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DEPOSITORY SYSTEM IN INDIAN CAPITAL MARKET: AN OVERVIEW

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ABSTRACT
In the recent times, Indian Capital market have witnessed various reforms and one of the important reforms which helps the capital market in their rapid growth which was introduced in 1996. This system helps the investors to invest in the capital market electronically which will eliminate the problems like bad delivery of shares and share certificates, transferability of shares, easy investment in the capital market, reduction of the cost of trading and it provides round the clock services to the investors through depository participants. The aim of this research paper is to understand the concept of depository system and to identify the contents of depository system in India because trading is being done in the stock market electronically and still a very limited literature is available. In this research paper, an effort has been made to discuss the depository system. This study is based upon the secondary sources.

KEYWORDS
depository system, depository participants, investors, stock market.

INTRODUCTION
The earlier settlement system on Indian stock exchanges was very inefficient as it was unable to take care of the transfer of securities in a quick/speedy manner. Since, the securities were in the form of physical certificates; their quick movement was again difficult. This led to settlement delays, theft, forgery, mutilation and bad deliveries and also to added costs. To wipeout these problems, the Depositories Act 1996 was passed. It was formed with the purpose of ensuring free transferability of securities with speed, accuracy & security. It has been able to do so by:
- Making securities of public limited companies freely transferable, subject to certain exceptions;
- Dematerializing the securities in the depository mode; and
- Providing for maintenance of ownership records in a book entry form.

For performing the above tasks, two depositories viz, NSDL & CDSL have come up. National Securities Depository Limited (NSDL) does the above tasks for the trades done on NSE. It is a joint venture of: · IDBI (Industrial Development Bank of India Limited); · NSE (National Stock Exchange); and · UTI (Unit Trust of India). NSDL is the first depository set up in India. It was registered by SEBI on June 7, 1996. The second depository is the Central Depository Services Limited (CDSL) which has been promoted by Bombay Stock Exchange and Bank of India. It was formed in February 1999. Both depositories have a network of Depository Participants (DPs) which are further electronically connected to their clients. So, DPs act as a link between the depositories and the clients. The Depository system to some extent works like the banking system. There is a central bank and the rules and regulations related to the working of all the commercial, foreign, co-operative and other types of banks are framed by the central bank. In order to do the daily transactions, the investors open an account called Demat account with the associate banks, and not with the central one. Like an investor can have a bank account with more than one bank, similarly one can have more than one Demat Account.[1]

DEVELOPMENTS OF SECURITIES DEPOSITORIES (SDs)
National Securities Depositories existed in Europe before World War II with the earliest being in Germany during Bismarck's time. In USA, the securities industry was enjoying the prosperity of an economic resurgence during 1960s. The average trade volume on the New York Stock Exchange (NYSE) grew from 3 million shares per day in 1960 to 12 million in 1970. On April 1, 1968 trading on the NYSE broke the previous record of October 29, 1929. Before the year ended, the record was broken in an additional 24 times and the expression 'paperwork crisis' had entered the nation's agenda. To cope with the situation, a number of temporary measures were taken like closing the market on Wednesdays, shortened trading days, and extending settlement from four to five days. In mid-1961, the NYSE together with Bankers Trust Company, The Chase Manhattan Bank and First National City Bank of New York initiated the 'Pilot Operation for Central Handling of Securities' with modest 15 securities and 31 firms. The deliveries were made between members via book-entry and without the physical movement of certificates. Movement towards immobilizing of shares in a vault begins with the millions of certificates held in 'street name' by NYSE member firms. Transfer of ownership among members could then be accomplished with accounting entries - book entry- eliminating physical certificate movement and the mushrooming paperwork needed to transfer them that is Central Certificate Service (CCS). This was activated on a limited basis in June 1968 and by the end of 1969, there were 464 million shares deposited with CCS. In search of a long-term solution to the problem, an organisation named Banking and Securities Industry Committee (BASIC) was constituted to design a model to take care of future developments in the industry. After deliberations, a two-stage evolution of the CCS into an expanded depository system was conceived. In the first stage, CCS was to move from a division of the Stock Clearing Corporation and become a wholly owned subsidiary of the Exchange (CCS Inc.) with representatives of the American Stock Exchange (Amex), National Association of Securities Dealers (NASD), and NYSE members on its board. The newly formed subsidiary would then seek a trust company charter under New York State Banking Law and Federal Reserve membership. In the second step, its users would share ownership of the depository. In this direction, CCS began the preliminary steps in March 1972, starting a yearlong process, which CCS Inc. would complete with the submission of a formal charter application on December 28, 1972. Later, the transfer of operations from CCS Inc. to Depository Trust Company was completed on May 11, 1973. The Depository Trust Company (DTC) superseded CCS in 1973. DTC was independent from the exchange and therefore, facilitated the participation of banks and institutions in DTC activities along with securities firms. DTC and National Securities Clearing Corporation (NSCC) have been merged to form Depository Trust and Clearing Corporation (DTCC) in 2000.
The japan Securities Depository center was founded in 1984 to immobilize securities transfer in Japan. On May 5, 1989, Hong Kong Securities Clearing Company Ltd. was established and many other countries in the Asian Pacific Rim and other countries slowly started setting up Central Securities Depositories (CDS) either to immobilise or to dematerialise securities.
In 1993, Deutscher Kassenverein (DKV), the German Depository, became DTC's first international participant. Recognising the need to provide a single American focus for international clearance and settlement, DTC and NSCC formed, in 1996, the International Depository & Clearing LLC (IDC), a jointly owned subsidiary to concentrate on cross-border settlement issues from a research, marketing and development standpoint.

In UK, the Bank of England, at the request of the London Stock Exchange, established and shared a Task Force on securities settlement under the chairmanship of Mr. Pen Kent, a Director of the Bank of England in March 1993. The Task Force recommended the introduction of rolling settlement and a new settlement service to be called CREST. The CRESTCo Limited was inaugurated on July 15, 1996.

NEED FOR DEPOSITORY IN INDIA
Clearing and settlement in equity shares in India, till recently, used to be only on "accounting period basis". Accounting period clearance and settlement increases both market and credit risk and also affects, smooth functioning of stock exchanges. Therefore, there was an urgent need to shift to rolling settlement. Nevertheless, Indian markets had paper based clearance system. Dematerialisation was needed if the industry had to move from the present accounting period settlement cycle to trade-date-plus- 5(T + 5) or even to trade-date-plus-3(T + 3) or to a trade-date-plus-zero (T + 0) cycle. If our financial markets are to continue expanding and globalising, there is a need keep identifying and eliminating those components of the clearance and settlement processes that are paper-intensive, error-prone and time-consuming. Refining and streamlining these sub-processes will help make our financial markets more efficient.
Historically retail and small investors were the dominant players in the Indian capital market till early part of 1990s. Financial institutions and insurance companies were not very active in the secondary market although they used to take a large chunk of equity in the primary market by participating through project finance and other routes. Unit Trust of India (UTI) was alone big institutional player in the equity market, primary as well as secondary, till late 1980s. With the advent of public sector banks and institutions sponsored mutual funds and offshore funds, the presence and influence of the institutions has grown in the market place. In the early nineties, Indian capital market further opened up to allow the entry of private sector mutual funds and foreign institutional investors (FIIs),[2] with the frequent growth in the activities and operations of capital market, the involvement of the investors increased and in the era of paying more emphasis upon customer services the mechanism of capital market felt the need of providing round the clock secured investment services which caused introduction of the depository system.

REVIEW OF LITERATURE
Aggarwal and Dixit (1996)[3] communicated their views about the legal framework for depository system in India in a critical way. They differentiated the scrip less and scrip trading in the Indian capital market. **Raja and Marathe (2000)[4]** have studied the cost of equity shares transaction in physical mode and d-mat mode. They found that the average cost for the FII's in India is lower than stock market of Singapore, China, and Thailand, due to dematerialization the transaction cost of FII's have come down by 60 % and for mutual funds by 75% which shows that dematerialization in the Indian capital market, not only brings the technological revolution but it helps in reducing the cost and increases the efficiency. **Goswami (2003)[5]** studied the stock trading in India through internet and she concluded that the net can help lower the cost of transactions, improve customer data, increase cost-selling opportunities, and integrate new financial products. **Schmiedel et. al. (2006)[6]** analysed the existence and extent of economies of scale in depository and settlement systems in his study. The study indicates the existence of significant economies of scale but degree of such economies differs by settlement, institution and region. **Karan (2008)[7]** highlighted that dematerialization has certainly brought about lot of improvement in the investment habits in our Country, it is bane for the companies and has created havoc in maintaining the members register and in conducting the members meeting. **Singh and Goyal (2011)[8]** they found that the education of the investors plays an important role in decision making where the difference in the opinions of the investors is found significant in most of the cases followed by other factors. **Garg and Katiyar (2013)[9]** studied customer's perception towards on line share trading in Kanpur and finds that online investing has benefits to offer investors as well as brokers. **Dhnada et.al. (2015)[10]** describes that dematerialization of shares is an important milestone in the annals of Indian Capital Markets. Understanding and measuring the impact of it on various segments is necessary since it stirred the microstructure of Indian capital markets in general and stock exchanges in particular.
In Indian Capital market, dematerialization has been introduced in the year 1996 but still limited scholarly work has been done on this research problem and mainly of the work is related to the comparison of two depository giants i.e. NSDL and CDSL whereas aware the people about the basic concept of the depository system is absent. So in this study, an attempt has been made to describe the basic concept of the depositor system and the key players of the depository system as well.

OBJECTIVES OF THE STUDY
1. To understand the concept of depository system
2. To identify the contents of depository system in India

RATIONALE OF THE STUDY
Capital Market is considered as the barometer of the economic growth of the economy particularly in the era when technology has been changing rapidly. So that in the consideration of the technology, it has been introduced in the Indian capital market and as a result depository system has been introduced. The need was felt to conduct the study about depository system so that there is understanding and the identification of the contents of the depository system in India.

DEPOSITORY
A Depository is an organization like a Central Bank where the securities of a shareholder are held in the electronic form at the request of the shareholder through the medium of a Depository Participant. To utilize the services offered by a Depository, the investor has to open an account with the Depository through a Depository Participant.
According to Section 2(e) of the Depositories Act, 1996. "Depository means a company formed and registered under the Companies Act, 2013 and which has been granted a certificate of registration under Section 12(1A) of the SEBI Act, 1992".
There are two Depositories functioning in India, namely the National Securities Depository Limited (NSDL) and the Central Depository Services (India) Limited (CDSL). Under the provisions of the Depositories Act, these Depositories provide various services to investors and other Participants in the capital market, such as, clearing members, stock exchanges, investment institutions, banks and issuing corporates. These include basic facilities like account opening, dematerialization, dematerialization, settlement of trades and advanced facilities like pledging, distribution of non-cash corporate actions, distribution of securities to allottees in case of public issues, etc.
All the securities held by a depository shall be dematerialized and shall be in a fungible form. To utilize the services offered by a depository, the investor has to open an account with the depository through a participant, similar to the opening of an account with any of the bank branches to utilize services of that bank. Registration of the depository is required under SEBI (Depositories and Participants) Regulations, 1996 and is a precondition to the functioning of the depository. Depository and depository participant both are regulated by SEBI.

CONTENTS OF THE DEPOSITORY SYSTEM
There are essentially four players in the depository system viz. a) the depository b) the depository participant c) the beneficial owner and d) the issuer.

A) THE DEPOSITORY

The depository is a firm wherein the securities of investors are held in electronic form. It functions as a custodian of securities of its units. The name of the depository appears in the records of the issuer as the registered owner of the securities, the rights of the depository are concerned only with the transfer of scrip and there are no other rights. In India, there are two depositories, NSDL and CDSL.

B) THE PARTICIPANT

A participant is an agent of the depository. He functions as a bridge between the depository and the beneficial owners. He maintains the ownership records of every beneficial owner in book entry form. The relationship between the depository and the participant is governed by their bye laws. The relationship between the DPs and the depository is governed by an agreement made between the two under the Depositories Act. In a strictly legal sense, a DP is an entity who is registered as such with SEBI under the sub section 1A of Section 12 of the SEBI Act. As per the provisions of this Act, a DP can offer depository-related services only after obtaining a certificate of registration from SEBI.

C) THE BENEFICIAL OWNER

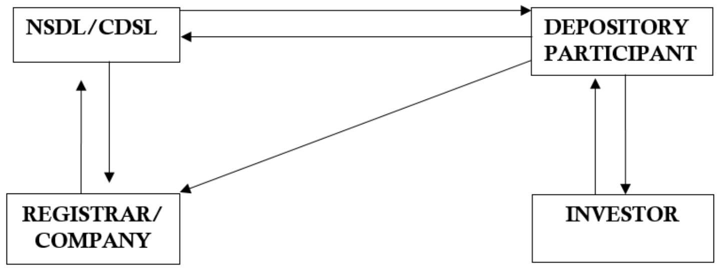
A beneficial owner is the real owner of the security lodged with the depository for custody which is of course, in the form of book entry and who would have his name recorded in the register of beneficial owners maintained by the depository. He will have all the rights and liabilities associated with the securities.

D) THE ISSUER

The issuer is the company which issues the security. It maintains a register for recording the names of the registered owners of securities. When the shareholders opt for the depository system, the issuing company sends a list of such shareholders to the depositories. The constituents of depository process are depicted as under:

DEMATERIALIZATION PROCESS

FIG. 1



- Investor surrenders certificates for dematerialization to DP
- DP intimates NSDL of the request through the system
- DP submits the certificates to the registrar
- Registrar confirms the dematerialization request from NSDL/CDSL
- After dematerializing, registrar updates accounts and informs NSDL for the completion of dematerialization
- NSDL updates its accounts and informs DP
- DP updates its accounts and informs investor.[11]

BENEFITS OF DEPOSITORY SYSTEM

In the depository system, the ownership and transfer of securities takes place by means of electronic book entries. At the outset, this system rids the capital market of the dangers related to handling of paper. The system provides numerous direct and indirect benefits, like:

1. **Elimination of bad deliveries** - In the depository environment, once holdings of an investor are dematerialised, the question of bad delivery does not arise i.e. they cannot be held "under objection". In the physical environment, buyer of shares was required to take the risk of transfer and face uncertainty of the quality of assets purchased. In a depository environment good money certainly begets good quality of assets.
2. **Elimination of all risks associated with physical certificates** - Dealing in physical securities have associated security risks of theft of stocks, mutilation of certificates, loss of certificates during movements through and from the registrars, thus exposing the investor to the cost of obtaining duplicate certificates and advertisements, etc. This problem does not arise in the depository environment.
3. **Immediate transfer and registration of securities** - In the depository environment, once the securities are credited to the investors account on pay out, he becomes the legal owner of the securities. There is no further need to send it to the company's registrar for registration. Having purchased securities in the physical environment, the investor has to send it to the company's registrar so that the change of ownership can be registered. This process usually takes around three to four months and is rarely completed within the statutory framework of two months thus exposing the investor to opportunity cost of delay in transfer and to risk of loss in transit. To overcome this, the normally accepted practice is to hold the securities in street names i.e. not to register the change of ownership. However, if the investors miss a book closure the securities are not good for delivery and the investor would also stand to lose his corporate entitlements.
4. **Faster disbursement of non-cash corporate benefits like rights, bonus, etc.** – Depository system provides for direct credit of non-cash corporate entitlements to an investors account, thereby ensuring faster disbursement and avoiding risk of loss of certificates in transit.
5. **Reduction in brokerage by many brokers for trading in dematerialized securities** - Brokers provide this benefit to investors as dealing in dematerialized securities reduces their back office cost of handling paper and also eliminates the risk of being the introducing broker. Reduction in handling of huge volumes of paper and periodic status reports to investors on their holdings and transactions, leading to better controls.
6. **Elimination of problems related to change of address of investor, transmission, etc.** - In case of change of address or transmission of demat shares, investors are saved from undergoing the entire change procedure with each company or registrar. Investors have to only inform their DP with all relevant documents and the required changes are effected in the database of all the companies, where the investor is a registered holder of securities.
7. **Elimination of problems related to selling securities on behalf of a minor** - A natural guardian is not required to take court approval for selling demat securities on behalf of a minor.

KEY FEATURES OF THE DEPOSITORY SYSTEM IN INDIA

1. Multi-Depository System: The depository model adopted in India provides for a competitive multi-depository system. There can be various entities providing depository services. A depository should be a company formed under the Company Act, 2013 and should have been granted a certificate of registration under the Securities and Exchange Board of India Act, 1992. Presently, there are two depositories registered with SEBI, namely:

- National Securities Depository Limited (NSDL), and
- Central Depository Service Limited (CDSL)

2. Depository Services through Depository Participants: The depositories can provide their services to investors through their agents called depository participants. These agents are appointed subject to the conditions prescribed under Securities and Exchange Board of India (Depositories and Participants) Regulations, 1996 and other applicable conditions.

3. Dematerialisation: The model adopted in India provides for dematerialisation of securities. This is a significant step in the direction of achieving a completely paper-free securities market. Dematerialization is a process by which physical certificates of an investor are converted into electronic form and credited to the account of the depository participant.

4. Fungibility: The securities held in dematerialized form do not bear any notable feature like distinctive number, folio number or certificate number. Once shares get dematerialized, they lose their identity in terms of share certificate, distinctive numbers and folio numbers. Thus all securities in the same class are identical and interchangeable. For example, all equity shares in the class of fully paid up shares are interchangeable.

5. Registered Owner/ Beneficial Owner: In the depository system, the ownership of securities dematerialized is bifurcated between Registered Owner and Beneficial Owner. According to the Depositories Act, 1996 'Registered Owner' means a depository whose name is entered as such in the register of the issuer. A 'Beneficial Owner' means a person whose name is recorded as such with the depository. Though the securities are registered in the name of the depository actually holding them, the rights, benefits and liabilities in respect of the securities held by the depository remain with the beneficial owner. For the securities dematerialized, NSDL/CDSL is the Registered Owner in the books of the issuer; but ownership rights and liabilities rest with Beneficial Owner. All the rights, duties and liabilities underlying the security are on the beneficial owner of the security.

6. Free Transferability of shares: Transfer of shares held in dematerialized form takes place freely through electronic book-entry system.[12]

CONCLUSION AND SUGGESTIONS

In the consideration of the advantages of the depository system, it is concluded that the introduction of the depository system gives a new life to the Indian Capital Market. The introduction of the depository system can be considered one of the greatest or biggest reforms of all times in the Indian capital market. This reform helps Indian Capital to grow in the faster rate and to work efficiently. It eliminates the problem like bad delivery of certificate and shares, free transferability of shares, with the help of the depository system any one can trade in the stock market easily. One of the notable things of this system is that investors can invest their savings in the capital market through depository participants and this whole system is run by the centralized system which is controlled by the depository i.e. NSDL and CDSL so that the savings of the investors are protected with the depositories.

The depository system has been introduced in the Indian Capital market in the year 1996 and limited number of studies have been carried out consequently, awareness about depository system can be expected very low keeping in view, the conclusions drawn from the study, the following measures are suggested:

There is a need on the part of depository participants to be more open and more frequent to interact with people and convince them to avail the services of depository system as per their occupational expectations. There is need to discuss the concepts of depository system and their role and as well as uses with the researchers by the executives of depository participants and merchant bankers.

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