UNIT 9: DEPOSITORY

UNIT STRUCTURE

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9.1 LEARNING OBJECTIVES

After going through this unit you will be able to:

- explain the meaning of depository
- explain the benefits of depository
- discuss the process of depository
- describe about NSDL and CDSL.

9.2 INTRODUCTION

In earlier days securities were in the form of physical certificates, due to which trading and settlement system of Indian stock exchanges was very slow and inefficient. Speedy and quick transfer of security was very difficult. Besides delay in settlement, there were some other problems like, theft, forgery, mutilation, bad deliveries of securities etc. To overcome the problems associated with physical securities, the Depositories Act, 1996 was passed. It was formed with the purpose of ensuring free transferability of securities with speed, accuracy & security. The first depository set up in

India is National Securities Depository Limited (NSDL) and is promoted by IDBI, UTI and NSE.

In this unit, we will discuss the concept, benefits and functioning of depositories, demat account and other areas associated with depositories.

9.3 MEANING OF DEPOSITORY

Depository is an organisation which holds securities of an investor in electronic form, in the same manner as a bank holds our money. Depository hold securities in book entry form in the account of the investor. Besides holding securities, a depository also provides services related to transactions in securities. A depository interfaces with its investors through its agents called Depository Participants (DPs). If an investor wants to utilize the services offered by a depository, the investor has to open an account with a DP.

According to Section 2 (e) of Depositories Act, 1996, “depository” means a company formed and registered under the Companies Act, 1956, and which has been granted a certificate of registration under sub-section (1A) of section 12 of the Securities and Exchange Board of India Act, 1992.

Depositories can be in two forms- dematerialized or immobilized. In dematerialized form paper certificates are completely eliminated after verification by the custodians. In immobilized form initial paper certificates are preserved in safe vaults by custodians and further movement of papers are discontinued.

9.4 BENEFITS OF DEPOSITORY

Following are the benefits of participating in depository system:

- Depository system enables immediate allotment, transfer and registration of securities.
- In depository system no stump duty is required on transfer of securities.
- Depository system eliminate the risks associated with physical certificates such as bad deliveries, fake securities etc.

- Depository system makes considerable reduction in the handling of large volumes of paper.
- Reduction in transaction cost.
- Faster disbursement of corporate benefits like rights and bonus shares.
- Periodic status reports to investors on their holdings and transactions, leading to better controls.



CHECK YOUR PROGRESS

Q 1: Define depository.

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Q 2: Name the first depository of India.

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9.5 DEPOSITORY PARTICIPANT

A depository participant (DP) is an agent of the depository through which it interfaces with the investor and provides depository services. Public financial institutions, scheduled commercial banks, foreign banks operating in India with the approval of the Reserve Bank of India, state financial corporations, custodians, stock-brokers, clearing corporations / clearing houses, NBFCs and registrar to an issue or share transfer agent complying with the requirements prescribed by SEBI can be registered as DP.

9.6 INTERNATIONAL SECURITIES IDENTIFICATION NUMBER

The International Securities Identification Number (ISIN) standard is used worldwide to identify specific securities such as debt securities, equities, options, derivatives and futures. Each security issued bears a unique ISIN issued by the International Organization for Standardisation (ISO). ISIN is a twelve-character long identification mark. An ISIN consists

of three parts: Generally, a two letter country code, a nine character alpha-numeric national security identifier, and a single check digit. For example, ISIN for Indian securities is like INE009A01021. In India, the task of issuing ISIN of various securities has been assigned to SEBI. For Government securities, allotment of ISIN is done by Reserve Bank of India.

9.7 DEPOSITORY PROCESS

The depository process consists of the following steps-

Opening an Account: It is mandatory to open an account with the depository to avail the services of a depository. The account is to be open through depository participant. At the time of opening an account, the DP will sign a standard agreement with the investor, which details the rights and duties of both investor and DP. A client account number or client ID number is issued to the investor which is to be quoted in all future correspondences. With effect from 1st April, 2006, SEBI has made PAN Card compulsory for all categories of investors for opening a Demat Account.

There are no restrictions on the number of depository participants, one investor can open account with. Depository accounts are similar to bank accounts. Just as you can have accounts with more than one bank, you can open accounts with more than one DP. In case of joint holdings, the investor needs to open accounts in the same order of names in which they hold the securities.

Dematerialization

Dematerialization is the process of converting physical securities into electronic form. An investor can dematerialise only those certificates that are already registered in his name and belong to the list of securities admitted for dematerialization in the depository. For converting physical securities into electronic form, the following process is followed:

First step, The Investor submits the Demat Request Form(DRF) and physical certificates to the DP. DP checks whether the securities are available for demat. The DP, upon receipt of the shares and the DRF, will

issue the client an acknowledgement and will send an electronic request to the Company.

Second step, DP enters the demat request in his system to be sent to the depository electronically and dispatches the physical certificates along with the DRF to the respective issuer or its registrar and transfer Agent.

Third step, Registrar and transfer agent, on receiving the physical documents and the electronic request, verify and check them. Once the registrar and transfer agent is satisfied, dematerialization of the concerned securities is electronically confirmed to the depository.

Fourth Step, the depository credits the dematerialized securities to the demat account of the investor and intimates the DP electronically.

Fifth Step, The DP issues a statement of transaction to the client.

Demat Account

A demat account is that account where the investor (holder of securities) can hold his securities in electronic or dematerialize form. Like the bank account, a demat account holds the securities like shares, bonds, government securities, mutual funds and exchange traded funds. One cannot trade in the stock market without a demat account.

Benefits of demat account

Following are the some benefits of demat account:

- It is a safe and convenient way to hold securities compared to holding securities in physical form.
- No stamp duty is required to pay for transfer of securities in the electronic form.
- Risks associated with physical certificates such as delays, loss, in transit, theft, mutilation, bad deliveries, etc. are eliminated.
- Dematerialized securities are most preferred by the financiers for providing credit against securities.
- Shares bought or sold are transferred in the name of the investor on the very next day of pay out.
- Change of address, registration of Power of Attorney –can be effected across companies by one single instruction to the DP.

- Eliminate the postal cost for sending share certificates and transfer deeds.

Rematerialization

The process of converting electronic form of security to physical form is known as rematerialization. If one investor want to withdraw his security in physical form balance with the depository, in such a case the investor makes an application to the depository in rematerialization request form (RRF) through the depositor participant. The DP will forward the request to the depository after verifying that the investor has the necessary balances. The depository in turn will intimate the registrar who will print the certificates and dispatch the same to the investor.

Distributing Dividend

The registrar or share transfer agent shall inform the depository about the corporate actions such as dates for book closer, redemption or maturity of securities etc. The depository will then electronically provide a list of the holdings of the investors. The company can then distribute dividend, interest and other monetary benefits directly to the investors on the basis of the list.

Closing an account

If a client wants to close an account, he shall make an application in the specified format. The client can close his account if no balance is outstanding to his credit. If any balance exists in the account, he may close the account in the following manner:

a. By rematerialization of all its existing balance in the account,

b. By transferring his security balances to his other account held either with the same DP or with other DP.



CHECK YOUR PROGRESS

Q 3: What is demat account?

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Q 4: What is meant by rematerialization?

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9.8 DEPOSITORIES IN INDIA

To wipeout these problems associated with physical certificates, the Depositories Act 1996 was passed in India. The Act was passed with the purpose of ensuring free transferability of securities with speed, accuracy and security by-

a) Making securities of public limited companies freely transferable, subject to certain exceptions;

b) Dematerializing the securities in the depository mode; and

c) Providing for maintenance of ownership records in a book entry form.

For performing the above tasks, two depositories viz, National Securities Depository Ltd. (NSDL) and Central Depository Services (India) Ltd. (CDSL) have come up.

National Securities Depository Ltd. (NSDL)

The NSDL is the first depository of India set up in the year 1996. It is the largest depository of the country promoted by Industrial Development Bank of India (IDBI), Unit Trust of India (UTI) and National Stock Exchange (NSE). As on July, NSDL has eliminated 2764 crore certificates and more than 75% shares of 7678 companies are dematted. NSDL open 3713 accounts per day on an average. The NSDL interacts with investors through Depository Participants. It has 266 DP as on August, 2017 with 27539 DP service centre. NSDL provides a wide range of security related services to its clients (the investors) through the DPs. These services are can be classified into two categories: Basic services and value added services.

Basic services

Following are the basic services offered by NSDL:

- **Account Opening**: To avail the services provided by NSDL an investor/ a broker/ an approved intermediary has to open a NSDL depository account with any of its DPs. There are three types of accounts.

  i) Beneficiary Account: An investor who wants to hold securities in dematerialized form and receive or deliver securities by inter-account transfers must have a depository account called

beneficiary account with a DP of his choice.

ii) Clearing Member Account: Member brokers of those stock exchanges which have established electronic connectivity with NSDL need to open a clearing member account, with a DP of his choice, to clear and settle trades in the demat form. This account is popularly known as Settlement account or "Pool account". This account is meant only to transfer securities to and receive securities from the clearing corporation/ house and hence, the member broker does not have any ownership rights over the shares held in such an account.

iii) Intermediary account: Any person who wants to act as an approved 'intermediary' for stock lending and borrowing needs to open an intermediary account with any DP of his choice. An intermediary account may be opened with the DP only after the intermediary has obtained registration from the Securities & Exchange Board of India and with the prior approval of NSDL. This account is meant only to deposit the securities received from the lender and lend them to the borrower under stock lending and borrowing scheme. The intermediary does not have any ownership rights over the shares held in such an account.

- **Dematerialisation:** Dematerialisation is the process by which a client can get physical certificates converted into electronic balances. This we had already discussed in the earlier section.
- **Rematerialization:** The process of converting electronic form of security to physical form is known as rematerialization. This we had already discussed in the earlier section.
- **Market Transfers:** Trading in dematerialised securities is quite similar to trading in physical securities. The major difference is that at the time of settlement, instead of delivery/receipt of securities in the physical form, the same is affected through account transfers. Delivery of securities to or from a clearing member is called "Market Trades". If, either source or target in a transfer instrument is a Clearing Member Account; such a transfer is a "Market Trade".

- **Off Market Transfer:** Trades which are not settled through the Clearing Corporation/ Clearing House of an exchange are classified as "Off Market Trades". Delivery of securities to or from sub brokers, delivery for trade-for-trade transactions, by this definition are off-market trades.
- **Inter-Depository Transfers:** Transfer of securities from an account in one depository to an account of another depository is termed as an inter-depository transfer. It can be done only for securities that are available for dematerialisation on both the depositories. Government securities cannot be transferred from one depository to another using this facility.
- **Transmission:** The Companies Act distinguishes transmission of shares from transfer of shares. While transfer of shares relates to a voluntary act of the shareholder, transmission is brought about by operation of law. The word 'transmission' means devolution of title to shares otherwise than by transfer, for example, devolution by death, succession, inheritance, bankruptcy, marriage, etc. While transfer of shares is brought about by delivery of a proper instrument of transfer duly stamped and executed, transmission of shares is done by forwarding the necessary to the company.

In case the deceased was one of the joint holders, then the surviving holders have to request the DP vide a form called the transmission form along with a copy of notarised death certificate to transmit the securities lying in the account of the deceased to the account of the surviving holders. For this purpose, the surviving clients must have a depository account, which can be with the same DP or with a different DP.

In case of death of the sole holder, the legal heir(s) or legal representative(s) of the deceased must request the DP to transmit the balances lying in the Client account of the deceased to the account of the legal heir(s) or legal representative(s). For this, the legal heir (s) or the legal representative(s) of such securities must submit an instruction called the transmission form to the DP along with the following documents:

1. A copy of the death certificate duly notarised

2. A copy of the Succession certificate duly notarised or an order of a court of competent jurisdiction where the deceased has not left a Will; or
3. A copy of the Probate or Letter of Administration duly notarised.

- **Corporate Actions:** Corporate actions are benefits given by a company to its investors. These may be either monetary benefits like dividend, interest or non-monetary benefits like bonus, rights, etc. NSDL facilitates distribution of corporate benefits.

Central Depository Service (India) Ltd. (CDSL)

The second depository Central Depository Services Limited (CDSL), has been promoted by Bombay Stock Exchange and Bank of India. It was formed in February 1999. CDSL was set up with the objective of providing convenient, dependable and secure depository services at affordable cost to all market participants. CDSL has a wide network of DPs, operating from over 17,000 sites, across the country. The DPs are directly connected to CDSL thereby providing on-line and efficient depository service to investors. The services offered by CDSL is same with the NSDL.



9.9 LET US SUM UP

In this unit we have discussed the following points:

- Depository is an organisation which holds securities of an investor in electronic form, in the same manner as a bank holds our money in accounts.
- A depository participant (DP) is an agent of the depository through which it interfaces with the investor and provides depository services.
- Dematerialization is the process of converting physical securities into electronic form.
- A demat account is that account where the investor (holder of securities) can hold his securities in electronic or dematerialized form.
- The process of converting electronic form of security to physical form

is known as rematerialization.

- In India there are two depositories viz, National Securities Depository Ltd. (NSDL) and Central Depository Service (India) Ltd. (CDSL)



9.10 FURTHER READINGS

1) Batra G.S. (2002). Financial services and markets. New Delhi, Deepand Deep Publication Pvt. Ltd.

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3) Srivastava, R.M. (2009). Management of Indian financial institutions. New Delhi, Himalaya Publishing House.

4) Khan, M. Y. (2007). Indian Financial System. New Delhi. Tata McGraw Hill.

5) Pathak, Bharati V (2006). The Indian Financial System : Markets, institutions and services. New Delhi, Pearson Education Ltd.



9.11 ANSWERS TO CHECK YOUR PROGRESS

Ans to Q No 1: Depository is an organisation which holds securities of an investor in electronic form, in the same manner as a bank holds our money.

Ans to Q No 2: National Securities Depository Ltd. (NSDL)

Ans to Q No 3: A demat account is that account where the investor (holder of securities) can hold his securities in electronic or dematerialize form.

Ans to Q No 4: The process of converting electronic form of security to physical form is known as rematerialization.



9.12 MODEL QUESTIONS

Q 1: State the meaning and benefits of depository.

Q 2: Define depository participant.

Q 3: Discuss the depository process.

Q 4: Discuss the services provided by NSDL.

Q 5: What are the benefits of demat account?

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