

## Introduction

Due to increase in trading volume trading system, and competition amongst the stock exchanges, increase in the number of players and changes in the trading system led to the operational inefficiency of clearing system in the form of delay in transfer, registration, fake certifications, forgery and non-availability of depositories, impeding the healthy growth of the capital market. To overcome the problems regarding the stock markets, the depository system was initiated by stock Holding Corporation of India Limited (SHCIL), in July 1992, when it prepared a concept on paper on "National Clearance and Depository System" in collaboration with price Water House under a programme sponsored by the US Agency for International Development. Thereafter, Government of India promulgated the Depositories Ordinance in September 1995, thus paving the way for setting up of depositories in the country. SEBI notified regulations under the Ordinance in May 1996 in order to provide the regulatory framework for the depositories. The Government of India enacted the Depositories Act 1996 to start depository services in India.

## MEANING OF DEPOSITORY SYSTEM

It is a system whereby the transfer and settlement of scrips take place not through the traditional method of transfer deeds and physical delivery of scrips but through the modern system of effecting transfer of ownership of securities by means of book entry on the ledgers or the depository without the physical of scrips.

The new system, thus eliminates paperwork, facilitates automatic and transparent trading scrips, shortens the settlement period and ultimately contributes to the liquidity of investment in securities. This system is also known as 'scripless trading system'.

### Players in depository system

#### 1. The Depository

The depositories are important intermediaries in the securities market. A depository is an organization which holds securities (like shares, debentures, bonds, government securities, mutual fund units, etc.) of investors in electronic form at the request of the investors a registered Depository Participant. The depository acts as a defacto owner of the securities lodged with it for the limited purpose of transfer of ownership. It functions as a custodian of securities of its clients. The principal function of a depository is to dematerialize and enable their transactions in book-entry form.

**Registration:** Depository has to register with Securities and Exchange Board of India. SEBI grants necessary approval for the same only on the satisfaction of the condition that adequate system and safeguards are available in such companies in order to ensure against manipulation of records and transactions.

At present, there are two such depositories in India, viz., National Securities Depository Limited (NSDL) and Central Depository Securities (India) Limited (CDSL) are registered with SEBI.

**NSDL** is the first and largest depository in India established in August 1996, which is sponsored by the Unit Trust of India, National Stock Exchange (NSE), State Bank of India, HDFC Bank and Citi Bank; and managed by Board of Directors as a public limited company. It commenced its operations during November 1996.

In the depository system, securities are held in depository accounts, which is more or less similar to holding funds in bank accounts. Transfer of ownership of securities is done through simple account transfers.

**CDSL** was the second depository company promoted by BSE Limited in association with the bank of India, bank of Baroda, state bank of India, and HDFC bank for dealing in the securities in the electronic form.

**2. The Depository Participants (DP)** is an agent of the depository. He functions as a bridge between the depository and the beneficial Owner. He maintains the ownership record of every beneficiary Owner in book entry form. Both the depository and beneficiary owner have to be registered under SEBI

**3. Beneficial Owner**

Beneficial owner refers to a person whose name is recorded as such with a depository. The investor – individual, corporate or institution – invests on the securities issuer. A beneficial owner is the real owner of the securities who lodged his securities with the depository in the form of book entry. She/he has all the rights and liabilities associated with securities.

**4. The Issuer**

The Issuer is the company which issues the security. It maintains a register for recording the name of the registered owners of securities, the depositories. These issuers send a list of share holders, who opt for the depository system, to the depositories.

**FACILITIES OFFRED BY THE DEPOSITORY SYSTEM**

- Dematerialization
- Rematerialization
- Electronic settlement of trade
- Nomination facility
- Electronic credit of securities allotted in public rights and bonus issue
- Pledging or hypothecation of dematerilazed securities
- Freezing of Demat account
- Freeze facility on SPEED-e
- Stock lending/borrowing facility

**MERITS/BENEFITS OF DEPOSITORY SYSTEM**

**1. Merits/Benefits to the Investors**

The following are the merits of Depository system:

- No danger of loss of share certificates since the shares are credited to investor's Demat account
- No loss of certificates in transit and saves substantial expenses involved in obtaining duplicate certificates.
- Eliminates the risk of theft, forgery and mutilation.
- Trading in Demat segment completely eliminates the risk of bad deliveries.
- No need to affix share transfer stamp as it is a paperless trading.
- Avoids the cost of posting/courier charges the need for further follow up with broker.
- Eliminates the problem of odd lost shares. Stock can sold in any number.
- Increases liquidity of securities due to immediate transfer and registration. Reduction in brokerage for trading in dematerialized shares.
- Receives bonuses and rights into the depository account as a direct credit thus eliminating risk of loss in transit.
- After the settlement, pay-in and pay –out are on the same day for paperless trading which means buyer get securities and seller get cash immediately.
- Scripless trading help allocate corporate benefits faster.

- Facilitates pledging and hypothecation of securities and raises funds, if needed.
- Lower margin securities pledged with banks normally 25 percent.
- RBI has increased the limit of loans availed against dematerialized securities as collateral to Rs.20 Lakhs per borrower as against Rs.10 lakh per borrower in case loans against physical securities.
- Lower interest charge for loans taken against Demat share as compared to interest for loan against physical shares.
- Reduction in brokerage by several brokers for trading in dematerialized securities.
- Facility to freeze Demat account , if needed
- Periodic status reports to investors on holding and transactions, leading to better controls.

## **2. Merits/Benefits to the Company**

- The depository system provides up-to-date knowledge of shareholder's names and addresses to the company.
- There is savings in costs of new issues from reduction in printing and distribution cost.
- It may also lead to increased efficiency of registrar and transfer agent functions and better facilities for communication with shareholders, conveying benefits of corporate actions and information notices.
- The system enables a company to attract international investors without having to incur the expenditure of issuance in overseas markets.

### **DEMATERIALIZATION (DEMAT) OF SHARES**

Dematerialisation is the process of converting physical shares into electronic format. An investor who wants to dematerialize his/her shares needs to open a Demat account with Depository Participant.

#### **Step in Dematerialisation of share Certificates**

1. The client (registered owner) will submit a request to the DP in the Dematerialisation Request Form for dematerialization, along with the certificates of securities to be dematerialized. Before submission, the client has to deface the certificates by writing " Surrendered for Dematerialization ."
2. The DP will verify that form is duly filled in and the number of certificates, number of securities and the security type (equity, debenture, etc.,) are as given in the DRF. If the form and security count is in order, the DP will issue an acknowledgement slip signed and stamped to the client.
3. The DP will scrutinize the form and the certificates. This scrutiny involves verification of client's signature on the dematerialization request with the specimen signature (the signature on the account opening form). If the signature differs, the DP should ensure the identity of the client, compare the names on DRF and certificates with the client account, paid-up status, ISIN (International Securities Identification Number), lock-in status and distinctive number.

4. In case the securities are in order, the details of the request as mentioned in the form are entered in the DPM (software provided by Depository to the DP) and a Dematerialisation Request Number (DRN) will be generated by the system.
5. The DRN so generated is entered in the space provided for the purpose in the dematerialization request form.
6. A Person other than the person who entered the data is expected to verify details recorded for the DRN. The request is then released by the DP which is forwarded electronically to DM (DM-Depository Module, Depository's software system) by DPM.
7. The DM forwards the request to the Issuer/R&T agent electronically.
8. The DP will fill relevant portion, viz., the authorization portion of the Demat request form.
9. The DP will punch the certificates on the company name so that it does not destroy any material information on the certificate.
10. The DP will then dispatch the certificates along with the request form and a covering letter to the Issuer/R&T agent.
11. The Issuer/R&T agent confirms acceptance of the request for dematerialization in his system DPM (SHR) and the same will be forwarded to the DM, if the request is found in the order.
12. The DM will electronically authorize the creation of appropriate credit balance in the client's account.
13. The DPM will credit the client's account automatically.
14. The DP must inform the client of the changes in the client's account following the confirmation of the request.

### **REMATERIALISATION (REMAT) OF SHARES**

#### **Steps in Dematerialisation of share Certificates**

1. An Investor/Beneficial Owner (BO) who wishes to rematerialize balance in his/her Demat account has to fill up a Remat Request Form (RRF). If the investor has multiple ISINs in his/her Demat account wishes to rematerialize all balances, then a separate Rematerialisation Request Form (RRF) should be submitted for each ISIN.
2. The RRF should be signed by all the account holders/Power of Attorney (POA) (if any).
3. Completely filled RRF should be submitted to his/her DP.
4. The BO may specify on the RRF whether all the quantity of an ISIN to be included in only one certificate (Jumbo Lot) or number of shares per certificate.
5. The DP will verify the details on the RRF form and enter the same in the Depository system.
6. The system generated Remat Request Number (RRN) is written on the RRF and it is sent to the Issuer/RTA.
7. The issuer/RTA verify the remat request and confirm the same to depository. Depository will debit securities in the BO's DeMar account to the extent of quantity rematerialised
8. Issuer/RTA issues securities in physical form to the BO

### **The Depository Act 1996**

Chapter II CERTIFICATE OF COMMENCEMENT OF BUSINESS

Chapter III RIGHTS AND OBLIGATIONS OF DEPOSITORIES PARTICIPANTS, ISSUERS AND BENEFICIAL OWNER

- Agreement between depository and participant (sec 4)

- Services of depository (sec 5)
- Surrender of certificate of security (sec 6)
- Registration of transfer of securities with depository (sec 7)
- Option to receive security certificate or hold securities with depository (sec 8)
- Securities in depositories to be in fungible form (sec 9)
- Right of depositories and beneficial owner (sec 10)
- Register of beneficial owner (Sec11)
- Pledge or hypothecation of securities held in a depository (sec 12)
- Furnishing of information and records by depository and issuer (sec 13)
- Option to opt out in respect of any security (sec 14)
- Act 18 of 1891 to apply to depositories (sec 15)
- Depositories to indemnify loss in certain cases (sec 16)
- Right and obligation of depositories (sec 17)

#### Chapter IV ENQUIRY AND INSPECTION

- Power of board to call for information and enquiry (sec 18)
- Penalty for failure to furnish information, return etc (sec 19A)
- Penalty for failure to enter into an agreement (sec 19B)
- Penalty for failure to redress investors grievances (sec 19C)
- Penalty for delay in dematerialisation or issue of certificate of securities (sec 19D)
- Penalty for failure to reconcile records(sec 19E)
- Penalty for failure to comply with directions issued by board under section 19 of the act (sec 19 F)
- Penalty for contravention where no separate penalty has been provided (sec 19 G)
- Power to adjudicate (Sec 19H)
- Factors to be taken into account by adjudicating officer(sec 19 I)
- Crediting sums realized by way of penalties to consolidated fund of India (sec 19 J)

#### Chapter V PENALTY

- Offences by adjudicating officer (sec 20)
- Offence By companies (sec 21)

#### Chapter VI MISCELLANEOUS

- Appeals( sec 23)
- Appeal to securities appellate tribunal (sec 23 A)
- Procedure and power of securities appellate tribunal (sec 23B)
- Appeal to supreme court (sec 23F)
- Power of central government to make rules (sec 24)
- Power of board to make regulation (sec 25)
- Power of depositories to make by law (sec 26)
- Removal of difficulties(sec 29)