DEPOSITORY

The depository is nothing but an organization where securities of the shareholders are kept. It is kept there in the form of electronic. It is just like a bank but useful only for securities. Thus, whenever an investor wishes to avail the service, he/she can opt for the service by opening an account. After the process is done the ownership of securities can be legally transferred to the beneficiary.

A **depository** is an organisation 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 depository can be defined as ‘an institution which transfers the ownership of securities in electronic mode on behalf of its members’’.

A depository is a nominee who keeps the scrips on behalf of the investors. He undertakes the custodian role. The depository leads the capital market towards a scripless system through immobilization and dematerialization of share certificates. Immobilisation of securities means stopping the physical movement.

Objectives of a depository:

1. Reduce the time for transfer of securities.
2. Avoid the risk of settlement of securities.
3. Enhance liquidity and efficiency.
4. Reduce cost of transaction for the investors.
5. Create a system for the central handling of all securities.
6. Promote the country’s competitiveness by complying with global standards.
7. Provide service infrastructure in a capital market.

Activities of the depository:

1. Accepting deposit of securities for custody.
2. Making computerized book entry deliveries of securities which are immobilized in its custody.
3. Creating computerized book entry pledges of securities in its custody.
4. Providing for withdrawal of securities.
5. Undertaking corporate actions like distribution of dividend and interest.
6. Redemption of securities on maturity.

INTERACTING INSTITUTIONS:

1. The Central Depository: The central depository is a nominee who holds the securities on behalf of the investors and maintains records related to that in an electronic mode.
2. Share Registrar and Transfer Agent: The registrar is an institution that controls the issuance of securities. The transfer agent is one who retains the names and addresses of registered securities owners and re-registers traded securities in the names of new owners.
3. Clearing and Settlement Corporation: It is a centre to do trade matching and settle the funds and exchange securities.

DEPOSITORY PROCESS:

Immobilisation of shares: Immobilisation of shares is the first step in the depository process. In the immobilization process the share certificates are submitted to the depository which converts the physical certificates into electronic data and starts issuing statement of accounts for the holdings of the investors or shareholders.

The steps involved in the process of converting the existing paper certificates into an electronic mode are as follows:

1. The stock exchange will notify through an advertisement after which the investors may deposit their shares into the Central Depository through an Authorised Depository Agent with whom the investors’ account will be maintained.
2. On receipt of the share certificate, the depository or the Depository’s agent sends the certificate to the Registrar and Transfer Agent for registering Depository Nominee’s name.
3. Within the prescribed period, the Registrar will transfer the scrips, after confirming that the shares are good for disposition, in the name of the Depository Nominee and return it for safe custody with the Depository. The depository will credit the account of the investor with the number of shares deposited.

Thereafter the shares get traded through a book entry system.

In case of fresh issues the securities are issued only through depositories and the applicants who wish to have their certificates dematerialized can apply through depositories.

Withdrawal of shares: The shares which are held in the depository can be withdrawn by the investor. The withdrawn scrip takes physical form as in the case of pre-immobilised model.

TRADING IN A DEPOSITORY SYSTEM:

When the investor sells his share, the Depository debits the ‘Free Balance’ of the seller and credits the ‘Available balance’ of the buyer for the scrip traded on the settlement day. After the payment has been made by the buyer, the Available balance will be converted into Free balance which can be traded by the buyer. It is like a Share bank where the balances are in the form of different corporate entities shares instead of currency. Confirmation statements are sent to the investors after the accounts are adjusted or at stipulated intervals. The delivery and settlement process will be the same as at present except that physical delivery will be replaced by a book entry. The clearing and settlement process will take place in the separate wing of the depository or in the different entity.

Transfer of ownership:

In the case of trade, ownership in the shares is transferred from one account to another. The transfer of shares can take place on account of the investor offering the shares as collateral security for a loan. In this process, the institution’s lien can be marked in the accounts. In case the lien is marked the share will not be treated as a ‘Free’ and could not be available for trade. When the loan is repaid, the lien is cancelled and thereafter the shares will be available for trade.

Declaration of dividend/bonus/rights:

Though the shares are in the names of the Depository Nominee, the real owners are individuals or institutions. When a company declares dividend/rights or bonus issues, the Depository will prepare the record of investors as on the record date and submit it to the Registrar of Company. The dividend will be sent by the Registrar after calculating the dividend payable to each investor directly.

When a company declares bonus shares, the Registrar will calculate the bonus entitlement and advise the depository about the number of shares to be credited to each account holder.

In the case of the Rights offer, based on the Record of Depositories, the Registrar will prepare a letter of offer and send it to the investor. The Registrar will advise the Depository the number of shares to be credited to each account on the basis of the application and allotment. Based on this advise, the investor’s account will be credited by the Depository Reporting System.

The Depository is functioning in an advanced automated environment. So, the reporting system is fast and highly superior. The investors get the following statements regularly: i) contract statements with details of trade, (ii) confirmation statements with details of trade, (iii) Monthly traded particulars and (iv) quarterly statements showing the security balances.’

Features of the SEBI (DEPOSITORY AND PARTICIPANTS) REGULATON ACT 1996:

Depository institutions: The Act provides for creation of one or more depository institutions registered under the Companies Act and predominantly owned by the market participants. The SEBI has proposed that the minimum net worth of a depository should be Rs.100 crores.

Depository participants: The depository can interact with the users through a set of depository participants (DP). They are persons dealing directly with the depository for their clients. The DPs are a link between the investor and the depository.

Investor’s choice: An investor has an option to either hold the securities physically or having dematerialized form of securities. Such option can be exercised by the investor either at the time of an initial offer of securities by a company indicating his choice in the application form or at any subsequent time. The investor also has the freedom to switch from the depository mode to non-depository mode and vice versa.

Free transferability: Once the agreed consideration is paid by the buyer he is automatically entitled to all the rights associated with the security. The transfer will be effected by a depository mode, no transfer deed is required.

Rights of transferee: The Act provides that the transferee of a security will be entitled to all the rights including voting rights associated with the security. The transferee will continue to enjoy the economic rights like bonus, rights and dividend attached to the security.

Fungibility: The securities held by a depository are fungible. Share certificates need not carry distinctive numbers and all shares will form part of a fungible mess. All share certificates will become interchangeable like withdrawing money from a bank account without being concerned about the number printed on the currency notes.

No stamp duty: The Act has cancelled stamp duty on all secondary market transactions in the depository mode. All transactions outside the depository mode will attract stamp duty.

Depository records as legal evidence: The ownership records maintained by the depository or the participants will be accepted as prima facie evidence in legal proceedings.

Pledge or hypothecation: A depository shall allow for the creation of pledge or hypothecation in respect of securities left in the depository mode.

Benefits of depository system:

Benefits to Investors:

1. This system will eliminate paper work as the book entry system does not need physical movement of certificates for transfer process.
2. The risk of bad deliveries, fraud and misplaced, mutilated and lost share certificates will not exist.
3. The electronic media will shorten settlement time and hence the investor can save time and increase the velocity of security movement.
4. Investors will be able to change portfolio more frequently.
5. The distribution of dividends, interest and other benefits will be speedier as the ownership can be easily identifiable.
6. The cost of transfer is less as the share transfers are exempt from stamp duty.
7. Faster payment in case of sale of shares.

Benefits to companies:

1. The companies will be able to know the particulars of beneficial owners and their holdings periodically.
2. At the time of declaration of dividends, bonus etc. there will not be any rush for transfer related activities for the companies.
3. Investor complaints will be reduced substantially as majority of the present day complaints relate to signature difference, time lapse during the transfer and mutilated certificates.
4. It would be possible to send notices and annual reports without delay because all securities of the company with the participant are accumulated and held in the name of the participant in the Depository’s book.

Benefits to the Capital market:

1. The capital market will be more transparent as the trading, clearing and settlement mechanism have to be highly automated and interlinked with the depository among themselves.
2. The market will be highly automated and efficient due to the usage of computing and telecommunication technology for the back office activities for all the capital market players.
3. The investors’ confidence will improve due to the above two aspects.
4. The foreign investors will start participating in the market resulting in a more buoyant capital market.
5. The existence of depository will result in increase in the volume of trade both by number and value.

NATIONAL SECURITIES DEPOSITORY LTD. (NSDL)

The NSDL is the first depository established in 1996 in India. It has been promoted by the IDBI, UTI and NSE. There were 341 Depository participants as on March 2007 operating through NSDL. Seven stock exchanges – the NSE, BSE, CSE, DSE, OTCEI, Ludhiana and Bangalore Stock exchanges have established connectivity with NSDL.

Functions of NSDL: The NSDL performs the following functions related to securities through Depository Participants.

1. Maintenance of individual investors’ beneficial holdings in electronic form.
2. Dematerialisation and rematerialisation of securities.
3. Account transfer for settlement of trade in electronic mode.
4. Allotments in the electronic form in case of initial public offerings.
5. Distribution of non-cash corporate actions.
6. Facility for freezing/locking of investor accounts.
7. Facility for pledge and hypothecation of securities.

CENTRAL DEPOSITORY SERVICES (INDIA) LTD. (CDSL)

The CDSL has been set up by Bombay Stock Exchange and co-sponsored by State Bank of India, Bank of India, Bank of Baroda and HDFC Bank. It commenced its operation on March 1999. As on March 2000, 680 companies made available their shares for demat. As on April 2008 there were 422 Depository Participants and the number of investors was 52,68,932.

Text book: Financial Markets and Services by Gordon & Natarajan, Himalaya Publishing House.