

PN-ACB-443

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**Follow up on the Organizational Structure Plan
for the National Securities Depository Limited**

**Financial Institutions Reform and
Expansion (FIRE) Project**

November 1996

**Financial Institutions Reform and Expansion (FIRE) Project
US Agency for International Development (USAID/India)
Contract #386-0531-C-00-5010-00
Project #386-0531-3-30069**

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Price Waterhouse LLP



November 30, 1996

Mr. C. B. Bhave
Managing Director,
National Securities Depository Limited
Trade Towers, 4th floor
Kamla Mills Compound
Senapati Bapat Marg
Mumbai 400 025.

Dear Mr. Bhave,

**Re: Follow-up on Development of Organizational Structure for the
National Securities Depository Limited (NSDL)**

At your request and as a part of our contract with the USAID, Ms. Susan Hertel, Vice President of Operations at the Midwest Depository in the US and a consultant to Price Waterhouse Capital Markets, has completed the third part of our activity towards assisting the NSDL organizational setup.

Purpose of Activity

The purpose of this activity was to follow up on our previous recommendations on an efficient organizational structure for the organization and on the recommended workflows and job descriptions related to the organizational structure of the NSDL.

Approach to Work

a. The Organizational Structure Plan

The basis of this work is the Organizational Structure Plan for National Securities Depository Limited, published in July, 1996. The departments and sub-departments recommended under the Plan were as follows: Operations Department (including the Registrar Interface, Clearing Corporation Interface, Participant Interface and Security Masterfile areas); Information Technology (including Communications and Computer Operations); Marketing Department (including Sales, Training, and Membership Departments); Compliance Department (including Surveillance, Risk Management and Legal Departments); Internal Audit; and Support Services (including Human Resources, Accounting, Administrative Services, Distribution/Mail and Corporate Security Departments).

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b. NSDL Workflows and Job Descriptions

On the basis of the Organizational Plan, work flows and job descriptions were presented to the NSDL in September, 1996. These were based on the review of all relevant regulations and procedures and in-depth discussions and reviews with the NSDL management team. Work flows were presented for all those new departments that are related to depository processing. The narratives and flowcharts for the five depository-specific areas were included in this report. Besides providing the narratives, 17 job descriptions were also presented for key staff positions.

The next part of Ms. Hertel's activity was to follow up on the previous recommendations made to NSDL and to review the business rules, Bye-Laws and procedures developed by NSDL for participants and registrars, as well as internal procedures. The following report addresses these issues.

Findings and Recommendations

a. Review of organizational development

A review of the organizational development of NSDL was conducted on the basis of discussions with the NSDL Management team. This included the creation of the management team and the development of recommended department and the staffing procedures.

b. Comparison of NSDL Bye-Laws, Business rules and procedures

The different documents prepared by the NSDL including the Bye-Laws, Business Rules and the drafts of procedures for internal users, participants and registrars were compared for any inconsistencies or weaknesses. The internal and external procedures and the legal documents need to be consistent with each other and require attention from the legal, operational or both sides of the NSDL business.

Next Steps

The development of the basic organizational framework will take some time. Over the next few months, the Management Team will be faced with many challenges in coordinating functions within and between their respective departments. Questions will surface on how to deal with situations. A complete set of procedures needs to be formalized. Management tools need to

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be developed to monitor the work of the depository.

To assist NSDL in the development of their management team as well as ensure that all parties understand the processes and interactions of the operational departments, it is proposed that Price Waterhouse conduct a series of in-depth interactive sessions on depository operations. Using the Plan and the subsequent Work flows and Job Descriptions as a basis, separate sessions should be conducted on subjects including

- Departmental Review
- Procedures - Internal
- Management Reports

All Members of the management team responsible for the day-to-day operation of the depository services should participate in these sessions.

These sessions would help in developing a more consistent understanding of the overall depository operations among management team members and shall create an awareness about the importance of interactions between the various depository departments. Inconsistencies between the Bye-Laws, Business Rules, and drafts of procedures indicate a need for more work in this area. These topics cover immediate needs. Other areas needing attention at a later date may be identified during this first phase, including quality control in a depository environment, internal audits, risk management issues, etc.

Each session should be a minimum of four hours (½ day). It is also recommended that the sessions be held “off-site” to enable the Management Team to focus on the discussions. This means a large time commitment on the part of the NSDL Management Team. However, this should be viewed as time well spent to pull together all of the depository operations as well as to discuss/resolve issues faced during the initial implementation process.

Price Waterhouse shall also assist NSDL in the next steps of implementing previous recommendations on the organizational structure and work flows and the fine tuning of internal departmental procedures and the external procedures for participants and registrars etc.

Ms. Susan Hertel shall be back in India in January 1997. The purpose of her next visit will be to follow up on the recommendations made to the NSDL and to assist NSDL in resolving current issues as identified above.

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For the success of this project the participation and cooperation of your management and staff is essential. We would like to thank you and your colleagues at NSDL and NSE for the time, courtesy and cooperation extended to us during the course of this project.

Please get in touch with us at the FIRE project for any clarifications you may require.

Thanking you,

Yours sincerely,

A handwritten signature in black ink, appearing to read "W. Dennis Grubb". The signature is written in a cursive style and is positioned to the left of a second, more stylized handwritten mark that resembles a set of initials or a flourish.

W. Dennis Grubb
Principal Consultant

*Follow-up on the Organizational Structure Plan
for
the National Securities Depository Limited*

*Price Waterhouse LLP
Mumbai
November 1996*

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I. EXECUTIVE SUMMARY

Price Waterhouse is committed to assisting the National Securities Depository Limited (NSDL) in developing the organizational structure and overall operations of the depository. To this end, an Organizational Structure Plan (the Plan) was published by Price Waterhouse in July, 1996, and Workflows and Job Descriptions based on the Plan in September, 1996. This paper addresses the status of the organizational development of NSDL and implementation of recommendations under the Plan. Included in the following document are:

- A general update on the organizational development as provided by the NSDL Management Team. This includes the creation of the Management Team itself, as well as the development of the departments within the depository and staffing of same. Work is being done in this area using the Plan as a guide.
- Comments on the comparison of NSDL's Bye-Laws, Business Rules, and drafts of procedures for internal users, participants, and registrars. These comments are intended to assist NSDL in insuring that there is consistency between the legal documents and both internal and external procedures. Each point is categorized as needing attention by either Legal, Operations, or both (Legal/Operational).
- General observations on the different drafts of the procedure manuals. Along with these comments, a sample procedure format has been provided. Use of such a format will insure clarity and consistency among all of the procedures written for use by the depository staff.
- Recommendations on additional support that can be provided by Price Waterhouse to NSDL in developing/strengthening its organizational structure. These recommendations center around a group of working sessions where the Management Team has an opportunity to review the responsibilities and interactions of the various departments of a depository as well as to reflect on the experience to date of operating after the system implementation.

II. BACKGROUND

The Organizational Structure Plan of National Securities Depository, Limited (the Plan) was published by Price Waterhouse in July, 1996. Based on the Plan, Workflows and Job Descriptions were developed and published by Price Waterhouse in September, 1996. This paper addresses the status of the organizational development of NSDL in relationship to these two documents, including:

- A general update on the organizational development as provided by the NSDL Management Team.
- Comments on the comparison of NSDL's Bye-Laws, Business Rules, and drafts of procedures for internal users, participants, and registrars.
- General observations on the different drafts of the procedure manuals.
- Recommendations on additional support that can be provided by Price Waterhouse to NSDL in developing/strengthening its organizational structure.

The update on the organizational development was provided in a meeting with the NSDL Management Team. An understanding of the Bye-Laws and Business Rules was obtained through previous discussions with the legal staff of both NSDL and Price Waterhouse.

III. UPDATE ON ORGANIZATIONAL DEVELOPMENT

The NSDL Management Team currently includes two Executive Directors (ED). One ED is responsible for the business operations; the other, information technology. To support these functions, two Vice Presidents have also been hired. All of this is consistent with the management structure recommended in the Plan.

Work is being done by the Management Team to begin creating the various departments of the depository. The NSDL management team has advised that the progress in this area as well as the overall implementation of the depository is as follows:

- Recommendations for departments and key staff positions as recommended by the Plan and the subsequent workflows and job descriptions are being used by NSDL as a basis for organizational development and staffing.
- Number of staff members hired to date: 50-55.
- Several of the key positions identified through the Plan have already been filled.
- Training of staff is in place.
 - Staff has been trained on the depository concepts.
 - TCS is training staff on the technical aspect of the depository.
- Internal and external (participant and registrar) procedures have been drafted.
- TCS is also preparing manuals for users of the depository system from the technical perspective.
- Preparation for implementation of the depository on 11/8/96 at the time of the update meeting included:
 - Software had been installed at one participant and one registrar.
 - External users were receiving training from TCS.
 - All types of system simulation were in process.
- A "Help Desk" had been set up (as recommended under the Plan).
 - Staff will provide 16-hour support to start.
 - All problems reported through the Help Desk are being documented.
- Plans for additional support to users include:

- A list of common questions and answers will be distributed to users to help in understanding the depository system.
- User manuals will be available on CD Rom.
- Depository participation kits will be created for distribution to brokers and individual investors.

Note: All current training and future plans for user support are consistent with the emphasis on training of internal and external users of the depository system as recommended by the Plan.

From the discussion that took place on the above points, it was clear that NSDL had created an organized agenda for implementation of the depository. Although all features of the Plan have not yet been incorporated into the organizational structure, the Management Team reassured Price Waterhouse that recommendations under the Plan are considered to be relevant to NSDL's objectives, and are being consulted as the depository evolves. Based on this feedback, Price Waterhouse will continue to use the Plan as a basis for future work with NSDL in the area of the development of the depository's organizational structure.

IV. COMPARISON OF NSDL'S BYE-LAWS, BUSINESS RULES, AND PROCEDURES

As part of the development of the organizational structure of the depository, Price Waterhouse has committed to assisting NSDL in the development of both internal and external procedures. In conjunction with this effort, a comparison was done of the following documents as provided by NSDL:

- Bye-Laws, published and dated October, 1996.
- Business Rules, published and dated October, 1996.
- Drafts of procedure manuals, including:
 - Internal.
 - Participant.
 - Registrar

Related topics were compared between the documents for consistency and completeness. It is recognized that the procedures are only in draft form at this stage. However, it is critical that NSDL is certain that all users of the system are following the same basic steps to avoid ongoing confusion, and that all procedures comply with the Bye-Laws and Business Rules.

To assist NSDL in this task, comments on the differences found under this comparison are provided in Appendix B. The comments are categorized as areas that need to be addressed by either Legal, Operations, or both (Legal/Operational) to bring the documents into agreement with each other.

Note: The comments also include some general observations noted during the comparison for consistency between the legal documents and procedures.

It should be noted that the number of differences between the documents is an indicator that work still needs to be done in the area of training NSDL management in the operations of the depository. (See "Recommendations for Additional Support by Price Waterhouse.")

V. OBSERVATIONS ON DRAFTS OF PROCEDURE MANUALS

To further support NSDL in the development of procedures, the following observations are offered on the recent drafts:

- Procedure format should be simplified.
 - Break larger procedures into smaller, less complicated procedures.
 - Create simple steps vs. paragraphs of narrative.

Note: A sample format for procedures is offered in Appendix C.

- Procedures should be precise. (Drafts were vague in some areas.)
 - Step-by-step outline.
 - Logical, chronological order.
- Exhibits should be used whenever a document is mentioned.
 - Forms
 - Terminal screens
 - Reports
- Procedures should be issued for each department. Manuals would then be provided to each staff member.
- Flowcharts and checklists may also be useful as exhibits.
- Efforts should be made to ensure consistency of terms among procedures. (Issuer/R&T agent vs. Registrar vs. R&T agent; client vs. individual investor, etc.)

In addition, it was observed that some key procedures identified under the previously published workflows and needed for the initial phase of the depository have not yet been drafted. These include but are not limited to:

- All functions of the Registrar, Clearing Corporation and Participant Interface Representatives, such as:
 - Receiving calls from the respective user of the depository and identifying actions that need to be taken.

- Researching security differences found under the reconciliation process.
- Researching problems related to corporate actions.
- Interactions with Information Technology.
- Documenting/communicating problems identified through work with the depository users.
- Initial review of applications for participation in the depository as performed by the Membership Clerk, including:
 - Screening for minimal eligibility requirements.
 - Insuring proper completion of forms.
 - Submission of applications to SEBI and all related follow-up work.
- Review/approval of applications by the Surveillance Department, ensuring compliance with requirements for participation in the depository.

The above list is not intended to reflect all of the procedures that NSDL will need to formalize in writing. Rather, they are the procedures needed for the immediate processes handled by the depository for those departments prioritized as the first group of departments to be established (Group 1 as recommended in "Workflows and Job Descriptions"). Ultimately, the functions of each department must be analyzed to determine which procedures need to be documented. (See "Recommendations for Additional Support by Price Waterhouse.")

VI. RECOMMENDATIONS FOR ADDITIONAL SUPPORT

To assist NSDL in the development of their management team as well as ensure that all parties understand the processes and interactions of the operational departments, it is proposed that Price Waterhouse conduct a series of in-depth interactive sessions on depository operations. Using the Plan and the subsequent Workflows and Job Descriptions as a basis, separate sessions would be conducted on each of the following subjects:

- Departmental Review
 - Responsibilities of each area
 - Work and communication flows
 - Staffing
 - Tools needed to meet responsibilities

- Procedures - Internal
 - Identifying tasks to proceduralize
 - Format for procedures
 - Content
 - Distribution to staff
 - Accountability of staff

- Management Reports
 - Indicators
 - Development of format
 - Timing of issuance

The above sessions should be attended by all members of the management team responsible for the day-to-day operation of the depository services. The attendees should plan to take an interactive role, discussing modifications that may be needed to the original Plan, problems they have encountered since implementation, and input on what they feel are the critical areas they need to monitor and effectively manage the depository.

Benefits of these sessions would be:

- A more consistent understanding of the overall depository operations among management team members. (Inconsistencies between the Bye-Laws, Business Rules, and drafts of procedures indicate a need for more work in this area.)

- The creation of an awareness about the importance of the interactions between

the various depository departments and the ramifications of ignoring such interactions.

- A standard presentation of internal operating procedures that provide clear directions for the operating staff.
- Management tools to monitor the proper indicators within the depository environment, ensuring quality control over operations.

Each session should be a minimum of four hours (½ day). It is also recommended that the sessions be held “off-site” to enable the Management Team to focus on the discussions. This means a large time commitment on the part of the NSDL Management Team. However, this should be viewed as time well spent to pull together all of the depository operations as well as to discuss/resolve issues faced during the initial implementation process.

The above topics to be addressed cover immediate needs. Other areas needing attention at a later date may be identified during this first phase, including quality control in a depository environment, internal audits, risk management issues, etc.

VII. SUMMARY AND NEXT STEPS

NSDL created an organized agenda for implementation of the depository. While all steps have not yet been taken, the Management Team of NSDL reassured Price Waterhouse that recommendations under the Plan are considered to be relevant to NSDL's objectives, and are being consulted as the depository evolves. Based on this feedback, Price Waterhouse will continue to use the Plan as a basis for future work with NSDL in the area of the development of the depository's organizational structure.

Part of this development process includes the documentation of procedures. NSDL has drafted procedure manuals to be used internally as well as manuals for participants and registrars. These procedures must be consistent throughout, and need to comply with the depository's Bye-Laws and Business Rules. To assist NSDL in this area, Price Waterhouse compared related topics among the five documents. Comments/observations based on this comparison have been provided in Appendix B. Additionally, general comments on the procedure drafts have been made and a sample format for uniform documentation is provided in Appendix C.

The development of the basic organizational framework will take some time. Over the next few months, the Management Team will be faced with many challenges in coordinating functions within and between their respective departments. Questions will surface on how to deal with situations. A complete set of procedures needs to be formalized. Management tools need to be developed to monitor the work of the depository. To assist NSDL in these areas, it is proposed that Price Waterhouse conduct a series of in-depth interactive sessions on depository operations for the Management Team. Using the Plan and the subsequent Workflows and Job Descriptions as a basis, separate sessions would be conducted on each of the following subjects:

- Departmental Review, including responsibilities of each area, work and communication flows, staffing, tools needed.
- Procedures (Internal), including identifying tasks to proceduralize, format, content, use by staff, and accountability of staff under documented procedures.
- Management Reports, including identifying what are the key indicators to monitor within the depository, development of report format(s), and issuance of reports.

The above sessions should be attended by all members of the Management Team responsible for the day-to-day operation of the depository services. The attendees should plan to take an interactive role, discussing modifications that may be needed to the original Plan, problems encountered since implementation, and input on what they feel are the critical areas they need to monitor and effectively manage the depository.

Such sessions would require a large time commitment from the Management Team. However, the benefits of this type of interaction will considerably strengthen the overall management of the depository.

APPENDICES

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- A. Individuals interviewed**
- B. Comments on the Comparison of Bye-laws, Business Rules and Procedures of the National Securities Depository Limited**
- C. Sample Procedures Format**

Appendix A

Individuals Interviewed

C. B. Bhave, Managing Director, National Securities Depository Ltd.

Gagan Rai, Executive Director, National Securities Depository Ltd.

Rajesh Doshi, Executive Director, National Securities Depository Ltd.

Shashikant S. Shirahatti, Vice President, National Securities Depository Ltd.

V. R. Narasimhan, Vice President, National Securities Depository Ltd.

Appendix B

Comments on the Comparison of Bye-laws, Business Rules and Procedures of the National Securities Depository Limited

Appendix B:

Comments on the Comparison of Bye-laws, Business Rules and Procedures of the National Securities Depository Limited

Note: Page numbers cited are for the beginning of the associated section, and not intended to be the page on which the related material appears.

TOPIC: *Admission Criteria*

CITES: *Bye-laws - Section 6.2, Page 15*

- The drafts of both the internal operations manual and the participant operational procedures are silent on admission criteria as established in the Bye-Laws. An internal procedure needs to be written for use in the initial screening of applicants. The procedure should include a checklist of both the SEBI regulations and additional requirements of NSDL. The procedure should describe the documents required by NSDL to ensure all criteria are met.

A procedure should also be written to give to potential participants. This could be as simple as a checklist of admission criteria, sample supporting documents, etc.

Note: It is recommended that any literature or procedures provided to participants be reviewed by NSDL's Legal staff to insure that information is in compliance with all regulations, rules, and bye-laws prior to distribution.

(Legal/ Operational)

TOPIC: *Admission of Participants*

CITES: *Bye-Laws - Section 6.1, page 14*

- The Bye-Laws require that all fees, deposits and other sums specified by the depository must accompany the application to SEBI by a potential participant. However, the Business Rules state that, “even after the applicant obtains the certificate of commencement of business from the Securities and Exchange Board of India, the Participant shall not transact business on the Depository system unless it has paid the security deposit and other fees as stipulated by the Depository.” This would indicate that a participant can apply to and be approved by SEBI to become a participant in the depository without paying fees. The Business Rules, therefore, are inconsistent with the Bye-Laws and need to be changed.

(Legal)

- Both the internal operations manual and the participant operations manual are silent on the admission of participants. Similar to “Admission Criteria”, an internal procedure is needed to support the screening of applications and at least a checklist for admission is needed for applicants. Both topics (Admission Criteria and Admission of Participants) could probably be covered under the same procedure and checklist.

(Legal/ Operational)

- Internal applicant screening procedures also need to include:

- Action to be taken by the depository within 30 days (Bye-Laws).

Note: A stipulation should be made as to whether this is calendar or business days both in the procedures and Bye-Laws.

- Applicant has opportunity to correct areas of noncompliance in application form, supporting documents, etc. (Bye-Laws)

- Depository has right to request additional information. (Bye-Laws)

- Depository may approve or reject applicant. Applicant may appeal rejection. (Bye-Laws)

- Executive Committee of Depository may require fund deposits to reduce risk. (Bye-Laws)

- Applicant must have appropriate safekeeping measures to store securities and physical records (Business Rules)

(Operational)

- The Business Rules do not state that the Executive Committee may require fund deposits to reduce risk as is noted in the Bye-Laws. However, this may be alluded to under the required payment of fees and security deposits that is set out in the Business Rules.

The statement about fund deposits in the Bye-Laws may be a duplication of fees to be paid with the application to SEBI under the Bye-Laws; or this may be intended to provide for additional deposits at any time after a participant account is activated. If the latter, the Bye-Laws need a clear statement about additional deposits to reduce risk. (This is needed from an operational perspective to support actions taken by NSDL management.)

(Legal)

TOPIC: Account Opening

CITES: *Bye-laws - Section 9.1, Page 34*
Business Rules - Section 12.1, Page 22
Internal Procedures - Section 2
Participant Procedures - Section 1.1, page 4

- Categories of accounts are not consistent as listed in the internal operations manual and the participant operations manual. Some of the accounts listed in the two procedure manuals may be internal to the system processing and/or actually represent positions within an account. If this is the case, this should be clarified within the procedures.

The Bye-Laws only reference participant accounts and separate accounts for each client. The separate accounts by client are presumably at the depository. This structure needs to be described in more detail within all documents.

Consideration should also be given as to whether or not different account types at the depository need to be described more specifically in the Bye-Laws or Business Rules.

(Legal/ Operational)

- The participant procedures state that an investor intending to hold securities in electronic form “should” open an account with a participant. This needs to be changed to “must” open an account with a participant. (There is no other way to hold the electronic form.)

(Operational)

- The participant procedures call for the client to execute “the agreement and forward the same to the Participant.” It should be made clear in the procedure that both the client and the participant are entering into the agreement -- not just the client (in compliance with the Bye-Laws).

(Operational)

- Participant procedures are silent on single or joint client accounts as provided for within the Business Rules. This possibility should be included in the procedures.

(Operational)

TOPIC: Dematerialization

CITES: *Bye-Laws - Section 9.2, page 35*
Business Rules - Section 11.1, page 18
Participant Procedures - Section 1.2, page 7
Registrar Procedures - Section 3, page 6

- Business Rules are silent on the fact that both existing securities and new issues (Initial Public Offerings - IPO's) may be dematerialized as described in the other documents. This should be reviewed to determine if this provision is needed in the Business Rules.

(Legal)

- The registrar operations manual indicates that the participant will have authorized the DRF. However, this is not clearly reflected in the participant procedures. The authorization step needs to be added to the participant procedures, and it should be insured that the "Dematerialization Request Form" (DRF) provides for such authorization. (The sample DRF in the Business Rules does not appear to have a section for the participant's authorization.)

This point should also be reviewed by the Legal staff to determine if the participant authorization should be in the Bye-Laws or Business Rules.

(Legal/ Operational)

- Per the participant operations manual, the R&T agent notifies the participant of mismatches through a letter or fax. The registrar procedures manual only indicates that the registrar intimates the mismatch to NSDL. A step needs to be added to the registrar procedures for the direct notification to the participant. Such notification will expedite the correction of the mismatch.

If this is to be a depository requirement, this step should also be considered for inclusion in the appropriate legal document(s).

(Legal/ Operational)

- The registrar operations manual indicates that mismatches will be rejected to participants if corrections are not received within 48 hours. However, the participant procedures call for corrections to be sent to the registrar within 15 days (business or calendar) after receiving notice of the mismatch. Therefore, the timing within the procedures is not consistent.

In addition, the Business Rules speak only to correcting "objections." Unacceptable DRF's appear to be categorized as either objections, mismatches, or rejections. Each category has its own procedure. The procedures for all unacceptable DRF's should be

standardized with specific time frames. The Business Rules should state such time frames. "Timely basis" is too vague and is often interpreted differently by the parties involved.

(Legal/ Operational)

- An acknowledgment to the participant of an accepted DRF is provided for in the registrar operations manual. However, the participant procedures do not reflect that the participant will receive such an acknowledgment directly from the registrar. This step should be added to the participant procedures as it is an important control checkpoint.

If this is to be a depository requirement, this step should also be considered for inclusion in the appropriate legal document(s).

(Legal/ Operational)

- Similar to the acknowledgment, the registrar procedures call for a dematerialization confirmation to be sent to the depository participant. The participant procedures do not reflect receiving such a confirmation. This step needs to be added to the participant procedures as it is an important control checkpoint.

If this is to be a depository requirement, this step should also be considered for inclusion in the appropriate legal document(s).

(Legal/ Operational)

- In the area of public or rights issuance, the Business Rules state:

11.1.16 - In the case of such issue in electronic form as specified above, the account of the client maintained with the participants shall be credited with such securities issued only when the pattern of holdings of such account matches with the pattern of application of the client in the form specified above...

Simply stated, this appears to mean that only the applicant for a new issue or a registered holder for a rights offering may receive an allotment credit. It is not clear under the Business Rules how this requirement is accomplished.

The "account of the client maintained with the Participants" could be either the account at the depository or the account on the participant's own books. If it is the account held at the depository, the depository has no way of knowing the applicants for new issues or the options elected for an offering. Therefore, how does the depository know that an allotment is being credited to the proper shareholder other than the fact that the shareholder happens to match a client account within the depository system? Is this a problem under the Business Rules structure? This area

needs to be reviewed further.

(Legal)

TOPIC: Rematerialization

CITES: *Bye-laws - Section 9.4, Page 38*
Business Rules - Section 11.2, Page 20
Participant Procedures - Section 1.9, Page 29
Registrar Procedures - Section 4, Page 16

- The Bye-Laws speak of “withdrawing security balances” and the participant “withdrawing its own security balance.” These statements might be interpreted to mean that rematerialization requests are for the total number of shares held in a given security. In fact, the request may be for either part or all of the security balance. This needs to be clarified in the Bye-Laws.

(Legal)

- Both the Business Rules and the participant procedures are silent on blocking that portion of an account position that is subject to a rematerialization request as called for in the Bye-Laws. This is a very specific and important control step in the rematerialization process and it is critical to future processing. Therefore, it should be noted in the procedures.

(Operational)

- The Business Rules state that the participant is to print a copy of the client profile from the depository system and forward it to the issuer/R&T agent along with the rematerialization request. This is a good control feature. However, this requirement is missing from the participant and registrar procedures on rematerialization. This step needs to be added to the procedure.

(Operational)

- The participant procedure simply states that the registrar dispatches the certificates for completed rematerialization requests. The fact that the certificates are sent directly to the client needs to be added to the participant procedure to correspond to the registrar procedure and make it clear that the participant does not receive the securities.

Similarly, the Bye-Laws only state that the R&T agent “shall dispatch the share certificates.” The fact that the shares are going directly to the client needs to be added.

(Legal/ Operational)

- The registrar procedures address rejected rematerialization requests. However, this subject is missing in other documents. Rejections and how to handle them need to be included in the participant procedures. It seems that either the Bye-Laws or the Business Rules should also make a statement on rematerialization rejections and

where responsibilities lie.

(Legal/ Operational)

- The Bye-Laws state that the certificates must be sent within 30 days (business or calendar) from the date of receipt of the Rematerialization Request Form (RRF). All other documents are silent on this requirement. The 30-day deadline needs to be added to the procedures.

(Operational)

TOPIC: Reconciliation

CITES: *Bye-laws - Section 10.1, Page 45*
Business Rules - Sections 15.1 and 15.2, Pages 29-30
Internal Procedures - Section 2
Participant Procedures - Section 2.1, Page 34

- The Bye-Laws state that the participant daily intimates balances on securities held at the depository. There is no further discussion on where the responsibility for reconciliation lies.

The Business Rules call for the participant to reconcile its internal records to depository records. This coincides with the participant procedures that have the participant initiating an internal reconciliation and a reconciliation with the depository. These statements seem to indicate a reconciliation of the participant's books with its positions at the depository. If this is what is intended, it is good. Statements just need to be more clear.

The depository's internal procedures call for the reconciliation of the DM module (software at the depository) to the DPM module (software at the participant). This is also good as this insures that the overall depository system is in balance.

Both types of reconciliation are needed:

- Reconciliation of participant internal records to depository positions.
- Reconciliation of system modules to each other.

The two types of reconciliations need to be clearly described within the Bye-Laws, Business Rules, and procedures. Responsibility for performing each step of the processes needs to be fixed with either the depository or the participant. This includes what actions are taken and who takes them in the correction of differences. (Procedures should be very detailed in this area.)

(Legal/ Operational)

- The internal procedures call for the end of the day (EOD) to occur after the reconciliation process is successful. This is appropriate for the transmissions of data between the DM and DPM. However, it should not be expected that all differences will be resolved before going on to the next day.

Ultimately, thousands of entries will be processed though the depository daily. To expect that participants and the depository staff would be able to trace all activity (even by security) to identify problems and take corrective action before the final system EOD is not realistic. Under such a scenario, the beginning of the next day could be delayed for several days.

A provision should be made, though, on the timing of notification by the participants to the depository of differences between depository positions and the participant's internal records. Such notifications would relate to real or perceived "errors" in processing on the depository side. If the participant did not notify the depository of these differences within the required time frame, then the depository could not be held liable for losses by the participant or its client arising out of the differences.

A reasonable time frame for the notification process at U.S depositories is 10 business days. This allows sufficient time for larger participants to reconcile their records and identify adjustments that they feel need to be made by the depository.

The timing of the completion of the reconciliation process needs to be better and more realistically defined throughout all of the documents. This is especially important to insure continuation of the depository processing, and also because participants may be suspended from the depository for not reconciling. (Participants could fail the reconciliation requirement very quickly under the current language.)

(Legal/ Operational)

- Bye-laws, business rules, and procedures for the depository and registrar address the exchange of files between the DPM for purposes of reconciliation.

The registrar procedures also state that the registrar reconciles the depository position to the registrar's internal records. Steps need to be added to both the depository's and registrar's procedures on how the resolution of differences found through this process are handled. Similar to the participant reconciliation procedures, a time frame needs to be established for notification by the registrar to the depository of differences due to real or perceived depository "errors" in processing.

(Legal/ Operational)

TOPIC: *Corporate Actions*

CITES: *Bye-laws - Section 9.8, Page 41*
Internal Procedures - Section 3
Participant Procedures - Section 2.2, Page 40
Registrar Procedures - Section 5, Page 19 and Section 7, Page 22

- The Business Rules have only one requirement under “Corporate Benefits.” That is the requirement that the issuer/ R&T agent obtain the details of the tax status of clients from the list of clients provided by the depository. The Bye-Laws only generally describe the provision of client holdings at the depository to the R&T agents, and the distribution through the depository of physical securities resulting from corporate actions.

Because of the extensive procedures on the reconciliation of beneficial owner information, time frames involved, liability in reporting same, and the allotment of shares, it seems that both legal documents lack depth in this area. This section under both the Bye-Laws and Business Rules should be reviewed for further development as these documents must support operational procedures.

(Legal)

- The internal depository procedures call for reporting beneficial owner details every 15 days (business or calendar). It is not stated who is reporting to whom.

The participant procedures require that beneficial ownership details be included in the end-of-day messages to the depository. How this information is used or how the EOD process relates to the 15-day (business or calendar) reporting cycle is not described. This process needs a better description.

Consideration should also be given to including reporting time frame requirements in the appropriate legal document(s).

(Legal/ Operational)

- Neither the Bye-Laws nor the Business Rules provide a clear definition of the depository’s end of day (EOD) or beginning of day (BOD). Consideration should be given to including such definitions in the appropriate legal document(s).

(Legal)

- The registrar procedures provide for “periodically” reporting changes in holding patterns (beneficial owners) by the depository to registrars. If this is the same 15-day reporting cycle noted above, then the procedure should state the time frame.

Consideration should also be given to including reporting time frame requirements in

the appropriate legal document(s).

(Legal/ Operational)

- Under the depository's internal procedures, beneficial owner details are transmitted to the R&T agent as of the record date. There is no mention of the timing of this transmission. Exactly when information is sent should be noted. (This should be the date after the record date where the depository has received advance notice of the record date.)

This timing should also be incorporated into the Bye-Laws or Business Rules (whichever is appropriate).

(Legal/ Operational)

- All documents do not consistently address both intransit and suspense accounts. These two types of accounts need to be clearly defined, processes described, and responsibilities fixed within the Bye-Laws, Business Rules and internal and external procedures.
- The internal depository procedures state that all holdings in suspense accounts should be reduced to zero for securities subject to corporate actions. This is not operationally realistic. Rather, incorporation of these balances into the process should be written into the internal procedures as they are in the participant and registrar procedures.

Also, the suspense and intransit accounts need to be addressed in the Bye-Laws/ Business Rules.

(Legal/ Operational)

- The Bye-Laws state that allotments will be credited to accounts of clients. Internal procedures reflect disbursements through participants. Participant and registrar procedures say that client and beneficial owner accounts respectively will be credited. Internal procedures need to be changed to clearly reflect that client/beneficial owner accounts are credited (not just participant accounts).

(Operational)

- Per the participant procedures, distributions that cannot be traced to a client account are held in suspense in the DPM. Participants are then responsible for researching and resolving suspense items with the registrar and client(s).

Conceptually, this will only work for corporate benefits received from the registrar for clients who have closed their accounts with participants, and the agent has identified the related participant. Provisions need to be made for allotments received where neither the participant nor the client can be matched by the depository system.

The Business Rules and Bye-Laws also need to address this subject.

(Legal/ Operational)

- With the exception of the Business Rules, all documents state that the registrar notifies the depository of allotments resulting from corporate actions. However, there is no indication of when this notification will occur. The timing of this process needs to be established and documented. (In the U.S., it would be on the payment date.)

(Legal/ Operational)

TOPIC: *Account Freezing*

CITES: *Bye-Laws - Section 9.3, page 37*
Business Rules - Section 12.6, page 24
Internal Procedures - Section 1
Participant Procedures - Sections 1.5, 1.6, and 1.7, page 25

- Per the participant procedures, where there is a directive/order from the Depository or other authority, all or part of a client's holdings may be frozen. The Bye-Laws only speak of the *account* being frozen. Provision for freezing part of an account (by security) needs to be made in the Bye-Laws.

(Legal)

- Under the participant procedures, the Participant is required to notify the client of a suspension due to a directive/order from the Depository or other authority. This requirement is not reflected in either of the legal documents. An addition to the Bye-Laws or Business Rules should be considered.

(Legal)

TOPIC: *Account Closure*

CITES: *Bye-laws - Section 9.5, Page 39*
Business Rules - Section 12.7, Page 24
Participant Procedures - Section 1.10, Page 31

- Bye-Laws indicate that the participant ensures all pending transactions and suspended accounts have been adjusted before closing an account. The Participant *then* executes a request for closure of the account. However, the participant procedures call for the Participant to change the account status from “Active” to “To Be Closed.” Once the balances in the account are at zero, the Depository system automatically changes the status to “Closed.” The Bye-Laws need to be rewritten to be consistent with the actual process.

TOPIC: *Account Transfer*

CITES: *Bye-Laws - Section 9.6, page 40*
Business Rules - Section 12.5, page 24
Participant Procedures - Section 1.3, page 13

- While this section is titled “Account Transfer” in the Bye-Laws, it actually deals with the transfer of security positions (all or partially) between participant accounts. Consideration should be given to changing this section title to more clearly reflect the subject matter as it relates to the other documents.

(Legal)

- The participant procedures describe two types of “transfers”: Intra-DP (within same participant) and Inter-DP (between participants). The Bye-Laws, however, only address transfers between Participants. A provision needs to be made in the Bye-Laws for the second type of transfer.

(Legal)

- Per the Bye-Laws, the mode and form of transfer authorizations is to be specified in the Business Rules. The Business Rules do call for a form completed by a “claimant.” This may be intended to address the transfer of balances as the result of a court order (as described in the Bye-Laws). If so, this needs to be clearly stated in the Business Rules. The form of authorization provided by the client for routine transfers of securities also needs to be described in the Business Rules to support the Bye-Laws.

(Legal)

- The Bye-Laws indicate that once debit and credit instructions from the respective participants are matched by the system, transfers are executed between Participant accounts. Participants must then execute the transfer in the client’s account. This last step is not covered in other documents, including the participant procedures. Further, if the Bye-Laws are correct, it is not understood why the Participant on the debit side would wait to execute a transfer from the client’s account. Not only is there a risk factor, but also the Participant account may not have the securities to cover the debit. This process needs to be reviewed and more clearly defined throughout the legal documents and procedures.

(Legal/ Operational)

- The Bye-Laws state that the Depository “may” on court order transfer balances in a Participant’s account. There are two issues here:
 - “May” should be changed to “will,” as the Depository has no choice but to act on a court order.

- The Bye-Laws need to address a court order against a client's account in addition to a Participant's account.
- The Bye-Laws state that the Depository may place securities in suspense where it is unable to give credit to a Participant or client. Suspense balances are then to be reconciled within 15 days (business or calendar) or the securities are to be returned to the R&T agent. The Bye-Laws do not indicate who is responsible for the reconciliation.

The participant procedures describe only securities that cannot be traced to a client account. Such securities are placed in a suspense account per the procedures. The Participant is then responsible for resolving entries in the suspense account. Neither the 15-day reconciliation period noted in the Bye-Laws nor any other time frame for the resolution of suspense items is written into the procedures.

(Legal/ Operational)

- Presumably, there could be two types of suspense items:
 - The Participant is known but the individual client details for posting the shares is not known. These would be credited to a suspense account for the Participant.
 - Neither the Participant nor the Client is known. These would be credited to a suspense account for the Depository.

Responsibility for resolving items in each type of suspense account (Participant and Depository) needs to be clearly described, and the required time frame for resolution of items needs to be established within all documents.

(Legal/ Operational)

TOPIC: *Accounting, Internal Control Reports, and Returns*

CITES: *Bye-Laws - Section 10.2, page 45*
Business Rules - Section 16.1, page 31 and Section 16.2, page 33

- The Business Rules dictate that the Participant maintains records for five years. The participant procedures do not give a time frame for retaining records. The 5-year requirement needs to be added to the procedures.

(Operational)

- There is disparity between the list of records to be retained under the Business Rules and those records indicated in the participant procedures. These two lists need to be brought into sync with each other.

(Legal/ Operational)

- The Business Rules state that Participants are to maintain records related to dematerialization/ rematerialization until the process is complete. These documents should be subject to the same 5-year retention time as the other documents.

(Legal)

- Similar to the Business Rules vs. participant procedures, the list of records to be retained under the R&T agent procedures do not agree with the Business Rules list specifically for R&T agents. This needs to be corrected between the two documents.

(Legal/ Operational)

- The Business Rules state that records may be in either physical or electronic form. Approval from the Depository is required for electronic records, and the *participant* must insure the integrity of the electronic data. However, the participant procedures are silent on these requirements.

The R&T agent procedures do describe records in computer or physical form, but do not indicate the approval from the Depository. The Business Rules do not mention R&T agents as they do the Participants.

All documents need to be brought into agreement on this topic.

(Legal/ Operational)

Appendix C

Sample Procedure Format

Appendix C

-----Sample Procedure Format-----

TITLE: Function being performed

PURPOSE: Brief description of why the procedure is being performed. Include any notes or general comments in this section.

Outline complex procedures under separate categories or break down into smaller procedures.

Person(s) responsible for performing each step

Chronological order of steps to be performed.

Steps should be simple and specific.

Notations of exhibits should be included. An exhibit should be attached whenever a form, report, terminal screen, etc. is mentioned in the procedure.

Appendix C (continued)

-----Sample Procedure-----

TITLE: Wire Transfers

PURPOSE: To effect money transfers by wire both between settlement banks and third parties.

OUTGOING WIRE TRANSFERS

1st Wire Transfer Clerk

1. Receives wire request form. (Exhibit I).
2. Reviews form for completeness and proper authorization.
3. Telephones wire room of appropriate bank.
 - a. Secondary banks for adjust wires to the primary (concentration) bank account.
 - b. Primary bank for adjust wires to the secondary bank accounts.
 - c. Primary bank for wires to third parties.
4. Instructs bank to send wire, providing receiving party data.

NOTE: Repetitive wire setup numbers may be obtained from banks for daily routine wires.

2nd Wire Transfer Clerk

5. Enters wire transfer to log. (Exhibit II)
6. Receives call from bank to confirm outgoing transfer of funds.
7. Confirms from wire log that bank has correct data.
8. Enters confirmation information to log.

INCOMING WIRE TRANSFERS

Wire Transfer Clerk

9. Maintains log in daily folder for further balancing processes and future research.
10. Receives telephone call from bank, advising receipt of a wire credit to one of the depository bank accounts.
11. Enters information to incoming wire log (Exhibit III), including:
 - a. Sending party.
 - b. Amount.
 - c. Bank clerk's name.
 - d. Time received.
12. Maintains log in daily folder for further balancing processes and future research.