.4. of the SEBI Circular mentions that the TM/CM shall release the pledge so that the securities are available to the client as a free balance, and clause 3.5. of the SEBI Circular mentions that the TM/CM shall dispose of such unpaid securities in the market within 5 (five) trading days after the pay-out.
- (ii) Here, the TM/CM has mainly two roles to perform – (a) if the client fulfils the fund obligation, the TM/CM shall release the pledge, and (b) if the client does not fulfil the fund obligation, the TM/CM shall invoke the pledge and dispose off the securities in the market. It is pertinent to note that the said clauses 3.4. and 3.5. are solely the obligations of the TM/CM who are not regulated by depositories and therefore are not obligations of the depositories. The responsibility of invoking or releasing a pledge lies solely with the TM/CM based on the client's fulfilment or non-fulfilment of the fund obligation. Further, disposing of the securities in the market as per aforesaid clause 3.5 is carried out on the stock exchange trading system and not in the depository system. Therefore, the onus of compliance with the said clauses rests entirely on the TM/CM, and not on CDSL, which is a depository.



- (iii) As per clause 3.9. of the SEBI Circular, in case the pledge is neither invoked nor released within 7 (seven) trading days after pay-out, then the pledge on such securities shall be auto-released and be available to the client as a free balance. According to the said clause, the depository is required to put in place appropriate systems which allow release of pledges anytime within 7 (seven) trading days after pay-out.
- (iv) As mentioned in para 5.3.1.2. of the SCN, SEBI's contention that CDSL failed to ensure the release of securities within 5 (five) trading days after pay-out is misplaced, as the depository's role is limited to ensuring that the system facilitates release or invocation within 7 (seven) trading days as per clause 3.9. Therefore, any release or invocation by the TM/CM on the 6th and 7th trading day cannot be considered as non-compliance with CDSL's regulatory obligations under the said SEBI Circular.
- (v) Further, the transition from the T+2 (trade plus two days) settlement cycle to the T+1 (trade plus one day) settlement cycle was fully implemented from February 2023. As per the earlier T+2 settlement cycle, if the TM/CM disposes off the securities on the 5th trading day after pay out, the settlement will come on the 7th trading day and the invocation can happen till the 7th trading day.
- (vi) SEBI did not mandate any amendments or provide clarity to CDSL to modify its system for handling the release and invocation process in light of the T+1 cycle which would have addressed the aforesaid ambiguity in clause 3.5 and 3.9 of the said SEBI circular. As a result, CDSL's existing system, which was designed in compliance with the T+2 cycle, continued to function based on that framework. However, based on the discussions with the SEBI inspection team and in order to address the inspection observation, CDSL took up necessary system-level changes to restrict the release/invocation of pledges on 6th and 7th trading days after the pay-out date which was implemented with effect from May 18, 2024.
- (vii) As mentioned in para 5.3.2.1. of the SCN, SEBI alleged that the TM/CM invoked the pledge on the 6th or 7th trading day, instead of the 5th trading day as required under clause 3.5. CDSL reiterated that the responsibility to invoke the pledge within the prescribed timeline is that of the TM/CM and not of CDSL.
- (viii) In addition, with reference to para 5.3.2.4 of the SCN, CDSL's systems were designed to ensure compliance with clause 3.9, which requires allowing the auto-release/invocation of the pledge if the TM/CM fails to release or invoke the pledge within 7 trading days. This demonstrates that CDSL had in place an adequate mechanism to address the regulatory requirements under the SEBI Circular. Given the T+2 settlement cycle at the time, the securities sold on the 5th trading day could be delivered in the pay-in till the 7th trading day. To honour the sell trade executed on T+5, CDSL's system allowed for the execution of confiscation transactions up until the 7th trading day. As per CDSL's knowledge, NSDL had also followed the same interpretation of the said SEBI Circular and had also followed the same practice of CDSL.



- (ix) Based on the discussions with the SEBI inspection team and in order to address the inspection observation, CDSL took up necessary system-level changes to restrict the release/invocation of pledges on 6th and 7th trading days after the pay-out date which was implemented with effect from May 18, 2024, thereby demonstrating its willingness and ability to adhere to evolving regulatory frameworks and compliance with respect to SEBI observations.
- (x) Therefore, the allegations of SEBI that CDSL is in violation of clause 5 of the SEBI Circular dated November 11, 2022 did not take into consideration the fact that CDSL's role was confined to ensuring the release/invoke of pledges as per clause 3.9 of the said SEBI Circular.
- (xi) SEBI clearly mentions under para 5.3. of the SCN that the TM/CM was invoking the pledge on the 6th and 7th trading day instead of the 5th trading day after pay-out. This clearly establishes in itself that CDSL, in its capacity as a depository, has not violated the clauses 3.4., 3.5., and 5 of the said SEBI Circular.

D. Allegation relating to Client Unpaid Securities Account with respect to non-compliance of clause 5 of the SEBI Circular dated November 11, 2022

- (i) To operationalize clause 5 of aforesaid SEBI circular, the MIs, i.e., stock exchanges, depositories and clearing corporations adopted a joint process which was communicated to SEBI on May 22, 2023. In reply, SEBI vide email dated May 29, 2023, did not raise any objection to the joint process and advised the MIs to put in place required processes with appropriate checks and balances for compliance with the SEBI Circular dated November 11, 2022. It is evident that the process referred to in the said SEBI communication itself was submitted as the joint proposal adopted by the MIs, including CDSL to ensure compliance with the said SEBI Circular.
- (ii) CDSL has put in place appropriate systems to ensure adherence to the said joint process. In any event, if SEBI considered any aspect of the system to be inappropriate, it should have reverted at the time of review to the test of appropriateness. Therefore, the assertion that CDSL did not have appropriate systems in place is unfounded and incorrect. Thus, CDSL cannot be held in violation of clause 5 of the said SEBI Circular.
- (iii) With respect to the instance of JM Financial's CUSA account, CDSL acknowledges that there was a delay in freezing JM Financial's CUSA account by the concerned official. However, this delay was immediately rectified during CDSL's weekly review process and immediate corrective action was taken by freezing the account on July 05, 2023. The delay occurred because the concerned official was involved in other critical operational activities and it was an operational error and therefore not a systemic error. To prevent recurrence in future, CDSL has implemented various checks including making it part of daily reviews and checklists and integrated it into the said joint process. CDSL asserted that there was no market impact or adverse effect, and no transfers



occurred during this period. This isolated incident does not indicate in any manner that there is no system in place to wind up all CUSA accounts.

- (iv) With respect to the instance of Bajaj Financial Securities Limited's CUSA account, CDSL clarifies that the request email from the stock exchange to unfreeze the CUSA account was missed by the concerned official and it was an operational error and therefore not a systemic error. There was no follow up by the stock exchange official or any concerned member during the intervening period. However, the BSE brought it to the notice of CDSL in May 2023, upon which CDSL promptly responded and requested BSE to provide a new unfreeze date. CDSL asserted that there was no market impact or adverse effect. . This isolated incident, similar to the previous one, does not reflect the absence of a system to wind up CUSA accounts and is merely a procedural lapse.
- (v) Further, CDSL submitted the following data to demonstrate that it has complied with the said SEBI Circular and the said joint process and wound up the following number of CUSA accounts by April 15, 2023, and froze for debit and credit:

<i>(During Inspection Period)</i>	
CUSA A/c active as on April 15, 2023	101
CUSA A/c frozen on April 16, 2023	101
<i>(Present status)</i>	
CUSA A/c closed up to September 25, 2024	24
CUSA A/c frozen as on September 26, 2024	77

- (vi) The abovementioned data demonstrates all CUSA accounts were frozen on April 16, 2023, in accordance with the said SEBI Circular and the said joint process, and there have been no systemic failures. The above two instances as observed by SEBI were a case of minor operational aberration by individuals and not a systemic error. Therefore, CDSL cannot be held accountable for non-compliance of the said SEBI Circular and the said joint process.
- (vii) Therefore, CDSL has established that these two instances were minor operational aberrations and not systemic errors. Thus, CDSL is not in violation of clause 5 of the said SEBI Circular and therefore, the allegation ought to be dropped by SEBI.

E. Allegation of IT-related issues/ matters relating to Unauthorized Transmission of Data with respect to non-compliance of clause 31 of Annexure A of the SEBI Circular dated July 06, 2015

- (i) CDSL denies the allegation of violation of clause 31 of Annexure A of the SEBI Circular dated July 06, 2015, as mentioned in the SCN. CDSL asserted that it has adhered to all SEBI regulatory guidelines and has acted within the scope of its obligations as a 'depository'.
- (ii) CDSL at the foremost denies any instances of unauthorized access, copying, or transmission of data as alleged by SEBI. The 24 (twenty-four) endpoints referred to are entirely within CDSL's internal ecosystem and are not associated with the exchange or transfer of information with any external parties. In addition, there is



no breach of data or transmission outside CDSL's environment, ensuring the confidentiality of information at all times.

- (iii) CDSL further confirms that there has been no third-party interaction involving the said endpoints, and therefore, no data exposure or compromise has occurred in violation of the said SEBI Circular.
- (iv) CDSL has implemented robust and comprehensive measures to secure sensitive data, which includes but is not limited to the deployment of a DLP solution. The DLP solution is an additional layer of security meant to prevent the leakage of sensitive data to external parties. However, the DLP is not solely responsible for ensuring access control within CDSL's environment. The implementation of the DLP solution is a supplementary measure to the existing security infrastructure. The DLP solution, by design, is not intended to perform access control checks but to prevent data exfiltration and leakage.
- (v) CDSL asserted that there are several other mechanisms in place to restrict unauthorized data transfers/ copying of data through any channels, including:
 - (a) *USB blocking and CD Drive Restriction*: USB drives are disabled through Active Directory (AD) controls to prevent unauthorized copying of data. CD drives on endpoints have also been disabled across CDSL's network. This restriction ensures that sensitive data cannot be copied or transmitted through physical storage devices, further reducing the likelihood of data leakage.
 - (b) *Email Controls*: While emails remain a potential point for data transmission, the DLP solution has been configured to monitor and restrict unauthorized email transmissions based on defined rules and criteria.
 - (c) *Privilege Identity Management (PIM) Tool*: CDSL has deployed a Privilege Identity Management (PIM) tool (named, Arcos) to prevent unauthorized access to its systems. This tool ensures that only authorized personnel have access to critical systems, and all access is monitored and controlled through this tool.
 - (d) *Web filtering and Restricted Internet Access*: CDSL has implemented web filtering rules since its inception to block access to websites that are potential channels for data transmission. This includes blocking access to file-sharing websites like *Google Drive* and other data upload platforms. Additionally, access to websites offering personal email services (e.g., *Gmail, Hotmail*) is restricted, thereby mitigating the risk of unauthorized data transfers through these channels.
 - (e) *Mobile device management (MDM)*: CDSL has implemented MDM solution to secure access of CDSL applications via mobile devices such as handheld phones, tablets, etc. This tool restricts copying of official information on personal devices.
- (vi) CDSL reiterated that there have been no incidents or cases of data leakage or security breaches from these 24 (twenty-four) endpoints, or any other machines within CDSL's infrastructure during the Inspection Period.



- (vii) Therefore, the allegations made by SEBI in the SCN lack merit. Thus, CDSL stated that it is not in violation of clause 31 of Annexure A of the said SEBI Circular.

F. Allegation relating to Cyber Security aspects with respect to Cyber Risk Assessment conducted being incomplete and therefore, non-implementation of the baseline standards uniformly

- (i) CDSL has established and adheres to the baseline standards for its IT systems, which include configurations for operating systems, databases, and network devices. These standards were initially set and have undergone regular updates, with the latest revisions done in the year 2021. These standards are comprehensively documented in CDSL's baseline configuration requirement documents.
- (ii) CDSL conducts periodic enforcement checks to ensure that the baseline standards are applied uniformly across all its IT systems. The checks are validated through periodic audits, including system and cyber security audits, which are performed by CERT-IN empanelled auditors. There were no adverse findings related to the enforcement of baseline standards for the inspection period in question. The system audit report dated July 28, 2023, and the Cyber Security Audit Report dated August 22, 2023, further confirm CDSL's compliance with SEBI's guidelines.
- (iii) In addition, CDSL has implemented various network security measures such as firewalls, intrusion prevention systems (IPS), and antivirus software since 2001, with regular upgrades, where the latest being on June 17, 2023. Additionally, CDSL has implemented web filtering rules that block access to websites that provide file sharing and email services such as Google Drive and Gmail. This ensures that data is not transferred to unauthorized external sources.
- (iv) CDSL clarified that the DLP is a data protection mechanism that operates alongside the existing baseline standards. SEBI's conclusion that DLP issues indicate a lack of baseline standards is erroneous. The implementation of DLP cannot define or establish baseline standards, as its configuration and usage vary based on organizational needs.
- (v) CDSL has implemented DLP in a phased manner, starting with the Alert Mode and later transitioning to Blocking Mode after addressing false positives. CDSL conducted the DLP configuration in the following phased manner to ensure effective deployment and minimal operational disruptions:
 - (a) *Data Flow Analysis*: Conducted to understand and map the flow of sensitive data within the environment.
 - (b) *DLP in Alert Mode*: Initially implemented in alert mode to monitor data flow and fine-tune the system based on real-time observations.
 - (c) *DLP in Blocking Mode*: Upon maturity and after addressing false positives, the DLP rules have been configured in blocking mode.



This approach ensures the operational stability at CDSL without hindering any valid communications. The fact that CDSL shifted to a comprehensive DLP solution demonstrates its continued commitment to enhanced data security, despite already having stringent mechanisms in place.

- (vi) It is pertinent to emphasize that the DLP solution, by its nature, generates numerous false positive alerts during its initial deployment phase. This necessitates a fine-tuning exercise to ensure its optimal performance before it can be safely transitioned to blocking mode. If DLP were to be switched directly to blocking mode without this adjustment, it could inadvertently restrict legitimate valid communications, causing unnecessary disruptions. At the time, CDSL was operating in 'alert mode' with the DLP solution, it was aligned with CDSL's baseline standard. This vigilant approach allowed CDSL to monitor and evaluate the system's effectiveness while minimizing potential false positives. This transition to a more holistic DLP solution represents an enhancement to CDSL's security measures. CDSL reiterated that DLP functions as a configuration tool tailored to specific organizational needs, rather than a rigid baseline standard itself. The baseline standards are primarily designed for components used to host applications and to ensure minimum security measures are maintained.
- (vii) In addition, CDSL has also implemented MDM solutions in accordance with O365 standards. Furthermore, access to USB and CD drives on endpoints has been disabled by CDSL to reduce the likelihood of unauthorized data transmission.
- (viii) CDSL has consistently adhered to the prescribed baseline standards and has proactively strengthened its data security initiatives through advanced solutions including DLP. The specific instances cited by SEBI do not indicate a systemic violation but rather reflect CDSL's ongoing commitment to continuous improvement and vigilance in safeguarding data.
- (ix) In light of the above, CDSL refuted SEBI's allegation that it is in violation of clauses 27 and 28 of Annexure A of the said SEBI Circular. SEBI's assertion that the DLP implementation reflects a lack of adherence to baseline standards is a clear misinterpretation by SEBI. Thus, CDSL is not in violation of clauses 27 and 28 of Annexure A of the said SEBI Circular and therefore, the allegation ought to be dropped by SEBI.

G. Allegation relating to Recovery Time Objective/ Recovery Point Objective not being in compliance with clauses 4(c) and (d) of the SEBI Circular dated March 22, 2021

- (i) CDSL denies the allegation of violation of clauses 4(c) and (d) of the SEBI Circular dated March 22, 2021, as mentioned in the SCN. CDSL asserted that it has adhered to all SEBI regulatory guidelines and has acted within the scope of its obligations as a 'depository'.



- (ii) It is pertinent to note that the said SEBI Circular, does not explicitly mandate that Recovery Time Objective (“RTO”) and Recovery Point Objective (“RPO”) values must be incorporated within the Cyber Crisis Management Plan (“CCMP”). The language of the said SEBI Circular is clear, and there exists no stipulation that requires these objectives to be documented in the CCMP. Therefore, any assertion by SEBI that CDSL is in violation of said SEBI Circular due to the alleged omission is fundamentally flawed and without basis in the regulatory framework.
- (iii) The RTO and RPO are vital parameters integral to business impact analysis. The RTO specifies the duration within which a particular application should be recovered following a disaster, while the RPO delineates the acceptable amount of data loss in such scenarios. While CDSL has included references to RTO and RPO within the CCMP, it is imperative to highlight that these said objectives are ideally required and are also extensively covered in detail in CDSL’s Business Continuity and Recovery Strategy Policy. The CCMP is referred to during the case of a cyber crisis. In addition to the SEBI, CDSL is also regulated by the National Critical Information Infrastructure Protection Centre (“NCIIPC”) and regularly engages in meetings with the NCIIPC, and the steering committee established by CDSL. In one of the said meetings, the NCIIPC recommended that the CCMP should include references to RPO and RTO. Hence, CDSL incorporated the process of RTO and RPO in the CCMP. The CCMP has been structured to reference the processes for RTO and RPO. CDSL adheres to the RTO of 45 minutes and RPO of 15 minutes as prescribed by SEBI. These said objectives are not only established but are also actively enforced through rigorous checks and audits. CDSL has put in place mechanisms to ensure that these timelines are met consistently, thereby reinforcing its commitment to operational resilience and data integrity.
- (iv) The fact that the said SEBI Circular does not impose a requirement for the explicit mention of RTO and RPO in the CCMP, CDSL stated that it has not violated any provisions of clauses 4(c) and (d) of the said SEBI Circular.

H. Allegation relating to Disaster Recovery Infrastructure with respect to non-compliance with clause 5(h) SEBI Circular dated March 22, 2021

- (i) CDSL denies the allegation of violation of clause 5(h) of the SEBI Circular dated March 22, 2021, as mentioned in the SCN. CDSL assert that the DR drills were indeed conducted in accordance with the said clause and that the deviations observed were part of the testing process rather than indicative of non-compliance.
- (ii) The purpose of DR drills conducted by CDSL is to test the switchover and disaster recovery capabilities of the organization in simulated scenarios. The said drills are intended to evaluate the preparedness and identify any potential issues that may arise during the switchover process. They are not intended to serve as



a definitive demonstration of achieving the RTO and RPO during an actual disaster event.

- (iii) The said SEBI Circular mandates RTO and RPO as target objectives to be achieved in the event of a real disaster scenario. CDSL's obligation is to demonstrate preparedness to meet the said objectives, which is the fundamental purpose of the DR drills. These drills are conducted on a quarterly basis to evaluate readiness and to resolve any deviations identified during the simulation. As such, the objectives of RTO and RPO are not mandatory metrics to be consistently met during the said drills, as they are contingent on the specific circumstances and technical environment present at the time of the said drill.
- (iv) CDSL acknowledged that there were 4 instances during DR drills where the stipulated RTO of 45 minutes was exceeded. However, it is pertinent to note that these instances were isolated cases that occurred during simulated exercises and were not reflective of CDSL's actual disaster recovery capabilities. Each deviation was subjected to a detailed root cause analysis to identify and address the underlying issues. The corrective actions taken were validated in subsequent DR drills, demonstrating that the issues were effectively resolved.
- (v) The deviations in RTO observed during DR drills were a result of the testing and simulation of different disaster scenarios and were not indicative of any systemic issues in CDSL's disaster recovery processes. Furthermore, these deviations were effectively addressed through corrective actions, which were communicated to the relevant stakeholders, including the CDSL Standing Committee on Technology (SCOT Committee).
- (vi) Therefore, the allegation by SEBI of non-compliance with clause 5 of the said SEBI Circular is unfounded. The deviations identified during DR drills were isolated instances that were promptly rectified, and they do not constitute a violation of clause 5(h) of the said SEBI circular by CDSL. CDSL has consistently demonstrated its preparedness to meet the RTO and RPO requirements in all other instances, thereby ensuring compliance with the said SEBI Circular.

I. Allegation relating to Manpower deployment at Primary Data Centre with respect to non-compliance with clause 3(d) SEBI Circular dated March 22, 2021

- (i) CDSL denies the allegation of violation of clauses 3(d) of the SEBI Circular dated March 22, 2021, as mentioned in the SCN. CDSL asserted that it has fully complied with all SEBI regulatory requirements and has operated in accordance with its mandated responsibilities.
- (ii) CDSL contended that clause 3(d) of the said SEBI Circular primarily focuses on ensuring that the DR site has adequate and trained manpower to independently handle operations without relying on the PDC. This requirement is to ensure that, in case of a disaster scenario, the DR site can function as a standalone facility. CDSL has more than fulfilled this obligation by deploying a sufficient number of



trained staff at the DR site (as affirmed by SEBI in the SCN), thereby ensuring that the DR site of CDSL can handle all critical operations independently.

- (iii) The said SEBI Circular does not mandate the physical deployment of CDSL's employees at the PDC on a permanent basis. CDSL has ensured that adequate personnel are available at its Mumbai head office and can be mobilized to the PDC as needed. Therefore, CDSL is in compliance with the requirements, as there is no deficiency in expertise or operational capability at the PDC.
- (iv) CDSL has engaged with third-party data center service providers to provide hosting services for both the PDC and DRS. These third-party data centers are designed to host servers for multiple clients with dedicated caged areas or independent racks and provide essential facilities like power, cooling, cabling, and network connectivity with multiple redundancies. The said data center service providers are responsible for maintaining the infrastructure and ensuring availability through strict service level agreements. As a result, it is not a requirement by design for CDSL's personnel(s) to be physically deployed at the data centers for regular operations. These data centers are connected to CDSL's office through point-to-point network connectivity.
- (v) CDSL's IT operations and system administration activities are conducted centrally from CDSL's office in Mumbai. To ensure seamless operations, CDSL has engaged its third-party data center service provider for 'hands-and-feet' support in cases that require physical access to the PDC. Additionally, in the event of planned activities or emergencies, CDSL deploys the necessary resources to the PDC as required. This arrangement ensures that CDSL's operational requirements are met without the need for constant physical presence at the PDC.
- (vi) CDSL has ensured that a dedicated team of 8 (eight) skilled professionals is deployed at the DR site in Hyderabad. These individuals are responsible for running critical IT operations, including end-of-day (EOD) and start-of-day (SOD) operations, backup of systems, and monitoring of infrastructure. The said dedicated team at DR site is well-trained and has the necessary expertise to carry out DR drills independently, without any dependency on the PDC personnel, thereby fulfilling the requirements under the said SEBI's Circular.
- (vii) The said SEBI Circular mandates that manpower at the DR site should have the same level of expertise as the PDC personnel and should be able to operate independently. CDSL has ensured compliance with this mandate by deploying dedicated and skilled personnel at the DR site, with the ability to mobilize additional personnel from the Mumbai head office to the PDC, whenever required, as the proximity of location and the point-to-point network connectivity is close. This flexibility and availability of trained staff at CDSL's head office in Mumbai ensure that the PDC can function effectively without permanent on-site personnel.
- (viii) The SEBI's allegation that CDSL is in violation of clause 3(d) is incorrect, as CDSL has, at all times, ensured that there is adequate manpower at the DR site



with the requisite expertise and skill to manage and operate independently. CDSL's operational model for the PDC and DR site has been structured in a manner that ensures compliance with the said SEBI Circular and also optimizes the resources based on the operational requirements.

- (ix) Therefore, the SEBI's allegation of non-compliance with clause 3(d) of the SEBI circular is not substantiated. The manpower deployment strategy of CDSL at the PDC and DR site is aligned with regulatory requirements, ensuring operational readiness and compliance at all times. Therefore, CDSL is not in violation of clause 3(d) of the said SEBI Circular.

J. Allegation relating to Disaster Recovery Site Drill and non-compliance of clause 5(c) of SEBI Circular dated March 22, 2021

- (i) The aforementioned clause 5(c) mandates that the Disaster Recovery (DR) drill should include running all operations from the DR site for at least one full trading day. During SEBI's visit to the DR site at Hyderabad on October 12, 2023, along with the Technical Advisory Committee (TAC) members, it was observed that the Security Information and Event Management ("SIEM") logs were being collected at the PDC during the DR drill. Based on this observation, SEBI concluded that all operations were not being conducted from the DR site, thereby alleging non-compliance with the said clause.
- (ii) The primary objective of a DR drill is to test and confirm that business operations can continue to run seamlessly from the DR site in the event of a disaster. The term "running all operations" refers specifically to ensuring the continuity of business activities and does not encompass ancillary or supplementary processes, such as log collection and monitoring, that do not directly impact business operations.
- (iii) The SIEM monitoring is a detective control activity, focused on analyzing security logs for potential anomalies. This function does not interfere with or impede the continuity of business operations. During the DR drill, all core business operations were indeed conducted from the DR site, thereby fulfilling the requirement of the said clause 5(c).
- (iv) For devices and systems located at the DR site, logs are collected by SIEM collectors physically located at the DR site. These logs are then forwarded to the SIEM component at the PDC for centralized monitoring and correlation. The purpose of maintaining the SIEM component at the PDC is to ensure comprehensive security monitoring and correlation amongst various logs across different devices and sites. This centralized monitoring is a standard security best practice and is necessary for effective security analysis.
- (v) It is pertinent to note that during the DR drills, the PDC environment remains technically available but is not utilized for any business operations. The continuous SIEM monitoring of the PDC is, therefore, essential to ensure security



oversight of the inactive environment. This practice does not contravene the requirement of running business operations solely from the DR site.

- (vi) CDSL has the capability to manually switch over the SIEM console to the DR site in the event of a disaster. This contingency plan ensures that in the case of an actual disaster scenario, all security monitoring can be conducted from the DR site without the need for PDC involvement.
- (vii) CDSL reiterated that the purpose of running the DR drill is to ensure the continuation of business activities from the DR site. The collection and monitoring of SIEM logs at the PDC do not detract from this objective, as the business operations themselves were entirely conducted from the DR site. The function of SIEM monitoring is inherently separate from the conduct of business operations, and hence, should not be considered as non-compliance with clause 5(c).
- (viii) Therefore, the allegation of non-compliance with clause 5(c) of the said SEBI Circular is without merit. CDSL has fully complied with SEBI's stipulations by running all business operations from the DR site during the DR drill, as required. The collection and centralized monitoring of SIEM logs at the PDC is a standard security practice that does not undermine the objectives of the DR drill or the requirements of clause 5(c). Thus, CDSL is not in violation of clause 5(c) of the said SEBI Circular dated March 22, 2021. Hence, the allegation ought to be dropped by SEBI.

K. Allegation relating to Identical Vulnerabilities repeated with respect to non-patching of vulnerabilities within stipulated timelines by SEBI and non-compliance of certain provisions of SEBI Circulars dated May 20, 2022, and July 06, 2015

- (i) The allegation of non-compliance is based on SEBI's observation that certain vulnerabilities reported during the VAPT were not patched within the stipulated timeline of 3 (three) months and that there were repeated vulnerabilities across VAPT reports for the financial years 2021-2022 and 2022-2023. SEBI further stated that the closure of these vulnerabilities occurred only after SEBI pointed them out through the Inspection Report, with the process taking a total of 7 (seven) months, thereby resulting in a significant delay.
- (ii) The VAPT process is conducted by an independent third-party auditor to identify, assess, and remediate potential vulnerabilities. During the Inspection Period, the VAPT was conducted by RSM Astute, a CERT-In empaneled auditor. The VAPT reports for both financial years FY 2021-2022 and FY 2022-2023 pertain to the same IP address. However, the nature of vulnerabilities observed in these two reports is entirely different. In 2021-2022, the vulnerabilities identified in the VAPT report for IP 61.95.148.49 were related to web server version disclosure, whereas in 2022-2023, the vulnerabilities were linked to the deprecation of the TLS v1.1 protocol. Thus, there is no repetition of identical vulnerabilities across



the two reports. The nature of these vulnerabilities is inherently different, despite being reported for the same IP address.

- (iii) CDSL acknowledged that there was a delay in closing certain vulnerabilities due to the prioritization of remediation efforts based on risk-based assessment. CDSL prioritized high and medium-risk vulnerabilities and ensured their closure within the stipulated time frame. As for the low-risk vulnerabilities, CDSL exercised discretion in addressing them based on their impact and likelihood of exploitation. It is significant to mention herein that none of the vulnerabilities classified as high-risk or medium-risk were left unaddressed. All high and medium-risk vulnerabilities were remediated prior to the closure of low-risk vulnerabilities. The delay in closing the low-risk vulnerabilities did not pose any substantial threat to the security or stability of the system and, therefore, did not warrant immediate attention.
- (iv) With respect to the specific vulnerabilities related to jQuery and Bootstrap libraries, it is submitted that these vulnerabilities were remediated as recommended. For instance, the version of jQuery was upgraded from 3.4.1 to 3.6.4 and the version of Bootstrap was upgraded from 3.3.5 to 5.2.3 as evidenced in the URLs³ provided below:
- <https://betamfr.cdslindia.com/Scripts/xxxxx-x.x.x.js>
 - <https://betamfr.cdslindia.com/Scripts/xxxxx-xx-x.xx.x.min.js>
 - <https://www.cdslindia.com/Includes/xxxxxxxxx-x.x.x/xx/xxxxxxxxxx.min.js>
- (v) The previous version of Bootstrap was retained in the '/includes' folder solely for contingency purposes, while the new version was in active use. As a result, the old version was not vulnerable and did not pose any security risk. Nevertheless, the old library was removed after SEBI's observation to avoid any misunderstanding.
- (vi) CDSL has performed a thorough root cause analysis of all observations made by SEBI and has taken corrective actions to ensure closure of any vulnerabilities identified. This has been verified and validated by another CERT-In empanelled auditor.
- (vii) The comprehensive VAPT status report, as shared with SEBI, provides evidence of closure and remediation of all vulnerabilities, confirming CDSL's compliance with SEBI's guidelines. CDSL has acted in accordance with the said SEBI Circular dated May 20, 2022, and the said SEBI Circular dated July 6, 2015. The risk prioritization and remediation strategy adopted by CDSL is consistent with industry best practices and ensures the security and integrity of its systems.
- (viii) Therefore, the SEBI's observation regarding vulnerabilities being repeated is incorrect. The SEBI's allegation of repeated vulnerabilities is factually incorrect. The vulnerabilities observed in the said two VAPT reports are distinct and have been remediated in accordance with their risk levels. In addition, the closure of

³ Details excised for privacy and security.



vulnerabilities occurred after due consideration of their severity and impact on the system. Therefore, CDSL is not in violation of clause 2(41) of the SEBI Circular dated May 20, 2022, read with clause 41 of Annexure A of the SEBI Circular dated July 6, 2015.

L. Allegation relating to VAPT activity and non-compliance of certain provisions of SEBI Circulars dated May 20, 2022, and July 06, 2015

- (i) The allegation by SEBI is based on the observation that the VAPT conducted by CDSL was not comprehensive, as it did not cover all domains as required under VAPT. Specifically, SEBI noted that there were no VAPT reports for certain critical applications such as eDIS and AuditWeb, and that a source code review was not undertaken. The SEBI claims that this is a violation of the prescribed regulatory requirements.
- (ii) CDSL clarified that VAPT consists of black box as well as grey box testing methodologies. CDSL conducts black box testing on the Production/live environment. The SEBI allegation regarding testing being conducted on UAT/ Mock environment pertains to grey box testing. CDSL further clarified that grey-box testing being intrusive in nature bears the risk of disruption of applications/systems. Hence, typically these tests are conducted on a production-like test environment to avoid any disruption or adverse impact on the live environment. As conducting VAPT on a live production environment could potentially affect the stability and performance of the applications.
- (iii) Contrary to SEBI's observations, VAPT was conducted for critical applications such as eDIS and AuditWeb, and the respective VAPT reports were shared with SEBI during the inspection. The scope of the VAPT was comprehensive, covering all key applications and systems as per the SEBI guidelines.
- (iv) CDSL highlighted that the VAPT and source code review are two distinct and independent security measures, each serving a unique purpose in the overall security assessment process. The VAPT is performed on the finished product, focusing on identifying vulnerabilities in the running application, whereas the 'Source Code Review' is a separate exercise conducted on the application's codebase during the development phase to identify any vulnerabilities that may exist in the code itself.
- (v) As per the industry best practices, VAPT and source code reviews are complementary activities, but one is not a substitute for the other. The said SEBI Circulars referenced herein do not explicitly mandate a combined VAPT and source code review. CDSL proactively engaged eSecForte Technology, a CERT-In empanelled auditor, to conduct a source code review of CDSL applications in March 2021. The scanning was completed, and the reports were submitted in July 2021. In April 2022, CDSL requested eSecForte to accommodate changes in the CDAS code, and the scanning was performed again. The updated report was placed before the SCOT (Standing Committee on Technology) meeting held



on May 10, 2022. This demonstrates that CDSL has conducted source code reviews periodically to ensure the security of its applications. Further, the SCOT, in its 25th Committee meeting held on March 27, 2023, suggested that source code reviews be carried out periodically for any new additions to the codebase. CDSL has taken this recommendation seriously and has scheduled annual reviews for all critical applications.

- (vi) Following the SCOT's suggestion, CDSL has engaged M/s KPMG, a CERT-In empanelled auditor, to conduct another source code review of its critical applications as of October 23, 2023. This activity is part of CDSL's ongoing efforts to maintain a secure environment and is scheduled to be completed by March 31, 2024. This further demonstrates CDSL's proactive approach to application security.
- (vii) During the Inspection Period, the source code review was not in progress as it is an independent exercise with its own timeline and is not directly linked to the VAPT process. SEBI's observations appear to conflate the two activities, suggesting that a lack of source code review implies a lack of comprehensiveness in the VAPT. This interpretation is incorrect as VAPT and source code review serve different objectives and are conducted at different stages of the application lifecycle.
- (viii) CDSL has provided a comprehensive VAPT report to SEBI during the inspection, which clearly outlines the scope and coverage of all applications and devices tested. This includes the eDIS and AuditWeb applications. The inclusion of these applications in the VAPT scope refutes SEBI's claim that the VAPT was not comprehensive. Moreover, the malware incident cited in the SCN, which occurred on November 18, 2022, was unrelated to the application's source code. The root cause analysis revealed that the issue was related to vulnerabilities in the peripheral system configuration and not due to any application vulnerability. Thus, it would be incorrect to link the malware incident with the comprehensiveness of VAPT or source code review.
- (ix) CDSL stated that the VAPT conducted was comprehensive and covered all critical applications as required. Furthermore, source code reviews have been conducted periodically, and CDSL is in compliance with the relevant SEBI Circulars.
- (x) Therefore, SEBI's allegation that VAPT was not comprehensive due to the absence of source code review is unfounded as they are distinct exercises. CDSL has taken proactive measures to maintain a robust security posture and continues to undertake periodic reviews of its applications to ensure their integrity and security. Thus, CDSL is not in violation of clause 2(40) of the SEBI Circular dated December 7, 2018, read with clause 40 of Annexure A of the SEBI Circular dated July 6, 2015, as stated in the SCN.



9. Noticee vide letter dated October 04, 2024 sought inspection of documents and the same was granted. The Authorized Representatives (hereinafter referred to as 'AR') of the Noticee conducted an inspection of the documents on October 15, 2024.
10. In the meanwhile, Noticee filed a settlement application on October 9, 2024. Thereafter, in the interest of natural justice, an opportunity of hearing was granted to the Noticee vide Hearing Notice dated October 30, 2024. The hearing was held on November 26, 2024. Further, as requested by the Noticee, time till December 06, 2025 was granted to the Noticee for submitting additional reply. Noticee vide email dated December 06, 2024 reiterated the submissions made vide letter dated October 04, 2024. However, the matter was kept in abeyance in view of the pending settlement application.
11. It is noted from the material on record that the settlement application of the Noticee was withdrawn on April 06, 2026.
12. Thereafter, another opportunity of hearing was granted to the Noticee vide Hearing Notice dated April 15, 2026. The hearing was held on May 18, 2026. On the said date, ARs of the Noticee, Mr. Rohan J. Cama, Mr. Kyrus Modi, Mr. Anubhav Ghosh, Mr. Vivek Shah, Mr. Taposh Das and Mr. Abhishek Venkataraman attended the hearing. Further, as requested by the Noticee, time till June 01, 2026 was granted to the Noticee for submitting additional reply.
13. The Noticee, vide letter dated June 01, 2026, submitted the following additional reply:

A. The Noticee has not violated regulation 79(5) of the DP Regulations

- (i) Regulation 79(5) of the DP Regulations requires the depository to send intimation to the pledgor and pledgee regarding the rejection of a pledge. The regulation contemplates two obligations: first, that the depository shall send intimation with respect to the rejection; and second, that a record of such communication is maintained. The regulation does not prescribe the manner or system field in which such record is to be captured.
- (ii) In the present case, CDSL had, as a matter of practice, intimated the relevant parties regarding pledge rejections. The observation in the SCN relates to 27 instances where the reason for rejection was not populated in a supplementary "Remarks" field in the system. This "Remarks" field was an additional field introduced by CDSL; it was not a mandatory field at the relevant time.



- (iii) The pledge creation and rejection process is a bilateral arrangement between the pledgor and the pledgee, conducted outside the purview of the depository. CDSL acts solely as a facilitator providing the technological infrastructure. CDSL neither dictates the terms of pledges nor is privy to the underlying reasons for rejection, which are determined bilaterally between the DPs. Further, the DPs desirous of giving further details of such rejections in the CDSL system could mention the same in the "Remarks" field which was provided by CDSL as an additional field.
- (iv) The SCN itself at Paragraph 5.1.2 itself acknowledges that the parties were informed and that the reason was just not captured in the system. Under regulation 79(5), non-recording in a supplementary system field cannot be elevated to a substantive breach.
- (v) Without prejudice to the above, CDSL undertook a review of its system and initiated necessary system changes to enhance compliance. CDSL submitted its Action Taken Report to SEBI on June 21, 2024, informing SEBI that it had begun implementing changes to make it mandatory for pledgee DPs to provide the reason for rejection of pledges in the system. These changes were successfully implemented in the system on July 13, 2024, before the issuance of the SCN. The upgraded system of CDSL now mandates the pledgee DP to provide the reason for rejection and the same is communicated to the pledgor's DP as well. Additionally, CDSL ensured that necessary communiques and guidance were given to all market participants to familiarize them with the upgraded system functionality before it was implemented.
- (vi) Accordingly, it is pertinent to note that: (a) no complaints, grievances, or representations were received in any of the 27 cases; (b) CDSL proactively made the "Remarks" field mandatory with effect from July 13, 2024, prior to the issuance of the SCN; (c) the pledge creation system has been operational since August 2001, and in no past SEBI inspection has this issue been raised as a deficiency; and (d) there has been no market impact whatsoever. In light of the above, the said allegation is unwarranted and ought to be dropped in its entirety.

B. Noticee has complied with its obligations under the applicable SEBI circulars dated August 27, 2012, July 01, 2014, and December 11, 2015, governing the BSDA framework

- (i) A strict reading of the above-said SEBI Circulars demonstrates that the obligations of the depositories (including the Noticee) are limited to: (a) bringing the provisions of the relevant circulars to the notice of DPs; (b) disseminating the said provisions on its website; and (c) communicating the implementation status to SEBI through MDR. It is submitted that CDSL has duly complied with each of these obligations.
- (ii) The obligation to actually convert eligible BO accounts to BSDA, and to obtain opt-out confirmations from BOs, rests squarely on the DPs, who have the direct



interface and relationship with the BOs and are mandated to convert the eligible accounts to BSDA as per the above mentioned circulars. The provisions of the said circulars must be read strictly and not in a purposive manner that would extend CDSL's obligation beyond what is expressly prescribed. CDSL's obligation cannot be tied to that of a DP.

- (iii) The communiqués issued by CDSL to DPs immediately following each SEBI Circular demonstrate that CDSL brought the provisions to the notice of DPs and directed them to ensure compliance. Further, in order to assist the DPs, CDSL proactively shared lists of eligible BOs with DPs on a monthly basis, thereby going beyond its mandatory obligations.
- (iv) Further, as part of its role, CDSL conducts regular and comprehensive audits and inspections of DPs in accordance with the CDSL DP inspection process to ensure adherence with SEBI requirements, including compliance with the BSDA framework and conversion of eligible accounts into BSDA.
- (v) It is also relevant to note that: (a) no prior adverse remark was made in any past SEBI inspection regarding BSDA; (b) as on May 31, 2024, approximately 3.5 crore demat accounts (29% of total) stand classified as BSDA; (c) CDSL has actively engaged with SEBI to refine the penal action framework for non-conversion; and (d) SEBI has allowed CDSL to believe in its *bona fides* by consistently accepting CDSL's approach across past inspection cycles without adverse observations.
- (vi) With respect to the allegation of pecuniary gain at paragraph 5.2.5 of the SCN, it is submitted that SEBI cannot arrive at such a conclusion on the basis of mere inference without placing specific evidence on record. Any unutilized portion of the amount set aside by CDSL for BSDA incentives is reflected as a liability in CDSL's books and do not constitute a "disproportionate gain" within the meaning of Section 15J of the SEBI Act.
- (vii) Therefore, the allegation that CDSL failed in its role is baseless and devoid of merit. CDSL has implemented a robust supervisory and compliance framework, including dissemination of SEBI circulars, periodic communiqués, monthly reporting to SEBI, and regular inspections of DPs. The responsibility for conversion of eligible BO accounts into BSDA and obtaining opt-out confirmations lies with the concerned DPs, and not with CDSL. CDSL does not gain any monetary benefit due to the non-conversion of regular accounts to BSDA accounts. In the absence of any regulatory breach, market disruption, or investor complaint attributable to CDSL, the present allegation deserves to be set aside in its entirety.

C. Noticee has not violated clauses 3.4, 3.5 and 5 of the SEBI Circular dated November 11, 2022



- (i) The obligations under clauses 3.4 and 3.5 of the SEBI Circular dated November 11, 2022, are cast upon the TM/CM and not upon the depository. A plain reading makes this clear that: -
- (a) Clause 3.4: *"If the client fulfils its funds obligation within five trading days after the pay-out, TM/CM shall release the pledge...."* The releasing of the pledge is the obligation of TM/CM.
- (b) Clause 3.5: *"If the client does not fulfil its funds obligation, TM/CM shall dispose of such unpaid securities in the market within five trading days after the pay-out...."* The disposal of the unpaid securities is carried out on the stock exchange trading system where CDSL has no role in this process.
- (ii) CDSL's specific obligation is mentioned in clause 3.9, which states that if the pledge is neither invoked nor released within seven trading days after the pay-out, the pledge on securities shall be auto-released. Hence, the role of CDSL is limited to ensuring that its system facilitates the release or invocation within this seven (7) days window. CDSL's system fully enabled this functionality at all material times. It was given to understand that NSDL also had adopted the same interpretation and practice under the same regulatory framework.
- (iii) The interplay between clause 3.5 and clause 3.9 must be understood in its proper context. Under the erstwhile T+2 settlement cycle, if the TM/CM disposed of the securities on the 5th trading day, settlement of that disposal would only complete by the 7th trading day. The seven-day window in clause 3.9 was designed precisely to accommodate this settlement timeline. Accordingly, any release or invocation by TM/CM on the 6th or 7th trading day was a natural consequence of settlement mechanics and cannot be characterized as non-compliance by CDSL.
- (iv) SEBI did not mandate any system modification or issue any clarification addressing the operational impact of the subsequent transition from T+2 to T+1 settlement cycle. CDSL's system, designed in compliance with the T+2 framework, continued to function on that basis. Nevertheless, CDSL implemented system-level changes restricting release/invocation beyond the 5th trading day with effect from May 18, 2024, prior to issuance of the SCN.
- (v) Further, it is relevant to note that clause 3.9 operates as a safeguard mechanism to ensure that any consequence of a TM/CM's failure to act within the stipulated five-day window falls upon the TM/CM and not upon the client. If by the 7th trading day after pay-out, the pledge has still been neither invoked nor released, whether on account of delayed disposal, delayed settlement, or the TM/CM's failure to act, the securities are auto released to the client as a free balance.
- (vi) The object of clause 3.9 is to ensure that the loss occasioned by the TM/CM's inaction is borne by the TM/CM and is not passed on to the client whose securities are being held. It is in this sense a check and balance on the TM/CM, if the broker has not acted within the prescribed time, the consequence must fall on the broker. The gap between the five-day window in clause 3.5 and the seven-



day limit in clause 3.9 exists precisely to accommodate the settlement process and to ensure that, in any event, the client is protected.

- (vii) Therefore, in light of above, the allegations against CDSL for non-compliance with clauses 3.4, 3.5, and 5 of the SEBI Circular are unfounded.

D. Noticee's actions were undertaken in accordance with the joint operational process formulated by stock exchanges and depositories in consultation with SEBI for implementation of clause 5 of the SEBI Circular dated November 11, 2022

- (i) CDSL's actions with respect to CUSA were undertaken in accordance with the joint proposal formulated by the depositories and stock exchanges, which was submitted to SEBI on May 22, 2023. SEBI, vide email dated May 29, 2023, did not raise any objection to the said joint process and advised MIs to implement appropriate checks and balances.
- (ii) Under the joint process: (a) TM/CM initiated requests for transfer from CUSA; (b) stock exchanges verified trade data, client demat accounts and holdings; (c) verified details were forwarded to depositories for temporary unfreeze and execution of transfers; and (d) post execution, depositories reconciled transfers, frozen/closed accounts, and reported status to stock exchanges. The SOP jointly prepared by MIs, specifically mentions that upon receipt of instruction from the stock exchange, the depository will unfreeze the CUSA. The actions of CDSL are in line with the said SOP
- (iii) All 101 active CUSA accounts were frozen for debit and credit by April 16, 2023, in compliance with the SEBI Circular dated November 11, 2022, and the Joint Proposal. As on September 26, 2024, 24 of these accounts had been closed and the remaining 77 continue to be frozen.
- (iv) Further, post SEBI's observations on the inspection, CDSL implemented additional internal processing steps to strengthen checks and balances for CUSA transfers, with effect from June 14, 2024. They are as follows (*also intimated to SEBI vide the ATR dated June 21, 2024*):
 - (a) Securities in all non-closed CUSAs are frozen at both account and BO ISIN levels;
 - (b) CDSL prepares four upload files for each transfer request:
 - BO-ISIN level unfreeze files for the exact balance to be transferred.
 - Additional BO-ISIN level freeze files for any surplus balance.
 - Account-level unfreeze files (till transfer execution) and freeze files (post-transfer if holdings remain).
 - Transaction upload files based on stock exchange's verified details.
 - (c) All prepared files are submitted to internal auditors for validation and confirmation before execution.



- (d) Upon auditor confirmation, files are executed sequentially to complete the transfer.
- (e) Post-transfer, client and CUSA transaction statements are shared with stock exchange and the relevant DP.
- (f) If CUSA balances reached nil post transfer, account closure requests are initiated, and statuses are shared with stock exchange and DPs on the following business day.
- (v) With respect to the specific instances relating to JM Financial and Bajaj Financial Securities Limited, they were a case of minor operation aberration by individual officials and not systemic error. It is submitted that the corrective action was immediately taken upon identification of the issues and that no market impact, unauthorized transfer, or investor harm occurred in either case.
- (vi) It is further submitted that two isolated instances of human error out of over 100 accounts cannot constitute a finding that CDSL does not have a system in place. For there to be a breach warranting penalty, there must be evidence of systemic failure or *mens rea*, neither of which is present, these are at best venial and technical breaches.
- (vii) In this regard it is pertinent to note that CDSL has taken appropriate actions to comply with clause 5 of the SEBI Circular and the Joint SOP. The isolated deviations of minor aberrations do not constitute systemic failures, and proactive measures have been implemented to prevent recurrence, thus, CDSL is not in violation of clause 5 of the November 11, 2022, circular.

E. Noticee has not violated clause 31 of Annexure A to the SEBI Circular dated July 06, 2015, as it does not specifically mandate implementation of a DLP solution across all channels of MIs

- (i) It submitted that clause 31 of Annexure A of the Circular dated July 06, 2015, does not mandate the implementation of a DLP solution. The said clause requires measures to prevent unauthorized access, copying, or transmission of data and to ensure confidentiality of information during exchanges or transfers with external parties. DLP is one possible measure and not the mandated measure and its implementation by CDSL was voluntary in nature.
- (ii) The DLP solution is an additional layer of security which is meant to prevent the leakage of sensitive data to external parties. It is a supplementary measure to the existing security infrastructure of CDSL. DLP is not solely responsible for ensuring access control within CDSL's environment as well as it is not a sole or exclusive requirement under said clause 31.
- (iii) It is pertinent to note that where an entity does more than what is required by voluntarily implementing supplementary measures such as DLP it cannot be penalized for not perfecting those very measures. CDSL's implementation of DLP, being an act beyond regulatory compulsion, cannot itself become the standard against which non-compliance is measured.



- (iv) Further, the allegation is vague considering the fact it states that DLP measures were “*not completely implemented*” without specifying what precisely was lacking. The SCN does not identify a single instance of unauthorized access, data breach, or compromise of confidentiality involving any of the 24 endpoints in question. The 24 endpoints were entirely within CDSL’s internal ecosystem and were not connected with external data transmission or third-party interaction.
- (v) CDSL has in place a comprehensive suite of security measures including: -
- disabling USB drives and CD drives through Active Directory controls;
 - DLP-based monitoring and restriction of unauthorized email transmissions;
 - deployment of a Privileged Identity Management (“**PIM**”) tool (Arcos) to restrict and monitor privileged access to critical systems;
 - implementation of web filtering rules restricting access to file-sharing platforms and personal email services; and
 - implementation of Mobile Device Management (MDM) controls restricting copying of official information onto personal devices.
- (vi) Accordingly, CDSL has implemented robust security measures that comply with clause 31 of the SEBI Circular dated July 06, 2015, and the allegations in the SCN are unsustainable. The absence of a DLP solution on certain endpoints was neither required under the said SEBI Circular nor indicative of non-compliance. In addition, there have been no data breaches or unauthorized transmissions with respect to these 24 endpoints.

F. Noticee had established and implemented baseline security standards for its IT infrastructure, including operating systems, databases and network devices

- (i) It is submitted that CDSL has established and adheres to baseline standards for its IT systems, including configurations for operating systems, databases, and network devices. These standards are comprehensively documented in CDSL’s baseline configuration requirement documents, updated in 2021, and periodically validated through cyber security audits which were conducted by CERT-In empanelled auditors to ensure uniform implementation of baseline standards across systems. The System Audit Report dated July 28, 2023, and Cyber Security Audit Report dated August 22, 2023, did not record adverse findings regarding enforcement of baseline standards.
- (ii) There has been no violation of clauses 27 and 28 of the said SEBI Circular. CDSL in fact satisfied the requirements under the said clauses, along with additional features to supplement it. As per the requirements of clauses 27 and 28 of the said SEBI Circular:
- (a) CDSL has established and adheres to the baseline standards for its IT systems, which include configurations for operating systems, databases, and network devices. These standards were initially set and have



undergone regular updates, with the latest revisions done in the year 2021.

- (b) These standards are comprehensively documented in CDSL's baseline configuration requirement documents.
 - (c) These standards are continuously updated and revised with technological advancements within the IT environment.
 - (d) CDSL conducts periodic enforcement checks to ensure that the baseline standards are applied uniformly across all its IT systems. The checks are validated through periodic audits, including system and cyber security audits, which are performed by CERT-IN empaneled auditors. The System Audit Report dated July 28, 2023, and the Cyber Security Audit Report dated August 22, 2023, further confirm CDSL's compliance with SEBI's requirements.
 - (e) CDSL has implemented various network security measures such as firewalls, intrusion prevention systems (IPS), and antivirus software since 2001, with regular upgrades, where the latest being done on June 17, 2023.
 - (f) CDSL has implemented web filtering rules that block access to websites that provide file sharing and email services such as Google Drive and Gmail. This ensures that data is not transferred to unauthorized external sources.
 - (g) CDSL also has MDM security controls in accordance with O365 standards, with access to USB and CD drive disabled.
- (iii) SEBI's observation that the DLP implementation issues indicate a lack of baseline standards is, with respect, an erroneous conflation. DLP is an additional, supplementary security feature, a customised solution whose configuration varies based on organisational needs. It is not, and cannot be, a "baseline standard" within the meaning of clauses 27 and 28. Baseline standards are primarily designed for components used to host applications and to ensure minimum security measures at the infrastructure level. The fact that CDSL introduced DLP as an additional layer does not imply that its existing baseline standards were deficient.
- (iv) The phased implementation of DLP (alert mode transitioning to blocking mode) is consistent with industry best practice. DLP generates numerous false positive alerts during initial deployment that require fine-tuning before transitioning to blocking mode without disrupting legitimate communications. Immediate deployment in blocking mode could have disrupted operations.
- (v) SEBI's observation that implementation of DLP is still in progress does not indicate a systemic violation but rather reflect CDSL's ongoing commitment to continuous improvement and vigilance in safeguarding such data. CDSL has consistently adhered to the prescribed baseline standards and has proactively strengthened its data security initiatives through advanced solutions including DLP.



- (vi) In light of the above, CDSL submits that SEBI's allegation that it is in violation of clauses 27 and 28 of Annexure A of the said SEBI Circular is not sustainable and the assertion that the DLP implementation reflects a lack of adherence to baseline standards is a clear misinterpretation by SEBI.

G. Noticee has not violated clauses 4(c) and (d) of the SEBI Circular dated March 22, 2021 pertaining to RTO/RPO

- (i) It is submitted that the said SEBI Circular does not explicitly mandate inclusion of the RTO and RPO values within the CCMP. Therefore, the absence of these references in CDSL's CCMP during the inspection period does not constitute non-compliance.
- (ii) CDSL has adhered to the prescribed RTO and RPO requirements as mandated under clauses 4(c) and 4(d) of the said SEBI Circular. It has mentioned the RTO and RPO in its Business Continuity and Recovery Strategy Policy since its inception in 2011. The relevant extract from has been reproduced hereinbelow:

“...3. Requirements for Continuity and Recovery Strategy

The requirements for business continuity and recovery strategies are derived from the business impact analysis and the risk assessment exercise.

The RTO and RPO have already been defined during the course of BIA. However, it is not always possible to ensure that every potential risk is mitigated and adequate resilience is built to overcome them. Hence, there is a need to have appropriate business continuity and recovery strategies to ensure the continuity of the business.

Man-made as well as natural threats such as terrorist attacks / bomb attacks / cyber attacks / riots / earthquake, epidemic/pandemic, floods, hardware / software failure to name a few have all been considered as part of the risk assessment exercise. These incidents, if not contained in a timely manner, could lead to potential disasters. Various risk mitigation measures have been thought for and have been implemented to build resilience within the organization. There are some risks with low likelihood but high consequences. Risk mitigation for these, by introducing resilience measures may be difficult and costly. There are other risks which are inherent in nature such as earthquakes, dependency on single vendor / supplier / service provider. Such risks are also addressed by selecting suitable business continuity and recovery strategies.”

- (iii) The RTO for depository services, which is the main business of CDSL, is as per the statutory requirement of 45 mins and CDSL's RPO has been maintained at “till the last transaction”, which exceeds SEBI's prescribed 15-minute threshold, ensuring a higher standard of data protection and operational resilience.
- (iv) The inclusion of RTO/RPO references in the CCMP was made following a recommendation by NCIIPC at a meeting held on September 20, 2023, duly after the inspection period. The absence of these specific references in the CCMP during the inspection period does not equate to non-compliance with the



substantive requirements of the abovementioned circular, as the values were documented and enforced through the Business Continuity and Recovery Strategy Policy throughout. Thus, the SEBI's assertion of a violation is, therefore, without merit.

H. Noticee conducted the DR drills in accordance with clause 5(h) of the SEBI Circular dated March 22, 2021

- (i) It submitted that the purpose of DR drills is to test and refine disaster recovery infrastructure under simulated stress scenarios, in order to identify potential areas of improvement. The drills are designed precisely to surface weaknesses so they can be addressed.
- (ii) There were 4 isolated instances during DR drills where the stipulated RTO of 45 minutes was exceeded. Each deviation was subjected to detailed Root Cause Analysis ("RCA"), where the underlying issues were identified and corrected, and the corrective actions were validated in subsequent DR drills. The deviations were communicated to CDSL's SCOT, ensuring transparency and governance oversight.
- (iii) The requirement under clause 5(h) is to demonstrate preparedness to meet RTO and RPO objectives. Deviations during simulated exercises do not indicate systemic incapability but reflect the testing process itself. Since the deviations have been identified, analyzed, and corrected, the purpose of the DR drills cannot be liable for regulatory action.

I. Noticee deployed adequate manpower at the Primary Data Centre in compliance with clause 3(d) SEBI Circular dated March 22, 2021

- (i) It is submitted that clause 3(d) focuses on ensuring that the DR site has adequate and trained manpower to independently handle operations without relying on the PDC. The said clause 3(d) does not mandate the physical deployment of CDSL's employees at the PDC on a permanent basis. Since said clause 3(d) pertains solely to the DRS, any allegation related to manpower deployment at the PDC does not fall within the purview of this clause. The interpretation and application of this clause to the PDC are misplaced. SEBI itself has acknowledged in the SCN that CDSL has deployed a dedicated team of 8 skilled professionals at the DR site in Hyderabad, thereby fulfilling the core objective of the clause.
- (ii) CDSL's IT operations are conducted centrally from its Mumbai office, the proximity of CDSL's head office to the PDC and robust network connectivity ensure rapid response capabilities and operational effectiveness. Further, adequately trained personnel are available and can be mobilized to the PDC as required.
- (iii) Further it is relevant to note that CDSL has engaged with third-party data center service providers to provide hosting services for both the PDC and DR site for hand and feet support. The data center service providers are responsible for maintaining the infrastructure and ensuring availability through strict service level



agreements. As a result, it is not a requirement by design for CDSL's personnel(s) to be physically deployed at the data centers for regular operations. These data centers are connected to CDSL's office through point-to-point network connectivity.

- (iv) In light of the above it submitted that CDSL has complied fully with clause 3(d) of the SEBI Circular dated March 22, 2021. It has ensured the independence and readiness of its DR site through adequate and trained manpower deployment and operational flexibility at its PDC through strategic resource availability and third-party support. The arrangement meets the operational requirements while maintaining compliance with SEBI's expectations.

J. Noticee was in compliance with clause 5(c) of the SEBI Circular dated March 22, 2021, that requires that all business operations be run from the DR site during the DR drill

- (i) It submitted that during SEBI's visit to the DR site at Hyderabad on October 12, 2023, along with the Technical Advisory Committee ("TAC") members of SEBI, it was observed that the Security Information and Event Management ("SIEM") logs were being collected at the PDC during the DR drill. SEBI's conclusion that this equates to non-compliance under clause 5(c) is incorrect, as the presence of SIEM log collection at the PDC does not impede or relate to the core requirement of running business operations from the DR site.
- (ii) The core requirement of clause 5(c) is to ensure that business operations can continue seamlessly from the DR site in a disaster scenario. The term "*running all operations*" in the said clause 5(c) pertains to the continuity of core business functions and not to ancillary activities like security log collection and monitoring, which are supplementary and do not affect operational continuity. SIEM monitoring is a detective control activity, focused on analyzing security logs for potential anomalies, i.e., this function does not interfere with or impede the continuity of business operations. During the DR drill, all core business operations were indeed conducted from the DR site, thereby fulfilling the requirement of the said clause 5(c).
- (iii) The SIEM monitoring at the PDC enables centralized security analysis across devices and systems located at both the PDC and DR site. For devices and systems located at the DR site, logs are collected by SIEM collectors physically located at the DR site. These logs are then forwarded to the SIEM component at the PDC for centralized monitoring and correlation. The purpose of maintaining the SIEM component at the PDC is to ensure comprehensive security monitoring and correlation amongst various logs across different devices and sites. This centralized monitoring is a standard industry best practice of security and is necessary for effective security analysis.
- (iv) In an actual disaster, CDSL can manually switch the SIEM console to the DR site, ensuring complete security monitoring from there without reliance on the



PDC. This contingency plan is part of CDSL's disaster preparedness strategy and ensures compliance with SEBI's objectives.

- (v) The purpose of running the DR drill is to ensure the continuation of business activities from the DR site. The collection and monitoring of SIEM logs at the PDC do not detract from this objective, as the business operations themselves were entirely conducted from the DR site. The function of SIEM monitoring is inherently separate from the conduct of business operations.
- (vi) In light of the above, it is submitted that CDSL has fully complied with clause 5(c) of the SEBI Circular dated March 22, 2021, by successfully conducting business operations from the DR site during the drill. The ancillary activity of SIEM log collection at the PDC does not constitute non-compliance, as it is unrelated to the continuation of core operations.

K. Noticee has not violated any clauses of SEBI Circulars dated May 20, 2022, and July 06, 2015, with respect to patching of vulnerabilities

- (i) It is submitted that SEBI's allegation in the present case is factually incorrect. The VAPT reports for FY 2021-22 and FY 2022-23 pertain to the same IP address (61.95.148.49); however, the vulnerabilities identified are entirely distinct. In FY 2021-22, the vulnerability related to web server version disclosure; in FY 2022-23, it related to deprecation of TLS v1.1 protocol. These are different vulnerabilities on the same IP address, not repetition of the same vulnerability.
- (ii) The delay in closing certain low-risk vulnerabilities was a consequence of CDSL's structured, risk-based prioritization strategy, under which high and medium-risk vulnerabilities were prioritized and closed within the stipulated timeframe. Low-risk vulnerabilities were addressed based on severity, operational impact, likelihood of exploitation, and dependencies on OEMs and vendors, such an approach is consistent with industry best practices. VAPT observations pending beyond three months, along with associated risks and compensatory controls, were placed before SCOT in its meeting dated March 11, 2025, which confirmed remediation of all findings for FY 2021-22 and FY 2022-23.
- (iii) With respect to jQuery and Bootstrap library vulnerabilities, the relevant versions were upgraded in accordance with recommendations from SEBI and CERT-In empanelled auditors and were validated in the next VAPT cycle. Older Bootstrap libraries retained in the "/includes" folder were preserved solely for contingency purposes while updated versions remained operationally active.
- (iv) Further, it may also be noted that VAPT observations pending beyond three months, along with associated risks and compensatory controls, was placed before the SCOT in its meeting dated March 11, 2025, which confirmed remediation of all findings pertaining to FY 2021-22 and FY 2022-23. Accordingly, CDSL's risk-based remediation strategy effectively addressed all identified vulnerabilities in alignment with industry's best practices and SEBI's



circulars. The allegation of repeated vulnerabilities is incorrect, and the comprehensive remediation actions taken by CDSL, as evidenced in the VAPT report, confirm compliance with SEBI's stipulations.

L. Noticee conducted comprehensive VAPT in compliance with clause 2(40) of the SEBI Circular dated December 07, 2018, read with clause 40 of Annexure A to the SEBI Circular dated July 06, 2015, 2015

- (i) It is submitted that VAPT for critical applications, including eDIS and AuditWeb (which are CII applications), was in fact conducted and the corresponding VAPT reports were shared with SEBI during the inspection process. The observations relating to testing on UAT/mock environments pertained to grey box testing, which is intrusive in nature and is ordinarily conducted on production-like test environments to avoid disruption to live applications.
- (ii) It was additionally submitted that VAPT and source code review are two distinct and independent security exercises serving different objectives at different stages of the application lifecycle and that the applicable SEBI circulars do not mandate a combined VAPT and source code review exercise.
- (iii) Further, it is relevant to note that CDSL had proactively engaged CERT-In empaneled auditors, including eSecForte Technology and subsequently KPMG, to undertake periodic source code reviews of critical applications. The source code reviews were conducted in March 2021, updated reviews were undertaken in 2022 following code modifications, and further periodic reviews were scheduled pursuant to recommendations of the SCOT.
- (iv) The scanning was completed, and the reports were submitted in July 2021. In April 2022, CDSL requested eSecForte to accommodate changes in the CDAS code, and the scanning was performed again. The updated report was placed before the SCOT meeting held on May 10, 2022. This demonstrates that CDSL has conducted source code reviews periodically to ensure the security of its applications.
- (v) Further, the SCOT, in its 25th Committee meeting held on March 27, 2023, suggested that source code reviews be carried out periodically for any new additions to the codebase.
- (vi) Moreover, the malware incident referred to in the SCN was unrelated to application source code vulnerabilities and instead pertained to vulnerabilities in peripheral system configurations, thereby demonstrating that the incident had no bearing on the comprehensiveness of the VAPT or source code review processes.
- (vii) Accordingly, CDSL has demonstrated full compliance with the said SEBI Circulars, adopting industry-standard practices for VAPT and source code review. The VAPT activities conducted on critical applications and the periodic source code reviews reflect CDSL's commitment to ensuring the security and stability of its systems. Allegations of non-compliance or conflation of VAPT and source code review are incorrect and unsupported.



M. LEGAL SUBMISSIONS

Section 19FA of the Depositories Act is misconceived and inapplicable

- (i) The SCN invokes section 19FA of the Depositories Act, which provides: “*Where a depository fails to conduct its business with its participants or any issuer or its agent or any person associated with the securities markets in a fair manner in accordance with the rules, regulations made by the Board or directions issued by the Board under this Act, it shall be liable to penalty...*”. It submitted that section 19FA is directed at unfair conduct of business by a depository, and the penalty thereunder is calibrated to the gains made from such unfair conduct. The provision contemplates situations where the depository has dealt with securities or conducted its operations in a manner that is unfair, inequitable, or prejudicial to market participants. The penalty provision, which stipulates that the penalty “...*shall not be less than five crore rupees but which may extend to twenty-five crore rupees or three times the amount of gains made out of such failure, whichever is higher*”, particularly the reference to “*three times the amount of gains made*”, reinforces that the provision is intended to address situations involving culpable conduct resulting in quantifiable, illegitimate gains.
- (ii) A bare reading of section 19FA makes clear that it is not applicable in the present case for the following reasons:-
 - a. section 19FA is not a provision qua failure to supervise a participant or ensure compliance of a participant. The present allegations relate primarily to CDSL’s supervisory and compliance functions, not to unfair dealing.
 - b. There is no allegation that CDSL dealt with its participants in a manner that is not fair or dealt in a manner biased in favour of one participant over another.
 - c. There is no allegation with respect to any unlawful gain made. The present case is one of routine compliance and inspection findings.
- (iii) The observations in the SCN relate to matters such as a supplementary system field not being populated, DR drills exceeding prescribed timelines in simulated environments, and supplementary security tools not being deployed on all endpoints. These are, at their highest, procedural observations and not instances of unfair business conduct. Accordingly, section 19FA of Depositories Act has no application to the facts of the present case and its invocation is misconceived.

The SCN has invoked both section 15HB of the SEBI Act and section 19G of the Depositories Act

- (i) The SCN invokes both section 15HB of the SEBI Act and section 19G of the Depositories Act and directs the Noticee to show cause why a penalty should



not be imposed under both statutes for the same alleged breaches. It submitted that the regulatory scheme does not contemplate imposition of dual penalties under both statutes for the same alleged contravention. The conduct of CDSL arises from a common factual background and cannot be penalised separately under parallel statutory provisions, merely because the circulars are issued invoking powers under both Acts.

- (ii) Further, it was submitted that the charges levelled in the SCN are general and lack specificity in terms of the charging provisions and the clauses. In various instances, the charging provision and/or clause do not squarely apply to the alleged violation. The penalty provisions, being penal in nature, must be construed strictly, and ambiguity in the charging provisions must be resolved in favour of the Noticee.

Purpose of Inspection is remedial in nature and not punitive

- (i) It submitted that the alleged violations, if any, are technical, procedural, and *venial* in nature, with no adverse impact on the market, investors, or the integrity of the securities ecosystem. In no manner can these alleged violations be seen to represent any systemic failure, willful default, or *mala fide* conduct on the part of CDSL.
- (ii) It is a well-settled principle that the purpose of carrying out an inspection is not punitive. The Hon'ble Securities Appellate Tribunal ("**SAT**") in *Religare Securities Ltd. v. SEBI*⁴ observed that the object of inspection is to make the intermediary comply with procedural requirements, and that every minor discrepancy or irregularity found during inspection is not culpable, that the object could well be achieved by pointing out the irregularities to the intermediary and making itself compliant. This principle was reiterated by the Hon'ble SAT in *DSE Financial Services Ltd. v. SEBI*⁵, where it was observed that where the violations committed are mostly technical in nature, some of them are solitary instances, and the intermediary has mostly taken or initiated corrective measures, the adjudicating officer is not justified in taking punitive action.
- (iii) It is further submitted, that penalty provisions are not to be mechanically applied. The Hon'ble Supreme Court in *Siddharth Chaturvedi v. SEBI*,⁶ held that where there is allegedly only a technical default, and the three parameters of section 15J are satisfied, namely that no disproportionate or unfair advantage has been made, no loss has been caused to an investor or group of investors, and there is no repetitive nature of default, no penalty at all ought to be imposed.
- (iv) In *Adjudicating Officer, SEBI v. Bhavesh Pabari*⁷, the Hon'ble Supreme Court further held that the factors laid down in section 15J are illustrative and not

⁴ Appeal No. 23 of 2011.

⁵ Appeal No. 153 of 2012.

⁶ (2016) 12 SCC 119.

⁷ (2019) 5 SCC 90.



exhaustive, and that factors beyond those enumerated therein may also be considered in mitigating or declining the imposition of penalty. The Hon'ble SAT in *Piramal Enterprises Ltd. v. SEBI*⁸ observed that SEBI is the watchdog and not a bulldog, and that if there is an infraction of a rule, remedial measures should be taken in the first instance and not punitive measures.

- (v) In the present case, : (i) no disproportionate gain or unfair advantage has been made by CDSL as a result of any of the alleged defaults; (ii) no investor, market participant, or stakeholder has suffered any loss, harm, or prejudice, and no complaints or grievances have been received; (iii) this is not a case of repetitive default, with most observations arising for the first time from a single inspection cycle; (iv) there has been no data breach, unauthorized access, market disruption, or systemic failure; and (v) the SCN does not allege, and there is no evidence to suggest, any *mala fides*, willful non-compliance, or contumacious conduct. CDSL has, at all times, implemented all recommendations of SEBI promptly and in good faith, and has proactively undertaken remedial measures and in many cases prior to the issuance of the SCN itself.
- (vi) Noticee stated that if the AO is of the view that CDSL has violated any of the provisions alleged in the SCN, It submitted that the violations, if found, would be merely technical and venial in nature, for which no penalty ought to be imposed. In the alternative, if the AO considers imposition of penalty necessary, only the minimum penalty ought to be imposed, having due regard to the factors under section 15J, the absence of any aggravating circumstances, and CDSL's prompt remediation and good-faith cooperation with SEBI throughout.

14. In view of the above facts and circumstances of the matter, I deem it appropriate to proceed against the Noticee, based on the material available on record.

PRELIMINARY SUBMISSIONS

15. Before dealing with the issues involved, I would like to address the preliminary submissions made by Noticee. Noticee, post the culmination of inspection, had requested for a certified copy of the list of all the documents and the index of the file along with an opportunity to inspect physical file on record in the office of the Adjudicating Officer. I note that all relied upon documents have been provided to the Noticee, ensuring compliance with the principles of natural justice in the instant case. Further, it is a matter of record that there lies no *lis* regarding the veracity of documents provided to the Noticee in the course of present inspection. Furthermore, Noticee has

⁸ SCC OnLine SAT 134.



not provided any cogent rationale for seeking all documents. Therefore, the instant request of the Noticee appears to be a roving and fishing enquiry.

16. In this regard, I further note that Hon'ble Tribunal, in the matter of *Reliance Commodities Ltd v. Mational Commodity Derivatives Exchange and Anr.*⁹ has observed as under:

"...

2. Having heard the learned counsel for the parties and having perused the list of documents so required for inspection we are of the opinion that the documents sought for is nothing but a roving and fishing enquiry. We accordingly do not find any merit in the submission of the learned counsel for the appellant that these documents are essential for the purpose of filing an appropriate reply...."

17. Accordingly, I find the instant submission of Noticee lacks merit and is rejected.

ISSUES

18. After careful perusal of the material on record, I note that the issues that arise for consideration in the present case are as follows:

- I. Whether the Noticee failed to communicate the reason for the rejection of the pledge to the participants of the pledger and the pledgee and thereby violated regulation 79(5) of the DP Regulations?
- II. Whether Noticee failed to effectively supervise and ensure conversion of eligible demat accounts into BSDAs, or obtain valid opt-out confirmations and thereby violated clauses 4(d) and 8 of the SEBI Circular dated August 27, 2012 read with clause 5 of SEBI Circular dated July 1, 2014 and clauses 3, 4 and 5 of the SEBI Circular dated December 11, 2015?
- III. Whether Noticee failed to ensure timely invocation or disposal of securities lying under CUSPA and lacked adequate system-level controls and thereby violated clauses 3.4. and 3.5. of the SEBI Circular dated November 11, 2022?
- IV. Whether the Noticee failed to maintain adequate system and control *qua* CUSA and thereby violated clause 5 of the SEBI Circular dated November 11, 2022?
- V. Whether Noticee failed to implement measures to prevent unauthorized transmission of data during the IP and thereby violated clause 31 of Annexure A

⁹ Appeal No. 173 of 2019.



of the SEBI Circular dated July 06, 2015 from the period July 2015 to October 2023?

- VI. Whether Noticee failed to implement baseline standards from the period July 2015 till October 2023 and delayed the implementation of block mode within force point technology and thereby violated clauses 27 and 28 of Annexure A of the SEBI Circular dated July 06, 2015?
 - VII. Whether Noticee failed to prescribe RTO and RPO in consonance with clauses 4(c) and (d) of the SEBI Circular dated March 22, 2021 and thereby violated clauses 4(c) and (d) of the SEBI Circular dated March 22, 2021?
 - VIII. Whether Noticee had exceeded RTO in four DR drills and thereby violated clause 5(h) of the SEBI Circular dated March 22, 2021?
 - IX. Whether Noticee failed to deploy adequate manpower at the PDC site and thereby violated clause 3(d) of the SEBI Circular dated March 22, 2021?
 - X. Whether Noticee collected SIEM logs from PDC during the DR drill and thereby violated clause 5(c) of the SEBI Circular dated March 22, 2021?
 - XI. Whether Noticee failed to patch the vulnerabilities within the three months' time stipulated by SEBI and thereby violated clause 2(41) of the SEBI Circular dated May 20, 2022 read with clause 41 of Annexure A of the SEBI Circular dated July 06, 2015?
 - XII. Whether Noticee failed to conduct a comprehensive VAPT exercise and thereby violated clause 40 of the SEBI Circular dated July 06, 2015 (as amended by SEBI Circular dated May 20, 2022)?
 - XIII. Does the violation, if any, on the part of Noticee attract monetary penalty under section 15HB of the SEBI Act and sections 19FA and 19G of the Depositories Act, 1996?
 - XIV. If so, what would be the monetary penalty that can be imposed upon Noticee taking into consideration the factors stipulated in section 15J of the SEBI Act and section 19I of the Depositories Act, 1996?
19. The aforesaid acts, regulations and SEBI Circulars¹⁰ alleged to have been violated, are reproduced below for reference:

¹⁰Text of the SEBI Circular dated August 27, 2012, SEBI Circular dated July 1, 2014, SEBI Circular dated July 06, 2015, SEBI Circular dated December 11, 2015, SEBI Circular dated March 22, 2021,



DP Regulations

“79. Manner of creating pledge or hypothecation

...

(5) If the depository does not create the pledge, it shall send along with the reasons an intimation to the participants of the pledger and the pledgee.

....”

20. The issues raised in this matter are dealt in the following paragraphs.

FINDINGS

I. Whether Noticee failed to communicate the reason for the rejection of the pledge to the participants of the pledger and the pledgee and thereby violated regulation 79(5) of the DP Regulations?

21. As per regulation 79(5) of the DP Regulations, if the depository does not create the pledge, it shall send, along with the reasons, an intimation to the DPs of the pledger and the pledgee. It was alleged that by not communicating the reason for the rejection of the pledge to the participants of the pledger and the pledgee, the Noticee was not in compliance with regulation 79(5) of the DP Regulations.
22. In this regard, Noticee, by placing reliance on paragraph 5.1.2 of the SCN, contended that the SCN itself records that the reasons for rejection were, in fact, communicated by CDSL, though not captured in the system. Here, it is apposite to reproduce the relevant extract of the SCN:

“5.1.2. In this regard, Noticee, further, submitted that the pledger and pledgee Depository Participants (hereinafter referred to as ‘DPs’) were informed about the rejection of the pledge but the reason for the rejection was not captured in the system of the Noticee.

....

5.1.4. ... Hence, by not communicating the reason for the rejection of the pledge to the participants of the pledger and the pledgee, the Noticee is allegedly not in compliance with Regulation 79(5) of the DP Regulations.

...”



23. From the perusal of the aforesaid extract, it is evident that paragraph no. 5.1.2 of the SCN records the submissions of the Noticee made in the course of inspection. Considering the same, the Noticee cannot pick one part of the SCN in isolation to contend that the allegation at hand is confined to the recording of reasons for rejection in its system. I note that the SCN has to be read as a whole and when it is read so, it is evident that the SCN alleges non-compliance with regulation 79(5) of the DP Regulations on the ground that the reasons for rejection of the pledge were not communicated to the participants of the pledger and the pledgee. Further, a bare reading of paragraph 5.1.2 of the SCN unequivocally demonstrates that it merely records that the counterparties *"were informed about the rejection of the pledge."* The said paragraph is conspicuously silent regarding any communication of the underlying grounds or reasons for such rejection to the DPs. Hence, a selective reading by the Noticee of its own submission, divorced from the allegation framed in the SCN, appears to be misplaced and such a reading cannot alter the scope of the charge.
24. Noticee argued that it serves purely as a facilitator in the pledge creation and rejection process. Noticee further stated that it provides the technological infrastructure that enables recording and management of pledges based on instructions received from the DPs. It also contended that the DPs desirous of providing further details of such rejections in the CDSL system could mention the same in the "Remarks" field which was provided by CDSL. In this regard, I note that as per regulation 79(5) of the DP Regulations, it was incumbent on the Noticee to provide reasons to the participants of the pledger and the pledgee if the depository was not creating the pledge. The existence of a "remarks" field, which may be used by DPs at their discretion, cannot dilute or substitute the statutory obligation imposed on the Noticee. It is not the case of the Noticee that it complied with the mandate of regulation 79(5) of the DP Regulations by providing the reasons for rejection as contemplated therein. In the absence of such compliance, it is not proper on the part of the Noticee to justify its lapses by shifting the responsibility to the DPs. Accordingly, the said contention of the Noticee is devoid of merit and is rejected.



25. Noticee averred that SEBI has conducted several inspections of CDSL's systems and processes. However, in none of these inspections has SEBI raised this issue as a deficiency or non-compliance. In this context, Noticee stated that this shows that the practice has long been accepted by the regulatory body and was not deemed to require rectification and hence, it is unreasonable to retrospectively declare the practice as non-compliant, especially when no change in the regulatory framework mandates such a finding and the same is completely contrary to the principles of 'substantive legitimate expectation' and placed reliance on the judgment of the Hon'ble Supreme Court in the matter of *SEBI v. Sunil Krishna Khaitan*¹¹ holding that once a regulation has been given an interpretation by SEBI, a consistency must be maintained by and a departure should not be made irrationally or on perverse grounds. At the threshold, I note that it is trite law that the doctrine of legitimate expectation cannot be invoked to override or derogate from an express provision of law. In this regard, reference is drawn to the judgment of the Hon'ble Supreme Court in the matter of *K. Purushottam Reddy v. Union of India*¹² wherein the Apex Court avowed as under:

"... 34. However, it is equally well-settled that the doctrine of legitimate expectation cannot override an express provision of law or the Constitution. It must be borne in mind that the expectation must be legitimate, in the sense that it is not only reasonable but also legally sustainable within the structure of the governing statute or constitutional scheme. In the event of any conflict between an expectation and the existing legal framework, the expectation has to run hand in hand with the legal intent and not against it. The doctrine of legitimate expectation is not a rigid rule and must be conceded where a superseding public interest or a statutory or constitutional bar exists. Thus, while legitimate expectation may guide how discretionary powers are exercised, it cannot be invoked to compel an authority to act contrary to a binding legal or constitutional command.

35. Keeping this in view, we find substance in the objection raised by the Union of India. It is trite law that the doctrine of legitimate expectation, while forming an integral part of the jurisprudence on fairness in administrative action, does not clothe a party with an enforceable right in itself. It operates within the bounds of legality and must necessarily conform to constitutional and statutory mandates. ..." (Emphasis supplied)

26. In light of the aforesaid dicta of the Hon'ble Supreme Court, it noted that the mandate of regulation 79(5) expressly casted an obligation on the Noticee to furnish the reasons for rejection of pledge to the DPs of the pledgor and pledgee. Considering the unambiguous regulatory mandate, Noticee cannot, in law, claim a right in contravention of a prevailing statutory mandate, nor can it invoke administrative fairness to defeat a clear statutory

¹¹ (2023) 2 SCC 643.

¹² 2025 INSC 894.



prescription on the mere fact that the alleged deficiency was not pointed out in earlier inspections. Further, it is a trite law that an individual who claims a benefit or entitlement based on the doctrine of substantive legitimate expectation has to establish, *inter alia*, the legitimacy of the expectation.¹³ In the present, for Noticee's plea to succeed, Noticee was required to establish, by cogent material, the existence of a consistent, and legally sustainable representation or past practice attributable to SEBI on the basis of which such expectation could be said to have arisen. However, I note that no such material has been adduced by the Noticee in support of its assertion. In the absence of any material being placed on record demonstrating that SEBI had accepted or approved the practice adopted by the Noticee, it is apparent that the plea of legitimate expectation remains unsubstantiated. Lastly, it is pertinent to state that every inspection is unique in its ambit and scope. Consequently, the very fact that the instant infraction was not brought to the notice of the Noticee in erstwhile inspections can neither be a ground to seek exoneration from the instant infraction nor can it preclude SEBI from examining and acting upon the same in a subsequent inspection. Accordingly, I find that the Noticee has failed to satisfy the essential conditions for invocation of the doctrine of substantive legitimate expectation, and hence, the said contention is rejected.

27. Noticee further stated that upon receipt of SEBI's observations, it undertook system-level changes. In this regard, I note that the subsequent compliance, if any, cannot efface or cure the non-compliance that had already occurred during the inspection period. I note that Noticee was required to comply with the mandate of regulation 79(5) of the DP Regulations while performing its operations as a depository without any exception at the relevant point of time. Thus, the subsequent modification of the system cannot operate retrospectively to validate past instances where the reasons for rejection were not communicated in the manner contemplated under the DP Regulations. Adding to that, I note that the subsequent introduction of a mandatory field for recording reasons along with communication of such reasons clearly demonstrates that the earlier system was not in consonance with the regulatory mandate. Therefore, the instant contention of the Noticee lacks merit and hence, is rejected.

¹³ *Sivanandan C T and Others v. High Court of Kerala*, 2023 INSC 709.



28. Noticee further stated that there have been no complaints or grievances in any of the cases cited which according to it, indicates that no stakeholder had suffered due to the earlier system configuration and the information provided was sufficient for all practical purposes. In this regard, I note that the obligation under regulation 79(5) of the DP Regulations is a statutory obligation. Noticee, being an MII, was expected to comply with the said regulatory requirement in letter and spirit. Consequently, the absence of complaint cannot be a ground to justify its failure to comply with the prevailing regulatory obligation. Here, reference is drawn to the order of the Hon'ble SAT in the matter of *Rencal Chemicals (India) Ltd. v. SEBI*¹⁴ wherein it was held as under:

"... 6. Fact that no investor grievance were pending at the relevant time cannot be a ground for the appellant to disobey the circulars issued by SEBI from time to time. Whether there was any investor complaint or not, appellant was bound to comply with the circulars issued by SEBI within the time stipulated therein. ..."

29. *Ergo*, the absence of complaints cannot cure the failure to communicate the reasons for rejection in the manner mandated by the DP Regulations. With respect to contention pertaining to investor loss, it is noted that the Hon'ble Supreme Court in the matter of *Kotak Mahindra Asset Management Company Limited v. SEBI*¹⁵, *inter alia*, observed that:

"The contention that no loss was caused to the investors/unitholders and, on the contrary, they gained and, hence, action should not have been taken is no defence at all. The 1996 Regulations make no distinction between a breach resulting in profit and a violation resulting in loss. Neither do we. Breaches of the regulatory framework, fortuitously, could ultimately result in gain but excusing a breach which led to profit is likely to incentivize the next breach. Progression from profit to greed, from greed to regulatory breach and from breach to systemic failure is not too unfamiliar. Market integrity being the paramount consideration, profit or loss to investors is immaterial to determine whether a regulatory infraction has occurred. A wrongdoer cannot be allowed to use the plea of the investors having gained, notwithstanding the violation, as a shield for evading penalty. The 1996 Regulations operate in a specific field: to ensure compliance. Variable scenarios of violation is not contemplated."

30. Therefore, the present contention of the Noticee regarding absence of complaint or loss to the investor is bereft of any merit and warrants no further consideration.

¹⁴ Appeal No. 4 of 2018.

¹⁵ Civil Appeal No. 6529 of 2026.



31. With respect to the admission of the Noticee that no reason for rejection was captured in the remarks field in 27 records, I note that the issue for consideration in the present proceedings is not whether such reasons were recorded in the system. The limited question, here, is whether the reasons for rejection of the pledge were duly communicated to the DPs of the pledgor and the pledgee. In that view of the matter, the aforesaid submission does not come to the aid of the Noticee.
32. Further, I note that paragraph no. 14.4 of the bye-laws of the Noticee provides as under:
“14.4. CDSL or a participant shall not refuse permission to the pledgor or hypothecator to create a pledge or hypothecation in respect of securities available for pledge or hypothecation unless operations in respect of those securities are restrained or frozen by virtue of any order or direction of any court, tribunal, Central Government, SEBI, RBI or the Central or State Government in case of Securities issued by RBI or the Central or State Government] or other competent authority or by CDSL itself and if the CDSL or a participant does not create such pledge or hypothecation as the case may be, it shall intimate the intending pledgor and pledgee of its decisions setting out its reasons for such refusal. ...” (Emphasis supplied)
33. The aforesaid clause of the Noticee’s bye-laws was in force during the inspection period and mirrored the requirement contained in Regulation 79(5) of the DP Regulations. While Regulation 79(5) required the Noticee to intimate the participants of the pledgor and the pledgee in the event of refusal of a pledge, paragraph 14.4 of the bye-laws required intimation to the intending pledgor and pledgee. In either case, such intimation was required to be accompanied by the reasons for the refusal. The conduct of the Noticee in the present case was, therefore, not in consonance with its own bye-laws.
34. In light of the discussion in the abovementioned paragraph, it is established that the Noticee has failed to communicate the reason for the rejection of the pledge to the participants of the pledgor and the pledgee. Therefore, I held that the Noticee has violated regulation 79(5) of the DP Regulations.

II. Whether Noticee failed to effectively supervise and ensure conversion of eligible demat accounts into BSDAs, or obtain valid opt-out confirmations and thereby violated clauses 4(d) and 8 of the SEBI Circular dated August 27, 2012 read with clause 5 of SEBI Circular dated July 1, 2014 and clauses 3, 4 and 5 of the SEBI Circular dated December 11, 2015?



35. It was alleged that the Noticee had adopted a lackadaisical approach in relation to the conversion of eligible demat accounts into BSDA. The allegation was founded on the observation that 1,10,95,451 BO accounts were eligible to be converted into BSDA, whereas opt-out confirmations were obtained only from 8,321 BO accounts during the inspection period. Further, it was alleged that Noticee had failed to ensure that BSDA eligibility intimations were being sent to BOs in a time bound manner.
36. Per contra, the Noticee submitted that the relevant SEBI Circulars must be read strictly and in accordance with their plain language. It contended that the obligation to identify eligible BO accounts, convert such accounts into BSDA, and obtain opt-out confirmations from BOs rests squarely upon the DPs. According to the Noticee, the SEBI Circulars invoked in the present case do not cast any independent obligation upon the depository to carry out such conversions on behalf of DPs or to obtain opt-out confirmations directly from BOs. On this basis, the Noticee asserted that its conduct during the inspection period was consistent with the regulatory framework.
37. At the outset, I note that it is a settled principle of statutory interpretation that where the words of a statute, regulation, or circular are clear, plain, and unambiguous, they must ordinarily be given effect according to their natural meaning, unless such interpretation leads to an absurdity or defeats the object of the provision. A similar view was upheld by the Hon'ble SAT in the matter of *Edelweiss Broking Limited v. National Stock Exchange of India Limited*¹⁶, wherein it was observed as under:
- "... 15. In our view the first principle of the interpretation to be applied is that there shall be no interpretation of statute. It means that a literal interpretation of statute is required to be made unless the context requires otherwise or unless it is contrary to the intent of the legislation upon consideration of the whole scheme of the relevant legislation. ..."*
38. In this regard, a conjoint reading of clause 8 of the SEBI Circular dated August 27, 2012, clause 5 of the SEBI Circular dated July 1, 2014, and clause 5 of the SEBI Circular dated December 11, 2015 indicates that the said SEBI Circulars primarily cast the following responsibilities upon depositories:

¹⁶ Appeal No. 201 of 2020.



- (a) make amendments to the relevant bye-laws, rules and regulations for the implementation of the above decision immediately, as may be applicable/necessary;
- (b) bring the provisions of the said circulars to the notice of their DPs and also disseminate the same on their website; and
- (c) communicate to SEBI the status of implementation of the provisions of the said circulars in the monthly development report.

39. On a plain reading of the aforesaid clauses, it is evident that the role assigned to the Noticee, being a depository, was confined to the aforesaid three aspects, namely, amending its regulatory framework where necessary, communicating the circulars to its DPs and disseminating them on its website, and reporting the implementation status to SEBI through the Monthly Development Report. Importantly, the SCN does not allege any failure on the part of the Noticee in respect of these three specified responsibilities.
40. Further, I note that clause 4(d) of the SEBI Circular dated August 27, 2012 and clauses 3 and 4 of the SEBI Circular dated December 11, 2015 imposed an explicit duty on DPs to convert eligible demat accounts into BSDA, subject to the applicable conditions and opt-out mechanism.
41. In light of the discussion above, it is apparent that the SEBI Circulars invoked in the present case specifically allocated distinct obligations between the depositories and the participants. As per the said SEBI Circulars, the depositories were responsible for establishing the regulatory framework, communicating the same and reporting its implementation while the participants were responsible for its BO-account level implementation. It is pertinent to mention that the provisions of the SEBI Circulars alleged to have been violated by the Noticee do not contain any express requirement obligating a depository to enforce BSDA conversion at the BO-account level or obtain opt out confirmation in cases where such conversion was not undertaken or regarding sending of intimations. Considering the same, I am of the view that the participant's independent failure to convert BSDA cannot automatically be transposed upon the depository by virtue of the underlying principal agent relationship or general supervisory role. Further, I note that the genesis of any enforcement action must be traceable to a specific legal obligation. In the absence of a clearly identified statutory, regulatory, or



circular-based duty, liability cannot be fastened on a party merely on the ground that a broader regulatory objective was not fully achieved. In this regard, I deem it apposite to take note of the decision of the Hon'ble SAT in the matter of *National Securities Depository Ltd. v. SEBI*¹⁷ wherein it was held as under:

"... This finding has been based on the stipulation in the Board's circular dated August 4, 2000 quoted by us in paragraph 6 but the logic that is being followed by the Adjudicating Officer in this case for holding CDSL responsible for the failures of DPs does not appeal to us. In the aforesaid circular, the responsibility for verification of an applicant's identity has been placed squarely on the DP and to shift the burden to the Depositories on the ground that a DP is an agent of the Depository is not at all justified. In the scheme of the regulatory process that exists in the securities market, the role of each intermediary has been specifically delineated and the Depositories cannot be saddled with the specific responsibility for any failure by the DPs. The DPs are also market intermediaries registered with the Board and, in terms of chapter VI of the DP Regulations, the Board has the responsibility of periodically inspecting them. Therefore, by the same logic that the Adjudicating Officer seems to be relying upon in this case, the Board itself can be held responsible for the alleged failures of the DPs and hence, indirectly, for the IPO scam.. ..." (Emphasis supplied)

42. Therefore, in the absence of a specific provision casting such duty upon the Noticee, the allegation that the Noticee failed to ensure conversion of eligible accounts into BSDA cannot be sustained merely on the basis of the vital role played by the depository in the securities market. In these circumstances, I deem it fit to accept the instant contention of the Noticee.
43. It is also mentioned that there is no material on record to indicate that the Noticee's conduct in relation to the conversion of the eligible demat account to BSDA was inconsistent with its bye-laws or any other regulatory requirement thereon.
44. It is also noted that, prior to SEBI Circular No. SEBI/HO/MIRSD/POD-1/P/CIR/2024/91 dated June 28, 2024, no requirement had been cast upon depositories to ensure compliance with the provisions relating to BSDA. It is only by virtue of the said Circular that depositories were, for the first time, specifically required to put in place appropriate systems and procedures to ensure compliance with the provisions of that Circular. The relevant extract of the said Circular is reproduced below:

".... 4. The Depositories are advised to:-

¹⁷ Appeal No. 68 of 2007.



- 4.1. make amendments to the relevant bye-laws, rules and regulations for the implementation of the above decision immediately, as may be applicable/necessary;*
- 4.2. bring the provisions of this circular to the notice of their DPs and also to disseminate the same on their website;*
- 4.3.put in place appropriate systems and procedures to ensure compliance of the provisions of this circular; and*
- 4.4. communicate to SEBI, the status of implementation of the provisions of this circular in the Monthly Development Report. ...” (Emphasis supplied)*

45. Furthermore, I have also taken note of the Noticee’s submission that it subsequently engaged with SEBI with a view to refining the punitive action framework governing non-conversion of eligible demat accounts into BSDA. It is observed that the Noticee amended Annexure 11.1 of its DP Operating Instructions, which deals with the penalty structure for DPs, and specifically introduced a new head of penalty for non-compliance relating to failure by DPs to convert eligible demat accounts into BSDA.
46. Considering the abovementioned discussions, I find that the allegation against the Noticee is not borne out from the provisions of the SEBI Circulars relied upon in the SCN. As noted above, the said SEBI Circulars do not place any specific BO-account level obligation on the Noticee, as a depository, to convert eligible accounts into BSDA, obtain opt-out confirmations, or send BSDA eligibility intimations. Therefore, any failure in carrying out such account-level conversion cannot be attributed to the Noticee merely because of its role as a depository. I therefore hold that the Noticee is not liable for violation of clauses 4(d) and 8 of the SEBI Circular dated August 27, 2012 read with clause 5 of the SEBI Circular dated July 1, 2014 and clauses 3, 4 and 5 of the SEBI Circular dated December 11, 2015.

III. Whether Noticee failed to ensure timely invocation or disposal of securities lying under CUSPA and lacked adequate system-level controls and thereby violated clauses 3.4. and 3.5. of the SEBI Circular dated November 11, 2022?

47. It was alleged that TM/CM were releasing securities under CUSPA to the client’s account or disposing of them on 6th and 7th trading days and were invoking the securities for pay-in on the same day for the said trades which was not in compliance with the SEBI Circular dated November 11, 2022. Further, it was alleged that Noticee has not



put in place an appropriate system to ensure that the said securities were not released / disposed of by TMs/CMs after the end of 5th trading day from the pay-out date.

48. During the SEBI inspection, it was observed that the invocation of the pledge by TM/CM was taking place on 6th and 7th trading days from the pay-out date.
49. Before addressing the submissions of the Noticee, I deem it appropriate to examine the role and responsibilities entrusted to the TM/CM and the depositories under SEBI Circular dated November 11, 2022. In this regard, the text of the aforesaid clauses 3.4, 3.5, 3.9 and 5 are reproduced for reference:

“... 3.4. If the client fulfills its funds obligation within five trading days after the pay-out, TM/CM shall release the pledge so that the securities are available to the client as free balance.

3.5. If the client does not fulfill its funds obligation, TM / CM shall dispose off such unpaid securities in the market within five trading days after the pay-out. TM/CM, before disposing the securities, shall give an intimation (email / SMS) to the client, one trading day before such sale. ...

3.9. In case, such pledge is neither invoked nor released within seven trading days after the pay-out, the pledge on securities shall be auto released and the securities shall be available to the client as free balance without encumbrance.

...

5. Stock Exchanges, Depositories and Clearing Corporations shall put in place appropriate systems to ensure compliance of the provisions of this circular.”

50. On perusal of the aforesaid provisions, it is evident that the obligation to release the pledge or dispose of the unpaid securities subject to non-fulfilment of the payment obligation within the period of five trading days after the payout lies on the TM/CM. In case such a pledge is neither invoked nor released within seven trading days after the payout, the pledge on securities shall be auto released and the securities shall be available to the client as a free balance without encumbrance. Further, clause 5, *inter alia*, requires the depositories to put in place an appropriate system to ensure the compliance of the provisions of the said SEBI Circular.
51. In the present case, the allegations against the Noticee are twofold. First, it is alleged that TM/CM were releasing the securities to the client's account or disposing of the unpaid securities on the 6th and 7th trading days which was beyond the prescribed timeline. Second, it is alleged that Noticee has failed to put in place an appropriate



system to ensure that the said securities were not released or disposed of by TMs/CMs after the end of 5th trading day from the payout date.

52. Noticee contended that clauses 3.4 and 3.5 of the SEBI Circular dated November 11, 2022 impose a duty on the TM/CM and not the depository, i.e., Noticee. In this regard, it is reiterated that when the language of a provision is plain, clear and unambiguous, effect must be given to its natural and ordinary meaning. As noted in the preceding paragraphs, under the framework stipulated under SEBI Circular dated November 11, 2022, the core responsibility of releasing the securities to the client's account or disposing of them within a period of five trading days from the payout lies solely on TM/CM and not on the depository. Therefore, the depository, i.e., Noticee cannot be held liable for the invocation of pledge or disposal by the TM/CM beyond the prescribed timeframe. Consequently, the aforesaid contention is accepted to the limited extent that the core responsibility of releasing the securities to the client's account or disposing of them within a period of five trading days from the payout lay with TM/CM.
53. The issue which remains for consideration is whether the SEBI Circular dated November 11, 2022 required the Noticee to put in place a system to restrict the disposal or release of securities on the 6th and 7th trading days after the payout.
54. At the outset, I note that the said SEBI Circular did not expressly specify what happens on the 6th and 7th trading days. It neither expressly prohibits the disposal nor does it prohibit the release of pledge during this period. Further, the said SEBI Circular prescribed no timeline for release of pledge.
55. I note that clause 3.4 of the said SEBI Circular granted the client five trading days from the pay-out date within which he had to make payment. While clause 3.5 permitted the TM/CM to dispose of the unpaid securities if payment was not received within that very same period. Accordingly, the two periods operated concurrently and expired at the same point, namely, on the fifth trading day. Moreover, the Circular neither prescribed any cut-off time on the fifth trading day for receipt of payment nor authorised the TM/CM to curtail the client's payment window by imposing an earlier deadline.



56. This had a significant consequence. On the fifth trading day, the client continued to have the right to make payment until the close of the day. Consequently, TM/CM could not, therefore, dispose of the securities in the market on the fifth trading day without cutting short the client's continuing right to pay. If the TM/CM had done so, and the client thereafter made payment within the permitted period, such disposal would itself have been contrary to clause 3.4. Put differently, the TM/CM could determine that the client had defaulted only after the fifth trading day had ended. The earliest point at which disposal could lawfully take place was therefore the sixth trading day.
57. The same reasoning is applicable to release as well. If the client made payment on the fifth trading day, especially after market hours, the pledge could, as a practical matter, be released only on the sixth trading day or thereafter. The Circular did not prescribe any timeline for such release.
58. Therefore, a construction requiring every disposal and every release to be completed by the fifth trading day would therefore lead to an unreasonable result. It would require the TM/CM either to curtail the client's entitlement under clause 3.4 or to act before any default had actually arisen. The Circular cannot reasonably be interpreted in a manner that makes compliance with one clause depend on breach of another. In my view, the Circular, as framed, necessarily contemplated that certain actions arising from the expiry of the five-day period would take place thereafter.
59. A TM/CM which waited until client's full five days could dispose the pledged securities only after that period had expired. Similarly, a client which paid on fifth day could have the pledge released only on a later date, since no timeline existed. In both the case, the disposal or release of securities would have transpired on 6th or 7th day. To put simply, the ambiguity surrounding the five working day from the payout had invariably spilled over into the 6th and 7th trading days. If it remained ambiguous when the funding period ended and whose right prevailed in this period, it invariably was equally unclear whether any action on the 6th and 7th trading day was permitted.
60. The wording of clause 3.9 appears to have recognized this as it provided for auto release without any encumbrance only where the pledge is "neither invoked nor released within seven trading days". These wordings fairly suggest that invocation or release until the



7th day was contemplated. It may be contended that Clause 3.9 operated merely as a fail-safe, or that the additional period was intended only for settlement of sales effected within five trading days. However, the Circular contained no such limitation, and no such restriction could be read into it while alleging a contravention. If no action was intended to be permissible beyond the fifth trading day, the auto-release mechanism would ordinarily have been triggered at that stage itself.

61. As set out in the preceding paragraphs, it was possible that the earliest point at which the unpaid securities could have been disposed of was the sixth trading day. Disposal on that day, and the consequent invocation, appear to fall within the period contemplated under clause 3.9. In any event, whether disposal on the seventh trading day was permissible was, at the very least, not free from doubt; and such doubt could not have been resolved against the Noticee in light of the reasoning stated in the preceding and subsequent paragraphs.
62. I note that the interpretation suggested in the SCN, namely that every disposal or release had to be completed by the fifth trading day, is at best only one possible reading of the Circular. As noted above, it is also observed that it is not the only reasonable reading.
63. I have taken note of the fact that the Circular was issued to protect investors by safeguarding clients' unpaid securities. It can therefore be argued that a purposive interpretation would require all action to be completed within five trading days. However, a purposive interpretation cannot be used to impose an obligation that the text does not expressly create or when the text is ambiguous. This is especially where a finding of contravention is sought to be recorded against the Noticee. As noted in preceding paragraphs, when the text itself appears to have permitted action up to the seventh trading day, the object of the Circular cannot be used to read in a stricter deadline.
64. It is noted that implementation of the CUSPA framework under the SEBI Circular dated November 11, 2022 gave rise to certain operational concerns and lacked clarity. SEBI



itself recognized it. In this regard, it is useful to refer to the following extract from the SEBI Consultation Paper dated April 24, 2026¹⁸, which read as follows:

“1. In order to strengthen investor protection by ensuring segregation and safeguarding of clients’ securities, SEBI vide Circular Nos. CIR/HO/MIRSD/DOP/CIR/P/2019/75 dated June 20, 2019 and SEBI/HO/MIRSD/MIRSD-PoD-1/P/CIR/2022/153 and November 11, 2022 specified certain provisions related to handling of unpaid securities of clients (i.e., the securities that have not been paid for in full by the clients).

...

3. Broker’s Industry Standards Forum (“ISF”) has represented certain operational concerns with respect to the CUSPA framework. Further, the regulatory developments such as introduction of mandatory pay-out of securities directly to clients’ demat account also has a bearing on the existing CUSPA framework. Representations have also highlighted need for clarity on certain provisions.

....

5.1. Providing clarity on maximum funding period

Concern: As highlighted by the Brokers’ ISF and exchanges, there is a misconception among some clients that the clients are entitled to a five-days window from payout date for meeting payment obligation towards unpaid securities, due to lack of clarity in existing provisions.

Solution proposed: For promoting ease of doing business, it is proposed to modify the concerned provision to specifically mention that a trading member may, at its discretion, allow unpaid securities for a shorter duration than five trading days from payout and require the client to fulfil the payment obligation within that period, in accordance with its policy communicated to the clients.

5.2. Timeline for release of pledge

Concern: Existing framework does not specify any timeline for release of pledge once the client fulfils the payment obligation.

Solution proposed: In order to provide ease of investment, it is proposed that if the payment obligation is received from a client before 5 P.M. on a particular day, the pledge on the securities shall be released on the same day. For receipt after the said cut-off time, the pledge will be released before 5 PM on the next trading day.

....” (Emphasis supplied)

65. In this Consultation Paper, the misunderstanding around the five-day funding period was attributed to the “lack of clarity in existing provisions.” It was also acknowledged that the existing framework did not prescribe any timeline for the release of the pledge once the client fulfilled the payment obligation. These are precisely the gaps on which the present allegation is based.

¹⁸Available at https://www.sebi.gov.in/reports-and-statistics/reports/apr-2026/consultation-paper-on-ease-of-doing-investment-and-ease-of-doing-business-handling-of-unpaid-securities-of-clients-by-trading-members-clearing-members-_101093.html.



66. Subsequently, the framework was replaced by the SEBI Circular dated July 03, 2026, which revised the provisions relating to '*Handling of Client's Securities by Trading Members (TM)/Clearing Members (CM)*' introduced by the SEBI Circulars dated June 20, 2019 and November 11, 2022. The rationale recorded in the SEBI Circular dated July 03, 2026 read as under:

“ ...

2. *Representations have been received from Brokers' Industry Standards Forum (ISF) seeking revisions to these provisions to align them with the current regulatory and market environment and to address certain operational challenges faced during implementation.*

... ”

67. It is noted that the subsequent framework expressly made the funding period subject to policy formulated by the TM. The five trading days from the pay out only operated as an outer limit. The revised framework further required the policy to set out timing of invocation and release of pledge. It is important to note that the revised framework expressly permits the TM to stipulate, through its policy, a period shorter than five trading days. In doing so, it resolved the issue of whose right is to prevail in favour of the TM's policy. As noted above, this aspect was left unaddressed under the SEBI Circular dated November 11, 2022.

68. In this regard, I note that there is no doubt that SEBI Circular dated July 03, 2026 does not apply to the facts of the present case. However, the reference to the SEBI Circular dated July 03, 2026 along with the consultation paper has been made to show that the framework was not clear during the inspection period. In my view, it is clear that the SEBI Circular dated November 11, 2022 left the aforesaid aspects open.

69. I further note that the clause 5 did not resolve this ambiguity. It required depositories to put in place appropriate systems to ensure compliance with “the provisions of this circular”. This is an obligation to implement the substantive provisions of the Circular and this obligation flows co-extensive with clauses 3.4, 3.5 and 3.9. As noted above, these clauses did not clearly prohibit the disposal or release of pledge on the 6th and 7th trading days. Clause 5, therefore, cannot be read as requiring the Noticee to implement a system that restricts such invocation or release on 6th and 7th trading day.



70. I have also noted the settlement order dated December 17, 2025, passed in respect of the other depository for the same inspection period.¹⁹ The relevant extracts reads as under:

“... 4.6.It was observed from the analysis of data submitted by NSDL that TM/CM were releasing the securities to client’s account on 6th and 7th trading day also which is not in compliance with SEBI circular dated November 11, 2022. It was observed that TM/CM were disposing off unpaid securities in the market (invocation of pledge) after five trading days also i.e on 6th and 7th trading day also and invoking the securities for pay-in on the same day for the said trades which was not in compliance with SEBI circular dated November 11, 2022. It was also observed that NSDL had not put in place appropriate system to ensure that the said securities were not released / disposed by TMs/CMs post end of 5th trading day from the pay-out date. ...”

71. I note that a settlement order is passed without an admission or denial of the findings. In this present case, it has not been relied on to support any particular interpretation of the Circular rather its relevance is only factual. The said settlement order shows that, during the same period, the disposal and release of pledge on the 6th and 7th trading days took place across both the depositories. This supports the view that the Circular was understood and implemented in a similar manner across the market. It also aligns with the gaps in the instant SEBI Circular that were later acknowledged by SEBI, rather than pointing to any failure unique to the Noticee.
72. In this backdrop, I note that in order for a breach to attract any consequence, the regulatory obligation alleged to be breached must be clear and unambiguous. This is principle applies with greater vigor where the interpretation adopted by the Noticee was shared across the market and the provisions were later clarified by the regulator itself.
73. In view of the foregoing, I deem it fit to grant a benefit of doubt to the Noticee *qua* the instant violation. Therefore, I find that the allegation of violation of clauses 3.4, 3.5 and 5 of the SEBI Circular dated November 11, 2022 is not established.
74. Since the allegation under the present issue has not been established, the contentions advanced by the Noticee in respect of this issue do not merit consideration.

¹⁹ Settlement Order No.:SO/SM/RG/2025-26/8259 dated December 17, 2025.



IV. Whether Noticee failed to maintain adequate system and control *qua* CUSA and thereby violated clause 5 of the SEBI Circular dated November 11, 2022?

75. It is alleged that the Noticee had failed to put in place and follow systems and controls for CUSA as required under clause 5 of the SEBI Circular dated November 11, 2022. In this regard, during inspection, it was observed that:

- (i) When the stock exchanges sent requests identifying specific securities, quantities, and client demat accounts, the Noticee unfroze the entire CUSA instead of limiting the unfreeze to the securities and quantities specified by the stock exchanges;
- (ii) The Noticee did not undertake adequate transaction statement verification, system-level checks, or ISIN-level unfreeze controls to ensure that transfers were made only as instructed by the stock exchanges;
- (iii) The Noticee did not have any system-level check to ensure that the DP transferred shares from CUSA to the same BO mentioned in the email forwarded by the exchange. Further, the Noticee did not have a system in place to undertake ISIN-level unfreeze where a BO-level freeze had been initiated in the system;
- (iv) The Noticee did not follow the system put in place in terms of the SEBI Circular dated November 11, 2022.

Allegation at Sr. No. (i)

76. In terms of SEBI Circular dated November 11, 2022, all the existing CUSAs were required to be wound up on or before April 15, 2023, *inter alia*, failing which such accounts shall be frozen for debit and credit. In this regard, to ensure compliance with the provisions of the said Circular, the stock exchanges, depositories and clearing corporations designed a joint process dated May 22, 2023.
77. In this regard, it was alleged in the SCN that on receipt of communication from the exchange for unfreezing the CUSA mentioned and ensuring that the specified list of securities was transferred to the specified demat accounts of clients only, Noticee was



unfreezing the entire CUSA of TM/CM when it was supposed to unfreeze only the securities and quantity which were specified in the email of exchanges.

78. Though Noticee has admitted that it was unfreezing the entire CUSA, it argued that its conduct during the inspection period was in line with the said joint proposal as the said proposal did not explicitly mandate 'ISIN and quantity level' freezing by depositories. In this regard, I take note of point 4 of the joint proposal dated May 22, 2023 which, *inter alia*, state as under:

"....

The Exchange forward the requests (from the designated email IDs only) received from the members along with the client master of the respective clients to depositories on a fortnightly/monthly basis for processing. Exchange provides client wise securities details along with the details of Collateral Accounts/Client Beneficiary Account to the depositories to facilitate the transfer of securities to the respective clients only.

....." (Emphasis supplied)

79. On a plain reading of the point 4 of the joint proposal, it is evident that the unfreezing of the securities and consequential release of securities were intended to be undertaken at the level of security and not by permitting an account level unfreeze without restriction. I note that the point 4 explicitly states that the "*Exchange provides client wise securities details*" to the depositories along with the details of Collateral Accounts/Client Beneficiary Account so as to facilitate "*the transfer of securities*" to the respective clients only. The expression "*client wise securities details*" is significant, as it shows that the information provided by the stock exchange was not merely account-level information but a granular instruction identifying the client and the securities to which the instruction related. Therefore, the depository was expected to act in a manner consistent with such granular information and to ensure that the transfer was confined to the securities and client accounts specified by the stock exchange. If the Noticee's interpretation were accepted, the requirement of providing client-wise securities details would be rendered largely redundant. The unfreezing of the entire account would run contrary and be inconsistent with the requirement that the transfer of securities has to be undertaken to the respective clients only. Such an interpretation would also undermine the purpose of the mechanism, which was to facilitate return of securities to the respective clients and not to confer a general authority to unfreeze the entire CUSA. In that context, the words "*to the respective clients only*" assume importance, as they impose a limiting condition



on the manner in which the depository was required to process the requests received from the stock exchange. Considering the same, I find that the absence of the exact words “*ISIN and quantity level*” in the joint proposal does not help the case of Noticee. Accordingly, the instant contention of the Noticee bereft of merit and hence unacceptable.

80. Considering the abovementioned reasoning, I am of the considered opinion that Noticee unfroze the entire CUSA instead of limiting the unfreeze to the securities and quantities specified by the stock exchanges when the stock exchanges sent requests identifying specific securities, quantities, and client demat accounts.

Allegation at Sr. Nos. (ii) and (iii)

81. It was alleged in the SCN that the Noticee failed to carry out adequate verification of transaction statements, system-level checks, and ISIN-wise unfreeze controls to ensure that securities were transferred strictly in accordance with the instructions issued by the stock exchanges. It was further alleged in the SCN that the Noticee did not maintain any system-level control to ensure that the DP transferred shares from CUSA only to the same BO account as specified in the email forwarded by the exchange. It was also alleged that the Noticee did not have an appropriate mechanism to carry out ISIN-level unfreezing where a BO-level freeze had already been recorded in the system.
82. Noticee has not disputed the aforesaid allegations. In this regard, Noticee submitted that it has taken corrective measures and strengthened its internal processes to avoid recurrence of such lapses. Further, it has implemented additional internal processing steps to strengthen checks and balances for CUSA transfers, with effect from June 14, 2024 including sharing of CUSA transaction statement with stock exchange and DP, ISIN level freeze and unfreeze and enhanced internal system. While these measures indicate subsequent corrective action, I note that such subsequent compliance can in no manner exonerate the Noticee from its earlier lapses. The regulatory obligation cast upon the Noticee was required to be complied with at the relevant point of time, and failure to do so cannot be cured retrospectively merely by putting appropriate controls at a later stage. Therefore, I am of the view that the Noticee is liable for the lapses



observed during the relevant period, notwithstanding the remedial measures subsequently undertaken by it.

83. Noticee argued that there were no adverse market impact or unauthorized transfers. I note that the extant requirement under the said SEBI Circular and joint proposal were not merely to avoid an adverse outcome, but to ensure that adequate systems, checks and controls were in place to prevent such risks from arising in the first place. The fact that no unauthorised transfer occurred may be relevant while considering the gravity of the violation, but it does not cure the underlying deficiency in the control framework. Therefore, this submission of the Noticee cannot be accepted.
84. Noticee contended that for a breach to warrant a penalty, there must be evidence of systemic failure or *mens rea*, neither of which is present. In this regard, I note that Noticee, being an MII, was expected to comply with the extant regulations in form and substance. Once non-compliance with such obligation is established, the absence of *mens rea* or an alleged lack of systemic failure does not, by itself, absolve the Noticee of liability. In this regard, I take note of the decision of the Hon'ble Supreme Court in the matter of *SEBI v. Shriram Mutual Fund & Anr.*²⁰ wherein it was held as under:
- "... In our considered opinion, penalty is attracted as soon as the contravention of the statutory obligation as contemplated by the Act and the Regulation is established and hence the intention of the parties committing such violation becomes wholly irrelevant. A breach of civil obligation which attracts penalty in the nature of fine under the provisions of the Act and the Regulations would immediately attract the levy of penalty irrespective of the fact whether contravention was made by the defaulter with guilty intention or not. ..."*
85. Further, I note that the prevailing law does require proof of systemic failure for establishing a contravention of securities law. Each regulatory obligation and mandate stands on its own footing and operates independently. Breach of any such obligation and mandate is a contravention of securities law. If the contention of the Noticee that only systemic failure warrants penalty is accepted, then it would have the effect of rendering a substantial number of regulatory lapses inconsequential, thereby weakening the enforcement framework. The aforesaid reasoning assumes greater significance when the critical role played by Noticee in the present scenario is analyzed wherein it

²⁰ (2006) 5 SCC 361.



was entrusted with clients' assets. Thus, the requirements relating to CUSA transfers and related controls cannot be dismissed as mere procedural formalities. Such requirements are intended to safeguard client securities, ensure traceability of transactions, and enable effective regulatory oversight. Therefore, this contention of the Noticee cannot be accepted.

86. Noticee argued that if SEBI considered any aspect of the system to be inappropriate, it should have reverted at the time of review to the test of appropriateness. I note that the duty to put in place proper systems and controls was squarely on the Noticee. A review by SEBI does not mean that SEBI certified or approved the Noticee's systems as adequate. It also does not bar SEBI from later examining how those systems actually worked. The absence of an adverse comment during an earlier review can neither cure a subsequent non-compliance nor can it be used as a defense against a statutory obligation. It is reiterated that Noticee was required to comply with the relevant SEBI Circular along with the joint process at all times and mere existence of a process was not enough. The process had to be properly implemented, monitored and followed in practice. In the present case, lapses were found in the actual working of the process. Therefore, the Noticee cannot rely on the absence of an earlier objection from SEBI.
87. Considering the foregoing discussion, I find that the allegation at Sr. Nos. (ii) and (iii) have been established against the Noticee.

Allegation at Sr. No. (iv)

88. It was alleged that Noticee did not follow the system put in place in terms of the SEBI Circular dated November 11, 2022. During the inspection, on perusal of the sample cases, it was observed that JM Financial's CUSA was required to be frozen by the end of day on June 27, 2023, as per the stock exchange's email, but it was frozen only on July 05, 2023. In another instance, the stock exchange had requested that Bajaj Financial Securities Limited's CUSA be unfrozen for transfer of specified securities to the respective client's demat account and re-frozen on August 31, 2023. However, the Noticee failed to process the unfreezing request and, when the relevant stock exchange



sought reasons for the same, it did not provide an explanation and instead requested a new unfreeze date.

89. It is an admitted fact that Noticee failed to freeze CUSA, Bajaj Financial Securities Limited (CUSA – 1208860000001371) and unfreeze CUSA, JM Financial (CUSA – 1203330001090865) on the date as instructed in the email of the stock exchange.
90. Noticee stated that the specific instances relating to JM Financial and Bajaj Financial Securities Limited were a case of minor operation aberrations by individual officials and not systemic error. It is submitted that the corrective action was immediately taken upon identification of the issues and that no market impact, unauthorized transfer, or investor harm occurred in either case. I note that the said two instances were identified from the selected sample set and not on the basis of a comprehensive review of all CUSA maintained with Noticee. I note that subsequent corrective action can in no manner absolve the Noticee of the violation established in the present matter. Therefore, this contention of the Noticee lacks merit and hence is rejected. In view of the foregoing discussion, I find that the allegation at Sr. No. (iv) stand established against the Noticee.
91. In light of the foregoing discussion, I note that the allegations at Sr. Nos. (i) to (iv) have been established against the Noticee. Accordingly, I find that Noticee has violated clause 5 of the SEBI Circular dated November 11, 2022.

V. Whether Noticee failed to implement measures to prevent unauthorized transmission of data during the IP and thereby violated clause 31 of Annexure A of the SEBI Circular dated July 06, 2015 from the period July 2015 to October 2023?

92. It was observed that as per the cyber audit report for the period from October 2022 to March 2023, 24 endpoints of Noticee were not integrated with the CDSL DLP solution. Further, as per the report on the Cyber Risk Assessment done by KPMG in August 2023 and the status submitted by Noticee, it was observed that DLP implementation at all channels was still incomplete.



93. It is not in dispute that the DLP solution was not implemented across the 24 endpoints during the inspection period. Further, it is not the case of Noticee that DLP was not among the measures adopted to secure its endpoints. As an inevitable conclusion, it is manifest that the said 24 endpoints were, in fact, excluded from the CDSL DLP solution.
94. Before examining the issue on merits, it is crucial to first understand what is encompassed within the ambit of an “end point”. In this regard, following observation made by the Microsoft²¹ assumes significance:

“What counts as an endpoint?”

An endpoint is any physical device that connects to and exchanges information with a network. That includes the obvious ones such as:

- *Laptops and desktop computers.*
- *Smartphones and tablets.*
- *Servers and workstations.*
- *Virtual machines.*

But it also includes a growing number of less obvious devices, such as Internet of Things (IoT) hardware. The cameras, smart speakers, thermostats, and other connected equipment that make up an IoT environment often fly under the radar when organizations assess their security posture.

...

Why endpoints are prime targets

Endpoints are attractive to attackers for two key reasons. First, they often exist outside the traditional network perimeter, making them harder to monitor and defend. Second, they depend heavily on user behavior, and users (even well-intentioned ones) make mistakes. A single click on a malicious link or an unpatched operating system can be all an attacker needs.

That exposure is compounded by the sheer variety of endpoints organizations manage. Every device type, operating system, and access pattern introduces its own set of potential weaknesses.

...” (Emphasis supplied)

95. Given this context, I note that endpoints commonly recognised as one of the weakest links in the security chain²². In this background, I take note of clause 31 of Annexure A of the SEBI Circular dated July 06, 2015 which reads as under:

“... MII should implement measures to prevent unauthorised access or copying or transmission of data / information held in contractual or fiduciary capacity. It should be ensured that confidentiality of information is not compromised during the process of exchanging and transferring information with external parties.
...”

²¹Available at <https://www.microsoft.com/en-us/security/business/security-101/what-is-endpoint-security>.

²²Available at <https://pmc.ncbi.nlm.nih.gov/articles/PMC7438053/>



96. Noticee stated that the DLP solution constituted only one layer of its overall cyber security architecture. It further mentioned that multiple additional controls including USB blocking and CD Drive Restriction, Email Controls, PIM, Web filtering and Restricted Internet Access and MDM had been implemented to prevent unauthorized transmission of data. At the threshold, I note that Noticee has not placed any material on record to show that these controls were actually applied to the 24 endpoints in question or that such controls at least provided protection that was equivalent to the DLP solution. In this regard, no endpoint-level records, logs, or reports have been furnished to establish that such controls were enabled and/or operating on the specific endpoints in question. Even otherwise, the said controls cannot be construed as performing the same function as DLP. I note that DLP is a collection of technologies, policies, and processes designed to identify, monitor, and prevent the unauthorized disclosure of sensitive information. While USB and CD blocking address only physical removable media²³; email and web filtering generally operate on the basis of sender, destination, or category rather than content; PIM controls are directed at privileged account misuse; and MDM enforces device-level policies. I note that none of these controls, as mentioned by the Noticee, can substitute the specific content-based data-loss-prevention function performed by DLP. Therefore, this submission lacks merit and hence, is rejected.
97. Noticee contended that the 24 endpoints so identified were entirely within CDSL's internal ecosystem. In this regard, I note that no supporting material has been provided by the Noticee to substantiate its contention that all the said endpoints were confined within its internal perimeter. Even assuming that the endpoints were within the internal perimeter, it was incumbent on the Noticee to not just adequately secure the endpoints but also to implement measures preventing unauthorised access or copying or transmission of data / information. The very fact that these endpoints were internal cannot eliminate the risk of unauthorised access or copying or transmission of data / information. Moreover, as noted above, the Noticee has not been able to establish that it had undertaken commensurate and essential measures to protect the said 24 endpoints in terms of the said SEBI Circular dated July 06, 2015. Therefore, the instant contention of the Noticee cannot be accepted.

²³Available at <https://learn.microsoft.com/en-us/defender-endpoint/device-control-overview>



98. Noticee also stated that there was no incident of unauthorized access, copying, transmission, data leakage or any form of compromise in any of the said 24 endpoints. I note that the compliance with cyber and data security is continuous and preventive in nature. The said compliance cannot be held contingent upon the occurrence of an adverse incident. It was incumbent upon the Noticee to ensure that the extant mandate was complied with in letter and spirit irrespective of any actual breach. Therefore, the mere fact that there was no untoward incident does not cure the failure of the Noticee to implement DLP across 24 endpoints. Once a deficiency is pointed out in the cyber audit which had the potential to undermine the data security of Noticee's system, failure to address the said deficiency until it was once again pointed out in the inspection, appears to show a casual approach to red flags by Noticee. Consequently, this contention of the Noticee cannot be accepted.
99. Noticee stated that the DLP solution has been fully deployed across the 24 endpoints based on the observation of the inspection. I note that the subsequent remedial action does not alter the factual position that the said endpoints were not integrated with the DLP solution during the inspection period. Any compliance undertaken after identification of the lapse may be a mitigating circumstance, but it cannot negate the non-compliance observed during the inspection period. Therefore, this contention of the Noticee cannot be accepted.
100. Considering the aforesaid discussion, I find that Noticee has violated clause 31 of Annexure A of the SEBI Circular dated July 06, 2015 from the period from July 2015 to October 2023.

VI. Whether Noticee failed to implement baseline standards from the period from July 2015 till October 2023 and delayed the implementation of block mode within force point technology and thereby violated clauses 27 and 28 of Annexure A of the SEBI Circular dated July 06, 2015?

101. It was alleged in the SCN that the DLP implementation at all channels was still incomplete during the inspection period. Further, this issue was also highlighted in the Cyber Risk Assessment report furnished by KPMG in August 2023. It was, further, alleged that the implementation of block mode within force point technology was still in



progress even after a cyber-incident. In this context, it was alleged that the Noticee had not implemented the baseline standards uniformly.

102. Before proceeding, I take note of clause 27 of Annexure A of the SEBI Circular dated July 06, 2015 which reads as follows:

“... 27. MII should establish baseline standards to facilitate consistent application of security configurations to operating systems, databases, network devices and enterprise mobile devices within the IT environment. The MII should conduct regular enforcement checks to ensure that the baseline standards are applied uniformly.

...”

103. Noticee argued that SEBI has wrongly treated DLP-related observations as evidence of non-compliance with baseline standards. In this regard, Noticee asserted that DLP is an additional data protection mechanism and not the baseline standard in terms of clause 27 of Annexure A of the SEBI Circular dated July 06, 2015. I note that for a violation of clause 27 to be sustained, it is necessary to first establish that the application in question fell within the ambit of the baseline standard before any deviation thereof could be treated as a violation. In this context, I note that there is no evidence on record to indicate that DLP fell within the scope of the Noticee's baseline standards. Arguendo, even if DLP is assumed to be a baseline standard, the allegation fails to meet the objective criteria that there was a failure to establish such a baseline standard and not that it was not uniformly implemented. In this background, I note that there lies no *lis* that as a matter of best practice, it was essential that the said application ought to be uniformly deployed across all of Noticee's systems. However, the non-uniform deployment of an application does not, by itself, amount to non-compliance with clause 27 of Annexure A to the SEBI Circular dated July 6, 2015. For the said clause to be attracted, it must first be established that the application in question formed part of the Noticee's defined baseline standards. I find that the material on record is insufficient to sustain such a finding. Accordingly, I deem it appropriate to accept the Noticee's contention.

104. Further, I have taken note of the submission of the Noticee wherein it has stated about the existence of the baseline standard, their periodic revision and audit through CERT-In empaneled auditors which did not record any adverse finding in this regard.

105. Having found that the charge under clause 27 is not established, I now examine whether the same facts nevertheless disclose a separate failure under clause 28, which imposes



an obligation to install network security devices capable of protecting the IT infrastructure from internal and external security exposures.

106. Preceding the analysis of the merits of the Noticee's submissions, reference is made to the clause 28 of Annexure A of the SEBI Circular dated July 06, 2015:

"Network Security Management

...28. MII should install network security devices, such as firewalls as well as intrusion detection and prevention systems, to protect its IT infrastructure from security exposures originating from internal and external sources. ..."

107. I note that clause 28 of Annexure A of the SEBI Circular dated July 06, 2015 is included in the subhead 'Network Security Management'. It is important to note that the heading sets out of the context of the clause. It shows that the clause deals with network security and not protection of data. Further, the said clause requires MIIs to install network security devices to protect their IT infrastructure from security exposures originating from internal and external sources. The said clause names devices such as firewalls, intrusion detection and prevention. I note that these devices guard the infrastructure against intrusions and attacks. It is important to note that the object of devices mentioned in clause 28 is protection of network infrastructure. However, DLP including block mode within force point technology serves a different purpose and objective. DLP detects, monitors, and blocks the unauthorized sharing, leakage, or exfiltration of sensitive information²⁴.

108. There lies no qualm that the use of the words "such as" indicates that the clause envisages the list to be non-exhaustive. However, it is also a cardinal rule of law that general words are restricted to things that belong to the same class or category as the specific items. In this regard, I take note of the decision of the Hon'ble Apex Court in the matter of *Siddeshwari Cotton Mills (P) Ltd. v. Union of India*²⁵, wherein it was held as under:

"... 7. The expression ejus-dem-generis, 'of the same kind or nature'--signifies a principle of construction whereby words in a statute which are otherwise wide but are associated in the text with more limited words are, by implication, given a restricted operation and are limited to matters of the same class or genus as preceding. If a list or string or family

²⁴Available at <https://www.microsoft.com/en-in/security/business/security-101/what-is-data-loss-prevention-dlp>.

²⁵ 1989 AIR 1019.



of genus-describing terms are followed by wider or residuary or sweeping-up words, then the verbal context and the linguistic implications of the preceding words limit the scope of such words.

In 'Statutory Interpretation' Rupert Cross says: " The draftsman must be taken to have inserted the general words in case something which ought to have been included among the specifically enumerated items had been omitted " (Page 116)

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The principle underlying this approach to statutory construction is that the subsequent general words were only intended to guard against some accidental omission in the objects of the kind mentioned earlier and were not intended to extend to objects of a wholly different kind. This is a presumption and operates unless there is some contrary indication. But the preceding words or expressions of restricted meaning must be susceptible of the import that they represent a class. If no class can be found, ejus-dem-gener- is rule is not attracted and such broad construction as the subsequent words may admit will be favoured. ..."

109. In this background, I note that the devices mentioned in the clause at hand form a genus wherein they envisage including network security devices that protect infrastructure against intrusion and attack. The subhead further reinforces the said view. Therefore, the word "such as" has to be limited to other devices of a similar kind and nature. It cannot be extended to a device of a different nature that is directed to protect sensitive data. Further, the reference to the term "internal" sources recognizes the fact that threats may arise within the network. However, such reference can by no means convert a network security provision into a data security mandate. It may also be noted that 'security of data' has been included in clauses 30 to 33 of the said Circular. Consequently, the obligation to install DLP and its associated compliance cannot be read into the said clause. It is also not the case that Noticee failed to install intrusion detection and prevention systems, or devices of similar nature.

110. With respect to the allegation that the firewall configuration was still a work in progress, and therefore evidenced that the installation of network security devices was incomplete, I note that SEBI, at paragraph no. 14.2.1 of the PIA, had recorded that "*Firewall related explanation submitted by CDSL may be considered.*" In view of the same, I deem it appropriate not to draw any adverse inference against the Noticee in relation to the firewall configuration.

111. Based on the reasoning given in preceding paragraphs, I find that the Noticee has not violated clauses 27 and 28 of Annexure A of the SEBI Circular dated July 06, 2015.



VII. Whether Noticee failed to prescribe RTO and RPO in consonance with clauses 4(c) and (d) of the SEBI Circular dated March 22, 2021 and thereby violated clauses 4(c) and (d) of the SEBI Circular dated March 22, 2021?

112. During the inspection, it was observed that clause 4.3 of the Noticee's CCMP considered the lowest values derived from the Business Impact Analysis exercise as the RTO and RPO. It was therefore alleged that the RTO and RPO recorded in the CCMP were not aligned with the SEBI guidelines.
113. As per clauses 4(c) and (d) of SEBI Circular dated March 22, 2021, the RTO - the maximum time taken to restore operations of 'Critical Systems' from DR site after the declaration of Disaster shall be 45 minutes. Further, RPO, the maximum tolerable period for which data might be lost due to a major incident, shall be 15 minutes.
114. Noticee contended that the said SEBI Circular does not explicitly mandate inclusion of the RTO and RPO values within the CCMP and the absence of these references in CDSL's CCMP during the inspection period cannot constitute non-compliance. In this regard, I note from perusal of SEBI Circular dated March 22, 2021 that the said SEBI Circular, *inter alia*, deals with BCP requirement and does not regulate the contents of the CCMP. Considering the same, even assuming the RTO and RPO in the CCMP were not in conformity with the threshold prescribed in the said SEBI Circular, Noticee cannot be held liable for the breach of SEBI Circular dated March 22, 2021 as the said Circular does not regulate the content of the CCMP. Considering the fact that the charge is specific to divergence in RTO and RPO in the CCMP of the Noticee with the timeline prescribed under SEBI Circular dated March 22, 2021, the contention of the Noticee is accepted.
115. In the course of present proceedings, Noticee has adduced a copy of its BCP version 2.2. On the perusal of the document, it is observed that RTO has been prescribed as 45 minutes and RPO has been stated as 'till the last transaction', which appear to be in line with the threshold specified under the said SEBI Circular. However, it is a matter of record that the BCP was not provided to SEBI during the inspection and several versions



of BCPs were submitted to the inspection team of SEBI that did not mention RTO and RPO parameters as mandated. Noticee's failure to place the relevant BCP before the inspection team appears to be a matter of concern since the sanctity and integrity of an inspection are dependent on the Noticee providing correct and complete documents in a prompt manner. However, considering the fact that there is no material on record to doubt the veracity of the BCP version 2.2 submitted by the Noticee, I am inclined to accept the contention of the Noticee.

116. In the light of the aforesaid reasoning, I am of the view that the allegation pertaining to the violation of clauses 4(c) and (d) of the SEBI Circular dated March 22, 2021 have not been established *qua* Noticee.

VIII. Whether the Noticee had exceeded RTO in four DR drills and thereby violated clause 5(h) of the SEBI Circular dated March 22, 2021?

117. As per the DR drills summary submitted by Noticee, it is observed that the RTO in the following four periodic drills exceeded the stipulated threshold of 45 minutes:

Table 3

Sr. No.	System	Date of DR drill	Primary Made down at time	DR made up at time	Total Time Taken (in hrs)/ RTO
1.	WEBCDAS	September 17, 2022	09:38	10:38	01 Hrs
2.	WEBCDAS	December 16, 2022	21:15	22:42	01 Hrs 27 Mins
3.	WEBCDAS	March 17, 2023	23:10	02:05	02 Hrs 55 Mins
4.	WEBCDAS	June 23, 2023	21:17	22:04	47 Mins

118. Clause 5(h) of the SEBI Circular dated March 22, 2021 requires the depositories to include a scenario of intraday shifting from PDC to DR site during the mock trading sessions in order to demonstrate its preparedness to meet RTO of 45 minutes. The said clause is concerned with mock trading sessions and envisages an assessment of the preparedness, resilience and response capability of the depository in a controlled environment before any real-life contingency arises.
119. I note that it is not a case that Noticee failed to undertake shifting from PDC to DR site during the mock trading sessions. The issue for consideration is limited to whether the Noticee failed to adhere to the stipulated RTO in the abovementioned four DR drills resulting in the violation of clause 5(h) of the SEBI Circular dated March 22, 2021.



120. At the threshold, I note that the mock trading sessions are intended for the purposes of testing and familiarization. In this backdrop, I note that the issue at hand specifically pertains to the delay in achieving the prescribed RTO threshold during mock trading sessions. While the RTO requirement in the mock sessions operates as a benchmark for assessing operational preparedness, the fact remains that these four DR drills were conducted in mock sessions. Thus, the lapses observed during these mock sessions' *ipso facto* cannot be construed as conclusive evidence of any substantive failure in real time.
121. Furthermore, it is crucial to emphasize that the clause 5(h) uses the term "*demonstrate its preparedness to meet RTO of 45 minutes*". The clause does not require the depository to meet, achieve, or ensure an RTO of 45 minutes during a mock drill. These expressions are neither synonymous nor interchangeable but are materially different. Thus, when construed holistically, the said clause requires the depository to establish its readiness to meet the RTO. It does not elevate actual compliance with the 45-minute timeline during the mock drill into the touchstone of regulatory compliance. The subject of the test is preparedness. In this regard, I note that had SEBI intended to mandate that the RTO of 45 minutes be strictly achieved in every mock drill, it would have employed clear and express language to that effect. Regulatory provisions imposing an outcome-based obligation ordinarily use terms such as "shall meet" or "shall achieve," or words of similar mandatory import. The absence of such language is significant and cannot be disregarded. It is a settled principle of interpretation that words cannot be read into a provision where none exist, particularly where such reading would widen the scope of the obligation imposed. To construe clause 5(h) as requiring that every mock drill must, in fact, achieve the prescribed RTO would amount to impermissibly supplying words to the provision and, in substance, rewriting it. Therefore, the said clause in no manner be construed to mean that the mock drill must meet the RTO of 45 minutes. Extending demonstrating preparedness to the meet to RTO to holding the Noticee liable for the same cannot be said to in accordance with the objective of the Circular.
122. Having said that, there lies no doubt about the fact that the failure to meet such a benchmark over four mock drills, *prima facie*, indicates that the Noticee's systems, procedures and coordination mechanisms had not achieved the expected level of preparedness and operational resilience at that relevant time. In this regard, it is noted



from Noticee's reply that it has taken remedial measures to address the deficiencies observed during the mock sessions.

123. In view of the above and considering that the allegation is confined to non-adherence to the RTO benchmark during mock drills, I am of the view that the findings observed in the course of mock sessions cannot be extrapolated to hold the Noticee liable for non-compliance with the stipulated RTO requirement.

124. Accordingly, I find that the Noticee has not violated clause 5(h) of the SEBI Circular dated March 22, 2021.

IX. Whether Noticee failed to deploy adequate manpower at the PDC site and thereby violated clause 3(d) of the SEBI Circular dated March 22, 2021?

125. It was alleged in the SCN that while the Noticee had deployed manpower at its DR site in Hyderabad, there was no manpower deployed at the PDC.

126. It is not in dispute that eight personnel were deployed at the DR site of Noticee located in Hyderabad. However, no official of the Noticee was deployed at the PDC or near the CDSL site.

127. The Noticee contended that clause 3(d) of the SEBI Circular dated March 22, 2021 envisages to ensure that the DR site has adequate and trained manpower to independently handle operations without relying on the PDC. It further averred that clause 3(d) does not mandate the physical deployment of CDSL's employees at the PDC on a permanent basis and, therefore, any allegation relating to manpower deployment at the PDC falls outside the scope of this provision.

128. Before examining the Noticee's contention on merits, I find it appropriate to reproduce clause 3(d) of the SEBI Circular dated March 22, 2021:

"... The manpower deployed at DRS/NS shall have the same expertise as available at PDC in terms of knowledge/ awareness of various technological and procedural systems and processes relating to all operations such that DRS/NS can function at short notice, independently. MIs shall have sufficient number of trained staff at their DRS so as to have the capability of running live operations from DRS without involving staff of the PDC. ..."



129. At the threshold, it is reiterated that when the words of a statute are clear or unambiguous, i.e., they are reasonably susceptible to only one meaning, the courts are bound to give effect to that meaning irrespective of consequences²⁶.
130. Having regard to the aforesaid position of law and upon a close reading of clause 3(d), it is clear that the provision deals with the deployment of manpower at the DR site. Its object is to ensure that sufficient trained manpower is available at the DR site to independently handle contingencies and run live operations without involving staff of the PDC. Therefore, it is apparent that deployment of manpower at the PDC does not fall within the plain scope of clause 3(d) of the SEBI Circular dated March 22, 2021.
131. Applying the above reasoning to the facts of the present case, it is evident from a plain reading of the SCN that the allegation is confined to non-deployment of manpower at the PDC, and not to any inadequacy in manpower at the DRS. It is also a matter of record that no allegation has been levelled in the SCN regarding either the adequacy or the training of the manpower deployed at the DRS. In this background, clause 3(d) cannot be stretched to cover deployment of manpower at the PDC. Consequently, I find merit in the Noticee's contention.
132. In light of the foregoing discussion and reasoning, I am of the opinion that the allegation *qua* violation of clause 3(d) of the SEBI Circular dated March 22, 2021 is not established.

X. Whether Noticee collected SIEM logs from PDC during the DR drill and thereby violated clause 5(c) of the SEBI Circular dated March 22, 2021?

133. It was alleged in the SCN that, during the DR drill, SIEM logs continued to be collected at the PDC. On that basis, it was alleged that all operations were not being carried out from the DR site during the drill.
134. Noticee has admitted that the SIEM logs were collected at the PDC during the drill.
135. In its defense, Noticee stated that the expression "running all operations" in clause 5(c) pertained to core business functions and not to ancillary activities such as security log

²⁶*Nelson Motis v. Union of India*, AIR 1992 SC 1981.



collection and monitoring, which is a supplementary activity that do not affect operational continuity. The Noticee further emphasized that all core business operations were conducted from the DR site in compliance with clause 5(c). It also stated that SIEM monitoring at the PDC enables centralized security analysis across devices and systems located at both the PDC and the DR site and that, in an actual disaster, it can manually switch the SIEM console to the DR site, thereby ensuring complete security monitoring from the DR site without reliance on the PDC.

136. Regulation 5(c) of the SEBI Circular dated March 22, 2021 required that the DR drill include running “all operations” from the DR site for at least one full trading day.
137. In this regard, I note that the said clause employs the expression ‘all operation’ without drawing any distinction between categories of operations. The deliberate use of the term ‘all’ preceding operations is of utmost significance. Here, I take note of the decision of the Hon’ble Supreme Court in the matter of *Gurudevdatla VKSSS Maryadit v. State of Maharashtra*²⁷ wherein the Apex Court avowed as under:

“... It is a cardinal principle of interpretation of statute that the words of a statute must be understood in their natural, ordinary or popular sense and construed according to their grammatical meaning, unless such construction leads to some absurdity or unless there is something in the context or in the object of the statute to suggest to the contrary. The golden rule is that the words of a statute must prima facie be given their ordinary meaning. It is yet another rule of construction that when the words of the statute are clear, plain and unambiguous, then the Courts are bound to give effect to that meaning, irrespective of the consequences. It is said that the words themselves best declare the intention of the law-giver. The Courts are adhered to the principle that efforts should be made to give meaning to each and every word used by the legislature and it is not a sound principle of construction to brush aside words in a statute as being inapposite surpluses, if they can have a proper application in circumstances conceivable within the contemplation of the statute...”

138. In view of the aforesaid legal position, I note that the expression ‘all operations’ in clause 5(c) must be construed in its plain and literal sense. The said expression covers every operational component, including ancillary and support activities. SIEM can in no manner be treated as detached or insignificant activities. It is important to highlight that SIEM solution performs log management, event correlation, continuous monitoring, and incident response²⁸. These functions are integral to the detection of security events,

²⁷ AIR 2001 SC 1980.

²⁸ Available at <https://www.microsoft.com/en-in/security/business/security-101/what-is-siem>.



assessment of operational risk, continuous monitoring and timely response to incidents²⁹. If the contention of the Noticee is accepted, then it would invariably amount to reading into clause 5(c) an exception in favor of ancillary or support functions when no such exception is provided therein. Such an interpretation would make the use of the term 'all' otiose, would dilute the mandatory requirement surrounding the said obligation and defeat the regulatory purpose of a DR drill. I, therefore, find that the obligation under clause 5(c) required the Noticee to ensure that all operations, including security log collection and monitoring, were run from the DR site during the DR drill. Consequently, the restricted interpretation canvassed by the Noticee of the clause is untenable.

139. Accordingly, it is established that all operations were not being carried out from the DR site during the drill. Therefore, I find that Noticee violated clause 5(c) of the SEBI Circular dated March 22, 2021.

XI. Whether Noticee failed to patch the vulnerabilities within the three months' time stipulated by SEBI and thereby violated clause 2(41) of the SEBI Circular dated May 20, 2022 read with clause 41 of Annexure A of the SEBI Circular dated July 06, 2015?

140. During the inspection, VAPT reports of 2021-22 and 2022-23 were compared on a sample basis. It was observed that there were repeat vulnerabilities. TLS version 1.1 protocol deprecated was present in both reports on the same IPs 61.95.148.49 [Port 10443]. Further, on cross verifying the closure of the vulnerabilities on a sample basis, it was observed that certain vulnerabilities were still open. This included using components with known vulnerabilities³⁰:

- <https://betamfr.cdslindia.com/Scripts/xxxxx-x.x.x.js>
- <https://betamfr.cdslindia.com/Scripts/xxxxx-xx-x.xx.x.min.js>
- <https://www.cdslindia.com/Includes/xxxxxxxxx-x.x.x/xx/xxxxxxxxxx.min.js>

141. On further analysis of the detailed revalidation reports submitted by the Noticee, it was similarly observed that certain vulnerabilities remained open beyond the prescribed

²⁹ *Ibid.*

³⁰ Details excised for privacy and security.



timeline of three months. Further, the vulnerability relating to "Using Components with Known Vulnerabilities" was found to be open during the present inspection as well.

142. Noticee argued that though the VAPT reports for FY 2021-22 and FY 2022-23 pertain to the same IP address (61.95.148.49), the nature of the vulnerabilities identified are entirely distinct. In FY22, the vulnerability related to web server version disclosure; in FY23, it related to the deprecation of TLS v1.1 protocol. In this regard, I note that the material on record, including the VAPT reports, does not contain the CVE number/ID or any other similar unique identifier of the vulnerabilities that were alleged to have been repeated. In the absence of such identifier, it cannot be conclusively determined whether the vulnerabilities observed across the two VAPT reports were one and the same or not. In this background, I find that the allegation that the same vulnerability with respect to TLS version 1.1 protocol was repeated across the two VAPT reports is not established and accordingly, I deem it fit to extend a benefit of doubt to the Noticee.
143. The Noticee has admitted the delay in closure of the vulnerabilities referred to in the SCN. Its explanation is that, under its risk-based prioritization framework, high and medium risk vulnerabilities were closed within time, whereas low risk vulnerabilities were addressed later based on severity, operational impact, likelihood of exploitation, and dependencies on OEMs and vendors. In this regard, I note that SEBI Circular dated May 20, 2022, read with Clause 41 of Annexure A to the SEBI Circular dated July 06, 2015, mandates closure of vulnerabilities within three months from the date of submission of the final VAPT report. The Circular does not distinguish between high, medium, or low risk vulnerabilities. It prescribes one timeline for all vulnerabilities. In the absence of any such distinction in the regulatory framework, the Noticee could not have carved out a separate compliance standard for itself on the basis of its internal assessment. The Noticee's risk-based methodology may serve its internal operational purposes. However, it cannot override a clear regulatory mandate. Once a vulnerability is identified, the Noticee is required to close it within the prescribed timeline, regardless of its classification. Any other view would amount to permitting the Noticee to determine the extent of its compliance based on its own assessment which would be impermissible with the text of the Circular. I also note that the classification relied upon by the Noticee is based on its self-assessment. If such self-assessment is accepted as a basis to defer



compliance, the regulatory timeline would be rendered discretionary, and the mandate of the Circular would stand diluted. The timeline has been prescribed uniformly and has not been left to the choice of the Noticee. I note that Noticee is an MII and its systems are part of the securities market infrastructure. Any unaddressed vulnerability in such systems can affect market integrity and security. Timely closure of vulnerabilities is, therefore, a substantive compliance requirement. Therefore, the instant contention of the Noticee is bereft of merit and warrants no further consideration.

144. Noticee stated that older Bootstrap libraries retained in the “/includes” folder were preserved solely for contingency purposes while updated versions remained operationally active. In this regard, it is not in dispute that the old Bootstrap libraries were flagged in the observations made in the VAPT report as vulnerable. Thus, it was incumbent on the Noticee to take prompt action regarding the said components. Further, the Noticee has neither explained the nature of the contingency nor submitted any supporting material. Furthermore, the mere fact that the updated versions remained operationally active does not justify the inherent risk arising from the continued presence of the older libraries. Therefore, the instant submission of the Noticee cannot be accepted.
145. Noticee mentioned that VAPT observations pending beyond three months, along with associated risks and compensatory controls, were placed before the SCOT in its meeting dated March 11, 2025, which confirmed remediation of all findings pertaining to FY22 and FY23. I note that it is an admitted fact that the Noticee failed to close the VAPT observations within the stipulated time frame and escalated the matter to SCOT after a considerable time gap. The subsequent remedial action may reflect course correction, but it cannot cure the lapse that had already occurred. Further, I note that even if the vulnerabilities are ultimately closed, the system remained exposed during the period of delay. Therefore, the belated SCOT review and remediation do not absolve the Noticee of the lapse, and this contention is rejected.
146. Therefore, I find that Noticee was non-compliant with clause 2(41) of the SEBI Circular dated May 20, 2022 read with clause 41 of Annexure A of the SEBI Circular dated July 06, 2015.



XII. Whether Noticee failed to conduct a comprehensive VAPT exercise and thereby violated clause 40 of the SEBI Circular dated July 06, 2015 (as amended by SEBI Circular dated May 20, 2022)?

147. The SCN alleged that the VAPT conducted by the Noticee was not comprehensive, on the ground that it did not cover all domains as required under clause 4.1(b) of the SEBI Circular dated December 7, 2018. It was further alleged that no VAPT reports had been provided in respect of its CII applications, including EDIS and AuditWeb, and that no source code review had been undertaken. The SCN also alleged, on the basis of sample cross-verification, that certain vulnerabilities continued to remain open.
148. At the outset, it is not in dispute that the VAPT was undertaken in furtherance of the regulatory mandate contained in clause 40 of SEBI Circular dated July 06, 2015 (as amended by the SEBI Circular dated May 20, 2022).
149. As regards the contention that the VAPT undertaken pertained to testing in a mock environment, I note that the regulatory mandate prevailing during the inspection period did not draw any distinction between testing conducted in a mock environment and testing conducted in a live environment. Further, since the VAPT exercise was undertaken pursuant to clause 40 of the SEBI Circular dated July 6, 2015, as amended by the SEBI Circular dated May 20, 2022, it was incumbent upon the Noticee to ensure that the scope of the exercise was in strict conformity with the requirements of the said clause. In this regard, it is apposite to refer to clause 40 of the SEBI Circular dated July 6, 2015, as amended, which provides as follows:

“... MIIs should carry out periodic vulnerability assessment and penetration testing (VAPT) which inter-alia includes all critical assets and infrastructure components like Servers, Networking systems, Security devices, load balancers, other IT systems pertaining to the activities done as a role of MII etc., in order to detect security vulnerabilities in the IT environment and in-depth evaluation of the security posture of the system through simulations of actual attacks on its systems and networks. MIIs should conduct VAPT at least once in a financial year.

However, for the MIIs, whose systems have been identified as “protected system” by National Critical Information Infrastructure Protection Centre (NCIIPC), VAPT shall be conducted at least twice in a financial year. Further, all MIIs are required to engage only CERT-In empaneled organizations for conducting VAPT. The final report on said VAPT should be submitted to SEBI after approval from Standing Committee on Technology (SCOT) of respective MIIs, within 1 month of completion of VAPT activity. ...”



150. In the present case, the material on record indicates that the relevant VAPT exercise did not extend to all domains and external applications, as required for full coverage under the applicable framework. In such circumstances, the Noticee cannot derive any benefit merely from the fact that the testing was conducted in a mock environment, particularly when the exercise itself fell short of the prescribed regulatory scope. Consequently, I find that the instant contention of the Noticee devoid of merit and hence, liable to be rejected.
151. Noticee stated that the VAPT for critical applications, including eDIS and AuditWeb (which are CII applications), had in fact conducted and the corresponding VAPT reports were furnished to SEBI during the inspection process. In support of its assertion, Noticee placed reliance upon its email dated March 12, 2024 addressed to SEBI. On perusal of the email, it appears that the audit report pertaining to eDIS and AuditWeb was indeed forwarded to the SEBI. Considering the same, I find it appropriate to accept the submission of the Noticee on this aspect.
152. Noticee contended that VAPT and source code review are two distinct and independent security exercises serving different objectives at different stages of the application lifecycle and that the applicable SEBI Circulars do not mandate a combined VAPT and source code review exercise. In this regard, the perusal of clause 40 of the SEBI Circular dated July 06, 2015 (as amended by SEBI Circular dated May 20, 2022) which deals with the ambit of the VAPT exercise does not explicitly prescribe source code review as part of VAPT. However, considering the broad formulation of the said clause, it becomes necessary to examine whether source code review can be impliedly read into the scope of VAPT. In this regard, I note that clause 40 primarily stipulates the nature of applications and systems, viz., servers, networking systems, security devices, load balancers, other IT systems pertaining to the activities to be covered and does not prescribe the testing methodology to be adopted. Further, I note that the source code review has not been made part of the VAPT's scope even under SEBI's Cybersecurity and Cyber Resilience Framework dated August 20, 2024. The fact SEBI has treated source code review as a standalone requirement in the subsequent framework further reinforces the view that source code review constitutes a separate and independent



obligation and cannot be read as a part of VAPT exercise. In light of these discussions, I note that source code review cannot be considered within the ambit of VAPT exercise.

153. It is further alleged that during cross verification on a sample basis the vulnerabilities as set below were found to be open:

- Using Components³¹ with known vulnerabilities:
 - <https://betamfr.cdslindia.com/Scripts/xxxxx-x.x.x.js>
 - <https://betamfr.cdslindia.com/Scripts/xxxxx-xx-x.xx.x.min.js>
 - <https://www.cdslindia.com/Includes/xxxxxxxxx-x.x.x/xx/xxxxxxxxxx.min.js>
- The detailed revalidation reports provide evidence that vulnerabilities are still open.

154. In this regard, I note that the aforesaid allegation, at best, points to a weakness in remediation, closure tracking, or revalidation. Even assuming that the vulnerabilities in question were found to remain open, such observations cannot, by themselves, form the basis for concluding that the VAPT coverage was not comprehensive. Further, the issue concerning closure of these vulnerabilities has already been examined under Issue XI.

155. In view of the foregoing, I am of the view that the scope of the VAPT exercise conducted by the Noticee was not comprehensive as it did not extend to all domains and external applications. Accordingly, Noticee is found to be non-compliant with clause 40 of the SEBI Circular dated July 06, 2015 (as amended by SEBI Circular dated May 20, 2022).

XIII. If yes, whether the failure on the part of the Noticee would attract monetary penalty under section 15HB of the SEBI Act and sections 19FA and 19G of the Depositories Act?

XIV. If yes, what would be the monetary penalty that can be imposed upon the Noticee taking into consideration the factors stipulated in section 15J of the SEBI Act read with rule 5(2) of the Rules and section 19I of the Depositories Act read with rule 5(2) of the Depositories Rules?

³¹ Details excised for privacy and security.



156. In the light of findings and observations made against the Noticee brought out in the foregoing paragraphs, it is evident that the Noticee has violated the following provision of law:

Table 4

Sr. No.	Charge	Provision violated
1.	Noticee has not communicated the reason for the rejection of the pledge to the DP of the pledger and the pledgee.	Regulation 79(5) of the DP Regulations.
2.	Noticee was unfreezing the ISINs for their respective quantities, as mentioned in the email of the exchanges. The same was not in line with the joint proposal put in place by the exchanges and depositories. There was no system level check to ensure that the DP transfers the shares to the same BO which is mentioned in the email forwarded by the SEs. Also, Noticee did not have a system in place in cases where BO level freeze is initiated in the system, subsequently, ISIN level unfreeze could not be initiated in the said system. Moreover, Noticee failed to freeze CUSA on the date as instructed in the email of exchange. Accordingly, Noticee was not following the joint proposal put in place in terms of SEBI Circular dated November 11, 2022.	Clause 5 of SEBI Circular dated November 11, 2022
3.	The measures to prevent unauthorized transmission of data were not completely implemented by Noticee.	Clause 31 of Annexure A of SEBI Circular dated July 06, 2015
4.	During the DR drill, the SIEM logs were being collected at the PDC. Hence, all the operations were not being carried out from the DR site during the drill.	Clause 5(c) of SEBI Circular dated March 22, 2021
5.	Noticee did not patch the vulnerabilities within the 3 months' time stipulated by SEBI.	Clause 2(41) of the SEBI Circular dated May 20, 2022 read with clause 41 of the Annexure A of SEBI Circular dated July 06, 2015.
6.	VAPT conducted by CDSL was not comprehensive.	Clause 2(40) of the SEBI Circular dated May 20, 2022 read with clause 40 of the Annexure A of SEBI Circular dated July 06, 2015.

157. Noticee stated that section 19FA of the Depositories Act is inapplicable in the present case as the said provision is directed at unfair conduct of business by a depository with the penalty being attuned to gains made from the unfair conduct. Noticee submitted that the present allegations are routine supervisory findings with no allegation of unfair dealing or any unlawful gain. In this regard, Noticee argued that the instant violations are outside the scope of the section 19FA of the Depositories Act. Before proceeding to



analyse the veracity of the Noticee's contention, it would be apposite to reproduce section 19FA of the Depositories Act, which reads as under:

Depositories Act

"Penalty for failure to conduct business in a fair manner.

19FA. Where a depository fails to conduct its business with its participants or any issuer or its agent or any person associated with the securities markets in a fair manner in accordance with the rules, regulations made by the Board or directions issued by the Board under this Act, it shall be liable to penalty which shall not be less than five crore rupees but which may extend to twenty-five crore rupees or three times the amount of gains made out of such failure, whichever is higher."

158. On bare perusal of the said provision, I note that section 19FA of the Depositories Act envisages to penalize the failure of the depository to conduct business in fair manner. In this context, I take note of the decision Hon'ble Supreme Court of India in the matter of *SEBI v. Shri Kanaiyalal Baldevbhai Patel*³² wherein while construing 'unfair trade practices' under PFUTP Regulations, it held as under:

"...Broadly trade practice is unfair if the conduct undermines the ethical standards and good faith dealings between parties engaged in business transactions. It is to be noted that unfair trade practices are not subject to a single definition; rather it requires adjudication on case to case basis. Whether an act or practice is unfair is to be determined by all the facts and circumstances surrounding the transaction. In the context of this regulation a trade practice may be unfair, if the conduct undermines the good faith dealings involved in the transaction. Moreover the concept of 'unfairness' appears to be broader than and includes the concept of 'deception' or 'fraud'....." (Emphasis supplied)

159. Having regard to the aforesaid judgment of the Hon'ble Supreme Court, I note that the term 'fair manner' in section 19FA of the Depositories Act has to be construed on the anvil of ethical and good faith dealing of the depositories in its engagements with participants or issuers or its agents or any person associated with the securities markets. As a necessary corollary, it appears that section 19FA of the Depositories Act is directed towards the conduct of a depository which undermines the ethical standards and good faith dealings with its counterparties and is not directed towards routine supervisory compliance. In the present case, section 19FA of the Depositories Act along with section 15HB of the SEBI Act has been invoked for the following two violations:

- (a) Failure to communicate the reason for the rejection of the pledge to the DP of the pledger and the pledgee in 92 instances; and

³² (2017) 15 SCC 753.



- (b) Failure to comply with the joint proposal for CUSA including unfreezing the entire CUSA instead of unfreezing the ISINs for their respective quantities, lack of system level check and failure to freeze CUSA on the relevant date on two occasions.

160. Upon examination of the aforesaid infractions, I am of the opinion that the infirmities in question are in the nature of operational shortcomings arising from the Noticee's day-to-day operations. I note that the Noticee rejected 23,272 pledges during the inspection period. Viewed against this volume, the instances in which the Noticee did not create the pledge and failed to communicate the reason for rejection are negligible and do not constitute a substantial proportion of the total rejected pledges. There is nothing on record to indicate that any client suffered loss or that the Noticee derived any undue gain on account of such lapses. It is also a matter of record that all 101 active CUSA were frozen for debit and credit by April 16, 2023, in accordance with the SEBI Circular dated November 11, 2022 and the joint proposal. I further note that, after the inspection, the Noticee acted promptly to align its conduct with the applicable regulatory framework in respect of CUSA. There is nothing on record to show that the Noticee dealt with its participants, any issuer or its agent, or any person associated with the securities market in a manner that was unfair, lacking in good faith, or deficient in ethical standards. It is also not the case that the Noticee derived any illicit gain pursuant to the aforesaid infractions. There is nothing on record to suggest that the aforesaid lapses were deliberate, fraudulent, or intended to mislead or prejudice clients. In the absence of any element of dishonesty, manipulation, or investor harm, these lapses cannot be characterised as unfair dealing. Accordingly, I find that the aforesaid two violations do not bear the character of unfairness in the conduct of business, which is a necessary precondition for invoking section 19FA of the Depositories Act.

161. In view of the aforesaid reasoning, I am of the opinion that section 19FA of the Depositories Act is not attracted to the above-mentioned two violations. Consequently, only section 15HB of the SEBI Act shall be invoked for the said two violations.

162. Noticee contended that SCN has invoked both section 15HB of the SEBI Act and section 19G of the Depositories Act and directs the Noticee to show cause why a penalty should not be imposed under both statutes for the same alleged breaches. In this regard, it



contended that that the regulatory scheme does not contemplate imposition of dual penalties under both statutes for the same alleged contravention. Further, the conduct of CDSL arises from a common factual background and cannot be penalised separately under parallel statutory provisions merely because the SEBI Circulars are issued invoking powers under both Acts.

163. In this regard, I note that section 15HB of the SEBI Act and section 19G of the Depositories Act are residuary provisions under the respective Acts. Both the provisions deal with the imposition of penalties *qua* violations for which no specific penalty has been provided. In this regard, both the said provisions appear *in pari materia*, performing analogous functions within the respective Acts. In the present case, the contraventions include SEBI Circulars whose source can be traced to both the SEBI Act and the Depositories Act. In this regard, I am of the view that the interest of justice would be best served by imposing a monetary penalty under one of the residuary provisions and not under both. Accordingly, for violations of SEBI Circulars whose source can be traced to both the SEBI Act and the Depositories Act, the penalty shall be considered only under section 15HB of the SEBI Act and section 19G shall not be separately invoked *qua* the said violations.
164. In light of the foregoing discussions, I note that aforesaid violations, as mentioned in Table 4, makes the Noticee liable for penalty under section 15HB of the SEBI Act.
165. Noticee stated that the violations are technical, procedural, and venial in nature, with no adverse impact on the market, investors, or the integrity of the securities ecosystem. In support of its submission, Notice has relied on the decisions of Hon'ble SAT in the matter of *Religare Securities Limited v. SEBI*, *DSE Financial Services Ltd. v. SEBI*³³ and *Piramal Enterprises Ltd. v. SEBI*³⁴ along with the decision of the Hon'ble Supreme Court in the matter of *Siddharth Chaturvedi v. SEBI*³⁵.
166. In this regard, I note that depositories occupy a vital and systemically important place within the in the securities market. Depositories are critical market infrastructure institutions as they enable recordkeeping of all types of securities of BOs in electronic

³³ Appeal No. 153 of 2012.

³⁴ SCC OnLine SAT 134.

³⁵ AIRONLINE 2016 SC 515.



form while ensuring efficient transfer of ownership rights, seamless settlement and data integrity. It promotes efficiency, transparency, and stability in the securities market. Considering the central role played by depository, any failure by it would have serious ramifications far beyond the securities market. The risk is heightened by the interdependence between depositories and other MIs. In this context, I note that depositories are expected to maintain highest standards of diligence and regulatory compliance. Therefore, considering the scale of harm and cascading impact that a depository failure could cause across the securities market any lapses by the depository has to be viewed seriously. In this regard, I take note of the decision of Hon'ble High Court of Allahabad in the matter of *U.P. Stock Exchange Brokers Association v. SEBI*³⁶ held that:

"The global financial crisis in 2008 impacted the international economic order besides manifesting itself in serious financial instability in economies across the world. India, as contemporary experience indicates, was not immune from its aftermath. A volatile securities market is a source of grave peril to investor confidence. SEBI constituted a Committee chaired by Dr. Bimal Jalan, former Governor of Reserve Bank of India, to examine issues arising from the ownership and governance of Market Infrastructure Institutions (MIs). The report of the Jalan Committee in 2010 adverted to the position of these institutions as constituting "the nucleus of (the) capital allocation system", indispensable for economic growth and constituting a part of the vital economic infrastructure. The Jalan Committee noted that unlike typical financial institutions, the number of stock exchanges, depositories and clearing corporations in an economy is limited due to the nature of their business. Any failure of those institutions could lead to bigger cataclysmic collapses that may result in an overall economic downfall that could potentially extend beyond the boundaries of the securities market and the country.

..." (Emphasis supplied)

167. In light of the aforesaid judgment, I am of the view that the instant violations cannot be characterized as mere technical or procedural violations but have to be viewed as failures affecting market integrity and investor confidence. In this context, due regard needs to be given to the observation of Hon'ble SAT in the matter of *Religare*, relied upon by the Noticee, held that: *"...This will, of course, depend on the nature of the irregularity noticed and we hasten to add a caveat that it is not being suggested that if any serious lapse is found during the course of the inspection, the Board should not proceed against the delinquent..."*

³⁶ Civil Misc. Writ Petition No. 45893 of 2012.



168. Moreover, Noticee's reliance on the decision in *Siddharth Chaturvedi v. SEBI* is misplaced the decision was based on the legal position as it existed before the amendments were introduced by the Securities Laws (Amendment) Act, 2014.
169. Further, I note that the case laws cited by Noticee does not deal with infractions by an MII and emanate from a different factual matrix. Moreover, as noted above, the violations in the present case can in no manner be considered as technical or venial. Therefore, the aforesaid case law cannot be applied to the facts of the present case.
170. In light of the aforesaid discussion, I note that the instant submission of the Noticee cannot be accepted.

171. The text of the above referred section 15HB of the SEBI Act is reproduced herein below:

SEBI Act

"15HB. Whoever fails to comply with any provision of this Act, the rules or the regulations made or directions issued by the Board thereunder for which no separate penalty has been provided, shall be liable to a penalty which shall not be less than one lakh rupees but which may extend to one Crore rupees."

172. While determining the quantum of penalty, it is important to consider the factors stipulated in section 15J of the SEBI Act which reads as under: -

SEBI Act

"Factors to be taken into account while adjudging quantum of penalty

15J While adjudging quantum of penalty under 15-I or section 11 or section 11B, the Board or the adjudicating officer shall have due regard to the following factors, namely:-

- (a) the amount of disproportionate gain or unfair advantage, wherever quantifiable, made as a result of the default;*
- (b) the amount of loss caused to an investor or group of investors as a result of the default;*
- (c) the repetitive nature of the default."*

173. In this case, from the material available on record, any quantifiable gain or unfair advantage accrued to the Noticee or the extent of loss suffered by the investors as a result of non-compliance to the provisions is not available. Further, from the material available on record, it is not possible to ascertain the exact monetary loss to the investors on account of violations by the Noticee. As regard the repetitive nature of default, I note that a penalty of Rs. 10,000,000/- (Rupees one crore) has been imposed on the Noticee under section 15HB of the SEBI Act and section 19G of the Depositories Act vide order dated July 20, 2026.



174. I have taken note of the critical role performed by depositories in the securities market. As an MI, they are integral to the fulfillment of SEBI's regulatory objectives. Further, the integrity of the data and systems maintained by them is critical to the orderly functioning of the market. In the present case, Noticee has been found to have committed multiple compliance lapses in the discharge of its depository functions. These include failure to communicate the reasons for rejection of pledge requests to the DPs of the pledgor and pledgee, non-adherence to the joint proposal framed pursuant to the SEBI Circular dated November 11, 2022 in relation to CUSA operations, inadequate measures to prevent unauthorised transmission of data, incomplete migration of operations to the DR site during the DR drill, failure to patch vulnerabilities within the timeline stipulated by SEBI, and conducting a VAPT exercise that was not comprehensive. These lapses directly impinge upon the Noticee's core obligations as a depository where it provides the foundational, system critical physical and digital infrastructure for electronic record keeping, dematerialization and ownership transfer, etc. Given the systemic importance of a depository, such deficiencies have implications not only for individual investors but also for the integrity and stability of Indian securities market. The violations are, therefore, serious in nature and warrant appropriate regulatory action.
175. The remedial measures undertaken by the Noticee subsequently have been duly considered.
176. The aforementioned factors have been taken into consideration while adjudging the penalty.

ORDER

177. Having considered all the facts and circumstances of the case, the material available on record, the factors mentioned in preceding paragraphs and in the exercise of powers conferred upon me under section 15-I of the SEBI Act read with rule 5 of the Rules, I, hereby, impose the following penalty on Noticee:

Table 5

Name of Noticee	Charging Provision	Penalty (in Rs.)
Central Depository Services (India) Limited	Section 15HB of SEBI Act	Rs. 1,00,00,000/- (Rupees One Crore Only)



178. I am of the view that the said penalty is commensurate with the lapses/omissions on the part of Noticee.
179. Noticee shall remit/pay the said amount of penalty within 45 days of receipt of this order through the online payment facility available on the website of SEBI, i.e., www.sebi.gov.in on the following path, by clicking on the payment link: ENFORCEMENT > Orders > Orders of AO > PAY NOW.
180. In the event of failure to pay the said amount of penalty within 45 days of the receipt of this Order, recovery proceedings may be initiated under section 28A of the SEBI Act for realization of the said amount of penalty along with interest thereon, *inter alia*, by attachment and sale of movable and immovable properties of Noticee
181. In terms of the provisions of rule 6 of the Rules and rule 6 of the Depositories Rules, a copy of this order is being sent to the Noticee and also to the SEBI.

Date : October 30, 2026
Place: Mumbai

JAI
SEBASTIAN
Digitally signed by JAI
SEBASTIAN
Date: 2026.10.30
12:48:15 +05'30'

JAI SEBASTIAN
ADJUDICATING OFFICER