



Corporate Governance Mechanism in Indian Depository System

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A depository is an organization which holds securities (like shares, debentures, bonds, government securities, mutual fund units etc.) of scattered investors in electronic form instead of physical form on the request of the investors through a registered Depository Participant. At present two Depositories in India viz. National Securities Depository Limited (NSDL) and Central Depository Services (India) Limited (CDSL) which are registered with Securities exchange Board of India (SEBI). In this system resultant that eliminates paper work, facilitates automatic and transparent trading in scrips, shortens the settlement period and ultimately contributes to the liquidity of investment in securities. As per the available statistics at BSE and NSE, 99.9 per cent transactions take place in dematerialized mode only. Therefore, in view of the convenience of trading in dematerialized mode, it is advisable to have a beneficial owner (BO) account for trading.

However to facilitate trading by small investors (Maximum 500 shares, irrespective of their value) in physical mode the stock exchanges provide an additional trading window, which gives one time facility for small investors to sell physical shares which are in compulsory demat list. The buyer of these shares has to demat such shares before further selling. To opt such option, Firstly an investor has to approach a DP and fill up an account opening form. The account opening form must be supported by copies of any one of the approved documents which serve as proof of identity (POI) and proof of address (POA) as specified by SEBI. Apart from these PAN card has to be shown in original at the time of account opening.

Thus, the Government of India decided to setup a fully automated and high technology based model exchanges, which could offer screen, based trading and depositories as the ultimate answer to all such reforms. Therefore, the government of India promulgated the Depository Ordinance in 1995. However, both houses of Parliament passed the Depositories Act in 1996. In India, multi-depository system existed at present to deal the securities listed in stock exchange. In the next section, two depositories are explained in details to know more about depository system in India.

National Securities Depository Ltd.(NSDL)

The first and largest depository in India, established in August 1996 and promoted by institutions of national stature has established a state-of-the-art infrastructure that handles most of the securities held and settled in dematerialized form in the Indian capital market. Using innovative and flexible technology systems, NSDL works to support the investors and brokers in the capital market of the country. NSDL aims at ensuring the safety and soundness of Indian marketplaces by developing settlement solutions that increase efficiency, minimize risk and reduce costs. In the depository system, securities are held in depository accounts, which is more or less similar to holding funds in bank accounts. Transfer of ownership of securities is done through simple account transfers electronically. This method does away

with all the risks and hassles normally associated with paperwork. Consequently, the cost of transacting in a depository environment is considerably lower as compared to transaction in the form of certificates. NSDL provides bouquet of services to end investors, stock brokers, stock exchanges, custodians, issuer companies etc. through its network of more than 260 Depository Participants / Business Partners. NSDL has been able to win the trust of crores of investors and other intermediaries. NSDL functioning under the directorship of **Mr. G.V. Nageswara Rao** , Managing Director & CEO.

At present, NSDL has three public interest directors and one shareholder director namely **Mr. J. Ravichandran**. NSDL provides various services to investors and other participants in the capital market like, clearing members, stock exchanges, banks and issuers of securities. These include basic facilities like account maintenance, dematerialisation, rematerialisation, settlement of trades through market transfers, off market transfers & inter-depository transfers, distribution of non-cash corporate actions and nomination/ transmission. The names of the e-services are given below:

SPEED-e

NSDL launched SPEED-e in September, 2001 and participant of NSDL can subscribe to SPEED-e. SPEED-e enables demat account holders to submit delivery instructions directly on the Internet through SPEED-e website. A demat account holder will have the option of accessing SPEED-e either as a Password User or as a Smart Card / e-Token User.

NSDL Mobile App

NSDL has developed a Mobile App for esteemed investors. You can download and use NSDL Mobile App to view balances in your demat account on your mobile anytime, anywhere. NSDL Mobile App is available on Google Playstore and Apple App Store and it is absolutely free for all demat account holders.

IDeAS

In 1st Jan 2004 provided Internet-based Demat Account Statement (IDeAS) which is the facility for viewing balances and transactions in the demat account updated on an online basis with a delay of maximum 30 minutes. This facility is available to the Users of SPEED-e, Clearing Members who have subscribed to IDeAS and to those clients whose Participants are registered for IDeAS. A demat account holder or a Clearing Member will have the option to access IDeAS either as a Password or a Smart Card / e-Token User.

STeADY

The Securities Trading Information easy Access and DeliverY (STeADY) is a facility which enables the brokers to deliver/submit contract notes to custodians/ fund managers electronically by transmitting digitally signed trade information with encryption. It further enables fund managers to enrich the contract note and convert it into instructions for the custodian.

Depository Account Validation (DAN)

Depository Account Validation (DAN) is an secured internet based facility which provides an online interface enabling subscribers to validate DP ID, Client ID and PAN of investors through a file upload. This facility is available to Book Running Lead Managers, Syndicate Members, etc., for Initial Public Offer, Public Issues etc.

SPICE

The Submission of Power of attorney based Instructions for Clients Electronically (SPICE) Clearing Members (Clients who have given Power of Attorney (POA) in favour of the Clearing Member) can submit auto pay-in instructions to Participants (where Clients maintain demat accounts) on SPEED-e facility to debit the demat accounts of the Clients and credit their Clearing Member (CM) Pool Accounts. Thus, eliminating the need to give paper based delivery instructions to the Participants.

Central Depository Services (India) Ltd. (CDSL)

National Securities Depository Limited which commenced operations during November 1996 was promoted by IDBI, UTI and National Stock Exchange (NSE). Central Depository Services (India) Limited commenced operations during February 1999 after receiving the certificate of commencement of business from SEBI. A Depository facilitates holding of securities in the electronic form and enables securities transactions to be processed by book entry. The balances in the investors account recorded and maintained with CDSL can be obtained through the DP. The DP is required to provide the investor, at regular intervals, a statement of account which gives the details of the securities holdings and transactions. The depository system has effectively eliminated paper-based certificates which were prone to be fake, forged, counterfeit resulting in bad deliveries. CDSL offers an efficiently and instantly transfer of securities in investor's account. CDSL was set up with the objective of providing convenient, dependable and secure depository services at affordable cost to all market participants. At present, CDSL has ten directors of which Shri P. S. Reddy is Managing Director & CEO since March 6, 2009 in CDSL and Shri Taruvai Subbayya Krishna Murthy is non-executive chairman and public interest director since March 30, 2016

The Depository Participant (DP) is the link between the investor, the company and CDSL and provides the following services:

Account Opening

To utilise the services offered by a depository, any person having investment in any security or intending to invest in securities needs to have a demat account with a CDSL-DP. The holder of such demat account is called as "**Beneficial Owner (BO)**". A BO can maintain a demat account with zero balance in such account. A BO can open more than one account with the same or multiple DPs, in the same name/s and order, if he/she desires so. The investor can approach any DP/s of his/her choice to open a demat account.

Dematerialization

Dematerialization is a process by which physical certificates (of shares / debentures / other securities) are converted into electronic balances. A BO has to submit the request for dematerialization by submitting the demat request form (DRF) duly completed along with the concerned physical certificates, to his/her DP.

Processing Delivery & Receipt Instructions

To settle trades done on a stock exchange (on-market trades) and trades, which are directly settled between two BOs (off-market trades), BOs submit duly completed delivery instructions in the prescribed form to DP. For receipt of securities into his/her account, a BO can give one time "standing instruction" to DP. Once such a standing instruction is given to the DP, there is no need to submit separate instructions for receipt every time the investor buys securities.

Account Statement

A DP sends to the BO, a statement of his account, monthly, if there is any transaction in the account or every quarter if the account is not operated during that period. The balances and transactions can also be viewed by the BOs through CDSL web based facility '*easi*'.

Rematerialization

Rematerialization is the process by which the electronic balances held in the demat account can be converted back into physical certificates with the demand of investor.

Pledging

If the BO decides to pledge any securities in his BO account, he can avail of the same by submitting the pledge creation form duly completed, to his DP.

Nomination

Individual BOs have a facility for nomination in favour of an individual. If the sole or all the joint holders are deceased, the shares of different companies held in the demat account will be transmitted easily to the demat account of the nominee on submission of the death certificate and transmission form.

Transmission of securities

CDSL offers a facility for transmission of balances held in BO account/s (to other BO account/s) if so required due to death, lunacy, bankruptcy, insolvency or required due to operation of any law.

Change in Address

A BO who wishes to register his change in address submits his/her request in writing to his/her DP. The changes entered by the DP in the CDSL system will be automatically downloaded to all the companies in which the BO is holding securities. This facility offered by CDSL saves money, time and effort for the BO.

Bank Account Details

SEBI has made it mandatory for companies to print details of bank account of the BO on dividend/interest warrants etc. to prevent possibilities of misuse of the warrants. All BOs should submit a request in writing to the DP if they wish to record / change their bank account details.

SMS

CDSL sends SMS regarding transactions and modifications in account details to the mobile number registered in the account of investor.

Advantages of the Depository System

The introduction of the depository system, it is claimed, would take away many of the ailments facing the present system, make the trading in scrips foolproof, would serve as a panacea and would ultimately contribute to the emergence of a highly efficient capital market. The system is expected to offer the much awaited custodial services to Indian and foreign investors together.

- Reduction in paper work.
- Elimination of risks associated with physical scrips such as theft, forgery, loss of share certificates etc.
- Elimination of bad delivers.
- Increased liquidity of scrips through speedy settlement and reduction in delays in registration.
- Low transaction costs for purchase and sale of securities compared to physical mode.
- No stamp duty on transfer of securities.
- Facilities the issuer companies to update the information regarding shareholders and to communicate with them in better ways.
- Attract foreign investors and promoting foreign investment.
- Emergence of Healthy and Efficient capital market.
- Greater opportunity for the development of sophisticated custodial services etc.

Problems of Depository System in India

Despite the various benefits of the depository system, for investor, stock exchange, financial institutions and other stakeholders. The following are the points that can be consider the drawbacks of depository system in India.

1. Agency risk

The major issue which keeps the retail investor away from the depository system is the agency risk. From the view point of the investor, the risk perception in the depository system is no less than that in the present system of trading and settlement. It is true to say that in the present system, the agency risk is diversified among various players like brokers, registrar, postal system etc. In the depository system, though the depository participant is a reputed bank, the retail investor does not feel confident until effective insurance coverage is provided.

2. Lack of awareness

It is estimated that in India retail investors hold about 30% of the market capitalization. In spite of their considerable share in the capital market, they do not show adequate interest in demat trading. This is mainly due to lack of awareness among the retail investors or the fear of being caught in the tax net. Most of the investors are not aware of the benefits of demat trading.

3. Risk of loss in transit

Distribution of cash benefits accruing to investors can be expedited under depository system. But cash benefits cannot be disbursed electronically. Still they have to be sent by post. So, the risk of loss in transit is to be borne by the investor.

4. Multiplicity of charges

Under depository system, there are charges for opening of account, dematerialization, rematerialisation, etc. Apart from this, investors who intend to hold their investments in dematerialised form have to pay custody charges to the depository participant. All these charges may deter the retail investors from taking advantages of the system.

5. Reluctance for trading

Most of the existing shareholders do not opt for depository system. They intend to keep their securities only in physical form.

6. Fear of tax liability

A large number of transactions related to securities are not accounted for, because most of the buyers and sellers are not comfortable with their names appearing in computer print-outs as they fear being brought into tax net. This aspect prevents the investors from taking advantage of the depository system.

7. Inadequate infrastructure

In India, the infrastructure available for trading in demat shares is inadequate. The Depository Act and SEBI have overlooked the role of Clearing and Settlement Corporation.

For the successful operations of the depository, there should be a centralized clearing and settlement corporation handling the trade in all exchanges. The establishment of such a central institution will effectively facilitate smooth interaction with the various exchanges. Another problem is that the investors living in smaller towns will find it impossible to open a demat account.

References and Footnotes

1. On dated 2009, June 19 from SEBI (Facilitation of Issuance of India Depository Receipts) (Amendment) Regulations, 2009 vide letter No. LAD/NRO/GN/2009-2010/10/166936.
2. On dated 2011, April 13 from SEBI (Change in Conditions of Registration of Certain Intermediaries) (Amendment) Regulations, 2011 vide letter no. LAD/ NRO/ GN/ 2011-12/03/12650.
3. On dated 2011, July from SEBI (Depositories and Participants) (Amendment) Regulations, 2011 vide letter no. LAD-NRO/GN/2011-12/14/21219.
4. On dated 2012, September from SEBI (Depositories and Participants) (Amendment) Regulations, 2012 vide letter no. LAD-NRO/GN/2012-13/15/20426.