BEFORE THE ADJUDICATING OFFICER
SECURITIES AND EXCHANGE BOARD OF INDIA
[ADJUDICATION ORDER No/Order/SM/S./2023-24/29497]

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

In respect of:
CDSL Ventures Ltd.
(PAN: AACCC9192Q)
(SEBI Registration No.- IN/KRA/001/2011)

In the matter of CDSL Ventures Ltd.

BACKGROUND

1. Securities and Exchange Board of India (hereinafter referred to as '**SEBI'**) conducted an inspection of CDSL Ventures Ltd – KYC Registration Agency (hereinafter referred to as '**CVL-KRA/CVL/Noticee')** under Regulation 18 of SEBI {KYC (Know Your Client) Registration Agency} Regulations, 2011 (in short "**KRA Regulations"**) at Noticee's office at A/401-409, Mahavir Icon, Plot No 89 & 90, Sector 15, CBD Belapur, Navi Mumbai - 400614, to examine its compliance with Securities and Exchange Board of India Act, 1992 (**SEBI Act**), SEBI (Intermediaries) Regulations, 2008 (hereinafter referred to as '**Intermediaries Regulations'**), KRA Regulations and circulars issued therein. The period covered in the inspection was from January 07, 2021 to December 31, 2022 (hereinafter referred to as '**Inspection Period/IP'**).

2. Noticee is a SEBI-registered KYC Registration Agency ('**KRA**'), having SEBI registration number as IN/KRA/001/2011.

3. Based on the findings of inspection and the response of Noticee submitted vide letter dated March 21, 2023, SEBI observed certain non-compliances, *inter-alia,* of KRA Regulations and various circulars issued therein.

APPOINTMENT OF ADJUDICATING OFFICER

4. Vide communique dated July 05, 2023, SEBI appointed the undersigned as the Adjudicating Officer (copy of the communique is placed as Annexure-A) under Section 15-I of the SEBI Act read with Rule 3 of SEBI (Procedure for Holding Inquiry and Imposing Penalties) Rules, 1995 (hereinafter referred to as 'Adjudication Rules'), to inquire into and adjudge under the provisions of:

   a. Section 15A(b) of the SEBI Act, the violation of provisions of paragraph 55 of SEBI Circular no. SEBI/HO/MIRSD/DOP/CIR/P/2019/111 dated 15 October 2019,

   b. Section 15HB of the SEBI Act, the violation of Clauses 3.1 and 3.2 of SEBI circular SEBI/HO/MIRSD/SEC-5/P/CIR/2022/100 dated July 27, 2022 read with SEBI Circular No. SEBI/HO/MIRSD/DoP/P/CIR/2022/89 dated June 24, 2022, SEBI circular no. SEBI/HO/MIRSD/DoP/P/CIR/2022/46 dated April 06, 2022 and Clause 15(da) of KRA Regulations and clauses 6.2 and 6.4 of Schedule III of Intermediaries Regulations,

   alleged to have been committed by the Noticee.

SHOW CAUSE NOTICE, REPLY AND HEARING

5. A Show Cause Notice (hereinafter being referred to as the **"SCN"**) dated August 04, 2023, was issued to Noticee in terms Rule 4(1) of Adjudication Rules to show cause as to why an inquiry should not be initiated against Noticee and why penalty, if any, should not be imposed upon them under Section 15HB of SEBI Act, for the aforesaid violations alleged to have been committed by Noticee.

6. The relevant extracts of the allegations levelled against Noticee in the SCN are as under:

   1) ***"A: System audit reports and Cyber Security audit framework:***

      a) The inspection team observed that CVL has not submitted system audit report to SEBI within time specified by paragraph 55 of SEBI Circular dated October 15, 2019.

The entity has submitted that delay in submission of audit report happened on account of delay in previous year audit (due to covid) and longer period of audit i.e. 15 months. In this regard, the reply submitted by entity is not tenable. In view of the above, it is observed that CVL-KRA has violated the provisions prescribed at paragraph 55 of SEBI Circular SEBI/HO/MIRSD/DOP/CIR/P/2019/111 dated 15 October 2019 by not submitting the audit report (period January 2021 till December 2021) to SEBI within three month of end of FY 2021-22 (i.e. by July 2022).

b) *In view of the foregoing, it is alleged that Noticee delayed system audit and submission of audit report to SEBI within the specified time period and thus, Noticee has violated the provisions prescribed at paragraph 55 of SEBI Circular no. SEBI/HO/MIRSD/DOP/CIR/P/2019/111 dated 15 October 2019 ("SEBI Circular dated October 15, 2019")."*

2) ***"<u>B: KYC validation</u>***

a) *With regards to inspection observation of not processing 10,44,248 fresh KYCs within TAT of 2 days, the CVL has submitted that validation got delayed due to malware attack on infrastructure of CDSL (Parent body). It is noted here that as per clause 6.2 of Schedule III of SEBI (Intermediaries) Regulations, 2008, an Intermediary also registered with the Board in any other capacity/ category shall endeavor to ensure that arm's length relationship is maintained in terms of both manpower and infrastructure between the activities carried out as an Intermediary and other permitted activities. Due to above mentioned clause of maintaining clear segregation between infrastructure of CVL and CDSL, the malware attack on the systems of CDSL should not have impacted activities carried out by CVL. In view of the above, the reply submitted by CVL is not acceptable. Therefore, CVL was found to be non-compliant during inspection period and violated clause 3.1 and 3.2 of SEBI circular SEBI/HO/MIRSD/SEC-5/P/CIR/2022/100 dated July 27, 2022 r/w SEBI/HO/MIRSD/DoP/P/CIR/2022/89 dated June 24, 2022, SEBI circular SEBI/HO/MIRSD/DoP/P/CIR/2022/46 dated April 06, 2022 and clause 15(da) of SEBI KRA Regulations, 2011*.

b) *In view of the foregoing, it is alleged that Noticee did not process 10,44,248 fresh KYCs within TAT of 2 days and thus, Noticee has violated Clauses 3.1 and 3.2 of SEBI circular SEBI/HO/MIRSD/SEC-5/P/CIR/2022/100 dated July 27, 2022 (SEBI Circular dated July 27, 2022) read with SEBI Circular No. SEBI/HO/MIRSD/DoP/P/CIR/2022/89 dated June 24, 2022 (SEBI Circular dated June 24, 2022), SEBI circular no. SEBI/HO/MIRSD/DoP/P/CIR/2022/46 dated April 06, 2022 (SEBI Circular dated April 06, 2022) and Clause 15(da) of KRA Regulations."*

3) ***"C: Segregation of operations between KRAs and CDSL***

a) *The inspection team observed that there is no segregation of cyber security services and infrastructure between CVL and CDSL (Parent body) i.e. CVL has been using the cyber security services and infrastructure of CDSL. Upon perusal of inspection observation vis-à-vis reply submitted by CVL in this regard, it is noted that there is no complete segregation between cyber security services and infrastructure of CVL and CDSL. It is also corroborated by the letter of CVL itself (Annexure 3.2 of reply of CVL) whereby CVL has mentioned, inter-alia, that "………Currently, CVL network is also linked to that of CDSL….." Further, malware attack on the systems of CDSL in November 2022 impacted operations of CVL also. Thus, it corroborates that there was not complete segregation of infrastructure between CVL and CDSL. In view of the above, CVL was found to be non-compliant during inspection period and violated clause 6.2 of Schedule III of SEBI (Intermediaries) Regulations 2008. (ii) With regards to inspection observation of loss of certain data due to malware attack on CDSL network, the reply submitted by CVL is not relevant and satisfactory. Clause 6.4 of Schedule III of SEBI (Intermediaries) Regulations, 2008 specifies "An Intermediary shall create and maintain the records of all documents and data in their in custody in such manner that the tracing of such document or data is facilitated in the event of loss of original records or documents for any reason." The explanation submitted by CVL that only pst files pertaining to the helpdesk emails could not be retrieved as the same was infected and there was no loss of data pertaining to KYC records of investor is not acceptable in light of above mentioned Clause 6.4. Therefore, CVL was found to be non-compliant during inspection period and violated provision of clause 6.4 of Schedule III of SEBI (Intermediaries) Regulations 2008.*

b) *In view of the foregoing, it is alleged that Noticee has been using the cyber security services and infrastructure of CDSL (Parent body) and infrastructure between Noticee and CDSL was not complete which led to loss of data including grievances data due to malware attack on CDSL and therefore, Noticee has violated clauses 6.2 and 6.4 of Schedule III of SEBI (Intermediaries) Regulations 2008."*

4) *Noticee is, therefore, required to show cause as to why an inquiry should not be held against it in terms of Rule 4 of Adjudication Rules read with Section 15(I) of the SEBI Act and penalty, if any, should not be imposed upon it under Sections 15A(b) and 15HB of the SEBI Act, for the aforesaid violations alleged to have been committed by it."*

7. The SCN was sent to Noticee through Speed Post Acknowledgment Due ("**SPAD**") on August 04, 2023 as well as digitally signed email dated August 04, 2023 and was duly served on Noticee.

8. Noticee submitted its reply to the SCN vide emails and letters dated August 18, 2023, September 07, 2023, and September 11, 2023. Thereafter, Noticee was granted an opportunity of hearing on September 05, 2023 vide Hearing Notice dated September 01, 2023. Noticee appeared on the scheduled date of hearing through Veritas Legal, Authorised Representative (AR) of the Noticee, and reiterated the earlier submissions made in its reply dated August 18, 2023. Considering the Noticee's request for filing additional submissions, the AR was granted time till September 11, 2023 to file its additional submissions. Thereafter vide email dated September 05, 2023 Noticee submitted a List of Dates summarising its key submissions and vide email dated September 11, 2023, Noticee submitted its additional submissions in the matter. The contentions as perused from relevant extracts of the reply, List of Dates, and the additional submissions of Noticee are summarised hereunder:
   a) *Noticee has admitted that it had filed its System Audit Report ("**SAR**") for the Audit Period 2021-2022 i.e. from January 2021 to March 2022, on October 28, 2022 i.e. after a delay of four months. Noticee has contended that the system audit for the said audit period which was delayed due to COVID-19 pandemic could have commenced only after the submission of the SAR for the calendar year 2020.*
   b) *Noticee has further contended that SEBI in its Circular No. SEBI/HO/MIRSD/DOP/P/CIR/2021/607 dated June 30, 2021 had extended the*

deadline for submission of the SAR for the year calendar year 2020 and Noticee submitted the SAR within the extended deadline w.r.t. calendar year 2020.

c) *Noticee has contended that it was unable to submit the SAR for the Audit Period 2021-2022 because of the restrictions imposed by Government of India in respect of offices and service providers, in the wake of increase in cases of COVID 19 infections, which continued until March 31, 2022.*

d) *Noticee has also contended that it was undergoing practical bottlenecks in ensuring the completion of SAR because the COVID-19 situation had not been completely mitigated and several employees/members of the audit team were affected by COVID-19 from time to time.*

e) *Noticee has further contended that the audit report for the calendar year of 2020 (which was carried out for a 12 (twelve) month period) was submitted after a period of 16 months, (as per the extensions granted by SEBI) and the audit for the period from January 2021 to March 2022 (which was carried out for a 15 (fifteen) month period) was submitted after a period of only 6 (six) months even though the same was carried out under similar circumstances as the SAR for the calendar year 2020.*

f) *Noticee has contended that the processing/validation of fresh KYCs in terms of aforementioned circulars required the KRAs to not only independently validate records of clients (existing as well as new) whose KYC has been completed using Aadhar as an OVD submitted by the Reporting Entities* ***("REs")*** *but also independently perform validation of the clients' email ID and mobile numbers using OTP validation.*

g) *Noticee has submitted that performance of these activities required a significant change in the KRA system design which includes the working, operations and processes adopted by KRAs as well as all intermediaries across the securities market as the same required the handling of Aadhar data, development of common SoPs and formats by the KRAs to support the market.*

h) *Noticee has also contended that since it was not permitted to store the Aadhar number as per Aadhaar (Authentication and Offline Verification) Regulations, 2021, it encountered significant technical challenges in ensuring that particulars of Aadhar data were captured adequately in its system without storing the Aadhaar number.*

i) Noticee has further contended that its parent company, CDSL had suffered a serious malware attack on November 18, 2022 due to which Noticee had isolated and disconnected its machines from the internet.

j) Noticee also stated that in view of the gravity and urgency of the situation it had taken steps in accordance with the National Critical Information Infrastructure Centre guidelines to address the situation which entailed sanitization of Noticee's servers.

k) Noticee has contended that the KYC data was not lost due to the malware attack and that only grievance related data in some email files/.pst files pertaining to the helpdesk were lost due to the malware attack.

l) Noticee has further contended that after the malware attack on CDSL on November 18, 2022, it had taken all the reasonable measures in timely manner to segregate its infrastructure from CDSL.

CONSIDERATION OF ISSUES, EVIDENCE AND FINDINGS

9. I have carefully perused the charges levelled against Noticee in the SCN and the material available on record. I have also perused the submissions made by Noticee in this regard. The issues that arise for consideration in the present case are:

   (i) Whether Noticee has violated the provisions as mentioned in para 4 of the order?
   (ii) Do the violations, if any, attract monetary penalty under Section 15HB of SEBI Act?
   (iii) If the answer to issue no. II is in affirmative, then what should be the quantum of monetary penalty?

10. Before proceeding to examine the matter, I find it pertinent to reproduce the aforesaid regulatory provisions of KRA Regulations, and other relevant circulars issued by SEBI which are as under:

    Relevant provisions of KRA Regulations
    "Functions and Obligations of the KRA
    15. *The KRA has the following functions and obligations: -*
    …

***(da)** KRA shall carry out an independent validation of the KYC records uploaded onto its system by the intermediary in such a manner as specified by the Board from time to time.”*

Relevant provisions of Intermediaries Regulations

“ ***SCHEDULE III***

SECURITIES AND EXCHANGE BOARD OF INDIA (INTERMEDIARIES) REGULATIONS, 2008

VI. INTERMEDIARY INFRASTRUCTURE REQUIREMENTS

6.2 *An Intermediary also registered with the Board in any other capacity/ category shall endeavour to ensure that arm’s length relationship is maintained in terms of both manpower and infrastructure between the activities carried out as an Intermediary and other permitted activities.*

…

6.4 *An Intermediary shall create and maintain the records of all documents and data in their custody in such manner that the tracing of such document or data is facilitated in the event of loss of original records or documents for any reason.*

<u>SEBI Circulars</u>

Circular No.

SEBI/HO/MIRSD/SEC-5/P/CIR/2022/100 dated July 27, 2022

SEBI, vide its circular no. SEBI/HO/MIRSD/DOP/P/CIR/2022/46 dated April 06, 2022, had issued guidelines in pursuance of amendment to SEBI KYC (Know Your client) Registration Agency (KRA) Regulations, 2011. The provisions of this circular at clause 9 and clause 13 were to come into effect from July 01, 2022.

2. Subsequently, an extension was granted vide circular no. SEBI/HO/MIRSD/DOP/P/ CIR/2022/89 dated June 24, 2022 whereby the aforesaid clauses were to come into effect from August 01, 2022.

3. In this regard, considering the KRA's request for extension of the timeline for applicability of the said clauses 9 and 13, it has been decided that:

3.1. KYC records of all existing clients (who have used Aadhaar as an OVD) shall be validated within a period of 180 days from November 01, 2022.

3.2. The validation of all KYC records (new and existing) shall commence from November 01, 2022.

4. This circular is issued in exercise of powers conferred under Section 11(1) of the Securities and Exchange Board of India Act, 1992 and Regulation 17 of the SEBI KYC (Know Your Client) Registration Agency) Regulations, 2011 to protect the interests of investors in securities and to promote the development of, and to regulate the securities markets.

Circular No.
SEBI/HO/MIRSD/DoP/P/CIR/2022/89 dated June 24, 2022

1. SEBI, vide circular no. SEBI/HO/MIRSD/DOP/P/CIR/2022/46 dated April 06, 2022, had issued guidelines in pursuance of amendment to SEBI KYC (Know Your client) Registration Agency (KRA) Regulations, 2011. The provisions of this circular at clause 9 and clause 13 were to come into effect from July 01, 2022.

2. SEBI has received requests from the KRAs to extend the timelines for applicability of the clause 9 and clause 13. After consideration, it has been decided that:

2.1. KYC records of all existing clients (who have used Aadhaar as an OVD) shall be validated within a period of 180 days from August 01, 2022.
2.2. The validation of all KYC records (new and existing) shall commence from August 01, 2022.

3. This circular is issued in exercise of powers conferred under Section 11(1) of the Securities and Exchange Board of India Act, 1992 and Regulation 17 of the SEBI (KYC (Know Your Client) Registration Agency) Regulations, 2011 to protect the *interests of investors in securities and to promote the development of, and to regulate the securities markets.*

Circular no.
SEBI/HO/MIRSD/DoP/P/CIR/2022/46 dated April 06, 2022

"SEBI vide its circular MIRSD/Cir- 26 /2011 dated December 23,2011 had issued guidelines to implement the SEBI {KYC Registration Agency (KRA)} Regulations, 2011. SEBI KRA Regulations, 2011, has been amended on January 28,2022 vide a Gazette Notification No. SEBI/LAD-NRO/GN/2022/72 (Annexure A). With a view to implement the regulations effectively, the following additional guidelines are being issued:

1. KRAs shall continue to act as repository of KYC data in the securities market and shall be responsible for storing, safeguarding and retrieving the KYC documents and submit to the Board or any other statutory authority as and when required.

2. KRAs shall independently validate records of those clients (existing as well as new) whose KYC has been completed using Aadhaar as an OVD. The records of those clients who have completed KYC using non-Aadhaar OVD shall be validated only upon receiving the Aadhaar Number.

3. During the process of validation, KRAs shall validate the following details:

a. Aadhaar through Unique Identification Authority of India (UIDAI) authentication/verification mechanism.

b. Mobile number and e-mail ID using OTP validation (only in cases where mobile number and e-mail ID provided by client are not seeded with Aadhaar)

c. PAN using the Income Tax Database.

4. The KRAs shall develop systems/mechanism, in consultation with SEBI and in co-ordination with each other, and shall follow uniform internal guidelines detailing aspects of identification of KYC attributes and procedures for KYC validation.

5. The systems of Registered Intermediaries (RIs) and the KRAs shall be integrated to facilitate seamless movement of KYC documents to and from the RIs to the KRAs.

6. KRAs shall promptly inform the respective RIs of deficiency/inadequacy in client's KYC documents, if any, that is observed for validation.

7. On successful completion of KYC validation, a unique client identifier called KRA identifier shall be assigned by KRA to the client and such KRA identifier may be used by the client for opening of account with any other intermediary, without repeating the KYC process.

8. The KYC records of new clients (who have used Aadhaar as an OVD) shall be validated within 2 days of receipt of KYC records by KRAs.

9. KYC records of all existing clients (who have used Aadhaar as an OVD) shall be validated within a period of 180 days from July 01, 2022.

10. KRA shall intimate the KRA identifier to the client within 2 working days of receipt of KYC records by the KRAs by post or email and maintain the proof of dispatch.

11. Clients whose KYC records are not found to be valid by KRA after the validation process shall be allowed to transact in securities market only after their KYC is validated.

12. In case of KYC based on non-Aadhaar OVD, the KRA shall only store such records and the same would not be validated by KRAs unless Aadhaar number is provided by the client.

13. The validation of all KYC records (new and existing) shall commence from July 01, 2022.

14. This circular is issued in exercise of powers conferred under Section 11(1) of the Securities and Exchange Board of India Act, 1992 and Regulation 17 of the SEBI (KYC (Know Your Client) Registration Agency) Regulations, 2011 to protect the interests of investors in securities and to promote the development of, and to regulate the securities markets."

<u>Issue No. 9 (i): Whether Noticee has violated the provisions as mentioned in para 4 of the order?</u>

11. It has been alleged that Noticee delayed system audit and submission of System Audit Report ('**SAR'**) for the audit period 2021-2022 to SEBI within the specified time period and thus, has violated the provisions prescribed at paragraph 55 of SEBI Circular no.

SEBI/HO/MIRSD/DOP/CIR/P/2019/111 dated 15 October 2019 ("SEBI Circular dated October 15, 2019").

12. I note that in terms of paragraph 55 of SEBI Circular dated 15 October 2019, a KRA is required to have its system audited on annual basis by an auditor empaneled with Indian Computer Emergency Response Team, Ministry of Electronics and Information Technology ("**CERT-IN**"), and submit the said audit report to SEBI along with the comments of the Board of Directors of KRAs within three months of the end of Financial Year ('**FY**').

13. I observe from the records of inspection and Noticee's letter dated March 21, 2023 to SEBI that the system audit of Noticee for the audit period 2021-2022 was carried out by the auditor, M/s. Network Intelligence Private Limited, in the month of September 2022. As per SEBI Circular No. SEBI/HO/MRD1/MRD1_DTCS/P/CIR/2022/58 dated May 02, 2022, SEBI has mandated that the system audit referred under SEBI Circular dated October 15, 2019 should be conducted once in a "financial year" instead of "calendar year". I note from the aforementioned records that Noticee had submitted the SAR for the Audit Period 2021-2022 i.e. from January 2021 to March 2022, on October 28, 2022 i.e. after a delay of four months instead of the deadline of June 30, 2022 as mandated under the aforesaid SEBI Circular. Therefore, I observe that the Noticee did not submit the SAR to SEBI within the stipulated time period and thus, failed to comply with the provisions prescribed under the said SEBI Circular dated October 15, 2019.

14. In its reply to the SCN, Noticee has admitted that it had filed its SAR for the Audit Period 2021-2022 i.e. from January 2021 to March 2022, on October 28, 2022 i.e. after a delay of four months. Noticee has contended that the system audit for the said audit period which was delayed due to COVID-19 pandemic could have commenced only after the submission of the SAR for the calendar year 2020. Noticee has further contended that SEBI in its Circular No. SEBI/HO/MIRSD/DOP/P/CIR/2021/607 dated June 30, 2021 had extended the deadline for submission of the SAR for the year calendar year 2020 and Noticee submitted the SAR within the extended deadline w.r.t. calendar year 2020. In this regard, I note that the allegation levelled in the SCN relates to the delay in the submission of SAR for the Audit Period 2021-22. I also note that SEBI had not issued any circular to grant relaxation of timelines w.r.t. the Audit Period 2021-22, in respect of compliance with

the requirements prescribed in the aforesaid SEBI Circular dated October 15, 2019. Thus, the aforesaid contention of Noticee w.r.t. its compliance of the aforesaid requirement for the calendar year 2020 is not relevant to the said allegation. Noticee has admitted that it was unable to submit the SAR for the Audit Period 2021-2022 because of the restrictions imposed by Government of India in respect of offices and service providers, in the wake of increase in cases of COVID 19 infections, which continued until March 31, 2022. Noticee has further stated that it was undergoing practical bottlenecks in ensuring the completion of SAR because the COVID-19 situation had not been completely mitigated and several employees/members of the audit team were affected by COVID-19 from time to time. As per Noticee, the audit report for the calendar year of 2020 (which was carried out for a 12 (twelve) month period) was submitted after a period of 16 months, (as per the extensions granted by SEBI) and the audit for the period from January 2021 to March 2022 (which was carried out for a 15 (fifteen) month period) was submitted after a period of only 6 (six) months even though the same was carried out under similar circumstances as the SAR for the calendar year 2020. I note that Noticee has admitted to the allegation levelled in the SCN and has brought out the surrounding circumstances due to which it had failed to comply with the requirements within the timelines prescribed in SEBI Circular no. SEBI/HO/MIRSD/DOP/CIR/P/2019/111 dated 15 October 2019. As noted above, SEBI had not issued any circular to grant relaxation of timelines w.r.t. the Audit Period 2021-22, in respect of compliance with the requirements prescribed in the aforesaid SEBI Circular. Thus, I am not inclined to accept the aforesaid contention of Noticee. Therefore, I find that the allegation that Noticee violated the provisions prescribed at paragraph 55 of SEBI Circular no. SEBI/HO/MIRSD/DOP/CIR/P/2019/111 dated 15 October 2019 ("SEBI Circular dated October 15, 2019") stands established.

15. It has also been alleged that Noticee did not process 10,44,248 fresh KYCs within Turnaround Time ("**TAT**") of 2 days and thus, Noticee has violated Clauses 3.1 and 3.2 of SEBI circular SEBI/HO/MIRSD/SEC-5/P/CIR/2022/100 dated July 27, 2022 (SEBI Circular dated July 27, 2022) read with SEBI Circular No. SEBI/HO/MIRSD/DoP/P/CIR/2022/89 dated June 24, 2022 (SEBI Circular dated June 24, 2022), SEBI circular no. SEBI/HO/MIRSD/DoP/P/CIR/2022/46 dated April 06, 2022 (SEBI Circular dated April 06, 2022) and Clause 15(da) of KRA Regulations. I note from the records of inspection and Noticee's letter to SEBI dated March 21, 2023 that Noticee did not process 10,44,248 fresh KYC applications of clients who had used Aadhaar as supporting Officially Valid Document

(OVD) within TAT of 2 days. I note that during inspection, Noticee, vide letter dated March 21, 2023 to SEBI, had submitted that KYC validation process got delayed due to malware attack on infrastructure of its parent company Central Depository Services (India) Limited (‘**CDSL**’) which occurred on November 18, 2022. Thus, I observe that it is an admitted fact that Noticee failed to comply with clause 3.1 and 3.2 of SEBI circular SEBI/HO/MIRSD/SEC-5/P/CIR/2022/100 dated July 27, 2022 r/w SEBI/HO/MIRSD/DoP/P/CIR/2022/89 dated June 24, 2022, SEBI circular SEBI/HO/MIRSD/DoP/P/CIR/2022/46 dated April 06, 2022 and clause 15(da) of KRA Regulations.

16. In its reply to the SCN, Noticee has contended that the processing/validation of fresh KYCs in terms of aforementioned circulars required the KRAs to not only independently validate records of clients (existing as well as new) whose KYC has been completed using Aadhar as an OVD submitted by the Reporting Entities ("**REs**") but also independently perform validation of the clients' email ID and mobile numbers using OTP validation. Noticee has submitted that performance of these activities required a significant change in the KRA system design which includes the working, operations and processes adopted by KRAs as well as all intermediaries across the securities market as the same required the handling of Aadhar data, development of common SoPs and formats by the KRAs to support the market. Noticee has also contended that since it was not permitted to store the Aadhar number as per Aadhaar (Authentication and Offline Verification) Regulations, 2021, it encountered significant technical challenges in ensuring that particulars of Aadhar data were captured adequately in its system without storing the Aadhaar number. Noticee has further contended that its parent company, CDSL had suffered a serious malware attack on November 18, 2022 due to which Noticee had isolated and disconnected its machines from the internet. Noticee also stated that in view of the gravity and urgency of the situation it had taken steps in accordance with the National Critical Information Infrastructure Centre guidelines to address the situation which entailed sanitization of Noticee’s servers. Thus, I note that while Noticee has sought to explain the reasons for the default, it has admitted to the allegation levelled in the SCN that it had failed to comply with the requirements prescribed at clause 3.1 and 3.2 of SEBI circular SEBI/HO/MIRSD/SEC-5/P/CIR/2022/100 dated July 27, 2022 r/w SEBI/HO/MIRSD/DoP/P/CIR/2022/89 dated June 24, 2022, SEBI circular SEBI/HO/MIRSD/DoP/P/CIR/2022/46 dated April 06, 2022 and clause 15(da) of

KRA Regulations. Thus, I am not inclined to accept the aforesaid contention of Noticee. In view of the foregoing, I find that the allegation that Noticee has violated clauses 3.1 and 3.2 of SEBI circular SEBI/HO/MIRSD/SEC-5/P/CIR/2022/100 dated July 27, 2022 (SEBI Circular dated July 27, 2022) read with SEBI Circular No. SEBI/HO/MIRSD/DoP/P/CIR/2022/89 dated June 24, 2022 (SEBI Circular dated June 24, 2022), SEBI circular no. SEBI/HO/MIRSD/DoP/P/CIR/2022/46 dated April 06, 2022 (SEBI Circular dated April 06, 2022) and Clause 15(da) of KRA Regulations, stands established.

17. It has also been alleged in the SCN that Noticee had used the cyber security services and cyber infrastructure of CDSL (Noticee's parent company) and cyber infrastructure between Noticee and CDSL was not completely segregated which led to loss of data including grievances data due to malware attack on CDSL's systems which occurred on November 18, 2022 and thus, Noticee failed to comply with clauses 6.2 and 6.4 of Schedule III of Intermediaries Regulations. I find that in terms of Clause 6.2 of Schedule III of Intermediaries Regulations, an intermediary is under an obligation to ensure that arm's length relationship is maintained in terms of both manpower and infrastructure between the activities carried out as an Intermediary and other permitted activities. In terms of Clause 6.4 of Schedule III of Intermediaries Regulations, an intermediary is under an obligation to create and maintain the records of all documents and data in their custody in such manner that the tracing of such document or data is facilitated in the event of loss of original records or documents for any reason.

18. I note from the records of inspection that during the inspection period, Noticee had been using the cyber security services & infrastructure of its parent company, CDSL. During inspection, vide letter dated March 21, 2023 to SEBI, Noticee had submitted that due to malware attack on CDSL's systems on November 18, 2022, certain data pertaining to its KYC operations, including grievance data, was permanently lost and such data was available only from February 01, 2022. I also note that vide email dated November 21, 2022, Noticee had informed, *inter-alia*, that CVL's network was also linked to that of CDSL and that its KYC operations had been significantly impacted by the said attack. I note that CVL and CDSL used the same cyber security services & infrastructure.

19. In its reply to the SCN, Noticee has contended that in the immediate aftermath of the malware attack on CDSL's systems, it had isolated and disconnected its machines from

the internet. Noticee has also contended that in view of the gravity and urgency of the situation, it had taken steps in accordance with the National Critical Information Infrastructure Centre guidelines to address the situation which entailed sanitization of Noticee's servers. Therefore, I note that any cyber attack targeting CDSL also endangered the security of the KYC data which was stored in CVL's systems. Noticee has itself admitted that its data was also lost due to the malware attack on CDSL which occurred on November 18, 2022. Hence, considering the fact that the malware attack on the systems of CDSL severely impacted the Noticee's KYC operations, I find that Noticee had failed to maintain segregation between cyber security services and infrastructure of CVL and CDSL. I further find that the permanent loss of data from Noticee's systems owing to the malware attack on the systems of CDSL demonstrates that Noticee had failed to ensure traceability of records of documents in the event of data loss. In view of the above, I find that Noticee failed to comply with clauses 6.2 and 6.4 of Schedule III of Intermediaries Regulations.

20. In its reply to the SCN, Noticee has contended that the KYC data was not lost due to the malware attack and that only grievance related data in some email files/.pst files pertaining to the helpdesk were lost due to the malware attack. However, at the same time, Noticee has also made a contradictory submission that its KYC operations were severely impacted by the malware attack on CDSL. I also note that in its email dated November 21, 2022 to SEBI and reply to inspection findings dated March 21, 2023, Noticee had admitted that the CDSL malware attack had severely impacted the KYC operations of the Noticee due to its use of common CDSL cyber infrastructure. In its reply to the SCN, Noticee has further contended that after the malware attack on CDSL on November 18, 2022, it had taken all the reasonable measures in timely manner to segregate its infrastructure from CDSL. Therefore, it is clear that Noticee had failed to maintain segregation between cyber security services and infrastructure of CVL and CDSL due to which Noticee's KYC operations were severely impacted and there was permanent loss of data from its systems. Therefore, I do not find the aforesaid contention to be acceptable.

21. Therefore, I find that the allegation that Noticee has violated clauses 6.2 and 6.4 of Schedule III of Intermediaries Regulations stands established.

<u>Issue No. 9 (ii): Do the violations, if any, attract monetary penalty under Sections 15A(b) & 15HB of SEBI Act?</u>

22. As established in the preceding paragraphs of this order, Noticee has contravened provisions of KRA Regulations, Intermediaries Regulations and various circulars issued by SEBI. In context of the violations as established, I refer to the observations of Hon'ble Supreme Court in the matter of Chairman, SEBI vs. Shriram Mutual Fund {[2006] 5 SCC 361} wherein the Hon'ble Court held that: "*In our considered opinion, penalty is attracted as soon as the contravention of the statutory obligation as contemplated by the Act and the Regulations 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 must made by the defaulter with guilty intention or not*.''

23. Therefore, in view of the violations as established and placing reliance on the aforesaid judgment, I find that Noticee would be liable for monetary penalty under Section 15A(b) and Section 15HB of SEBI Act. The text of Section 15A(b) and Section 15HB of SEBI Act are reproduced as under:

Section 15A(b) of SEBI Act** - **Penalty for failure to furnish information, return, etc.

*"**15A.** If any person, who is required under this Act or any rules or regulations made thereunder,—*

…

(b) to file any return or furnish any information, books or other documents within the time specified therefor in the regulations, fails to file return or furnish the same within the time specified therefor in the regulations or who furnishes or files false, incorrect or incomplete information, return, report, books or other documents, he shall be liable to a penalty which shall not be less than one lakh rupees but which may extend to one lakh rupees for each day during which such failure continues subject to a maximum of one crore rupees."

***Section 15HB of SEBI Act**: - Penalty for contravention where no separate penalty has been provided:*

"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."

Issue No 9 (iii): If the answer to issue no. 9(ii) is in affirmative, then what should be the quantum of monetary penalty?

24. While determining the quantum of penalty under Section 15HB of the SEBI Act, factors stipulated in Section 15J of the SEBI Act have to be given due regard. The aforesaid provisions are reproduced hereunder:

Factors to be taken into account by the adjudicating officer under SEBI Act

15J. *While adjudging quantum of penalty under Section 15-I, 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

Explanation. — For the removal of doubts, it is clarified that the power of an adjudicating officer *to adjudge the quantum of penalty under sections 15A to 15E, clauses (b) and (c) of section 15F, 15G, 15H and 15HA shall be and shall always be deemed to have been exercised under the provisions of this section*

25. In view of the charges established and the facts and circumstances of the case, the quantum of penalty would depend on the factors referred in Section 15J of the SEBI Act, as stated above. In this context, I note that Hon'ble Supreme Court in the matter of Bhavesh Pabari vs SEBI [(2019) 5 SCC 90] has held that the factors under section 15J are not exhaustive but are inclusive i.e. there can be circumstances beyond those enumerated by clauses (a), (b) and (c) of Section 15J which can be taken note of by the adjudicating officer while determining the quantum of penalty.

26. I note that in the present matter, no quantifiable figures are available to assess the disproportionate gain or unfair advantage made as a result of the default by Noticee. Further, from the material available on record, it is not possible to ascertain the exact monetary loss to the investors/clients on account of default by Noticee. As regards the repetitive nature of the default, I do not find that the Inspection having brought on record any regulatory action taken by SEBI in the past against Noticee for the same violations as those observed in the instant matter. I also note that the delay in submission of the SAR for Audit Period 2021-22 by Noticee was mainly on account of circumstances arising out of the COVID-19 pandemic. Although, Noticee has itself admitted to having delayed the submission of SAR for the stated period, I also cannot lose sight of the difficult circumstances faced by various entities in the wake of the COVID-19 pandemic, and resultantly many regulatory restrictions also having been relaxed. Therefore, I am inclined to treat the same as mitigating circumstance. I further note that in the aftermath of the malware attack on CDSL on November 18, 2022, it had taken all the reasonable measures in timely manner to segregate its infrastructure from CDSL and the aforesaid segregation activity was scheduled for completion by September 29, 2023, as communicated by Noticee vide its email dated August 18, 2023 to SEBI. I am also conscious of the fact that the compliance with the requirements regarding KYC validation as specified under SEBI Circular dated July 27, 2022 read with SEBI Circular dated June 24, 2022, and SEBI Circular dated April 06, 2022 was delayed on account of the malware attack on CDSL's systems which were being shared with the Noticee. Therefore, I am of the view that the aforementioned facts can be considered as mitigating factors while determining penalty in the matter.

ORDER

27. Having considered all the facts and circumstances of the case, the material available on record, the submissions made by Noticee and also the factors mentioned in Section 15J of the SEBI Act, as enumerated above, I, in exercise of the powers conferred upon me under Section 15-I of the SEBI Act read with Rule 5 of the Adjudication Rules, hereby impose a penalty of Rs 2,00,000/- (Rupees Two Lakhs only) under Section 15A(b) and Section 15HB of SEBI Act on the Noticee.

28. Noticee shall remit/pay the said amount of penalty within 45 days of receipt of this order through 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. In case of any difficulties in payment of penalties, said Noticee may contact the support at portalhelp@sebi.gov.in.

29. The Noticee shall forward the said confirmation of e-payment made in the format as given in the table below which should be sent to "The Division Chief, EFD – DRA - III, Securities and Exchange Board of India, SEBI Bhavan, Plot no. C- 7, "G" Block, Bandra Kurla Complex, Bandra (E), Mumbai - 400 051" and also to e-mail id:- tad@sebi.gov.in

1. Case Name:	
2. Name of payee:	
3. Date of payment:	
4. Amount paid:	
5. Transaction no.:	
6. Bank details in which payment is made:	
7. Payment is made for: (like penalties/ disgorgement/ recovery/ settlement amount and legal charges along with order details)	

30. 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 SEBI Act for the realisation of the said amount of penalty along with interest thereon, *inter alia*, by attachment and sale of movable and immovable properties of Noticee.

31. In terms of the provisions of Rule 6 of the Adjudication Rules, a copy of this order is being sent to Noticee and also to SEBI.

Date: September 27, 2023 **SOMA MAJUMDER**

Place: Mumbai **ADJUDICATING OFFICER**