THE DEPOSITORIES IN INDIA AND THEIR ROLE

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The Depositories Act came into force as an ordinance viz. The Depositories Ordinance, 1995 promulgated on 7th January 1996. It was promulgated to provide a legal framework for establishment of a depository system. The earlier system of stock exchange, involved the movement of securities in the form of physical certificates. As a result the investors as well as companies faced various problems. These included among other things settlement delays, theft, forgery, mutilation, and bad deliveries and also added costs.

The depository system was introduced in India in 1996 to ensure transparency and efficiency in the securities market transactions and to eliminate various hassles including paperwork involved in securities in physical mode. It was designed to provide a legal framework for establishment of depositories to record ownership details in book entry form. The Act also made consequential amendments in the Companies Act, 1956; the Securities and Exchange Board of India Act, 1992; the Indian Stamp Act, 1899; the Income tax Act, 1961; and the Benami Transactions (Prohibition) Act, 1988.

A "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. Thus, 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 through a registered Depository Participant. It also provides services related to transactions in securities.

At present there are two depositories in India:

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National Securities Depository Limited (NSDL) and **Central Depository Services (CDS).**

National Securities Depository Limited (NSDL) is the first central securities depository in India based in Mumbai. NSDL is promoted by Industrial Development Bank of India Limited (IDBI) - the largest development bank of India, Unit Trust of India (UTI) - the largest mutual fund in India and National Stock Exchange of India Limited (NSE) - the largest stock exchange in India.

The NSDL is governed by Bye Laws of National Securities Depository Limited. It is managed by Board of Directors headed by a managing director. It interfaces with the investors through depository participants who are known as business partners.

Constituents of depositories consist of clearing corporations, brokers, clearing members, registrar and transfer agents, company or issuer, stock exchange, bank depository participant and investors. All are connected to the Depository for the settlement of daily trade in securities as have been registered with NSDL.

Central Depository Services (India) Limited

CSDL is promoted by Bombay stock exchange in association with most of the leading banks such as bank of India, bank of Baroda, state bank of India, HDFC. It is an agency that has a main function is centralizes data base and accounting. It aims to retain the entire data of the investors in the central database of CSDL.

KEY FEATURES OF DEPOSITORY SYSTEM IN INDIA

<u>Multi depository system</u>- India has a multi depository system. At present there are two depositories registered with SEBI i.e. National Securities Depositories Limited (NSDL) and Central Depository Services Limited. (CSDL).

<u>Depository Participants</u>- A Depository Participant (DP) is an agent of the depository through which it interfaces with the investor and provides depository services. These agents are appointed under Securities and Exchange Board of India (Depositories and Participants) Regulations, 1996 and other applicable conditions.

Dematerialization- Dematerialization is the process by which the physical securities of the investor are converted into electronic terms. An investor will have to first open an account with a Depository Participant and then request for the dematerialization of his share certificates through the Depository Participant so that the dematerialized holdings can be credited into that account.

Fungibility- Fungibility means that the securities held in electronic form do not possess any like distinctive number, folio number or certificate number. Thus all securities are interchangeable and identical[1].

Registered owner/beneficial owner- under the dematerialized system, the registered owners are the depositories whereas the beneficial owners are the persons who hold the securities. In the depository system, the ownership of securities dematerialized is bifurcated between Registered Owner and Beneficial Owner. According to the Depositories Act '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.

Therefore, the index of members keeping a record of the owners of the company, which the company is required to maintain consists of only two registered owners i.e. the two depositories. The depositories on the other hand keep a track of the clients through depository participants.

The beneficial owner is treated as a member of the company and is entitled to all benefits that are declared and issued by the company. It is the beneficial owner in whom the rights and libilities of owning the shares vest.[2] The depository does not have any voting rights or other rights.

Free transferability of shares- transferability of shares takes place through the electronic book entry system. The shares are freely transferable as movable property. Under this system, physical transfer of securities does not take place. Instead, to facilitate the change of ownership, a book entry is passed.

ROLE OF DEPOSITORY

[1] Section 9 Depositories Act
[2] Section 10(3) Depositories Act, 1996; Section 2(55) Companies Act, 2013

The role of the depositories can be witnessed in the process of dematerialization of securities. The process of dematerialization is explained as under:

1. As per Section 5 of the Depositories Act, 1996, the investor is required to enter into an agreement with the DP in the specified format under the Bye Laws of the depository. Once the DP has accepted the application, the applicant investor will be issued a Client account (Client Identity for short "Client Id") number. The Client Id is a unique number with respect to the DP with which the investor is holding a Beneficial Owner account. The DP's are also identified in the depository system by a unique DP identity (DP Id) number. The combination of Client Id and DP Id forms the unique identification number for any person who desires to hold his securities in the depository system
2. The investor submits the Demat Request Form (DRF) and physical certificates to Depository Participant. The Depository Participant has to check whether the securities are available for dematerialization i.e. they must be recognized by the NSDL/CSDL. Thus only those securities whose ISIN (International Securities Identification Number) has been recognized by these depositories. ISIN is a twelve-character long identification mark.
3. The DP enters the demat request in his system which is electriniclly connected to NSDL/CDSL.
4. The DP dispatches the physical certificate alongwith DRF to the Registrar & Transfer (R & T) Agent.
5. The NSDL/CDSL records the details of the electronic request in the database and forwards it to R&T agent.
6. Upon receipt of physical documents and electronic request, verifies them. On satisfaction of the R&T agent the dematerialization of the securities is confirmed to the NSDL/CDSL.
7. The NSDL/CDSL credits the dematerialized securities to the beneficiary account of the investor and intimates the DP electronically. Thereafter, the DP isues a statement of transaction to the investor.

Thus, a holder of shares can surrender his certificate in physical form to the depository through the Participant. On receipt of such a request the issuer (the company whose shares are sought to be held in dematerialized form), will cancel the certificate and substitute in its records the name of the depository as a registered owner in respect of that security and inform the depository accordingly. A depository shall, on receipt of information under from the issuer that its name has been recorded as registered owner enter the name of the person holder of the shares who surrender them for dematerialized as the beneficial owner of such shares in its records.[3]

[3] *Jt. Commissioner of Income-Tax* v *Shri Mukesh D. Ambani* [2011]8ITR353(Mum)