

STUDY NOTES

SEBI Grade 'A' (Assistant Manager)

Securities Law Depositories Act, 1996



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Depositories

- A depository is an organisation
 - **which holds securities** (like shares, debentures, bonds, government securities, mutual fund units etc.) of investors
 - **in electronic form** (i.e. dematerialised form)
 - **through a registered Depository Participant (DP)**
- India has adopted the Depository System for securities trading in which book entry is done electronically and no paper is involved.
- The physical form of securities is extinguished and shares or securities are held in an electronic form.
- An effective and fully developed depository system is essential for maintaining and enhancing the efficiency of a mature capital market.

A depository system helps to address the following problems related to securities:

- Bad deliveries
- Fake certificates
- Loss of certificates in transit
- Mutilation of certificates
- Delays in transfer
- Long settlement cycles
- Mismatch of signatures
- Delay in refund and remission of dividend
- Higher cost of transfer of securities

Box 1 – Depositories in India

- The depository model adopted in India provides for a competitive multi-depository system.
- A depository should be a **company formed under the Companies Act, 2013** and should have been granted a certificate of **registration under the SEBI Act, 1992**.
- There can be various entities providing depository services. Presently, there are two depositories registered with SEBI, namely NSDL and CDSL

<u>Parameter</u>	<u>NSDL</u>	<u>CDSL</u>
Abbreviation for	National Securities Depository Ltd	Central Depository Securities Ltd
Founded in	1996	1999
Headquarters	Mumbai, India	Mumbai, India
Promoters	IDBI Bank, UTI, NSE, etc.	BSE, HDFC, SBI, BOI, BOB, etc
Chairman (as of Sep 30, 2018)	Mr. B. A. Prabhakar	Mr. T.S. KrishnaMurthy
MD & CEO (as of Sep 30, 2018)	Mr. G. V. Nageswara Rao	Mr. P.S. Reddy
No. of Active client accounts (as on Sep 30, 2018)	1.77 crore	1.61 crore
No. of DP (as on Sep 30, 2018)	276	595

Functioning of a Depository

The functioning of Depository and its constituents in India is primarily governed by the

- Depositories Act 1996
- SEBI Act, 1992
- SEBI (Depositories and Participants) Regulations, 1996
- Bye-laws of depository
- Companies Act, 2013

The Depository functions and is inter-linked with the various constituents as below:

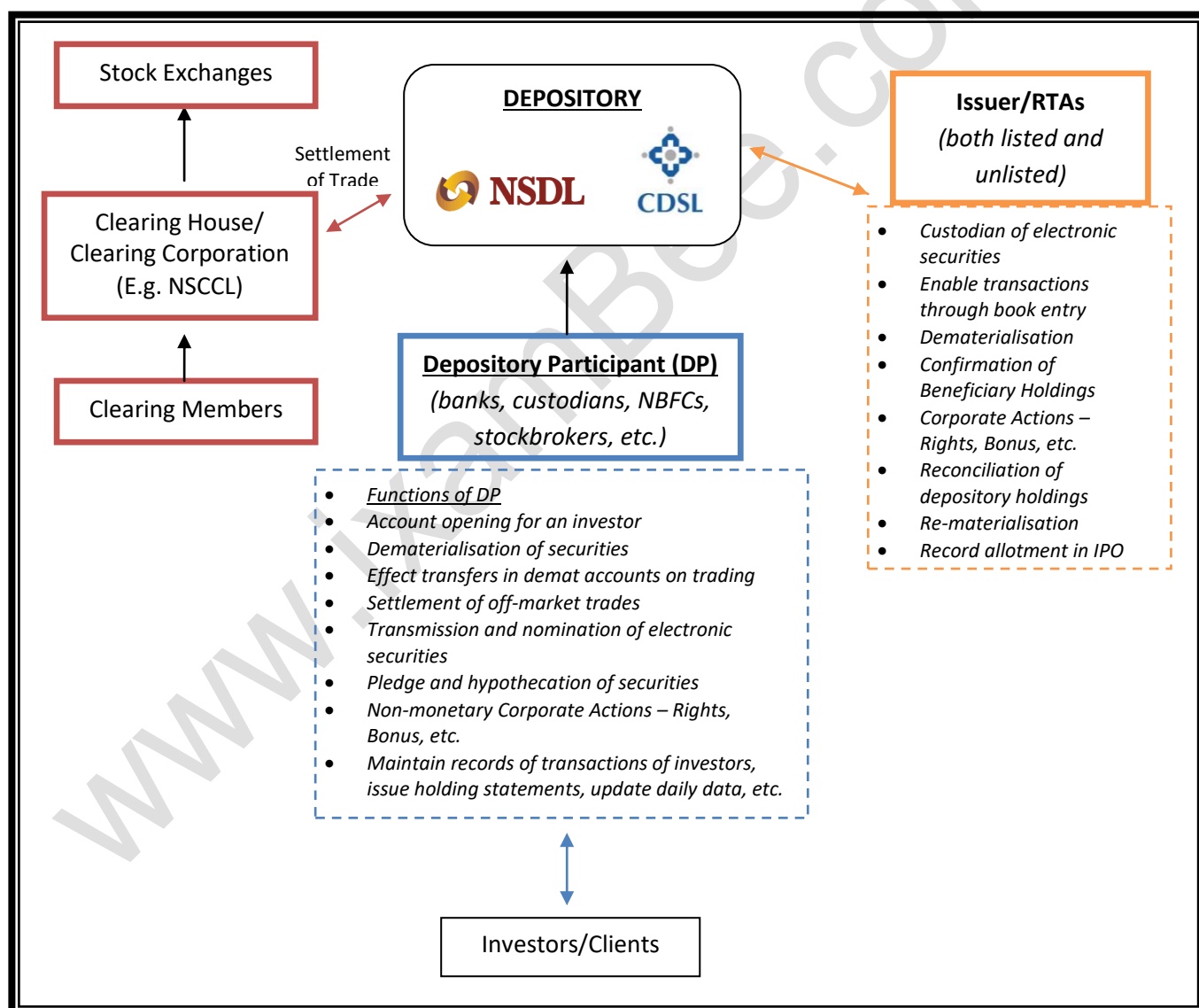


Figure: Depository System

Objectives of the Depository System

- Maintenance of ownership records and effecting changes in ownership records through book entry;
- **Dematerialisation** of securities in the depositories mode as well as giving option to an investor to choose between holding securities in physical mode and holding securities in a dematerialized form in a depository;
- Making the securities **fungible**
- Making the shares, debentures and any interest thereon of a public limited company **freely transferable**
- Exempting all transfers of shares within a depository from stamp duty

Both depository and custodial services are responsible for safe keeping of securities but they are different in the sense that the Depository can legally transfer beneficial ownership, while a custodian cannot.

Box 2 – Dematerialisation (Demat)

Meaning

- Process by which the physical share certificates of an investor are taken back by the Company and an equivalent number of securities are credited his account in electronic form at the request of the investor.
- An investor will have to first open an account with a DP and then request for the dematerialization of his share certificates through the DP so that the dematerialized holdings can be credited into that account.
- This is very similar to opening a Bank Account
- In Public Issues/Right Issues, shares are issued only in demat form.

Process of Demat

1. Investor opens demat account with DP
2. Submit duly filled Dematerialisation Request Form (DRF) with share certificates to DP
3. DP intimates Depository
4. Depository intimates Registrar & Transfer Agent (RTA)/Issuer
5. DP sends DRF and share certificates to RTA/Issuer
6. RTA/Issuer confirms demat to Depository
7. Depository credits investor's demat account

Latest regulatory updates on demat

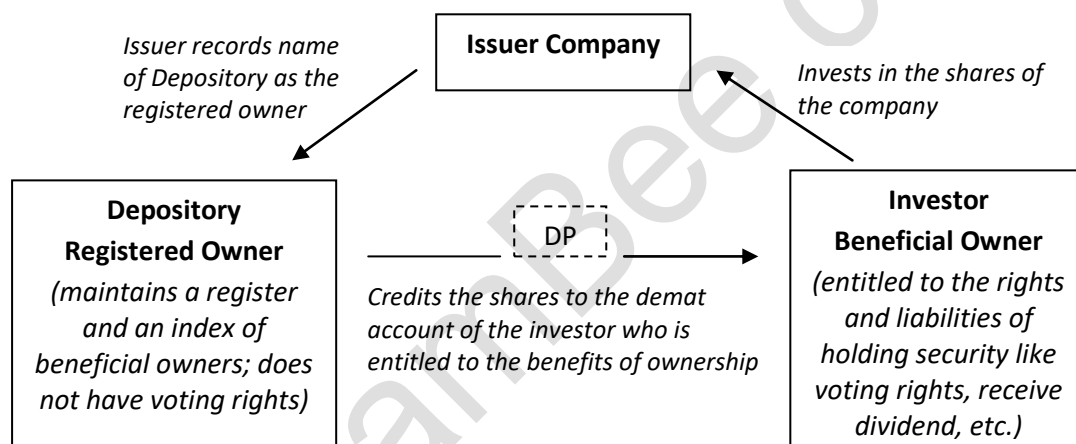
- SEBI, in September 2018, amended relevant provisions of SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 to **disallow listed companies from accepting request for transfer of securities which are held in physical form with effect from December 5, 2018**. The shareholders will need to convert the physical share certificates to demat form compulsorily if they wish to affect any transfer.
- Also from October 02, 2018, **public unlisted companies are also required to issue securities in dematerialised form**.

Box 3 – Understanding Terms

What is meant by fungibility?

- Fungible essentially means interchangeable and uniform.
- All certificates of the same security shall become interchangeable in the sense that investor loses the right to obtain the exact certificate he surrenders at the time of entry into depository.
- It is like withdrawing money from the bank without bothering about the distinctive numbers of the currencies.
- Securities in depositories are in fungible form

Registered owner and Beneficial Owner



Any loss caused to the beneficial owner due to the negligence of the depository or the participant, would be indemnified by the depository to such beneficial owner. Where the loss due to the negligence of the participant is indemnified by the depository, the depository has the right to recover the same from such participant.

Pledge or Hypothecation of Securities held in a Depository

- If an investor (beneficial owner) needs to pledge or hypothecate the security owned by him through a depository, he/she would require approval of the depository and give intimation of such pledge or hypothecation to the depository participant.
- The depository will then make entries in its records of such pledge of securities which will serve as evidence of a pledge or hypothecation.
- Both pledger (borrower) and pledgee (lender) must have depository account

Box 4 – Learning through Quiz

What is ISIN?

- ISIN stands for International Securities Identification Number
- It is a code that uniquely identifies a specific security, which is allocated at the time of admitting the same in the depository system.
- In India it is a 16 digit alpha-numeric number starting with 'IN' where 'IN' indicates the country code of India.

What is the difference between Transfer of securities and transmission of securities?

Transfer arises due to trading in securities i.e. when securities are bought or sold.

Transmission refers to process by which ownership of securities is transferred to a legal heir or to some other person by operation of law

Who is a Designated Depository Participant (DPP)?

These are SEBI approved DDPs that grant registration to Foreign Portfolio Investors (FPIs) on behalf of SEBI and also carry out other allied activities.

Regulatory change in Oct 2018 - The DDPs will have to provide the number of FPI applications received and the average time taken in processing of such applications during the immediate preceding month to SEBI by fifth working day of every month, in a prescribed format. This has been done with an aim to bring transparency in processing of applications for FPI registration.

How are demat shares reconciled?

Regulation 55A of SEBI (Depositories and Participants) Regulations, 1996 provides that every issuer shall **submit audit report on a quarterly basis** to the concerned stock exchanges audited by a practicing Company Secretary or a qualified Chartered Accountant, for the purposes of reconciliation of the total issued capital, listed capital and capital held by depositories in dematerialized form, the details of changes in share capital during the quarter and the in-principle approval obtained by the issuer from all the stock exchanges where it is listed in respect of such further issued capital.

What is a Basic Services Demat Account (BSDA)?

A demat account that provides limited services at reduced costs to retail investors. SEBI vide its circular dated December 11, 2015 advised the DPs to convert all the eligible demat accounts into BSDA unless such Beneficial Owners (BOs) specifically opt to continue to avail the facilities of a regular demat account.

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