

Consultation paper on Review of SEBI (Custodian) Regulations, 1996 and operational guidelines for Custodians

1. Background

- 1.1. Securities and Exchange Board of India (Custodian) Regulations, 1996 (“Custodian Regulations”) were notified in the year 1996. Currently, there are 17 Custodians registered with SEBI. These Custodians are engaged by non-institutional and institutional clients like Foreign Portfolio Investors (FPIs), Mutual Funds (MFs), Portfolio Managers, Alternative Investment Funds (AIFs) to avail custodial services such as safekeeping of assets, maintenance of accounts of securities, collection of benefits pursuant to corporate actions, reconciling of records, etc.
- 1.2. The Assets Under Custody (AUC) of Custodians has increased from INR 2.70 lakh crore in March 2002 to INR 278.50 lakh crore in September 2024 at a CAGR of around 23%.
- 1.3. Custodians are critical to SEBI’s mandate of protection of investors’ interest in the context of assets that they safe keep for the funds registered with SEBI that manage third party funds including retail investors (small ticket investors in MFs).
- 1.4. In the context of FPIs, Custodians have been mandated to act as Designated Depository Participants (DDPs) as well and grant registration to FPIs on behalf of SEBI. They also monitor various investment norms applicable to FPIs, ensure continuous compliance with KYC requirements, record change in status of FPI and examine the applicability of various exemptions from requirements of granular disclosures etc.
- 1.5. Custodians’ role became even more important in the context of reduction of settlement cycle in equity cash segment. SEBI has over a period of time brought down the settlement cycle to T+1 and is now overseeing the adoption of optional T+0 settlement cycle. Custodians have facilitated improvements in the process of confirmation of funds and securities of their clients to enable T+1 settlement cycle, which was acknowledged worldwide as a major achievement of Indian securities market. Further, for the optional T+0 settlement cycle, Custodians played an important role for process reengineering and the same is being implemented.

2. Objective

2.1. Given the time since Custodian Regulations were first introduced and the substantial growth in market size, regulatory scope, and technological advancements, SEBI has identified a need to review and update the Custodian Regulations.

2.2. With this backdrop, SEBI constituted a Working Group ('WG') with the following terms of reference: -

- a) to review the Custodian Regulations and the circular/ guidelines issued thereunder.
- b) to review the reporting requirements of Custodians to avoid duplication and redundancy and to facilitate data based offsite inspection.
- c) to review the Custodian Regulations vis-a-vis regulations for other intermediaries for incorporation of relevant clauses in the Regulations.
- d) to discuss any other relevant issues.

2.3. The WG submitted its Report, *inter alia*, setting out its recommendations on the following:

- a) Framework for seeking prior approval for change in control
- b) Code of Conduct
- c) Business Continuity Planning (BCP)
- d) Contingency planning;
- e) Segregation of activities
- f) Outsourcing of custody activities
- g) Storage of physical records
- h) Review of reporting requirements
- i) Recognition of Global Custodians
- j) Review of Power of Attorney (POA)

2.4. In addition to the above, based on an internal review, SEBI has made the following proposals on the subject:

- a) Review of Net Worth requirement
- b) Enhanced obligations and responsibilities

3. Recommendations of the Working Group

3.1. Framework for seeking prior approval for change in control

3.1.1. Regulation 9(aa) of these Regulations provides that a Custodian shall obtain prior approval of SEBI in case of change in control in such manner as specified by the Board. The WG deliberated on the requirement and recommended that a framework similar to that prescribed for other intermediaries such as Stockbrokers, DPs, IAs, RAs, RTAs etc. for seeking prior approval from SEBI may be adopted. The framework for aforesaid intermediaries is prescribed vide SEBI circular SEBI/HO/MIRSD/MIRSD-PoD-2/P/CIR/2022/163 dated November 28, 2022.

Proposal:

3.1.2. To harmonize requirements across intermediaries, it is proposed to provide a framework for Custodians similar to that for Stockbrokers, DPs, IAs, RAs, RTAs and KRA. This framework shall, *inter alia*, include:

- 3.1.2.1. Submitting online applications to SEBI via the Intermediary Portal for prior control changes.
- 3.1.2.2. Submitting details about the applicant, the acquirer(s)/the person(s) who shall have the control and the directors/partners of such acquirer(s), etc.
- 3.1.2.3. Setting a six-month validity period for SEBI approvals.

Question for public comments

1. Do you agree with the proposal to prescribe a framework for prior approval for change in control of Custodian, similar to the one prescribed for other intermediaries?

3.2. Code of Conduct:

3.2.1. Regulation 12 of the Custodian Regulations specifies that every Custodian shall abide by the Code of Conduct as set out in the Third Schedule. The WG deliberated on the extant code of conduct. In this regard, clauses 11(a) and 11(b) of the Code of Conduct, read as follows:

“11. (a) A custodian or any of his employees shall not render, directly or indirectly any investment advice about any security in the publicly accessible media, whether real-time or non-real time, unless a disclosure of his interest including

long or short position in the said security has been made, while rendering such advice.

11. (b) In case an employee of the [custodian] is rendering such advice, he shall also disclose the interest of his dependent family members and employer including their long or short position in the said security, while rendering such advice.”

3.2.2. Since Custodians are not permitted to provide investment advice as per SEBI (Investment Advisors) Regulations, 2013, the WG stated that the clauses are no longer relevant and may be removed.

3.2.3. The WG also recommended adding the following new clauses to the Code of Conduct:

3.2.3.1. The Custodian shall comply with and abide by all the applicable laws and regulations of SEBI, RBI, Clearing Corporations and Depositories in practice and in spirit. A yearly undertaking to that effect shall be submitted by the Custodians to the Board.

3.2.3.2. The Custodian shall not indulge in any unfair competition, which is likely to harm the interests of other Custodians or clients or is likely to place such other Custodians in a disadvantageous position while competing for or executing any assignment.

3.2.3.3. The Custodian shall not make any exaggerated statement whether oral or written to the clients either about its qualifications or capability to render certain services or about its achievements in regard to services rendered to other clients.

3.2.3.4. The Custodian shall not make any untrue statement or suppress any material fact in any documents, reports, papers or information furnished to the Board.

3.2.3.5. The Custodian shall ensure that good corporate policies and corporate governance are in place.

3.2.3.6. The Custodian shall endeavour to ensure that—

a) inquiries from client are adequately dealt with.

b) grievances of client are redressed in a timely and appropriate manner.

c) where a complaint is not remedied promptly, the client is advised of any further steps which may be available to the client under the regulatory system.

- 3.2.3.7. The Custodian shall have internal control procedures and financial and operational capabilities which can be reasonably expected to protect its operations, its clients, and other registered entities from financial loss arising from theft, fraud, and other dishonest acts, professional misconduct or omissions.
- 3.2.3.8. The Custodian shall ensure that all its Directors and key management personnel are fit and proper persons at all times.
- 3.2.4. The SEBI (Investment Advisers) Regulations, 2013 (IA Regulations) prohibits any person from acting as an Investment Adviser unless it has obtained a certificate of registration under those Regulations. While certain persons have been exempted from the said registration requirement, Custodians have not been exempted from the requirement of seeking registration under IA Regulations. If a Custodian chooses to register itself as an IA, the Code of Conduct under those Regulations relating to disclosure of conflict of interest apply. Hence, the above mentioned reference to the same obligation under the Custodian Regulations, may not be separately required.

Proposal:

- 3.2.5. It is proposed to accept the recommendation of the WG regarding removal of clauses 11(a) and 11(b) from the Code of Conduct as referred to above.
- 3.2.6. Considering the significant changes in market practices and regulatory environment since the notification of the Custodian Regulations, and with a view to bring uniformity with code of conduct for other intermediaries, it is proposed to accept the recommendation of the WG at Para 3.2.3 above. Accordingly, it is proposed to appropriately add the Clauses referred to by the WG in Para 3.2.3 above in the Code of Conduct for Custodians:
- 3.2.7. In addition to the above, the following clauses are also proposed to be included in the Code of Conduct for custodians in order to bring harmonization with Code of Conduct for other intermediaries:
- 3.2.7.1. The Custodian shall co-operate with the Board as and when required.
- 3.2.7.2. The Custodian shall not neglect or fail or refuse to submit to the Board or other agencies with which it is registered, such books, documents,

correspondence, and papers or any part thereof as may be demanded/requested from time to time.

- 3.2.7.3. The Custodian shall ensure that the Board is promptly informed about any action, legal proceedings, etc., initiated against it in respect of material breach or non-compliance by it, of any law, Rules, regulations, directions of the Board or of any other regulatory body.
- 3.2.7.4. The Custodian shall be responsible for the acts or omissions of its employees and agents in respect of the conduct of its business.
- 3.2.7.5. The Custodian shall make all efforts to protect the interests of its clients and shall act in the best interest of its clients.
- 3.2.7.6. The Custodian shall provide adequate freedom and powers to its compliance officer for the effective discharge of his duties.
- 3.2.7.7. The Custodian shall ensure that the senior management, particularly decision makers have access to all relevant information about the business on a timely basis.

Questions for public comments

2. Do you agree with the proposal to remove Clauses 11(a) and 11(b) from the Code of Conduct for Custodians?
3. Do you agree with the proposal to include additional clauses, as mentioned under Para 3.2.6 and 3.2.7 above, in the Code of Conduct for Custodians?

3.3. Business Continuity Planning (BCP):

3.3.1. Considering the increased scope of services and importance of Custodian while providing custody services to institutional and corporate investors, WG has recommended that Custodians be mandated to have a policy on Business Continuity Planning (BCP)/ Disaster Recovery System (DRS).

3.3.2. The WG has recommended adding the following clause to the Custodian Regulations:

“The Custodian shall put in place a comprehensive BCP-DR policy document for custody services approved by its Board or respective committee of the custodian. The BCP-DR policy document should be periodically reviewed at least once in six months and after every occurrence of disaster.”

- 3.3.3. The WG has further recommended that the BCP-DR policy of the Custodian should outline the following requirements similar to the BCP-DR requirements for Market Infrastructure Institutions (MIIs):
- 3.3.3.1. Broad scenarios that would be defined as a Disaster for a Custodian.
 - 3.3.3.2. Standard Operating Procedure to be followed in the event of Disaster.
 - 3.3.3.3. Escalation hierarchy within the Custodian to handle the Disaster.
 - 3.3.3.4. Clear and comprehensive Communication Protocols and procedures for both internal and external communications from the time of incident till resumption of operations of the Custodian.
 - 3.3.3.5. Documentation policy on record keeping pertaining to DR drills.
 - 3.3.3.6. Scenarios demonstrating the preparedness of Custodians to handle issues in Critical Systems that may arise as a result of Disaster.
 - 3.3.3.7. Preparedness of Custodians to handle any issue which may arise due to trading halts in Stock Exchanges.
 - 3.3.3.8. Framework to constantly monitor health and performance of Critical Systems in normal course of business.

Proposal:

- 3.3.4. It is pertinent to note that transactions executed by institutional investors constitute significant proportion of the turnover in the equity cash segment, e.g. during 2023-24, FPIs contributed 14.8% and 13% of turnover in cash segment at NSE and BSE, respectively. Considering that Custodian is a key constituent of the Institutional investors ecosystem, any disruption in Custodian services may significantly impact the orderly functioning of securities market and severely impact investor confidence. It is therefore necessary that a framework on BCP and DR, similar to those provided for Qualified Stock Brokers (QSBs), may be provided for Custodians through appropriate provisions under Custodian Regulations or circulars.

Question for public comments

4. Do you agree with the proposal that Custodians be mandated to have a policy on BCP/DRS in line with the requirements for QSBs?

3.4. Contingency Planning:

- 3.4.1. Considering the scope and volume of activities handled by Custodians, any temporary disruption in Custodian services or winding down of critical Custodian operations may not only affect the market continuity but may also impact the orderly functioning of securities market. In this regard, the WG recommended that:
- 3.4.1.1. a contingency plan for Custodians may be prescribed in case of temporary failures.
- 3.4.1.2. In case of permanent failures, winding down process may also be prescribed, similar to the orderly winding down plan prescribed for the Depositories/ Clearing Corporations.
- 3.4.1.3. Custodians in consultation with SEBI would adopt detailed guidelines/ framework in this regard, after examining the corresponding provisions on the same subject for Clearing Corporations/ Depositories.
- 3.4.1.4. This may be adopted by way of a SOP by the Custodians.

Proposal:

- 3.4.2. It is necessary that Custodians have a policy framework to deal with orderly winding down of their business to ensure client asset protection, client confidence, operational resilience, risk mitigation etc. It is also noted that the activities of Custodians have more in common with those provided by Stock Brokers, as both are in the business of providing intermediation services to their clients. Further, considering that the clients of Custodians include large institutional investors, the activities of Custodians become critical to the orderly functioning of the securities market.
- 3.4.3. In view of the above, while accepting the recommendation of the WG, it is proposed that with respect to requirements for contingency planning, a framework for orderly winding down, in line with that prescribed for QSBs under SEBI's Master Circular for Stock Brokers, may also be prescribed for Custodians. Temporary disruptions can be handled under the BCP framework as proposed at Para 3.3.4 above.

Question for public comments

5. Do you agree with the proposal to prescribe a framework for orderly winding down of Custodians, in line with QSBs?

3.5. Segregation of activities:

3.5.1. Regulation 9 of Custodian Regulations, inter alia, specifies that-

“Conditions of certificate.

9. The certificate granted to custodian shall be subject to the following conditions, namely:—

(a) ...

(f) besides providing custodial services, it shall not carry on any activity other than activities relating to rendering of financial services.”

3.5.2. Further, Regulation 13 of Custodian Regulations specifies that-

“Segregation of activities

13. Where a custodian is carrying on any activity besides that of acting as custodian, then, —

(i) the activities relating to his business as custodian shall be separate and segregated from all other activities;

(ii) its officers and employees engaged in providing custodial services shall not be engaged in any other activity carried on by him.”

3.5.3. The WG emphasized that institutional investors require Custodian to provide related or allied services with respect to their investments in Indian capital market which helps investors in appointing single entity to provide all related services for their investments. Further, it will help Custodian develop synergies across activities to provide one stop solution to their client’s requirements. WG highlighted that investors typically require following activities to be performed by the Custodian:

3.5.3.1. Fund accounting services

3.5.3.2. Clearing services for exchange traded derivative contracts

3.5.3.3. Escrow services

3.5.3.4. Designated Depository Services under DDP license

3.5.3.5. Depository Participant services

3.5.3.6. Middle office support for reconciliation and reporting.

3.5.4. The WG recommended that the Custodian can provide related or allied services to its clients without segregation only to their custody clients. For non-custody clients, such activities may continue to be segregated from the Custodian activities.

Proposal:

- 3.5.5. A Custodian may be undertaking any activity in financial services arena besides custodial services which are under the purview of specific regulatory authorities. In line with the principle of activity based regulation and supervision, permitting such related or allied services without segregation under same legal entity merits consideration. Further, the manpower resources and systems can also be shared across these activities provided controls and mechanisms are in place to address issues of conflicts of interest. For instance, custodial services, which involve commercial consideration, may have a potential conflict of interest with the regulatory activity of DDP.
- 3.5.6. If such other activities are not specifically under the ambit of any regulatory authority, there may be a spill over of the risk emanating from such activities to the regulated activities. In these instances, such related services shall be executed through a separate legal entity.

Questions for public comments

6. Do you agree with the proposal to permit non-segregation of allied activities in financial services that are under the purview of specific regulatory authorities?
7. Do you agree with the proposal to segregate activities that are not specifically under the ambit of any regulatory authority, to a separate legal entity?

3.6. Outsourcing of Custody Activities

- 3.6.1. Regulation 15 of Custodian Regulations specifies as under:

“Prohibition of assignment.

15. No custodian shall assign or delegate its functions as a custodian to any other person unless such person is a custodian:

Provided that a custodian may engage the services of a person not being a custodian, for the purpose of physical safekeeping of goods or gold or silver belonging to its client including a mutual fund having a gold exchange traded fund scheme or a silver exchange traded fund scheme, subject to the following conditions—

...”

- 3.6.2. Thus, from the above, Custodian Regulations permit assigning or delegating functions of a Custodian to another Custodian. Further, Regulations also permit

engaging the services of a non-Custodian for the purpose of physical safekeeping of goods or gold or silver belonging to its client, subject to certain conditions.

3.6.3. In terms of SEBI circular CIR/MIRSD/24/2011 dated 15 Dec 2011, the registered intermediaries are allowed to outsource non-core activities. The Intermediaries, however, cannot outsource their core business activities and compliance functions.

3.6.4. In this regard, WG recommended categorization of activities performed by Custodians as core and non-core, for the purpose of outsourcing while continuing to be responsible with respect to all such outsourced activities and maintenance client/data confidentiality for such outsourced activities. Specifically, the Custodian shall remain fully responsible, in all respects, for all acts of omission and commission of the entity executing the outsourced work.

3.6.5. The categorization of activities as recommended by the WG is given below:

Core (to be performed by Custodian)	Can be performed by affiliates (having more than 90 % common holding with Custodian)	Non – core: Can be performed by any entity under Custodian’s supervisory control
1. KYC documentation and checks 2. Account Opening 3. DDP activities 4. Depository Participants’ activities 5. Compliance & Regulatory interface 6. Client & Product management 7. Supervision and governance framework 8. Safekeeping activities 9. Clearing and settlement	1. Asset Servicing – Mandatory and Voluntary Corporate Action processing 2. Reconciliation of positions and Reporting 3. Billings	1. Technology support 2. Cash and FX processing 3. Taxation issues 4. Proxy/ e-voting 5. Record keeping

3.6.6. The WG also recommended that the following guidelines need to be adhered to by the Custodian while outsourcing such activities:

3.6.6.1. Custodian shall have in place a comprehensive policy to guide the assessment of whether and how those activities can be appropriately outsourced. The

senior managing official(s) of the Custodian to be responsible for the outsourcing policy and related activities undertaken under that policy.

- 3.6.6.2. Custodian shall establish a comprehensive outsourcing risk management programme to address the outsourced activities and the relationship with the third party.
- 3.6.6.3. Custodian shall ensure that outsourcing arrangements neither diminish its ability to fulfil its obligations to customers and regulators, nor impede effective supervision by the regulators.
- 3.6.6.4. Custodian shall conduct appropriate due diligence in selecting the third party and in monitoring its performance.
- 3.6.6.5. Outsourcing relationships shall be governed by written contracts / agreements / terms and conditions (as deemed appropriate) that clearly describe all material aspects of the outsourcing arrangement, including the rights, responsibilities and expectations of the parties, client confidentiality issues, termination procedures, etc.
- 3.6.6.6. Custodian and the third party shall establish and maintain contingency plans, including a plan for disaster recovery and periodic testing of backup facilities.
- 3.6.6.7. Custodian shall take appropriate steps to require that third party protects confidential information of both the Custodian and its customers from intentional or inadvertent disclosure to unauthorised persons.

Proposal:

- 3.6.7. In this regard, it is noted that the SEBI circular dated December 15, 2011 while providing guidelines for outsourcing of activities by intermediaries already include the principles suggested by the WG and the same are applicable to Custodians as well. With respect to categorization of activities, it is noted that no such categorization has been made for other intermediaries. Given the operational and dynamic nature of the business, demarcation of core/non-core activities for a Custodian with an exhaustive list of such activities is not proposed to be provided by SEBI. However, for a harmonious interpretation amongst industry participants in this regard, it is proposed that the pilot Custodians and DDPs Standards Setting Forum ('CDSSF') may work out and adopt a list of such categorization, in consultation with and with due approval from SEBI.

Questions for public comments

8. Do you agree with the proposal for non-categorisation of activities for the purpose of outsourcing by SEBI?

3.7. Storage of Physical records:

- 3.7.1. SEBI's Master Circular for Custodians specifies following in respect of vault to be maintained by Custodians:

“Custodians hold securities of considerable value on behalf of their clients. It is expected that they would take adequate measures to ensure safety of the assets held. Reserve Bank of India (RBI) specifications for construction of vaults can be referred as per the following notification: [Reserve Bank of India - Notification regarding Minimum Standards for a Currency Chest \(RBI/2018-19/166; DCM \(CC\) No. 2482/03.39.01/2018-19 dated April 8, 2019\)](#).

Adherence to other extant technical specifications issued by RBI vide DCM (CC) No G18/03.39.01/2008-09 dated November 14, 2008 relating to construction, etc. can be found at Annexure B.

Custodians shall submit the specifications of their vaults along with their size as part of their quarterly report.”

- 3.7.2. The WG deliberated on the above requirement and highlighted that Custodians mostly hold securities on behalf of their clients in electronic form in respective depository accounts, and as per extant regulatory requirement the institutional investors are not allowed to transact in physical securities. The WG recommended that technical requirement for holding the physical securities by custodian in the vault can be dispensed with. The WG recommended the following:

“As long as the Custodian is not holding any physical documents or assets, there would be no requirement of vaults; but, as soon as the Custodian holds any physical securities, it should comply with the requirement of having vaults or entering into agreement with WSPs.”

- 3.7.3. The WG further highlighted that maintaining of vaults by Custodians in line with RBI specification for currency chests may not be required considering low quantum of physical securities held by Custodians presently. The WG recommended that the physical securities can be held in the fireproof vault/safe or equivalent storage with the following features:

- 3.7.3.1. Security Features: High-grade locking mechanisms, access control systems, surveillance cameras for continuous monitoring, covering all angles, and to ensure restricted access.
- 3.7.3.2. Fire Protection: Fire-resistant construction materials and climate control to protect documents from damage.
- 3.7.3.3. Space and Organization: Adequate shelving, filing systems, and space management for efficient organization and retrieval of documents.
- 3.7.3.4. Durability: Sturdy construction to withstand potential damage from natural disasters or unforeseen events.

Proposal:

- 3.7.4. To facilitate ease of doing business for Custodians, in respect of requirement of vault the following is proposed:
 - 3.7.4.1. If the Custodian is not holding any physical securities, there shall be no requirement of vaults.
 - 3.7.4.2. If the Custodian holds any physical securities, it shall comply with the requirement of having vault. Subject to taking informed consent from client, the physical securities can be held in the vault/safe or equivalent storage with features that may be adopted by the industry through the pilot CDSSF, in consultation with SEBI.
 - 3.7.4.3. Further, safekeeping of securities being a core custodial service, it is proposed not to accept the recommendation of the WG regarding entering into agreement with Warehouse Service Providers for holding physical securities.

Questions for public comments

9. Do you agree with the proposal to do away with the requirement of having vault if the Custodian is not holding any physical securities?
10. In case Custodian is holding physical securities, do you agree with the proposal to hold physical securities in the vault /safe or equivalent storage with features as may be adopted by the industry through the industry standards forum?
11. Do you agree with the proposal to not allow Custodians to enter into agreement with Warehouse Service Providers for holding physical securities?

3.8. Review of Reporting Requirements:

3.8.1. Custodians are required to submit various reports to SEBI and Depositories with respect to clients' investment activity for periodical monitoring purposes. To avoid duplicity in submission of such reports to SEBI and Depositories, the Working Group recommended that the following reporting to SEBI may be discontinued as the data is already submitted by custodian to the Depositories:

3.8.1.1. **ISIN wise AUC report:** SEBI Master Circular May 10, 2024 mandates Custodians to report on fortnightly basis ISIN wise AUC details of FPIs. Based on these report, fortnightly Sector-wise FPI investment data was disseminated on SEBI website. With the notification of the SEBI (FPI) regulations, 2014, Custodians are required to submit the same to NSDL and CDSL. In the SEBI website, it has been stated that since June 01, 2014, the fortnightly Sector-wise FPI investment data is being disseminated on the websites of NSDL and CDSL and an appropriate link to the websites of NSDL and CDSL has been provided for public consumption. Web-links to the said reports are as under:

https://www.fpi.nsd.co.in/web/Reports/FPI_Fortnightly_Selection.aspx

<https://www.cdslindia.com/publications/FII/FortnightlySecWiseData.html>

The WG recommended that the aforesaid report to SEBI may be discontinued as the same report is being submitted to NSDL and CDSL and Sector-wise FPI investment data is being disseminated on their websites.

3.8.1.2. **Monthly Reports - Assets Under Custody:** SEBI Master Circular dated May 10, 2024 advised Custodians to report AUC details on monthly basis in the requisite format as under:

- a) Report A - Category wise AUC data for all clients (FPI/FDI/MF etc.)
- b) Report B - Category wise AUC data for FPIs
- c) Report C- AUC data for Sub-accounts (since disabled).
- d) Report D – Country wise AUC data for FPIs
- e) Report E - Report of short sales by FPIs for the Month
- f) Report F – ADR / GDR - Dual fungibility report
- g) Report G - Change of Custodian details during the month
- h) Details of Reports A, B and D were disseminated on SEBI website.

3.8.1.3. Custodians are also required to submit Reports A, B and D to Depositories. In the SEBI website, it has been stated that since June 01, 2014, the Assets Under Custody (AUC) is being disseminated on the websites of NSDL and CDSL and an appropriate link to the websites of NSDL and CDSL has been provided. Web-links to the said reports are as under:

<https://www.fpi.nsdl.co.in/web/Reports/ReportsListing.aspx>

<https://www.cdslindia.com/publications/FIIreports.html>

3.8.1.4. The WG recommended that the following reporting to SEBI be discontinued:

- a) Report A (Category wise AUC data for all clients viz. FPI, FDI, MF, etc.) may be shared by Custodians with depositories who in turn will share consolidated position on SEBI portal
- b) Report B - Category wise AUC data for FPIs
- c) Report D - Country wise AUC data for FPIs
- d) Report G – Change of Custodian details during the month: - data required for Annexure G is available with NSDL and if required same can be shared with SEBI.

3.8.1.5. The WG recommended that the following reports may continue to be submitted by Custodians

- a) Report E - Report of short sales by FPIs for the month
- b) Report F - ADR / GDR - Dual fungibility report

Proposal:

3.8.2. As Custodians already report the data to NSDL and CDSL, with a view to facilitate ease of doing business for the Custodians through removal of duplicate reporting requirement, it is proposed that the following reports to SEBI may be discontinued:-

- a) Report on fortnightly basis to submit ISIN wise AUC details of FPIs
- b) Report A (Category wise AUC data for all clients viz. FPI, FDI, MF, etc.).
- c) Report B - Category wise AUC data for FPIs
- d) Report D - Country wise AUC data for FPIs
- e) Report G – Change of Custodian details during the month

Question for public comments

12. Do you agree with the proposal to discontinue the reports as mentioned under Para 3.8.2 to SEBI?

3.9. Recognition of Global Custodians:

3.9.1. Globally, financial institutions approach Global Custodian that offer custody services in multiple markets. The global Custodian role is referred by SEBI in SEBI (FPI) Regulations and Master Circular for Foreign Portfolio Investors, Designated Depository Participants and Eligible Foreign Investors, and by RBI under Master Direction on KYC. Further, in line with the FPI Regulations, Global Custodian, on behalf of an FPI, can enter into an agreement with local Custodian.

3.9.2. WG recommended inclusion of a similar reference in Custodian Regulations for bringing parity with FPI regulation. This will help identify FPI clients under Global Custodian. Further it will help local Custodians and market participants to place reliance on the KYC documents attested by Global Custodian. This may also help in transition of Global Custodian and its FPI from one local Custodian to other.

3.9.3. WG recommended to include following provision in the Custodian Regulations to recognise the role of Global Custodian:

“Appointment of Custodian

A foreign investor or its global custodian who is acting on behalf of the foreign investor, shall enter into an agreement with the Custodian engaged by it to act as a custodian for Indian securities, before making any investment under these regulations.

A local custodian can rely on KYC carried out by the Global Custodian of the same financial group which is regulated and coming from an FATF member country, where KYC is carried out as per their home jurisdiction standards. Where this reliance is placed, such entity shall provide an undertaking to the effect that the relevant KYC documents, would be submitted to the local custodian when required by regulator/law enforcement agency/ government departments/ tax authority, etc.”

3.9.4. Regulation 25(1) of SEBI (FPI) Regulations, 2019 provides:

“25. (1) A foreign portfolio investor or a global custodian who is acting on behalf of the foreign portfolio investor, shall enter into an agreement with the designated depository participant engaged by it to act as a custodian, before making any investment under these regulations.”

3.9.5. Further, Master Circular dated May 30,2024 for Foreign Portfolio Investors, Designated Depository Participants and Eligible Foreign Investors, inter alia, specifies that-

“For non-PAN related KYC documents (including KYC form), a local custodian can rely on KYC carried out by another entity of the same financial group (like a Global Custodian or Investment Manager) which is regulated and coming from an FATF member country, where KYC is carried out as per their home jurisdiction standards. Where this reliance is placed, such entity/ FPI shall provide an undertaking to the effect that the relevant KYC documents, would be submitted to the DDP/ Local Custodian when required by regulator/law enforcement agency/ government departments/ tax authority, etc. However, the Custodian / local intermediary will be required to collect constitution documents and BO related declarations (wherever applicable) of the FPI and also, upload the evidence of KYC reliance on KRA.”

3.9.6. In SEBI (FPI) Regulations, 2019 and the corresponding Master Circular, the provision for reliance on Global Custodian is made applicable specifically in respect of FPIs. However, in the recommendation of WG, said provision has been sought to be made applicable to “Foreign investors”.

Proposal:

3.9.7. The term “Foreign Investor” implies investors from Foreign Country which is very wide in scope and may include Foreign Portfolio Investor, Foreign Direct Investor, Non – Resident India, Foreign Venture Capital Investor. Thus prescribing the aforesaid clause in Custodian Regulation may result in the requirement becoming applicable to entities and activities outside of the jurisdiction of SEBI. Hence, it is proposed not to accept the recommendation of the WG.

3.9.8. It may also be noted that the provision of reliance on KYC carried out by Global Custodian has already been made applicable in respect of Foreign Venture Capital Investor through SEBI Circular dated September 26, 2024.

Questions for public comments

13. Do you agree with the proposal to drop the recommendation of WG to recognise the role of a Global Custodian in Custodian Regulations?

3.10. Review of Power of Attorney

- 3.10.1. The WG noted that Custodians currently insist on receiving an executed Power of Attorney from clients at the time of account opening to meet depository guidelines and evidence that client has provided power to Custodian to open, operate the accounts and sign documents/deeds on behalf of its clients. The POA issued by the clients need to be appropriately legalized in their home country (notarized/consularised/apostilled). Investors have expressed a view that this legalization can be time consuming and expensive.
- 3.10.2. The WG also noted that the Custodian Regulations only prescribe the agreement with the client for providing custody services. The WG deliberated on the requirement of the POA. It considered the authority that the POA enables the Custodian to open and operate the accounts and evidence the authority, to third parties, provided by the client to the Custodian to operate, sign and execute documents on behalf of their clients.
- 3.10.3. After deliberations, the WG recommended that:
- 3.10.3.1. The Custodian can seek the authority through the Custodian agreement to open and operate the accounts, sign and execute the documents and perform necessary actions as required under the Custodian agreement with the client.
- 3.10.3.2. The Custodian regulations to be accordingly amended to include authority from the client to open and operate the accounts. If the authority is provided in the agreement, the POA is not required to operate the accounts and the extract of the agreement can be provided to depositories/third parties for evidencing authority from client to Custodian.
- 3.10.3.3. Such authority would be recognized by proxy scrutinizers of Issuer companies/third parties appropriately and can help make Power of Attorney (POA) a truly optional document.
- 3.10.4. Regulation 17 of the Custodian Regulations specifies the following with respect to agreement between Custodians and clients:

“Agreement with the client:

17. Every custodian shall enter into an agreement with each client on whose behalf it is acting as custodian and every such agreement shall provide for the following matters namely: –

(a) the circumstances under which the custodian will accept or release securities, goods, assets or documents from the custody account;

(b) the circumstances under which the custodian will accept or release monies from the custody account;

(c) the circumstances under which the custodian will receive rights or entitlements on the securities or goods of the client

(d) ...

(e) ...”

Proposal:

3.10.5. It is seen that Regulation 17 of Custodian Regulations specifies broad terms in regard to dealing with client assets and provides flexibility on the circumstances for receipt/release of funds/securities, etc. PoA is intended to be a choice at the hands of clients rather than a mandatory document, which may give unfettered rights to Custodians to act on behalf of clients.

3.10.6. In view of the above, it is proposed not to accept the recommendation of WG in this regard.

Question for public comments

14. Do you agree with the proposal to not allow Custodians to seek authority through an agreement as stated in Para 3.10.3?

4. Other Proposals

4.1. In addition to the above proposals, based on an internal review, SEBI has made additional proposals which are discussed below.

4.2. Review of Net Worth requirement

4.2.1. The existing net worth requirement for a Custodian is Rs. 50 crores. This requirement was specified at the time of inception of the Custodian Regulations in 1996, i.e., almost three decades ago.

- 4.2.2. Considering the increased scope of services and the exponential growth in the volume of business provided by Custodians to its clients, Custodians are prone to fraud and operational risks. Such risk can result in financial losses which may lead to erosion of the net worth of the Custodian. Higher net worth requirements help provide a cushion against potential fraud losses and operational risks. Custodians with higher net worth may be better equipped to absorb losses, maintain operational stability and enhance the trust of their clients and stakeholders in the ecosystem.
- 4.2.3. To manage these risks and enhance market stability, and considering the time elapsed since the prescription of the current net worth requirement, it is proposed to increase the net worth requirement for Custodians to Rs. 100 Crore. The Custodian shall fulfil the net worth requirements under Custodian Regulations, separately and independently, of the capital adequacy requirements, if any, for each activity undertaken by it under the relevant regulations.
- 4.2.4. Existing Custodians who do not meet the revised net worth requirement on the date of notification of requirement, shall be given a time period of three years to comply with the revised net worth requirement.

Questions for public comments

15. Do you agree with the proposal to increase the Net Worth requirement for Custodians to Rs 100 Crore?
16. Do you agree with the proposal that net worth requirements under Custodian Regulations should be separate and independent of the capital adequacy requirements, if any, for each activity undertaken by a Custodian under the relevant regulations?
17. Do you agree with the proposed time period of three years to comply with the revised net worth requirement by the existing Custodians?

4.3. Enhanced obligations and responsibilities

- 4.3.1. Custodians, due to the quantum of client assets and amount of clients' funds and securities handled by them, on behalf of foreign investors and domestic investors, etc. have come to occupy a significant position in the Indian securities market.
- 4.3.2. In order to further strengthen the compliance and monitoring requirements relating to Custodians, it is proposed that the Custodian be required to meet enhanced obligations and discharge responsibilities to ensure appropriate governance

structure, appropriate risk management policy and processes, scalable infrastructure and appropriate technical capacity, framework for orderly winding down, etc.

- 4.3.3. In terms of Regulation 6(2) of Custodian Regulations, every custodian is a body corporate. It is proposed that enhanced obligation and responsibilities, on similar lines to those prescribed for QSBs, may be specified for Custodians.

Question for public comments

18. Do you agree with the proposal to prescribe enhanced obligation and responsibilities framework for Custodians, on similar lines to that prescribed for Qualified Stock Brokers (QSBs)?

5. PUBLIC COMMENTS:

- 5.1. Considering the implications of the aforementioned matters on the market participants, public comments are invited on the above-detailed proposals. The comments/suggestions should be submitted latest by November 28, 2024, through the following link:

<https://www.sebi.gov.in/sebiweb/publiccommentv2/PublicCommentAction.do?doPublicComments=yes>

- 5.2. Any technical issue in submitting your comment through web based public comments form, may be communicated through email to afdconsultation@sebi.gov.in with a subject: *"Issue in submitting comments on consultation paper on Review of SEBI (Custodian) Regulations, 1996"*

Issued on: November 13, 2024