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DEPOSITORY SYSTEM IN INDIA: AN OVERVIEW

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ABSTRACT

In India the need for setting up a depository was realized after the large scale of irregularities in securities transactions of 1992 exposed the limitations of the prevailing system. Therefore, the need for depository system was realised for the growth of primary market, which would reduce the time between the allotment of shares and transfer of entitlements arising out of each allotment. Depositories gave a new dimension and a new scope for conducting transactions in capital market- primary as well as secondary, in a more efficient and effective manner, in a paperless form on an electronic book entry basis. It provided electronic solution to the aforementioned problems of bad deliveries and long settlement cycle

KEYWORDS

depository system, depositories, electronic system.

INTRODUCTION

In India the need for setting up a depository was realized after the large scale of irregularities in securities transactions of 1992 exposed the limitations of the prevailing system. Therefore, the need for depository system was realised for the growth of primary market, which would reduce the time between the allotment of shares and transfer of entitlements arising out of each allotment. Depositories gave a new dimension and a new scope for conducting transactions in capital market- primary as well as secondary, in a more efficient and effective manner, in a paperless form on an electronic book entry basis. It provided electronic solution to the aforementioned problems of bad deliveries and long settlement cycle. 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.

A Depository is an organization where the securities of share holders are held in the electronic format the request of the share holder through the medium of a depository participant. A depository holds the securities of investors in electronic form just like a bank holds cash of its customers. As in a Bank, investors can deposit/withdraw and transfer securities. This system is also known as Scrip Less Trading system. A depository is a centralized warehouse of securities (like shares, debentures, bonds, government securities, mutual fund units etc.) in dematerialized form. The eligible securities are warehoused in the depository in computerized form to enable securities trading and other transactions in electronic mode. Thus, the recordings are done in the form of a book-entry and securities are not issued or exchanged in physical form. The depository system offers an efficient transfer mechanism by interfacing with the stock market related clearing operations.

Depository means a company formed and registered under Companies Act, 1996 and which has been granted a certificate of registration under section 12(1A) of the Securities and Exchange Board of India Act, 1992". It is a system whereby the transfer and settlement of scrip's take place not through the traditional method of transfer deeds and physical delivery of scrip's through the modern system of effective transfer of ownership of securities by means of book entry on the ledgers of the depository without physical movement of scrip's.

DEPOSITORIES ACT, 1996

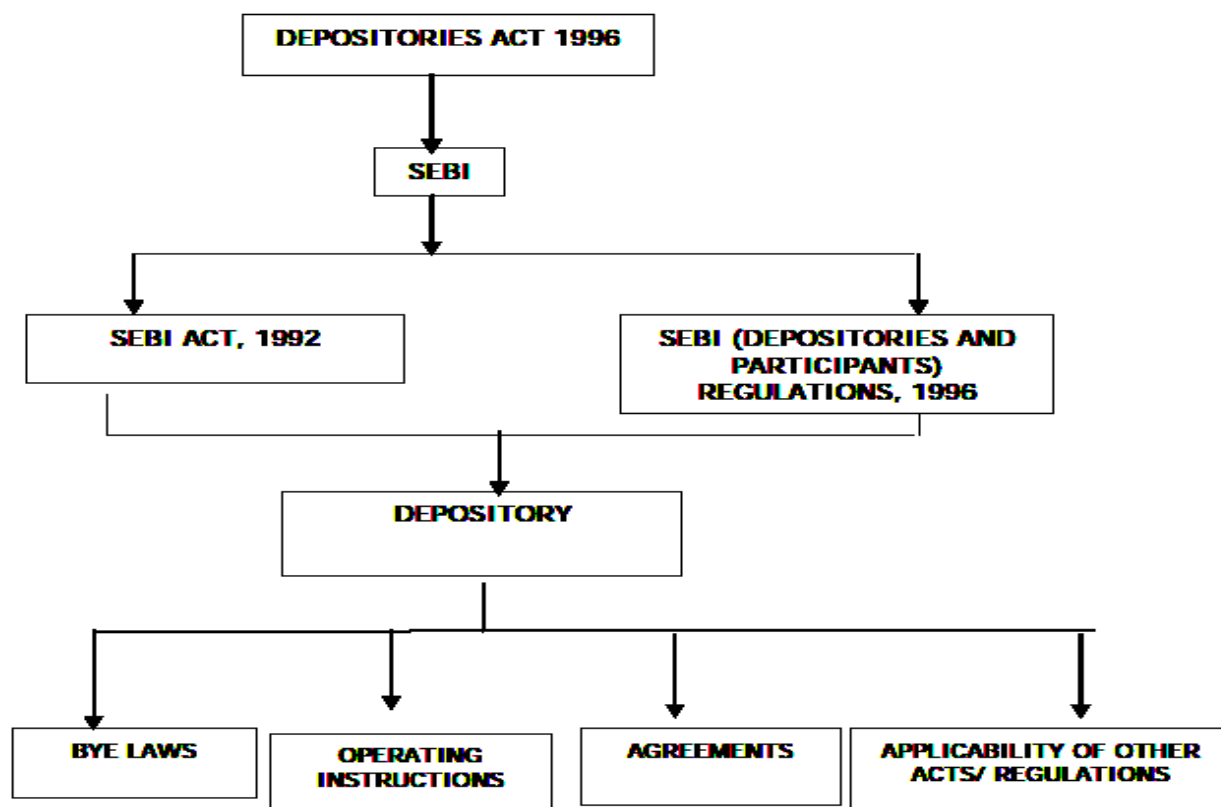
The Depositories Act was passed by the parliament in the August, 1996. Which lays down the legislative frame work for facilitating the dematerialisation and book entry transfer of securities in a depository. The Act provides that a depository, which is required to be a company under the Companies Act, 1956, and depository participant i.e. agents of the depository need to be registered with Stock Exchange Board of India (SEBI). The Depositories Act, 1996 provides for the establishment of depositories in securities with the objective of ensuring free transferability of securities with speed, accuracy and security by:

- (a) making securities freely transferable subject to certain exceptions;
- (b) dematerialization of the securities in the depository mode; and
- (c) providing for maintenance of ownership records in a book entry form.

The Act has made the securities of all companies freely transferable in the depository mode, restricting the company's right to use discretion in effecting the transfer of securities. The other procedural and the transfer deed requirements stated in the Companies Act have also been dispensed with.

CHART 1

The schematic diagram of legal framework of regulation of depositories is shown below:



FEATURES OF A DEPOSITORY SYSTEM

1. In the depository system, securities are held in depository accounts, which is more or less similar to holding funds in bank accounts.
2. Transfer of ownership of securities is done through simple account transfers.
3. This method does away with all the risks and hassles normally associated with paperwork.
4. Consequently, the cost of transacting in a depository environment is considerably lower as compared to transacting in certificates.

CONSTITUENTS OF DEPOSITORY SYSTEM

The depository system comprises of:

1. Depository
2. Depository Participant (DP)
3. Security Issuers, Registrars and Share Transfer Agents
4. Stock Exchanges and Stock Brokers
5. Clearing Corporation/ Clearing House and Clearing Members
6. Banking system
7. Investors

1. DEPOSITORY

It is an organization where the securities are held in electronic form and carries out the securities transaction by book entry. Depository functions like a securities bank, where the dematerialized physical securities are traded and held in custody. This facilitates faster risk free and low cost settlement. In India a depository has to be promoted as a corporate body under Companies Act, 1956. It is also to be registered as a depository with SEBI. It starts operations after obtaining a certificate of commencement of business from SEBI. It has to develop automatic data processing systems to protect against unauthorized access. A network to link up with depository participants, issuers and issuer's agent has to be created. Depository, operating in India, shall have a net worth of rupees one hundred crore and instruments for which depository mode is open need not be a security as defined in the Securities Contract (Regulations) Act 1956. The depository, holding securities, shall maintain ownership records in the name of each participant. Despite the fact that legal ownership is with depository, it does not have any voting right against the securities held by it. Rights are intact with investors.

Depository is much like a bank and performs many activities that are similar to a bank depository:

- a) Enables surrender and withdrawal of securities to and from the depository through the process of 'demat' and 'remat',
- b) Maintains investors' holdings in electronic form,
- c) Effects settlement of securities traded in depository mode on the stock exchanges,
- d) Carries out settlement of trades not done on the stock exchanges (off market trades).

There are two depositories in India at present i.e.

A. NSDL: National Securities Depository limited

National Securities Depository Limited is the first depository to be set-up in India. It was incorporated on December 12, 1995. NSDL is a public limited company managed by a professional Board of Directors. The Industrial Development Bank of India (IDBI) - the largest development bank in India, Unit Trust of India (UTI) - the largest Indian mutual fund and the National Stock Exchange (NSE) - the largest stock exchange in India, sponsored the setting up of NSDL and subscribed to the initial capital. NSDL commenced operations on November 8, 1996. The aim is to provide facilities for holding and handling securities in electronic form.

TABLE 1

As on Jan 31 2015	
Number of certificates eliminated (Approx.)	1807
Number of companies in which more than 75% shares are dematted	5571
Average number of accounts opened per day since November 1996	3577
Presence of demat account holders in the country	89% of all pincodes in the country

Source: Website of NSDL

B. CDSL: Central Depository Services (India) Limited

CDSL was set up with the objective of providing convenient, dependable and secure depository services at affordable cost to all market participants. CDSL received the certificate of commencement of business from SEBI in February 1999. All leading stock exchanges like the National Stock Exchange, Calcutta Stock Exchange, Delhi Stock Exchange, The Stock Exchange, Ahmadabad, etc have established connectivity with CDSL.

TABLE 2: FACTS AND FIGURES AS ON 31ST JANUARY 2015

	NSDL	CDSL
Year operation started	1996	1999
Promoters	IDBI, UTI and NSE	BSE, SBI, BOB, HDFC, Standard chartered Bank, Union Bank etc.
Number of Accounts	1,36,97,744	9433059
Value of demat securities (In Crore)	117,01,061	145,62,750
Number of companies	10,843	12,801
DP service centres	15,936	11,422

Source: website of CDSL and NSDL

2. DEPOSITORY PARTICIPANTS (DP)

DP is an agent of the depository and functions as the interacting medium between the depository and the investor. A DP is investors' representative in the depository system and as per the SEBI guidelines, financial institutions/banks/custodians/stock brokers etc. can become DPs provided they meet the necessary requirements prescribed by SEBI. DP is also an agent of depository which functions as a link between the depository and the beneficial owner of the securities. DP has to get itself registered as such under the SEBI Act. The relationship between the depository and the DP will be of a principal and agent and their relation will be governed by the bye-laws of the depository and the agreement between them. Application for registration as DP is to be submitted to a depository with which it wants to be associated. The registration granted is valid for five years and can be renewed. Eligibility criteria for depository participants are;

- A public financial institution as defined in section 4A of the Companies Act
- A bank included in the Second Schedule to the Reserve Bank of India Act
- A foreign bank operating in India with the approval of the Reserve Bank of India
- A recognized stock exchange
- An institution engaged in providing financial services where not less than 75% of the equity is held jointly or severally by these institutions
- A custodian of securities approved by Government of India, and
- A foreign financial services institution approved by Government of India.

3. SECURITIES ISSUERS, REGISTRARS AND SHARE TRANSFER AGENTS

There is an agreement between the depository, issuer of security and the designated registrar/ share transfer agents for the underlying security in the cases of issues like transfer of securities by their beneficial owners. The issuer is the co. which issues the securities. It maintains a register for recording the names of the registered owners of securities and the depositories. The issuer sends a list of shareholders who opt for the depository system. And only that co.'s can issue the securities which are registered under stock exchanges

4. STOCK EXCHANGES AND STOCK BROKERS

Stock Exchanges are an organized market for dealings in securities commonly referred as secondary market. One of its main functions is price discovery i.e to cause prices to reflect currently available information about a security. Stock Brokers are members of SE primarily engaged in 2 main activities i.e buy and sell securities for their clients charging a commission and as dealers or traders and dealers they buy and sell on their own a/c for trading gains

5. CLEARING CORPORATION/ CLEARING HOUSE AND CLEARING MEMBERS

A clearing corporation is a central organization created to facilitate efficient, fast and economical settlement of transactions at a SE. It being an internal department of a SE is an independent entity. The members of Clearing Corporation brokerage firms, banks or other financial institutions who are called as clearing members.

6. BANKING SYSTEM

Depository essentially plays a dual role i.e of a depository and a limited bank. It maintains current a/c's for participants and executes fund transactions relating to securities transactions for participants

7. BENEFICIAL OWNER/ INVESTOR

Beneficial owner is a person whose name is recorded as such with a depository. It means a person who is engaged in buying and selling of securities issued by the companies and is registered his/ her securities with the depository in the form of book entry. And he/ she has all the rights and liabilities associated with the securities

FACILITIES OFFERED BY DEPOSITORY SYSTEM

- Dematerialization:** It is a process of conversion of physical share – certificate into electronic – form. So, when a shareholder uses the dematerialization facility, company take back the shares, through depository – system and equal numbers of shares are credited in his account in e-form.
- Rematerialization:** Rematerialization is the exact reverse of Dematerialization. It refers to the process of issuing physical securities in place of the securities held electronically in book-entry form with a depository.

OTHER SERVICES

- Pledging Dematerialized Shares:** Dematerialized shares could be pledged; in fact, this is more advantageous as compared to pledging share certificates. After loan is repaid one can request for a closure of pledge by instructing one's DP through a standard format. The pledgee on receiving the repayment as well as the request for closure of pledge will instruct his DP accordingly. Even the locked-in securities can be pledged. The pledger continues to remain the beneficiary holder of those securities even after the securities are pledged.
- Initial Public Offerings:** Credits for public offers can be directly received into demat account. In the public issue application form of depository eligible companies, there will be a provision to indicate the manner in which securities should be allotted to the applicant. One is to mention one's client account number and the name and identification number of DP. All allotment due to investor will be credited into required account.
- Receipt of Cash/non-cash Benefits:** When any corporate event such as rights or bonus or dividend is announced for a particular security, depository will give the details of all the clients having electronic holdings in that security as of the record date to the registrar. The registrar will then calculate the corporate benefits due to all the shareholders. The disbursement of cash benefits such as dividend/ interest will be done directly by the registrar. In case of non-cash benefits, depository will directly credit the securities entitlements in the depository accounts of all those clients who have opted for electronic allotment based on the information provided by the registrar.

4. Stock Lending and Borrowing: Through the depository account securities in the demat form can be easily lent/ borrowed. Securities can be lent or borrowed in electronic form through an approved intermediary, who has opened a special 'intermediary' account with a DP. Instructions are to be given to DP through a standard format (which is available with DP) to deposit securities with the intermediary. Similarly to borrow securities from the intermediary, one has to instruct DP through a standard format (which is available with your DP).
5. Transmission of Securities: Transmission of securities due to death, lunacy, bankruptcy, insolvency or by any other lawful means other than transfer is also possible in the depository system. In the case of transmission, the claimant will have to fill in a transmission request form, (which is available with the DP) supported by valid documents.
6. Freezing Account with DP: If at any time as a security measure one wishes that no transaction should be effected in one's account, one may advise one's DP accordingly. DP will ensure that account of such investor is totally frozen until further instructions from him.

BENEFITS OF DEPOSITORY SYSTEM

A. To the nation:

1. Growing and more liquid markets
2. Increase in competitiveness in the international market place attracting many investors
3. Improved prospects for privatisation of public sector units by creating a favorable environment
4. Considerable reduction in delay
5. Minimizes settlement risk and fraud restoring investors' faith in the capital markets

B. To the investing public:

1. Reduction of risks associated with loss, mutilation, theft and forgery of physical scrip
2. Elimination of financial loss from loss of physical scrip
3. Greater liquidity from speedier settlements
4. Reduction in delays in registration
5. Faster receipt of corporate benefits
6. Reduced transaction costs through greater efficiency

C. To issuers:

1. Up-to-date knowledge of shareholders' names and addresses
2. Reduction in printing and distribution costs of new issues
3. Easy transfer of corporate benefits
4. Improved ability to attract international investors without having to incur expenditure of issuance in overseas markets

CONCLUSION

At present, the Indian stock exchanges are following screen based trading and electronic settlement system. The market width are also enlarged, quantity of investors scattered to various distance places from trading and settlement place. Depository system have a significant role at eliminating voluminous and cumbersome paper work involved in the script-based system and offers scope for 'paperless' trading through state-of-the-art technology. Well-developed securities markets are the backbone of any financial system. Apart from providing the medium for channelizing funds for investment purposes, they aid in pricing of assets and serve as a barometer of the financial health of the economy. The Indian securities markets have witnessed reforms in the post-liberalization era in terms of market design, technological developments, settlement practices and introduction of new instruments. The improved banking system, adequate infrastructure and fast information technology are all going to play a crucial role in the success of depository System in India. The electronic trading and trading of securities is a step in the right direction, paperless trading will prove to be boon to the stock market in the years to come.

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