

# **CONTRIBUTIONS OF THE DEPOSITORY SYSTEM IN INDIA TOWARDS THE DEVELOPMENT OF INDIAN SECURITIES MARKET\***

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## **ABSTRACT**

A depository, in the simplest way, refers to a place where something is deposited/ kept for storage and/ or security. However, from the perspective of securities market, Depository is defined as an organization like a Central Bank where-in the securities of a shareholder are, at his request, held in electronic form, through the medium of a Depository Participant.

Depository is a company that has been formed and registered under the Indian Companies Act, 2013 & has been granted a certificate of registration by SEBI, subsequent to registration under the Depositories Act, 1996.

A Depository, in order to act as such should obtain a certificate of commencement of business from SEBI. Furthermore, a registration under SEBI (Depositories and Participants) Regulations, 1996 is also mandatory. In order to utilize the services offered by a Depository, the investor has to have an account with the Depository through his participant called as a DEMAT ACCOUNT. The process is quite similar as that of opening of a bank account, with any of its branches, so as to utilize the services of the said bank. All the securities held by the Depository shall be in dematerialized & fungible form only.

This study reviews the Depository System of India and its contributions/ benefits generated for the Indian Securities Market.

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## **DEPOSITORY SYSTEM – An Introduction**

The concept of depository dates back its origination to the mid of 19<sup>th</sup> century when the first depository of the world was established in Germany. As the name stated, depository is an organization that was created by the market regulators to facilitate the business of electronic dealing in securities and stocks.

As stated in the Black's Law vocabulary "depository" is portrayed as "the social occasion of the Institution tolerating a store. One that holds anything in trust, as "depository" is the place where it is put. The obligation upon the depository is that it keeps the thing (shares or other securities) with sensible consideration and upon request restores it to the concerned." So, it's more like a store that holds securities (like shares, debentures, bonds, Government Securities, mutual funds, etc.) on behalf of market investors. It works like a trustee of the proprietor since the securities are lodged with him in trust. He is therefore, in like manner, a trustee for the owner of the securities.

The services of a depository in the securities market can be availed by an investor (referred to as a beneficial owner (BO)) by means of opening of a Dematerialization (demat) account through any of the registered Depository Participant(s) (DPs) and thereafter the trading can be done in his securities.

The above explanation, therefore, evidences the fact, that an effective and fully developed securities depository system is vital for maintaining and enhancing the market efficiency, which happens to be one of the essential characteristics of a mature capital market. The traditional settlement and clearing system has been proved incapable due to operational deficiencies, delay in transfer, registration, transmissions, fake certificates and forgery thereby obstructing the healthy growth of the capital market.

In India, the urgency for having up an established depository system was realized after the large scale abnormalities in the securities transactions of 1992 which not only exposed the limitations of the prevailing settlement system but also revealed the pressing need of an efficient regulator in terms of demat transactions. A depository system was thereafter invented that not only benefits the investing public but also the issuers of securities (corporate raising funds from the securities market), the intermediaries and the entire nation, as a whole. The Depositories Act passed by the Parliament in August 1996, lays down the legislative framework for facilitating the dematerialization and transfer of securities in depository mode. Free transferability of securities with speed, accuracy & security was the major objective behind establishment of the said act.

The National Securities Depository Limited (NSDL) was the first depository established in India. NSDL is promoted by three premier institutions in India, viz., Industrial Development Bank of India (IDBI), Unit Trust of India (UTI) and National Stock Exchange of India (NSE) that started functioning from November 8, 1996. The Central Depository Services (India) Limited (CDSL) is the second depository in India that has been promoted by Bombay Stock Exchange Limited (BSE) together with leading banks such as State Bank of India, HDFC Bank and others. CDSL has received its certificate of commencement of business from Securities and Exchange Board of India (SEBI) SEBI in February 1999.

## LITERATURE REVIEW

**Bhatt & Bhatt (2012)** in their paper entitled “Financial Performance Evaluation of depositories in India (A comparative study of NSDL & CDSL)” explores the fact that the trend of electronization of the operations of the securities market, particularly, Dematerialization, has enabled the Indian capital market to move leaps and bounds and scale to unexampled heights. Securities market in India has witnessed growth, exponentially. The analysis of the growth and progress of NSDL & CDSL in economic terms, clearly reveals that both the depositories have shown a remarkable jump in the terms of demat accounts opened; demated value & quantity of securities, settlement values and quantity and the number of depository participants. The study reflects that both the depositories have been working financially smoothly and efficiently over a period of last eight financial years.

**Chaudhary & Malik (2011)** in their paper “Depository system in India: An appraisal” supports the views that majority of the participants in the Indian Securities Market are resided with NSDL with a stake of 57%. It, therefore, acts as the primary organization with a holding of majority of participants in the system. The paper also states the fact based on its findings, that the majority of respondents were comfortable with the prevailing fee structure of depository which is an indicator that the existing fee structure followed by NSDL is benevolent.

**Kaur (2013)** in her paper “Investors preference between DEMAT & REMAT and awareness regarding depository & its various laws” explains the depository system of India with special focus on the reasons for investors preferences between REMAT & DEMAT of securities. To conclude, she adds that the growth rates of DEMAT account holder has been substantially increasing over a period of few years.

The Indian Government allows holding securities in any form i.e. either in physical mode or in electronic (DEMAT) form, though with its latest circulars, SEBI has made it mandatory for all the public limited companies to have their securities in demat mode only. The respondents, in her research reveal that dematerialization supports excellent services & it is convenient to operate as well. Majority of the investors are now shifting towards dematerialization owing to the immense benefits it offers and the ease of operation it supports.

**Olekar & Talwar (2013)** in their paper “Online trading & DEMAT account in India – Some issues” observed the fact that banks normally levied a lower service charge as against the charges by Depository Participants.

**George (1996)** in his article “Towards a paperless settlement system” examines the role of the National Securities Depositories Limited in revolutionizing the paperless stock settlement system across the country. He has explained the steps taken by the depositories and it’s participants to ensure that the scrip-less trading system be a success. He has also stressed the rational and importance of the role of a regulatory body so as to ensure that the depository system be successful.

### **OBJECTIVE OF THE STUDY**

Currently, the Stock Exchanges in India follow screen-based automated online trading and settlement mechanism. However, a prominent fact is that investors are scattered across whole of the India and even outside India, at places distant from the trade and settlement point and therefore, there are certain problems confronted in the settlement and transfer system. There is a need to evaluate and improve the effectiveness of the Indian Depository System and at the same time understand the need and importance of electronic trading in the capital market simultaneous to studying the benefits this system offers.

### **HYPOTHESIS OF THE STUDY**

Contribution of depositories, NSDL and CDSL towards investor awareness and promoting screen-based online trading is significant.

## **RESEARCH METHODOLOGY**

The present study happens to be exploratory cum descriptive in nature as the researcher intended to study the opinion of securities market investors on various matters relating to depository services, benefits offered, hardships faced, dispute settlement and investment decisions.

## **RESEARCH FINDING**

A Depository System works on the idea of holding of securities in the electronic casing and enabling the securities trades to be set up with the help of an intermediary, a Depository Participant (DP), acting as an administrator and offering storage facility to its investors. On the basis of the set hypothesis and collected data some of the major findings are as follows:

- 1.** The securities demat system was introduced in India towards the end of 1996 with creation of NSDL as the first depository. In August, 1998, CDSL was set up to accelerate growth of electronic securities in India.
- 2.** The speed with which India has dematerialized its securities is remarkable and has left behind some advanced world markets like that of UK, Japan, France, Germany and Australia.
- 3.** Companies are the major beneficiaries of the demat system both in terms of cost as well as of comforts. Companies get updated list of investors on weekly basis from the depositories and are saved from the hassles of printing and dispatching of certificates as well as from effecting transfer of securities. Various issues associated with fake, forged, stolen and duplicate certificates are also solved once the company joins any depository.
- 4.** The demat system has witnessed significant growth since its inception till now. At present there are two fully functional depositories in India who have the right to dematerialize securities. Since the introduction of demat system, large number of physical securities have been dematerialized under different companies by the investors spread all over the country.
- 5.** Unquestionably, when compared on the parameter of corporate benefits, demat system, as against the physical trading system, has resulted in drastic improvement in the convenience level and service standards for investors. There is a direct positive association between number of investors benefited through the depository model, in the form of receiving corporate benefits through demat system, with the number of investors joining the demat system.

6. The crux of the successful implementation of the depository system is that investors should be taken special and full care and they should be imparted with some 'Charter of Rights' to be observed by the DPs.
7. NSDL has been taking this responsibility in the past through its efforts in the form of Investors Depository Meets (IDMs), nation-wide advertisement campaign in leading newspapers, website of NSDL, monthly bulletin known as 'Nest Update', DP Directory, Investors Guide to the Depository System and Help-desk of Depository. But all these efforts of the NSDL have their own weaknesses.
8. The above analysis shows that with the passage of time, investors in securities market are approaching towards short term selling or buying of securities (within few days, weeks or months). This also indicates one more important fact that the system is more suitable and attractive for traders in market. Although the long term investors in primary market enjoy many benefits in terms of corporate benefits, safety against duplicity of securities, early allotments in IPOs and no tension of maintaining share certificates in physical mode.
9. Unfortunately, the demat system in India was implemented without paying any attention to the needs and problems of small long-term investors who are not frequent traders. Such investors have many complaints against the demat system, the main complaint being high demat charges which has been one among the other criterias for non-conversion of some of the securities by the investors.
10. Long term investors are not interested in trade in securities so they have not converted all their holdings in demat form.
11. Although the DPs and their branches are increasing but the speed of growth is slow. Number of DPs in India is comparative very less keeping in view the large investors base in India.
12. It's expected that SEBI, being the chief regulatory body of the Indian Securities Market should make some strict guidelines in favor of investors to resolve the problem of pending demat requests and resolution of grievances. In case any of the demat request gets rejected many times; the matter should be referred to the SEBI by the issuer company for final solution. SEBI must issue some guidelines to resolve this issue of repeated rejected demat requests by the company or its RTA.

## CONCLUSION

The paper concludes that, there has been a sizable increment in the number of beneficiary accounts, number of companies opting for Demat facility, number of depository participants, number of depository participants' service centers, quantity of Demat Shares/Securities and Demat Custody in NSDL & CDSL (Value of Dematerialized Securities). Further a positive annual average growth rate also indicates the growth of Indian Capital Market in a sound direction.

The points enumerated above are quite clear in their implications. In nutshell, it can be concluded in context of the objectives of the study that:

1. Depository system has been gradually implemented in a planned and systematic manner in India starting from voluntary acceptance for investors towards a compulsory requirement prescribed by SEBI for trading in demat securities only. Though the system has been welcomed by investors, DPs and issuer companies yet there is lack of desired popularity of the demat services in India.
2. Retail investors of the securities market gets undoubtedly benefited owing to the introduction of entry-based computerized depository system, in terms of improved services, greater protection of their interests, strong elements of accessibility, efficiency and transparency in operations concerning securities market.
3. On the ground of 'Investors' Education and Awareness', although depositories are trying their best but their efforts are not much fruitful and rewarding. DPs should also join hands with depositories for accelerating level of awareness among present and prospective users of demat system.
4. In the context of cost of demat comfort, the system is costly for investors who want to hold securities in their demat accounts for a long period and are not regular traders in securities market.
5. The system has, clearly, proved to be effective and efficient in overcoming the chances of early evils of physical handling of securities. It has further, also facilitated shorter settlement cycles and faster movement of securities irrespective of the geographical limitation.

6. There are numerous clauses and provisions for safeguarding the interests of demat accountholders under Depositories Act, SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009 and the Bye-laws of depositories.

However one cannot expect retail investors to have knowledge of so many acts rather it would be too much to expect them to be aware about all the provisions, by-laws, regulations and rules available for implementation of their rights and protection against any negligence or fraud committed by the DPs.

Demat is a public utility service. In addition to the above mentioned suggestions and recommendations, the paper also explains the fact as stated by SEBI: **Investors should make the investments with their eyes and ears open as precautions are always better than cure.** Self-education, alertness, activeness and attentiveness of beneficial owners are the basic rules for trading under the operational framework of Depository System.

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