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INVESTMENT THROUGH DEPOSITORY SYSTEM IN INDIAN SECURITY MARKET: A LEGAL ANALYSIS

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Date:26-04-2024

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List of Abbreviations

A.I.R	-	All India Reporter
ACG	-	Asia Pacific Central Securities Depository Group
BSE	-	Bombay Stock Exchange
CDSL	-	Central Depository Services Limited
CLA	-	Corporate Law Adviser
Comp. Cas	-	Company Cases
FFS	-	Flat Fee Structure
IDBI	-	Industrial Development Bank of India
IEPF	-	Investor Education Protection Fund

IPO	-	Initial Public Offer
NSDL	-	National Securities Depository Limited
NSE	-	National Stock Exchange
PL	-	Public Law
SCL	-	Society for Computers and Law
UIDAI	-	Unique Identification Authority of India



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CHAPTER-I

INTRODUCTION

1.1. Statement of Problem

The term 'Depository' refers to an organization, providing financial services where the securities (shares, debentures, stocks, bonds) of investors are kept in electronic form. Depository interfaces with its investors through agents known as Depository Participants.¹ Earlier, trading in securities was done through physical mode and as a result the regulators of the market need to be cautious to maintain the records. In current scenario, Indian security market has adopted a safe and stable framework, which allows the trading of securities in electronic form. The depositories are the novel creation for a stable financial system, which works in similar manner as the bank works.² The Depository system is the game changer of the Indian Security market. It ensures smooth trading of securities and enables the stock exchanges to ensure that buyers and sellers receive their shares and money respectively in the market.³

Trading with physical form of shares is a very time-consuming and tedious process. Also, investors have reported that trading takes a lot of time in settling their accounts. Major risks identified were theft of physical share certificates, presence of forged certificates, delay in transfer of shares to investors etc. In the paperless trading system, the securities of the investors are held electronically through a process called dematerialization, which converts the physical shares into electronic form.⁴ The scripless trading system is one of the significant initiatives taken by the Government so that the stock market can change the face of the Indian financial system. Two depositories are registered with the Securities Exchange Board of India (SEBI) i.e. National Securities Depositories Limited and Central Depository Services Limited (CDSL).⁵ The above two depositories have changed the settlement account period from paper mode to electronic mode in a short time. The total number of investors registered with these depositories for security has increased tremendously in a short span of time. Investors prefer

¹ Bhagwat and Ritesh More, "A Study on Indian Depository System: Growth and Role in Indian Financial Market", JETIR, Vol. 5, No. 7, 2018, p. 266.

² M.Sajithra and M. Kannappan, "A Study on the Role and Function of Depositories in Securities Market", INTERNATIONAL JOURNAL OF PURE AND APPLIED MATHEMATICS, Vol. 119, No. 17, 2018, p. 904.

³ Yogesh Garg, "An Exploratory Study on Dematerialization & Depository System in India", CASIRJ, Vol. 7, No. 12, 2016, p. 38.

⁴ G. Maheshwari and S. Mabel Latha Rani, "A Study on Investors Perception and Satisfaction of Depository Services", JETIR, Vol. 5, No. 5, 2018, p. 142.

⁵ Abhishek Vaidya, "Depositories and the Regulations Governing them in India: An Analysis", ASIA PACIFIC LAW AND POLICY REVIEW, Vol. 4(Annual), 2018, p. 262.

electronic/paperless mode of trading due to some of the benefits offered which are shorter settlement period, safer mode than traditional system, reduction in transaction cost, services provided by Depository Participants as custodian etc.⁶ Depository Model was introduced in the capital market to provide benefits to the intermediaries, issuers of securities etc.⁷ There is no doubt that demat system is efficient against the traditional paper trading system. The investors are receiving more benefits in the scripless trading model due to the services provided by the depositories in this system.

Long-term investors are especially benefitted by this system as they noticed that it is safer and less time consuming. Government introduced Depository model in 1992 to improve the infrastructure of the capital market and prevent high risk factor for the foreign investors to invest in the security market in India. Developing country like India has to keep a pace with International Financial Market and thus by introducing the paperless trading system, Indian capital market has become more efficient and stable. SEBI has mandated trading in dematerialization of shares for traders in the stock market from January 4, 1999.⁸ It implies that investors have not provided with any option to choose paper or scripless trading system. Though it cannot be denied that Depository system proved to be one of the significant initiatives of the Government to improve economic and financial system, but on the other hand, the charges for availing the depository services are too high for the small investors. Small investors in the market are not trading frequently in the stock market. The Working Group set up under the guidance of SEBI in 1994 on the legal framework of depository system has explicitly stated in its report that investors would be allowed to choose to hold their securities either in physical or electronic form. They have considered the problem for investors who are residing in distant/remote places, where depository services are not available.⁹ Small investors would not be able to afford certain charges to avail depository services by NSDL and CDSL for debit transaction, custodian charges, Depository Participant fees etc. Various studies proved that these investors are not ready to opt for depository services due to residing at remote places, high charges etc.¹⁰ It is an undisputed fact that depository system in India is a major revolution in the Indian Securities market and due to this, Indian economy has attained recognition at the international level. The Depository system has resolved various issues and challenges brought

⁶ Pravesh Kumar Mann, "Structure of the Indian Depository System", JMME, Vol. 09, No. 04, 2019, p. 55.

⁷ Hari Babu Bathini and B.K. Surya Prakasha Rao, DEPOSITORY SYSTEM IN INDIA, 1st ed., 2018, p. 16.

⁸ Kiran Chaudhary and Ramesh Kumar Malik, "Depository System in India: An Appraisal", IJRSS, Vol.1, No. 1, 2011, p. 209.

⁹ R. Olekar & C. Talwar, "Online trading & DEMAT account in India-Some issues", IJMSSR, Vol. 2, No. 4, 2013, p. 83.

¹⁰ "Depository Services: Basics to Benefits", <https://www.financialexpress.com/archive/depository-services-basics-to-benefits/47498/>, (visited on July 21, 2021).

by the paper based trading system, which are duplicity of physical share certificates, theft of these certificates during transit, delay in delivery etc.

However, this new system is not able to attract the small investors as they cannot afford the higher fees/charges charged by the depositories in return of the services. Moreover, the compulsory Demat registration for all investors would increase the burden of both the depositories and existing inadequate infrastructure would not suffice. Depository Participants do not follow any uniform standards while handling demat transactions, which provide them opportunity to act according to their discretion. They charge investors high demat fees against utilization of demat services. This leads to revisit the existing provisions and procedures of depositories. The research has made an attempt to analyze the need and importance of demat trading system and to assess whether the depository participants and other stakeholders are adopting safeguards to protect the interest of investors.

1.2.Rationale of Study

There are several studies done which deals with financial performance of the Depository System and its impact in the Indian security market but few studies has analysed role of depositories in promoting investment and legal framework regulating paperless transactions in the Indian security market. It is an undisputed fact that a large percentage of investors preferred trading through dematerialization but the present study has made an attempt to assess and evaluate whether paperless trading (which has been made compulsory by SEBI) would be considered as a boon for small investors. Shareholders of small companies would not prefer paperless trading due to high costs and charges applicable in this system. Moreover, the step taken by SEBI to trade securities through Demat system leaves small shareholders/investors in dilemma which has prevented the participation of these investors in Indian security market.

After collecting relevant data and information, the study would try to address the issues and challenges in the Depository system by analyzing its laws and its impact on the investors in the security market. This research would help to identify the problem and prospects of the Depository System, to increase the awareness among the investors and other people about the merits and demerits of the Depository System. This research can proved to be helpful for law students, scholars and other stakeholders for further research purpose.

1.3. Objectives of the Study

In the light of existing issues, the researcher has formulated following research objectives for the proposed research –

1. To analyze the importance of dematerialization of securities along with evolution of depository system in India.
2. To study the role of depositories in promoting investment in securities market in India.
3. To analyse the existing legal framework regulating transaction of securities through depository system in India.
4. To analyse the issues and challenges in depository system in India.

1.4. Research Hypotheses/Questions

1.4.1. Research Hypotheses

To study the above-mentioned research objectives, the Researcher has formulated following hypotheses:

1. Depository system has eliminated the problem of bad deliveries of securities to investors in the Indian security market.
2. Depositories has provided cost-effective demat charges structure to investors.
3. The laws governing depository system and mechanism are inadequate to achieve their ends in the era of technological developments.
4. Evolution of Depository system in India has not affected the quantum of small investors and failed to attract their investment in Indian security market.

1.4.2. Research Questions

The present research is conducted with an aim to attain solutions to the following questions –

1. What is the contribution of depository system in the growth of Indian security market?
2. How the Demat System has promoted the investment in Indian securities market?
3. Whether the current legal framework and the remedies provided is sufficient to protect the interest of investors?
4. What are the steps required to be taken by the authorities to protect the interest of small investors?

1.5. Literature Review

The researcher has made all efforts to provide answers to preliminary questions based on

available and accessible primary and secondary literature, significant to the present study. Various studies directly and indirectly, which are in relation to the domain of the study have been analysed for the formulation of research problem, research objectives, hypotheses and research questions.

To analyze and understand the concept of Depository system, it is imperative to understand the role of two depositories, different services being provided to investors by them. In view of the above, reference has been taken from the work of Bharti V. Pathak, who in her book, has discussed concept of the Depository System along with the need for such system in Indian security market. The author discussed elaborately the role of the two depositories NSDL and CDSL and services provided by them to the investors while trading their shares through demat account.¹¹

For the better analysis, it is crucial to study the objectives and purpose of the legislations regulating the depository system. In his book, MY Khan analyzed the objectives of the Depositories Act and other SEBI regulations specified to regulate the transaction of securities through dematerialized form. The author discussed the rights and obligations of depository Participant, issuers etc. Also, the author discussed an overview of legislations dealing with Indian Depository Receipts.¹² For the better understanding of working and functioning of depository system, there is need to analyse and study role of different stakeholders of depository system. Jaydeb Sarkhel and Seikh Salim in their work analyzes the need of Depository system in India to protect the interest of investors in Indian security market. The author also discussed different stakeholders in depository system such as role of Depository Participant, functions of depositories i.e. NSDL and CDSL in stock market.¹³ Also, various researchers like G. Ramesh Babu also make its focus of study on the need of demat trading system in India. For this, he pointed out the problems faced by the investors in traditional/physical trading system and why there is need of Depository system in India to protect the interest of investors. The author also discussed the legal provisions of the Depositories Act in relation to rights and obligations of the depositories, Depository Participant; powers of the SEBI to regulate the depositories etc.¹⁴

The success rate of working of any system depends on its performance. When there are two depositories working in the same field, then it is bound to make comparisons among both the depositories. Raj S. Dhankar has made the comparison of traditional trading system and depository system and analyzed the positive aspects of the dematerialization form in India. The author also discussed how the paperless trading system is an effective clearing settlement process

¹¹ Bharati v. Pathak, THE INDIAN FINANCIAL SYSTEM: MARKET INSTITUTIONS AND SERVICES, 3rd ed. 2010.

¹² MY Khan, INDIAN FINANCIAL SYSTEM, 10th ed. 2018.

¹³ Jaydeb Sarkhel and Seikh Salim, INDIAN FINANCIAL SYSTEM AND FINANCIAL MARKET OPERATIONS, 1st ed. 2017.

¹⁴ G. Ramesh Babu, FINANCIAL SERVICES IN INDIA, 1st ed. 2005.

and has benefitted the investors of Indian security market.¹⁵ In his work, Alan R. Kanuk discussed the evolution of the depository system in India. The author also conducted various surveys to evaluate and assess the performance of the two depositories i.e. NSDL and CDSL. The survey found out that NSDL has more number of registered investors as compared to CDSL and even stock brokers and Depository Participants prefer to maintain the accounts of investors with NSDL.¹⁶ SEBI has introduced Depository system with an aim to protect the interest of investors and increase the participation of domestic and foreign investors in the securities market. The Depository system increases the market efficiency and transparency in the securities market. A.K. Vashisht and B.B. Tandon discuss about how the security trading can be done efficiently through process of Dematerialization. The author also analyzes the features introduced in the Depositories Act 1996, favouring the interest of investors.¹⁷

In an attempt, the scope and application of depository system has been widened by including various financial assets along with securities. This has been done to widen the arena of investors participation in the securities market. For this, reference has been taken from Depository System Review Committee in its report has discussed the objective of the Depository System and stated that the process of dematerialization is not only confined to securities but also to other financial assets. Depositories and other market participants accepted the recommendation made by the Committee. The intention of the Committee behind proposing the above recommendation was to provide wider access to consumers so that they can have more choices to prefer among wide range of financial assets.¹⁸

In current scenario volume of demat trading has been increased at an alarming rate. Both the depositories are required to handle bulk demat trading transactions simultaneously. M.T. Raju and Prabhakar Patil conducted the study on Dematerialization of shares and through statistical data proved that volume of trade has increased tremendously in the securities market after Government has introduced the trading through process of dematerialization. The transaction cost has reduced to a large extent as compared to the pre-demat era. NSDL and CDSL are coordinating with each other so that investors do not have to borne high transaction cost. India is one of the few countries which have made progress in short span of time and increased volume of trading in has contributed to the growth of equity market.¹⁹

¹⁵ Raj S. Dhankar, CAPITAL MARKETS AND INVESTMENT DECISION MAKING, 1st ed. 2019.

¹⁶ Alan R. Kanuk, CAPITAL MARKETS OF INDIA: AN INVESTOR'S GUIDE, 1st ed. 2007.

¹⁷ A.K. Vashisht and B.B. Tandon, FINANCIAL SECTOR REFORMS: AN UNFINISHED AGENDA FOR ECONOMIC DEVELOPMENT, 1st ed. 2002.

¹⁸ Securities and Exchange Board of India, "Interim Report of the Depository System Review Committee" https://www.sebi.gov.in/sebi_data/meetingfiles/1416996968224-a.pdf, (visited on July 21, 2021).

¹⁹ M.T. Raju and Prabhakar Patil, "Dematerialisation: A Silent Revolution in Indian Capital Market", https://www.sebi.gov.in/sebi_data/attachdocs/1321590203466.pdf, (visited on July 21, 2021).

Small IC Gupta and Naveen Jain critically analyzed the impact of depository system on small investors who are the major contributors in the growth of the equity market. They have emphasized on the high charges borne by the investors to avail the services from depositories like NSDL and CDSL, which leads to withdrawal of small investors from the market. Shareholders of small companies are in dilemma as SEBI has made the trading of securities through demat compulsory. Therefore, policymakers are required to redesign the law regulating transactions through demat form so that more and more investors can contribute in the market.²⁰

Report of the SEBI Committee on Reduction of Demat Charges has examined the issue of high charges borne by the small investor to avail depository services especially in the case of switching from one depository to another. The Committee has provided its recommendations by relaxing the limit of charges to be borne by these small investors. Committee has also observed that the Depository Participants charge their fees in arbitrary manner and there is no uniform standard or criteria, which can ascertain their fees. Committee has specifically noted that small investors have to born high charges to avail the depository services.²¹

Depositories like NSDL has not accepted the recommendations of the Committee and decided the structure of charges at its discretion. The author has examined the benefits and challenges posed by the Depository System and putting its special emphasis on the role of NSDL and its implication on the trading in the security market. On the one hand, he discussed about the achievements made so far in the security market and on the other, also focused on the challenges and obligations on these depositories and market regulator for smooth functioning of the depository system as a whole. It is an undisputed fact that with introduction of depositories like NSDL and CDSL, securities market has seen tremendous growth in a decade. However, the responsibilities of the market regulator have increased and they are under an obligation to increase the investors awareness regarding the benefits and the functioning of depository system.²²

1.6. Research Methodology

The study will be based on combination of doctrinal method. Secondary resources will be the main source of study. The researcher aims to adopt exploratory research design for the present study. It is to be understood that there are three purposes for which exploratory studies takes place.

²⁰ I.C. Gupta and Naveen Jain, "Indian Securities Depository System: What Has Gone Wrong", ECONOMIC AND POLITICAL WEEKLY, Vol. 38, No. 20, 2003, p. 1969.

²¹ Securities and Exchange Board of India, "Report of the Group on Reduction of Demat Charges", https://www.sebi.gov.in/reports/reports/jan-2004/report-of-the-group-on-reduction-of-demat-charges_11921.html, (visited on July 22, 2021).

²² C.B. Bhawe, "Demat: Achievements and Challenges", <https://www.primedatabase.com/Article/dir-00ar3.pdf>, (visited on July 22, 2021).

This has been preferred to satisfy the researcher's curiosity and desire for better understanding. It is to test the feasibility of conducting a more extensive study. It is also to develop the methods of the employed in any subsequent study.

The idea of this research is to analyze the need of dematerialisation of securities and the how with the help of depository system the investment in the securities market has been promoted by SEBI.

1.7. Scope and Limitations

The study would be confined to problems and prospects involved in Depository system in India. Through the use of relevant data and information, the researcher would aim to analyse the depository laws and whether depository system is increasing the scope of investment for investors in the security market. The study is exclusively confined to India and if laws of other countries are mentioned in the research, that is only for the purpose of analyzing Indian laws. For the present research, the researcher has placed reliance on data comprising of articles, committee reports, working papers etc. and recent amendments in laws made by SEBI in this regard.

1.8. Chapterization

After taking into consideration the hypothesis and research questions of the study, decided under the supervision of the notional supervisor, the researcher has divided the research into following chapters

The first Chapter titled INTRODUCTION would deal with the study on the concept of Depository System, how process of dematerialization has changed the face of the Indian security market. It further consists of the review of literature for the purpose of clarity and the impact of paperless trading system on the investors in the security market. On the basis of review of literature, the identification of the statement of problem would be done and in the light of the problem, the objectives of the study along with the hypotheses and research questions of the study would be framed. It would also consist of research methodology used for the purpose of present study along with the scope and limitations of the study. It further consists of the brief overview of the chapters, which would be dealt by the researcher in the study.

The second chapter titled NEED AND IMPORTANCE OF DEMATERIALISATION OF SHARES would deal with the evolution and concept of dematerialization of shares. Further, it

would also deal with the constituents and features of the Depository system, need and importance of depository system contributing to the growth of Indian securities market. Further, it would also discuss the impact of depository system on investors in the security market and how the paperless trading system has brought a major revolution in the capital market in India.

The third chapter titled **ROLE OF DEPOSITORIES** would deal with the role played by two major depositories in India i.e. National Securities Depositories Limited (NSDL) and Central Depositories Services Limited (CDSL). Further, it would also analyse their performance to enable the investors to trade their securities.

The fourth chapter titled **LEGAL FRAMEWORK FOR DEPOSITORY SYSTEM IN INDIA** would deal with the existing regulatory framework comprising of different laws applicable while dealing with depository system. This chapter would also analyse different legal aspects of the depository system providing protection to the investors. Further, it would also discuss the judgments of Supreme Court, High Courts and Securities Appellate Tribunals related to status of Depository Participant, determining the liability of the depositories, rights of the investors engaged in transaction of securities.

The fifth chapter titled **ISSUES AND CHALLENGES IN DEPOSITORY SYSTEM** would deal with the problems and challenges faced by the regulatory authorities to protect the interest of the investors and other stakeholders involved in security market. Further, it would also deal with the impact of demat system on small investors and its consequential effect on the capital market. Moreover, the legal structure adopted for the depository system in India is inadequate to prevent fraud cases in market and it is complex, preventing the investors from reporting complaints and their grievances before the proper forum.

The sixth and the last chapter titled **CONCLUSION AND SUGGESTIONS** would deal with the conclusion of the research and enlightening the reader about the issues and significance of current demat system. It would also provide the suggestions to meet the purpose and intention of the policymakers behind introducing the paperless trading system. Moreover, the researcher would also highlight the future roadmap for the effective implementation of the depository system and its various laws.

CHAPTER-II

IMPORTANCE OF DEMATERIALISATION OF SHARES

2.1 Indian Stock Market- A Historical Perspective

In the period of 1990s, a need was felt for an efficient and systematic securities market to achieve the desirable growth. It cannot be denied that securities market plays a very crucial role in the economic growth of any country. The securities market will assess the quantity of savings, capital received from the national income and it also improves the system of funds allotment in the market. These all factors can only run in a stable securities market and for that purpose, the market efficiency, transparency, accountability etc. needs to be taken into consideration. Further, to prevent any malpractice in the market one needs to follow certain rules and regulations and market regulator has to set higher standards which can meet the global expectation. Keeping the purpose and aforesaid factors in mind, Indian market was liberalized and to regulate the securities market, the laws were implemented since 1990s.¹

2.2 Concept of 'Trading of Securities'

The concept of trading of securities is not a novel concept but it dated back to 18th century when East India Company has started trading in loan securities. During the time of 1830s, in Bombay (which at present is Mumbai), trading of corporate shares has initiated with the popular stock of Bank and Cotton presses. The famous Dalal Street in Bombay was set up in 1874, when the number of stock brokers has increased within a period of time. At that time, an informal association, which was known by name of Native Share and Stockbrokers Association and later on the same, was popular with the name of Bombay Stock Exchange (BSE) in 1875. BSE is the oldest stock exchange in Asia and this was the first stock exchange, which received so much appreciation from various stockbrokers, and finally it was provided with recognition in 1956 under Securities Contract Regulation Act, 1956.²

After some time, in 1894, Ahmedabad stock exchange came into existence, which was emphasized on trading in shares of textile companies and mills. Later on, in 1908, Calcutta stock Exchange started its trading with focusing its shares on plantation and jute mills. Lastly, in 1920,

¹ Securities and Exchange Board of India, "A *Historical perspective of Securities Market Reform*", https://www.sebi.gov.in/media/speeches/mar-2004/a-historical-perspective-of-the-securities-market-reforms_2882.html, (visited on August 16, 2021).

² Investeek India, "The *History of Stock Exchanges in India*", <https://medium.com/@askteek/the-history-of-stock-exchanges-in-india-c97f1ec6f1c1>, (visited on August 16, 2021).

Madras Stock Exchange was being followed³.

2.2.1 Trading of securities post-independence period

At the post-independence stage, trading of securities took a different turn. BSE has dominated the securities market and voluminous trading took place during that time vide this stock exchange. During that time, due to less emphasis on regulation of markets and these stock exchanges, the market was not trustworthy and less transparent and accountable. This factor, in turn, arises the need of a specific market regulator, and consequently, Securities Exchange Board of India (SEBI) was set up in 1992. It was at this time, the famous scam Harshad Mehta took place, and again more pressure was exerted on SEBI to set up another stock exchange to ensure transparency and accountability in the market. As a result, National Stock Exchange (NSE) was set up in 1992 and trading of securities began with this stock exchange in 1994.⁴

Further, in 1986, BSE introduced Sensitivity Index, which is known as 'Sensex'. This is a base stock index, which assesses the performance of this exchange. For instance, in 1990, *the index reached the level of 1,000 in July 1990, 2,000 in January 1992, 4,000 in March 1992, 5,000 in October 1999, and 6,000 in February 2000.*⁵ In contrast to this exchange, NSE introduced its base exchange, known by the name of CNX Nifty, at present known by the name of Nifty 50. This was the first stock exchange to bring electronic screen-based trading and improved the efficiency of the markets.⁶

2.2.2 Purpose of Regulation of Security Market

The term 'security' has been defined in our laws, rules and regulations. It states that *securities include shares, scrips, bonds, debentures etc.*⁷ There is no mandate that any specific instrument have to be deemed as security. There can be reason for such rationale is that securities are *insecure instruments*. If there is no law or policy to regulates such instruments, then no market can run smoothly and achieve a stable and systematic financial system. Regulation of market is very essential to prevent any malpractices or unfair trade practice⁸, which sometimes results in failure

³ A. Rjumohan, "Stock Markets: An Overview and A Literature Review", https://mpr.aub.uni-muenchen.de/101855/1/MPRA_paper_101855.pdf, (visited on August 17, 2021).

⁴ *Supra* n.2.

⁵ BSE, "History and Milestones- BSE", https://www.bseindia.com/static/about/History_Milestones.html, (visited on August 16, 2021).

⁶ NSE, "History and Milestones-NSE", <https://www.nseindia.com/national-stock-exchange/history-milestones>, (visited on August 16, 2021).

⁷ Section 2(h)(i) of Securities Contract (Regulation) Act, 1956.

⁸ Ana Carvajal and Jennifer Elliott, "Strengths and Weaknesses in Securities Market Regulation: A Global Analysis", https://www.researchgate.net/publication/5125284_Strengths_and_Weaknesses_in_Securities_Market_Regulation_A_Global_Analysis, (visited on August 17, 2021).

of markets. Further, if there is no regulation or control over the market, then the market participants like investors have no security and they would prevent themselves from investing funds. Due to effective regulation of markets, the investors are gaining confidence to invest more and more in the market. Without the absence of regulation, securities markets would not survive.⁹

The present rules and regulations to regulate the securities market would aim at restricting liberalization whereas the prior in 1990s the aim was to liberalize the market. Even the market participants gave different meaning to the term liberalization as they implied it as absence of code and statute to regulate the markets. In that manner, they believe that market would function smoothly and our financial system can achieve desirable economic growth. The case is quite different and the purpose was not to have excessive regulation or control over the markets otherwise the implementation would be poor. The regulation would not be benefitted to market participants in this manner.¹⁰

2.2.3 Liberalization of Securities market

Different academic scholars hold different viewpoints regarding liberalization of securities market. Most scholars have the belief that more liberalized the securities market is, the economic growth will be more stable. In the earlier period, the government has the method to allocate funds to various small enterprises and also set the terms and manner as to how to allocate these funds. The result of the aforesaid experiment of government was that the resources were utilized for their own use, which favours their purpose rather than benefitting the financial projects designed for more stable growth. Therefore, return from investment in the manner discussed above was not profitable. By view of such interventions of government, various projects were not successful and therefore need was felt for more liberalized policies to regulate securities market.¹¹

With the passage of time, the stakeholders witnessed the development in the security market. In absence of development of market, the purpose of regulation cannot be achieved rather it would be defeated. As an initiative to develop markets, various economic measures were introduced and policies were being implemented. These policies were in relation to rate of interest, prices etc. These elements have an influence over the securities market and ultimately it affects the economic growth of the country. There are other elements, which require the attention such as payment mode i.e. to what extent payment system can be relied upon, clearing mechanism, procedure to be followed, good corporate governance needs to be practiced, etc. These factors must be kept in

⁹ *Supra* n. 1.

¹⁰ Sona Kapila, ACADEMIC FOUNDATION`S BULLETIN ON MONEY, BANKING AND FINANCE, 1st ed. 2004, p. 203.

¹¹ G. N. Bajpai, “*Significance of Securities Market in the Growth of an Economy: An Indian Context*”, https://www.sebi.gov.in/sebi_data/attachdocs/1288676814777.pdf, (visited on August 16, 2021).

mind to achieve the purpose of efficient and stable capital market.¹²

2.2.4 Major Reforms during liberalization period

During the period of 1990s, various reforms took place to achieve the liberalization of market. These are discussed hereunder:

- **Control over Issue of Capital:** This was the crucial reform during the period of liberalization and it was during this time that Capital Issues (Control) Act, 1947 in May 1992 was repealed. As soon as it is repealed, the control Government over the issues such as capital, pricing of issues, fixing of premium, rate of interest on debentures etc. was withdrawn and the market got an opportunity to allocate the financial resources. During this period, the market regulator has issued Disclosure and Investor Protection (DIP) guidelines in the favour of investors. These guidelines provide the issuers to issue the securities in the market at the rate or price, which has to be determined by the market. This change was viewed as regulation, which requires disclosures from the investors and issuers before investing in the securities market.¹³
- **Establishment of Regulator:** With the entry of the market regulator, who acts as the watchdog of the securities market, it was safe for the investors and other market participants to invest in the securities market. Specific responsibility was assigned to SEBI which were *protection of interest of investors, promotion of development of securities market, regulation of securities market etc.* The control of SEBI was not confined to this but also extends over corporates when they are involved in issuing capital and transferring their shares etc. In addition to this, SEBI is also responsible to handle intermediaries. Also, one compliance officer has been appointed to ensure that these market participants are complying with all the securities laws.¹⁴
- **Screen Based Trading:** An innovative development was introduction of fully-automated screen based trading system (SBTS). In this system, member has the option to punch into quantities of securities (which are in electronic mode), price at which one wants to transact his/her securities, the transaction is complete as soon as it finds appropriate match. The purpose of this system is to match the transaction order of investors on fixed price, assess costs and risk, frauds and any such malpractices practiced by fraudsters, to improve the operation of such system, which is making it more efficient and transparent. These factors are taken into consideration to meet the international standards of market regulation. This, consequently influences the securities market

¹² *Supra* n.1.

¹³ National Securities Depository Limited, “*Handbook for NSDL Depository Operations Module, Capital Markets and NSDL-Overview*”, <https://nsdl.co.in/downloadables/pdf/capital-markets-and-nsdl-overview.pdf>, (visited on August 16, 2021).

¹⁴ G. V. Satya Sekhar, FINANCIAL INNOVATION: THEORIES, MODELS AND REGULATION 1st ed. 2018, p.118.

to a great extent and increase the stability of the capital markets in India. There is no restriction on market participants and allows large number to trade simultaneously from different areas, further making it easier and convenient for public to invest and trade in the securities market.¹⁵

It also provides for adequate mechanism and standard procedure to safeguard the interest of investors and provides for quick resolution of disputes. At present, SBTS can be operated from the place of stockbrokers and also extended to personal system of investors for the convenience. Receiving access in this manner was a new development in capital market, which makes the trading easier and convenient for public.¹⁶

➤ **Risk management:** When it comes to securities market, which are very unsecured instruments one has to deal with so many risk. Investors have to assess the risk before making any investment in the market. There is need for some initiatives and reforms to deal with such risk existing in the securities market to ensure the interest of investors and market participants in the securities market in India. Certain measures are discussed herein:

➤ **Trading cycle:** The Trading cycle has a range from 14 days (for specified securities mentioned by SEBI) to 30 days for (for other securities). The settlement of these securities will take one more fortnight to complete the process. This was the standard practice, which must be followed, but most of the time, this has not been adhered to. Often investors have to face various grievances due to defaults by any of the market participants involved in the trading process.

➤ **Dematerialisation:** Earlier, settlement risk often arises due to longer period of time in settling trades. Trades settling process was very time taking due to physical movement of paper at that time. Often there were delays in settling trades at that period of time, which prevents the investors from investing in the market. The paper based trading system had two aspects. Firstly, in the process purchaser made the payment for the shares and seller make the delivery of shares. In this process, the main criticism was that physical movement of securities from seller to purchaser involves the risk such as delay in settling trades. Secondly, transferring the shares to the purchaser is whole different process.¹⁷

In the paper based trading system, paper securities were transferred to the issuer for registration, to complete the process of transfer of ownership in the aforesaid case. Further, the change in ownership is done via endorsement on the certificate of registration. This system involves lot of paperwork and increases scope for doing faults in the process of transfer of paper securities. In

¹⁵ Arnav Mehra, "Securities Market Reforms & Regulatory Measures to Promote Investor Confidence", <https://www.taxdose.com/securities-market-reforms-regulatory-measures-to-promote-investor-confidence/>, (visited on August 17, 2021).

¹⁶ *Ibid.*

¹⁷ *Supra* n. 1.

these circumstances, cases of theft, forgery of certificates etc. was increased at an alarming rate. These issues gave rise to increase in cost, risk of delay in settlement of trades etc. Moreover, investor's complaints take longer period of time to resolve and were time consuming.¹⁸

It was during this period of time to resolve these issues, a need was felt for appropriate legislation to handle with such issues and especially transfer of securities. The Depositories Act, 1996 was passed to deal with the issue of transfer in securities and replace the paper based trading system. This act ensures the transfer of securities in systematic manner and provides the public limited companies to freely transfer their shares and making it mandatory for companies to issue the securities in demat form. Also, apart from the above features, the depository system provides for maintain the records of purchaser in book-entry form which was more systematic than previous paper based trading system. The main purpose of the Depository system is to ensure transfer of securities in electronic mode rather than transfer shares from seller to buyer in paper based trading system.¹⁹

In the security market, there are various transactions, which took place and most crucial one is the transfer of any security from person to person in paper based trading system or in electronic trading system. To handle all the transactions of securities, various participants played their role in making these transactions easier and convenient. These are:

- Stock Exchanges
- Depositories
- Clearing Corporations

The aforesaid market participants or institutions are known as Market Infrastructure Institutions (MIIs).²⁰

2.3 Concept of Dematerialisation

The term Dematerialisation implies transfer of securities in electronic mode. In paper based trading system, the securities were transferred from person to person via physical mode. Investor receives the physical certificates after completion of the whole process. At present, through the process of dematerialisation, these physical certificates of investors will be maintained electronically in the name of particular investor. The place where all these certificates are stored

¹⁸ "An Insight into the Depositories Act, 1992", <https://rna-cs.com/an-insight-into-the-depositoriesact1996/#:~:text=The%20Depositories%20Act%2C%201996%20was,in%20effecting%20the%20tra nsfer%20securities>, (visited on August 18, 2021).

¹⁹ *Supra* n. 13, p.9.

²⁰ Securities and Exchange Board of India, "Booklet on Securities Market Understanding from Investor's Perspective", https://www.cdslindia.com/downloads/SM%20Booklet%20-%20Final_Low%20res.pdf, (visited on 1 August 18, 2021).

electronically is depository. Moreover, depositories are also accountable for handling the process of transfer of securities by taking the payment from the seller and making it credit in the account of the buyer who purchases any particular security. Often, the depositories are resembled as a bank and are holding the accounts of investors.²¹

These depositories function through Depository Participants. These Depository Participants facilitate the investor in withdrawing the securities and in the transaction of securities from depository through the process of dematerialisation and rematerialisation. Moreover, DPs also kept and maintained the record of investors as to holding of securities in electronic mode and also aids in process of settlement of trade of securities kept in the depository. To run the depository system smoothly, it involves three agreements i.e. a depository has to made contract with every participant involved in the transaction; participant has to made an agreement with the client; tripartite agreement between depository, issuer or investor and Registrar.²² The major market participants who are responsible for the functioning of the depository system are:²³

- Depositories such as National Securities Depository Limited (NSDL) and Central Depository Services Limited (CDSL)
- Depository Participants
- Companies/Registrars
- Investors

It is pettiness to discuss about the role of depositories. The first depository registered with SEBI was NSDL in 1996 and was gained recognition with the help of various financial institutions. It is one of the largest depositories established in India and was responsible for handling most of the securities of the investors, which were settled in demat form in the Indian financial market. Though in earlier times also, Indian capital market holds a good recognition but the paper based trading system had many loopholes such as delayed in transferring shares of investors, transfer of ownership etc. With the Depositories Act 1996, these problems were resolved and depositories got an opportunity to enter the Indian capital market.²⁴

The second depository established in 1997 and the same was incorporated in Mumbai. The actual commencement of the depository services was initiated by CDSL in 1999 and its objective is to provide investors convenient, dependable and secure depository services at the low cost,

²¹ Arun Roy V., “*Half a decade of Dematerialisation: A review*”, [2000] 28 SCL 12 (MAG.).

²² *Ibid.*

²³ Akhin. P, “*Study on Customer Satisfaction on Services Provided by Depository Participants in Calicut*”, https://www.devagiricollege.org/old/uploads/project/10_devagiri.admin_9910705180727.pdf, (visited on August 19, 2021).

²⁴ *Ibid*, p. 19.

which can be afford by small investors and can be easily accessible to all market participants.²⁵

The agents of the Depositories are Depository Participants who acts as a market intermediary. DP often interacts with the issuer or investor, as the case may be, the company and the depositories such as NSDL etc. As per the guidelines of SEBI, they can be financial institutions, banks, custodians, stock-brokers, etc. They are required to get them registered with SEBI. At present, over 100 registrations have been done with SEBI for depository participants.²⁶

They played a very crucial role in aiding or facilitating the investors or issuers' shares getting dematerialised i.e. conversion of physical shares into electronic form. The investor cannot approach depositories directly for the aforesaid purpose.²⁷

2.4 Need of Depository system in India

Indian Capital Market is considered to be one of the fastest growing markets in at the global level. It comprises of the largest number of listed companies. With the growth of the capital market at such extent, it is bound to assume the problems associated with trade settlement. This problem is not new but an old one. Investors need some surety before investing its funds and transfer the shares through any trading system. In paper based trading system, investors has often faced the issues like complex registration process, they have to make various efforts to receive dividend, bonus etc. in their favour. This process requires lot of paper work, which brings various issues along with it.²⁸

It does not matter whether the investor is foreigner or domestic, as both have to face the aforesaid issues and receiving the same treatment from the market participants. The major problem faced by the investors was that paper based trade system takes lot of time in settlement of trade and thus it is very time consuming. This problem results in bad deliveries of shares to investors, which puts the investor often at difficult position, as they fear whether they will receive their funds from such method of trade settlement. At that period of time, cases of theft, forgery, mutilation of certificates were common cases often reported by the investors before the concerned authorities.²⁹

The traditional trade settlement system was entirely based on transferring physical share certificates from one person to other and thus there were few investors who participate in the

²⁵ *Supra* n.23.

²⁶ K Srinivasan, "Depositories Ordinance, A Review", [1995] 19 CLA 1 (Mag.).

²⁷ *Ibid.*

²⁸ "National Securities Depository Limited-I" [1997] 11 SCL 33 (MAG.).

²⁹ *Ibid.*

market at that time. The settlement of trades requires lot of paperwork, which hinders the clearing corporation to complete the process in time. Some of the issues identified in physical trading of shares are detection of various defects/faults in the filing of share transfer form, too much attention of courts towards issues of defective title in shares purchased by the buyers, registration of transfer of shares cannot be done easily and can be prevented by third party, additional cost of stamp duty on share transfers has to be borne by the investors etc.³⁰.

In view of such circumstances, a need was felt to set up an organization and scripless trading system has been introduced in the capital market. The aim was to improve the market efficiency and eliminating the issues associated with the physical delivery of securities of investors. As a result, in 1995, Government passed the Depositories Ordinance, making the way for the depositories to enter into the capital markets in India.³¹

In August 1996, Parliament passed the legislation and Depositories Act was passed in the same year. The first depository registered with SEBI was National Securities Depositories Limited (NSDL) on 7th June 1996.³²

2.4.1 Features of Depository system

With the passing of depositories Ordinance in 1995, investors have been given choice to opt for depositories mode or paper based trading system to hold their securities. Certain features associated with the electronically based trading system are:³³

- i. Those investors who opt for depository system have to be registered with one or more Depository Participants, who are considered as agent of the depositories. These can be *banks, financial institutions, large corporate brokerage firms etc.*
- ii. Investors registered with depositories will be considered as beneficial owners in the book maintained by participants. The name of the investor registered with the depository is registered in the name of the depository concerned or not in the name of any particular investor.³⁴
- iii. The companies issuing new securities after the depository system has been introduced, is provided investor with both options either to choose depository mode or physical mode to hold their securities. The latter will receive the share certificate from the company and their

³⁰ *Supra* n. 28.

³¹ The Institute Of Company Secretaries Of India, "*Internal & Concurrent Audit Of Depository Participants*", <https://www.icsi.edu/media/prb/pdf/INTERNAL%20&%20CONCURRENT%20AUDIT%20OF%20DEPOSITORY%20PARTICIPANTS.pdf>, (visited on August 20, 2021).

³² *Ibid.*

³³ K.K Jhanwar, "*Depository Ordinance, 1995 and its implications for law relating to transfer of securities under Companies Act, 1956*", [1996] 7 SCL 60 (MAG.).

³⁴ *Supra* n. 23.

name will be substituted as registered owner.

- iv. The companies are required to intimate the depositories about information regarding change in ownership of investors. It is further provided in the Ordinance that if any company found out that transfer of security is in conflict with the legal provisions of legislations such as takeover code, Sick Industrial Companies (Special Provisions) Act, etc. then in that case company is expected to make an application before Company law Board to rectify the ownership (if the conflict involves the change in ownership) which are kept with the depository. At this time, the transferee will receive the other rights related to shares but the voting rights will be suspended or as the CLB orders the same regarding the same.
- v. The Depositories Ordinance provides for comprehensive legislation and regulations, which will be framed by SEBI and other relevant bye-laws to be framed by depositories in consensus and approval of SEBI. These bye-laws will provide for specific rights and obligations of depository participants or agents and beneficial owners. Moreover, it will also provide for adequate procedure and mechanism favouring the interest of the investors. Any loss caused to the investor or beneficial owner due to the negligence of the depository participant or the depositories, investors will be indemnified by depository and later on loss can be recovered from DPs if the loss is caused due to their negligence.
- vi. The depository system will ensure that no investor shares or securities will be pledged or hypothecated for their own personal purpose without the consent of that particular investor holding that security. An investor is not expected to transfer all his securities to the depository. The securities registered in the name of the depository will be considered eligible for registration and such securities will be considered as 'dematerialised'. The depository is responsible to ensure that investors receives all the economic benefits attached to the securities registered, or it can delegate the same to the depository participants, who are the agents of the depositories.³⁵

2.4.2 Benefits of holding shares in Demat form

The securities market has taken a crucial step in switching the transfer of securities from physical mode to electronic mode. Many scholars hold the viewpoint in favour of concept of dematerialisation of securities and they have a belief that it makes the financial system of India more transparent and accountable. Certain advantages are being discussed of holding the shares by investors in demat form. These are:³⁶

³⁵ *Supra* n. 28.

³⁶ Vivek Sadhale and Vikas Agarwal, "Dematerialization for Private Companies", [2007] 77 SCL 55 (ART).

- i. Firstly, since the investors are holding the shares in electronic mode so there is no risk for getting the share certificate lost by any person.
- ii. In view of the holding of shares in electronic mode, investors had an upper edge as they do not have to face the cases such as forged certificates, mutilation, theft etc., which were rampant in the paper-based trading system.
- iii. Investors are no longer needed to fix any stamp on share certificate while transferring them.
- iv. The demat system is more appreciated when it comes to the issue of pledging and hypothecation of shares. Investors often take a back seat when it comes to adopt mode of pledging or hypothecate their shares, as they believe that it is a very complex process and time consuming. But this has now been resolved as the demat allows the investors to maintain their shares electronically which helps them to making such process more investor-friendly and convenient.
- v. All the policies and actions of the company, which includes *rights, bonus, mergers, consolidations, sub-division, conversion of securities, issue of shares on mergers or amalgamation, buy-back, etc.* can be easily dealt with in demat form in less time and at lower cost in comparison to paper-based trading system.
- vi. The company needs the information for the arrangement of shareholding pattern and if any change has made in the same then companies needs to amend its documents like Article of Association etc. accordingly in time. Therefore, this system provides the companies to receive information at any time about the shareholding pattern, and if any change has been made in this regard then the intimation has to be given to the company.
- vii. It is a very long journey for the depository system to make the capital market more sound and stable. The market efficiency has become better as compared to the previous trading settlement system. It was decided that the depository system must be executed phase wise. As its aim is to provide speed and accuracy in market transactions, investors can do share transactions in convenient manner, secondary market liquidity transactions can be increased etc.³⁷
- viii. Under the electronic based trading system, investors registered with the concerned depositories are the beneficial owner of shares within a day from the date of settlement. Their name is automatically entered in the register of members maintained electronically. The advantage is not for the investor i.e. the buyer but also for the seller as seller can easily sell his shares, which are in, demat form and can receive the payment in less time. On the other hand, in paper based trading system, transfer of ownership takes around 30 days³⁸ approximately for a single transaction.

³⁷ *Supra* n. 26.

³⁸ Bank of India, "Benefits of Dematerialisation-FAQs", <https://www.bankofindia.co.in/customerfaq1>, (visited on August 19, 2021).

- ix. Another advantage with the new electronic based trading system is that investor can save the charges of the stamp duty incurred on transfer of shares. They have to borne such charges at the time of transfer of securities in physical trading of shares. Instead they have to borne the service charges, which have to be paid to the Depository Participant and are fewer amounts than the stamp duty paid by them in the previous trading system.³⁹
- x. The investor has an option to utilize shares of one company for the transaction of securities of other company provided he must have an account with the agent of the depository i.e. Depository Participant.⁴⁰ These two companies must be part of the depository system.
- xi. In case of any fault committed by issuer or investor, then in that case, the accounts of that particular investor can be blocked. Further, the feature of pledge and hypothecation of securities are also available with the investor.⁴¹

2.4.3 Implications of Dematerialisation

There is often confusion regarding the dematerialisation of shares in case of private companies. All the companies can get their securities dematerialized, the nature of the companies does not make them ineligible to do so. Whether the company is a public limited company or private limited company, they can get their shares dematerialised. The procedure for both the companies to open demat account is quite same. Once a company opened its demat, and get their securities dematerialized, then that company will receive lot of benefits in the future. Therefore, it is the belief of various academicians and scholars that private company should take a step towards adopting the novel system of share trading i.e. holding their shares in depository mode.⁴²

There are various numbers of private limited companies, which are already registered with concerned depositories and get their securities dematerialised. Some companies are getting their shares dematerialized in accordance with the terms and condition agreed upon by them in the agreement with the investors. As per the guidelines of SEBI, the companies to initiate for IPO process have to get their shares dematerialised. Therefore, on account of the above guideline, various private limited companies are getting their shares dematerialised. They are doing in advance as they are being made to do so by market regulator compulsorily.

SEBI has made it mandatory for every company whether it is public or private limited company to get their shares dematerialised. This move was taken by the market regulator and the

³⁹ *Ibid.*

⁴⁰ Investor Education and Protection Fund Authority, “*Depository Account (DEMAT)*”, http://iepf.gov.in/IEPF/Depository_Account_CDSL.html, (visited on August 19, 2021).

⁴¹ *Supra* n. 38.

⁴² *Supra* n. 26.

government to bring transparency and accountability in the securities market and also providing the benefits such as pledging of shares, hypothecation of securities etc. In case of any complaint or disputes, SEBI has provided specific forum to approach or seek redressal of grievance.⁴³

2.5 Legal Nature of Dematerialisation of Securities

With the introduction of Depositories Act in 1996 the paper based trading system was totally eliminated and the investor got rid of the cumbersome and time consuming process in getting their shares transferred. The novel depository system has given an option to the investors paperless trading of shares. It was for the first time in India that paper securities got converted into electronic holding through Dematerialisation. Without involvement of lot of paperwork and physical papers, securities can be easily transferred in electronic mode. This process is much faster and less time consuming process. Thus, the investor confidence and attitude towards investment was quite change with the coming of the depository system in the Indian Capital Market.⁴⁴

2.5.1 Steps taken by SEBI towards dematerialisation of securities

After a period of time, and observing the attitude of investors and companies towards the new trading system, SEBI decided to make compulsory for every company to get their shares dematerialised. Therefore, the Working Group, time and again, took many decisions regarding the issue of compulsory dematerialisation of securities. In view of the above, SEBI has exercised its powers under the Securities Contract Regulation Act, 1956 to implement the decisions given by the working Group. Some of these are given herein:⁴⁵

- Stock brokers whose performance is not good i.e. complaints are registered against them regarding bad delivery of shares etc. it is mandatory for them to deliver their shares in demat form for the purpose of settlement.
- The Custodians are required to make the payment simultaneously as soon as they receive the securities in demat form and they cannot make any delays in making the payments to the investors.
- SEBI has made compulsory for institutions to get their securities dematerialised in respect of negotiations entered by them. SEBI has incorporated the above decision of Working Group.⁴⁶

⁴³ PTI, "From Oct 2, unlisted companies to issue new shares in demat form: Government", <https://economictimes.indiatimes.com/wealth/personal-finance-news/from-oct-2-unlisted-companies-to-issue-new-shares-in-demat-form-government/articleshow/65782249.cms>, (visited on August 19, 2021).

⁴⁴ *Supra* n. 21.

⁴⁵ TV Narayanswami, "Zeal outstripping legal propriety in efforts to push through dematerialization of securities", [2000] 38 CLA (Mag.) 18.

⁴⁶ Business Standard, "Demat Shares For Bulk Deals Are Good Delivery", https://www.business-standard.com/article/specials/-demat-shares-for-bulk-deals-are-good-delivery-198092401019_1.html (visited on August 20, 2021).

- Investors of companies for whom the dematerialisation of shares has been made compulsory by SEBI, are required to make an application to the shareholders stating that delivery of shares shall be only in demat form and also educate them about the features of the dematerialisation.
- Depository Participants can be any financial institutions, bankers, stock-brokers etc. as per the Depositories Act 1996. SEBI often encourages stock-brokers and bankers to act as agent of the depositories i.e. DP. For the aforesaid purpose, SEBI decided to approach Reserve Bank of India (RBI).
- SEBI has made convenient for investors and companies to get them registered with the depository as it directed Registrar not to reject application of demat registration on trivial grounds and if the application is rejected of any investor, then, in that case, Registrar should provide document in support of that decision.
- SEBI should direct banks who are acting as DPs, not to expect from investors to maintain minimum balance account in bank before opening a DP account.⁴⁷ If in any case, any bank acting as DP has breach or violated such directive of SEBI, then the registration of DP can be cancelled in that case.
- One such decision was regarding the appointment of registrar and share transfer agent by every company for both the depositories.
- In case of partial rejection of dematerialisation requests of any investor or company by the registrar, then, in these cases, the registrar should not send such requests to the DPs. This aimed to exert less pressure on DPs.
- In case of non-receipt of physical shares by investor to DP, he/she can send the information regarding shares holding in demat form to the registrar. On the basis of indemnity, if any, given by DP and the supporting documents in favour of holding of demat shares, by DP, registrar can proceed to carry out the request of dematerialisation.
- DPs having branch offices, which are handling more than 5000 accounts of investors, are expected to have direct connectivity in electronic mode with the depository or any branch office of DP, having live connectivity with the depository.⁴⁸

2.5.2 SEBI Directives Against Companies in Default

⁴⁷ Handbook for NSDL Depository Operations Module, "Core Services", <https://nsdl.co.in/downloadables/Core%20Services.pdf>, (visited on August 20, 2021).

⁴⁸ Handbook for NSDL Depository Operations Module, "Business Partners – Systems, Procedures and Practices", <https://nsdl.co.in/downloadables/pdf/business-partners-systems-procedures-and-practices.pdf>, (visited on August 21, 2021).

In any security market, stock exchanges play a very crucial role. All the transactions would happen through these stock exchanges and therefore they need to act in fair and transparent manner. Since they have the bigger responsibility and obligation, therefore they are required to keep the default companies in check and those who are acting in violation of any directions given by SEBI or not complying with the requirements are in default. In view of the above, SEBI has exercised its power under Section 11A and 11B of the SEBI Act, 1992, and given the directions to take strict action against the companies in default whose securities are in demat form. The directive was regarding temporary suspension of shares trading for companies who are not complying with the requirement of SEBI.⁴⁹

Such action of SEBI will attack the investors instead of the companies in default and the purpose of SEBI to protect the interest of investors can be defeated. The penalty provided by SEBI in such cases are too harsh i.e. suspension of trading of securities by that company implies that investors of that particular have to opt out of securities market. To attract more and more investors towards dematerialisation of securities, and achieve the dematerialisation of securities in complete sense, SEBI are imposing harsher penalties on companies. Companies are the major investors of the securities market and such actions would prevent them from making more investments in market. If SEBI is trying to protect the interest of small investors, then such actions of SEBI is not justifying the purpose of protecting the interest of small investors. In view of the above, to take a step towards protecting the interest of small investors SEBI has provided and allowed small investors to engage in physical trading of shares and can sell shares upto 500 shares along with trading of shares in demat form.⁵⁰

It cannot be denied that SEBI has taken various steps to incorporate dematerialisation of securities and time and again, exercise its powers under SCRA to frame regulations regarding dematerialisation of securities. In recent amendments, SEBI has made compulsory for every company to get their securities dematerialised. This action of SEBI has created doubts and criticisms in the minds of the academicians and companies who are biggest victims of this case. The object of the Depositories Act was nowhere related to making the dematerialisation of securities compulsory for companies. Instead, the objective of the act is to allow investor or company to opt the physical trading of shares or holding shares in demat form.

Time and again, SEBI has passed various bye-laws, rules and regulations to widen the scope of dematerialisation of securities. At present, the action of SEBI to make it compulsory for every company to get their securities dematerialised, shows the effort of SEBI towards attracting

⁴⁹ *Supra* n. 46.

⁵⁰ *Supra* n. 46.

investor towards this new depository system. SEBI is not exercising its powers under the Depositories Act but under the SCRA and other rules and regulations to make the shares of company and other investors dematerialised. The following act of SEBI shows that what it cannot do directly under the Depositories act, 1996, it is doing indirectly under various laws like SCRA and other regulations. In light of the above, in the judgment of Delhi High Court in **Mahanagar Telephone Nigam Limited v Telecom Regulatory Authority of India**⁵¹, Court held that

“It is settled law that what cannot be done directly, cannot also be done indirectly. No authority is required for this proposition, but if any authority is required, the authorities in the case of Jagir Singh v. Ranbir Singh [1979] 1 SCC 560 and in the case of District Collector v. Chittoor District Groundnut Traders’ Association [1989] 2 SCC 58 are sufficient. In Jagir Singh’s case the Supreme Court has held that what cannot be done directly, cannot be allowed to be done indirectly, as that would be an evasion of the statute. The Supreme Court has held that it is a well known principle of law that the provisions of law cannot be evaded by shift or contrivance. The Supreme Court has held that in an indirect or circuitous manner the objects of a statute cannot be defeated. In the District Collector’s case (supra), a circular was issued under the Commodities Act purporting to impose restrictions on movement of edible oil and oil seeds and to impose compulsory levy for supply of oil to State Government at a fixed price. The Supreme Court held that there was no power to impose levies and what could not be done directly could not be done indirectly by using regulatory powers given to that authority.”

In light of the above paragraph of the Delhi High Court judgment, Court has clearly pointed out that action of any authority must be in line with the principles of the statute. Moreover, if any statute is not allowing and has not provide the particular power to be exercised by any authority, then that authority cannot pass any such legislation, bye-laws, rules or regulations to incorporate its action. If the authority is doing such act, then it is evading the objective and principles of statute. Therefore, SEBI action of making compulsion for private and public companies to dematerialize its securities is not in line with the provisions of Depositories act, 1996 and is not justified in legal sense. Such action of SEBI is clearly said to be acting beyond the scope and powers granted to SEBI under Depositories Act.⁵²

⁵¹ [2000] 1 Comp LJ 335 (Delhi).

⁵² *Supra* n. 26.

2.5.3 Investor Grievance Redressal Forum

The specific forum has been established for the investors to seek redressal for their grievance against the actions of Depositories or Depository Participant etc. this forum is known as Investor Grievance Redressal Forum. The other option for the investor to approach to get help to resolve their complaints or disputes is the Securities and Exchange Board of India. This forum has been established under the power provided to SEBI under Section 15 C of Securities and Exchange Board of India Act, 1992. SEBI has the authority to check the parties or persons in default in non-compliance with the provisions of SEBI Act, 1992.⁵³

If any of the grievances or complaints were not resolved by these forums, then under Section 15 C of the SEBI Act, 1992, SEBI can exercise its power to act as facilitator so that it can aid the investors in resolving their disputes and complaints. The board itself does not resolve the complaint of the investor directly but helps or ensure that investors have been provided with remedies against the grievances brought before the aforesaid Forums. For this purpose, the Board can make the company or intermediary to help the investor in resolving its particular disputes or complaints.⁵⁴ These all provisions such as the power conferred on SEBI to check whether the investors' complaints are getting resolved or not and if not, then it aids them to get it resolved. The Board acts as guide to investor and ensures that provisions of law are getting complied with and moreover aids the investor to exercise its rights. Here, in this case, the aforesaid legal provisions are not benefitting the investors. It has been nowhere defined the meaning of redressal. It is doubtful whether the term 'redressal' is pointing out compensation or any other penalty.⁵⁵

In this regard, NL Mitra Committee has given its recommendations in its report that powers of SEBI must be widened to protect the interest of investors in the sense that it can actually benefit the investors. The recommendations made regarding these powers were regarding providing powers to SEBI for investigation, confiscating public funds and other assets so that misappropriation of these funds can be prevented. SEBI can only act as facilitator and guide to the investors and not act as a judge to grant any award of compensation as a remedy to these investors. It is the duty of the Courts and other authorities to do the same. Section 15 C of SEBI Act, 1992 only provides SEBI to ensure whether the law has been complied or not and aid the investors in getting their disputes resolved.⁵⁶

⁵³ Asif Iqbal, "Investor Education and Grievance Redressal in the Present Regulatory Setup", [2004] 63 CLA (Mag.) 93.

⁵⁴ Securities and Exchange Board of India, "Guidance to general public about effective ways to redress their grievances", https://www.sebi.gov.in/sebi_data/commondocs/PublicComplaint_A_p.pdf, (visited on August 21, 2021).

⁵⁵ *Ibid.*

⁵⁶ *Supra* n. 54.

In the matter relating to redress the grievance of investors, Joint Parliamentary Committee on Stock Market Scam has made recommendations in its report that the concept of Ombudsman must be extended to Indian capital market in order to enable investor to resolve their complaints. The extract of the aforesaid recommendation has been reproduced as under:⁵⁷

“14.60 – There also appears to be a need to have an independent look at resolution of investor complaints against companies and market intermediaries. The Committee recommends that the concept of Ombudsman, which is already being used in the Banking Sector, should also be extended to the capital market. The issue of power, duties and responsibilities of the Ombudsman should be suitably worked out. As regards, investors complaint against broker and other market intermediaries, Arbitration Councils at exchange level can be used for resolution of investors complaints. Such body would be independent of market intermediaries, particularly the brokers ...”

2.6 Multiple depository system in India

The Depository system operates more in a technical and requires lot of resources, which are technologically advanced. Such resources require lot of expenditure of government and it is required to spend lot of funds in just maintenance of such resources. Such expenditure of government has directly affected the economy of our country and installation of such equipment's required lot of amount to be incurred. In other countries, depositories system is in the hands of the financial institutions. As if one is handing over control of entire system to single institutions or any one group of company then it may face lot of criticism. In that case, there is scope of monopoly of any one institution or group of company. Many stock exchanges in India have given their viewpoints regarding set up of regional depositories. There is no rationale behind set up of regional depositories, as it cannot fulfill the purpose of the investor.⁵⁸

Investors are holding shares in different companies, which are situated in different regions. The expectation of any investor from the security market is quite simple. They do not concern themselves with the business of any stock exchanges but only concerned about the services they received must be at lower cost. Therefore, in view of the aforesaid rationale, SEBI has kept the charges of depository services lower than what the investor has to bear in the case of physical

⁵⁷ Securities and Exchange Board of India, “A Concept Paper on Ombudsman for Securities Market”, https://www.sebi.gov.in/sebi_data/attachdocs/1293102862086.pdf, (visited on August 22, 2021).

⁵⁸ *Supra* n. 26.

trading of securities.⁵⁹

In India, at present there are two different depositories working in the securities market to provide the depository services. Many of the academicians and scholars have this rationale that single depository system will work out better than multiple depository system. Others are objecting to such opinions, as single depository system would create the monopoly in providing depository services to the investors. They can incur demat charges at their discretion from the investors, which would definitely not in the interest of investors. At present, the issue has still got debated whether India should opt for single depository or multiple depository as these will depend on the condition of market of particular country⁶⁰. The whole purpose of Depositories Act is to protect the interest of investors and time and again, SEBI take crucial steps in this regard so that investors do not have to face any grievance.⁶¹

2.7 Conclusion

Depository system has been practiced in many developed countries. Its aim is to protect the interest of investors. Various empirical studies have been conducted on the need and importance of dematerialisation of shares in India. Most of the studies have provided us with results in favour of depository system. Also, many investors have already registered with the depositories to avail depository services. For the rest of the investors, who are still registered with the depository system to get their shares dematerialised, SEBI is making every efforts to persuade them to get their securities registered with depositories. Time and again, SEBI has introduced Investors Awareness Programme to educate the investors, establishing Investor Complaint Cell and other forums like Investor Redressal Grievance Forum to handle with resolving disputes of investors.

With making of dematerialisation of securities compulsory for every company, SEBI is making every effort to register all the securities dematerialised. The rationale behind such action of SEBI is to prevent transfer of black money etc. The companies often enter the securities market by getting them listed at stock exchanges, in this case, the proper manner is to opt for Initial Public Offer, but in the case of new company, they get their shares dematerialised before entering the IPO stage. Free share transfer is cardinal principle, which concept of dematerialisation supports

⁵⁹ FE Online, "What is a depository and how it is different from depository participant", <https://www.financialexpress.com/market/what-is-a-depository-and-how-it-is-different-from-depository-participant/995329/>, (visited on August 22, 2021).

⁶⁰ Naresh Kumar, "Need for Organising Custodial Services and Depository System in India", [1994] 15 CLA (Har.) 138.

⁶¹ Kiran Singh and Indra Kumar Singh, "Legal framework safeguarding the interest of investor in India", [2018] 90 TAXMANN.COM 255.

and is making the shares of public limited company freely transferrable. The advantages associated with the depository system are more than its disadvantages. But the only problem is with provision of compulsion of dematerialisation of shares for every company, which is restricting the choice of the companies to keep their shares in physical form.



Chapter-III

Role of Depositories in Indian Security Market

3.1 Introduction

India has a capital market, which is highly recognized and appreciated, at the global level. Though it is the different case that earlier the market has paper based settlement of trades due to which investors have to face various problems like delay in transfer of securities, transfer of ownership etc. With the Depository system in existence, investors have an option to hold their securities in demat form. This process has made the transfer of securities less time consuming and attract more and more investors for investment in the securities market. Doing away with the application of stamp duty on such transfer of securities, it can be said that the investor has to borne less charges as what they borne in previous system. The Depositories Act, 1996 has made the first depository National Securities Depository Limited NSDL to enter into Indian capital market and was set up in that year.¹

Depository means an organization holding securities in electronic form and enable investors transact their securities through agents called Depository Participants. These are the agents of the depositories responsible for providing depository services to investors. These are appointed by NSDL after they get themselves registered with SEBI. Depository is often compared with a bank and is called as “bank of shares”. Here, the investors keep their securities in depository just like we keep our money in any particular bank account.² As per SEBI guidelines, depository participants can be *financial institutions, stockbrokers, banks, custodians etc.*³ Depository system provided different services and has been considered to be the largest contributor in Indian capital market. These services are provided hereunder:⁴

- *Dematerialization*
- *Re-materialisation*
- *Transfer of securities;*
- *Change of beneficial ownership;*
- *Corporate action benefits directly transfer to the Demat and Bank account of customer; and*

¹ Kaushal A. Bhatt and Kinjal Bhatt, “Financial Performance Evaluation of Depositories in India (A Comparative study of NSDL and CDSL)”, INTERNATIONAL JOURNAL OF SCIENTIFIC AND RESEARCH PUBLICATION, Volume 2, No. 2, 2012, p. 1.

² National Securities Depository Limited, “e-Guide for Demat Account Holders”, <https://nsdl.co.in/downloadables/pdf/e-Guide%20for%20demat%20account%20holders%20-%20English.pdf>, (visited on August 23, 2021).

³ Central Depository Services (India) Limited, <https://www.cdslindia.com/DP/CurrentDPs.html>, (visited on August 23, 2021).

⁴ Rajnikant Kumar, “Role and growth of Depository System: In Indian Financial Market”, INTERNATIONAL JOURNAL FOR INNOVATIVE RESEARCH IN MULTIDISCIPLINARY FIELD, Vol. 6, No. 4, 2020, p. 96.

➤ *Electronic credit in public offerings of companies.*

In the year 1947, the first depository was set up at the global level was in Germany. At that period of time, the number of depositories in the world was 22 only and at present this number was extended to 310. In India after the Depositories act, 1996 came into existence; two depositories were set up i.e. National securities Depository Limited in 1996 and Central Depository Services Limited in 1999.⁵

3.1.1 NSDL and CDSL – Historical Background

As soon as the era of paperless transaction of securities came into existence in 1996, the first depository NSDL was registered with SEBI on June 7, 1996. This depository was registered as a Public Limited Company under the Companies act, 1956 and it was having paid –up capital of Rs. 300 crores. At present, the depository NSDL is having present ownership has been structured with different institutions as *Union Trust of India (41.9%), IDBI (39.10%), National Stock Exchange (14.3%) and State Bank of India (4.7%)*. The other shareholders of NSDL depository are *Citi Bank, Standard Chartered Bank, HDFC Bank, HSBC, Dena Bank, Canara Bank, and Deutsche Bank*.⁶

3.2 Objective of National Securities Depositories Limited

NSDL was set up as the first depository and has goal towards achieving the scripless trading system. This was set up with an aim to expand the scope of depository system and made the capital market of India more sound and stable. The objectives are being discussed herein:⁷

- *to speed up the trend of shifting the scripless trading;*
- *to use innovative and flexible technology system to promote depository system;*
- *to ensure the safety and soundness of Indian capital market by developing settlement solutions that increase efficiency and minimize risks, and reduce costs; and*
- *to support the investors and brokers in the capital market of the country.*

The legal framework governing the depositories such as NSDL etc., comprises of:⁸

- *Depositories Act, 1996 provides the broad framework for the setting up and working of depositories in India.*

⁵ *Supra* n. 4.

⁶ Prakash and Neetu, “NSDL v/s CDSL-A Comparative Analysis”, INTERNATIONAL JOURNAL OF RESEARCH IN COMPUTER APPLICATION AND MANAGEMENT, Vol. 7, No. 7, 2017, p. 984.

⁷ *Ibid*, p. 986.

⁸ National Securities Depositories Limited, “Legal Framework”, <https://nsdl.co.in/about/legal.php>, (visited on August 24, 2021).

- *SEBI (Depositories and Participants) Regulations, 1996 provide the regulatory framework for depositories.*
- *Bye Laws and Business Rules of NSDL govern the functioning and operational procedure for NSDL and its business partners.*

3.2.1 Contribution of NSDL towards Indian Capital Market

National Securities Depositories Limited was encouraged and promoted by institutions of national stature. These institutions are the ones, which are responsible for development of economy of any country. This depository was set up in lines with international standards i.e. like the transactions in dematerialization of securities are handled internationally.⁹ The depository utilized various innovative technologically advanced systems to operate and aid the investors and stockbrokers in the Indian capital market. The aim of the NSDL while the same was set up was to provide safety to the market participants of Indian capital market with the development of settlement mechanisms, which can improve market efficiency, minimize the risk of investors and their losses, reduce cost of transactional charges etc.¹⁰

NSDL plays a very crucial role and contribute towards the development of financial system of any country. As per the data of November 2011, NSDL depository had 13,767 service centres of Depository Participant. The services of Depository Participant are expected to provide the investors a document of statement of account, providing the details of all holdings of securities and transactions. NSDL is the first depository, which has replaced the paper based trading system of securities. This depository is providing its services through *Depository Participants, issuing companies, registrars, share transfer agents and clearing corporations/clearing houses of stock exchanges*. These are business partners of NSDL depository and these provide various services to *investors and clearing corporations/clearing house of stock exchanges*. NSDL functions in different phases, as every phase comprises of different activities to be performed by the depository.¹¹

In the initial phase, the depository NSDL would convert all the holdings of securities into dematerialise scripts and these got replaced by electronic entries. This depository has been established with an aim to develop the depository system in lines with the international standards. Most of the trading and settlement in demat form in Indian securities market has been handled at

⁹ Sweta Chhaochharia, “*Capital Market Development: The Race between China and India*”, [https://deliverypdf.ssrn.com/delivery.php?ID=254067068126021007123001087017095105022014038021002005108124070028021076000125077120033036018034122000060030116007005094010001025085028077060111089088097031071001025026040002121071110066114113092025007106117117104113072096019080106080006096127098068&EXT=pdf&INDEX=, \(visited on August 24,2021\).](https://deliverypdf.ssrn.com/delivery.php?ID=254067068126021007123001087017095105022014038021002005108124070028021076000125077120033036018034122000060030116007005094010001025085028077060111089088097031071001025026040002121071110066114113092025007106117117104113072096019080106080006096127098068&EXT=pdf&INDEX=,)

¹⁰ *Supra* n.8.

¹¹ *Supra* n.1, p. 3.

the international level and the principles followed in regulation of such depository system has been adopted in Indian as well. Indian Depository system utilized many technologically advanced systems, the depositories like NSDL and CDSL aids stockbrokers and investors in the securities market and attract more and more people to participate in the securities market of India.¹²

3.2.2 Benefits of National Securities Depository Limited (NSDL):

Many investors and stockbrokers have preferred NSDL, as they found it to be very safe to utilize for the purpose of doing transaction of holdings of securities. Certain benefits, which attract them to prefer NSDL over other depository like CDSL,¹³ can be summarized as -

- *Elimination of bad deliveries*
- *Elimination of all risks associated with physical certificates*
- *No stamp duty*
- *Immediate transfer and registration of securities*
- *Faster settlement cycle*
- *Faster disbursement of non cash corporate benefits like rights, bonus, etc.*
- *Reduction in brokerage by many brokers for trading in dematerialized securities*
- *Reduction in handling of huge volumes of paper*
- *Periodic status reports*
- *Elimination of problems related to change of address of investor*
- *Elimination of problems related to transmission of Demat shares*
- *Elimination of problems related to selling securities on behalf of a minor*

NSDL, being the first depository has been considered to be one of the safest and sound depository services. Due to this reason, Indian capital market has become one of the platform, which is considered to be the safest option for investors to trade in their securities. The resemblance between depository and banks are being widely discussed among various academicians and scholars. Depository accounts work similar to bank accounts, as investors have depository accounts in which they kept their securities. One of the essential features of the depository system is that transfer of ownership of securities is quite simple and there is no delays in transferring title of ownership like in the case of paper based trading system. With the introduction of this system in Indian capital market, it is less cumbersome for the concerned authorities as well as investors due to less involvement of paperwork in the transaction of

¹² National Securities Depository Limited, <https://www.evoting.nsdl.com/eVotingWeb/aboutus.do>, (visited on August 25, 2021.)

¹³ National Securities Depository Limited, "Investor Guided Tour/Benefits", <https://nsdl.co.in/guidedtour/investor2.php>, (visited on August 26, 2021).

securities.¹⁴ Earlier due to lot of paperwork in transaction of securities, SEBI and investors were burdened with keeping the papers safely of share transfer etc. The depository system has allowed them to keep these in electronic mode, which can be accessed from anywhere in the country.

When we compare cost of transaction and opening a demat account with any depository, it is comparatively lesser than paper based trading system. NSDL is promoted and supported by financial institutions such as *IDBI (the largest development bank of India)*, *UTI (the largest mutual fund in India)* and *NSE (the largest stock exchange in India)*, *State Bank of India*, *HDFC Bank Limited*, *Deutsche Bank A.G.*, *Axis Bank Limited*, *Citibank N.A.*, *Standard Chartered Bank*, *The Hongkong and Shanghai Banking Corporation Limited*, *Union Bank of India*, *Canara Bank*, *Kotak Mahindra Bank Limited*, *Dena Bank*, *Kotak Mahindra Life Insurance Company Limited* have taken a stake in NSDL.¹⁵

3.2.3 Obligations of NSDL towards Investors

It is the obligation of depository to protect the interest of investors, which are holding the securities in depository accounts. If any grievance or problem is caused to the investor, then it is the responsibility of the depository to look after such issues. For benefitting the investors, NSDL act as a guide for the investors and often develop new technologically advanced systems and different softwares to resolve their issues. For instance, these software systems developed by NSDL in such manner that connect the softwares of depository and depository participants. Moreover, for the safety of investors, their accounts are protected through highly operated system developed by NSDL. This system is responsible for maintaining the investor accounts through depository participants and it has already been implemented. Being a depository, NSDL has been provided with access to all accounts of investors, which are maintained by the agent of the depositories, ensuring sufficient control over these accounts.¹⁶

The other softwares developed by NSDL are fulfilling the purpose of maintenance of electronic connectivity with registrar and agents of the companies. The securities of the registrar and agents of the companies are in demat form and has account with the depository like NSDL. The purpose of aforesaid software is to ensure performance of reconciliation of all the accounts of the investors existing with depository like NSDL. For instance, ACC, BPCL, CRISIL, HDFC, ICICI, L&T, LML, NSDL, RIL and Siemens are the initial institutions which have opened the accounts with NSDL for dematerialization of their securities. The securities admitted for demat

¹⁴ *Supra* n. 4, p. 96.

¹⁵ Bhagwat and Ritesh More, "An Analysis on Financial Performance of Indian Depositories", INTERNATIONAL JOURNAL OF RESEARCH AND ANALYTICAL REVIEWS, VOL. 5, No. 3 2018, p. 1151.

¹⁶ National Securities Depository Limited-I,[1997] 11 SCL 33 (MAG.)

rely on some criteria, which needs to be fulfilled before making it eligible for dematerialization.¹⁷

3.2.4 Services Provided by NSDL

NSDL provides the institutions and retail investors with the following services provided hereunder:¹⁸

3.2.4.1 *Maintain beneficial holdings through depository participants*

NSDL, being a depository, through the agents of the depository, is responsible for maintenance of accounts of individual investors. The accounts of the investors will indicate the portfolio of securities hold by them¹⁹.

3.2.4.2 *Provide for dematerialisation and rematerialisation of securities*

Before making any dematerialization request before the depository, an investor has to surrender the certificate to the depository. This certificate then has to be cancelled by the registrar and transfer agent. At initial stage, the investor has to hand over certificate to the depository participant, who then forwards the same to the registrar. NSDL acknowledges such request of dematerialization through a telecommunication system. On verification of details and after getting the confirmation request from NSDL regarding the request of dematerialisation, registrar will destroy the securities and inform about the same to NSDL. Provided such act of destroying securities has to be completed within a prescribed time. The owner of the dematerialised will be the depository i.e. NSDL and the same will be entered in the register. NSDL ensures that the account of the investor is credited, which must be to the extent of its securities in demat form. This information has to be provided to the depository participant²⁰.

The process of dematerialization explained can be covered in few steps. These steps are as follows:²¹

- *Investor surrenders certificates for dematerialisation to depository participant.*
- *Depository participant intimates NSDL of the request through the system.*
- *Depository participant submits the certificates to the registrar.*
- *Registrar confirms the dematerialisation request from NSDL.*
- *After dematerialising certificates, Registrar updates accounts and informs NSDL of the completion of dematerialization.*
- *NSDL updates its accounts and informs the depository participant.*

¹⁷ *Ibid.*

¹⁸ Handbook for NSDL Depository Operations Module, “*Capital Markets and NSDL-Overview*”, (visited on august 27, 2021).

¹⁹ *Ibid.*

²⁰ *Supra* n. 18.

²¹ *Supra* n. 16.

- *Depository participant updates its accounts and informs investor.*
- *The entire process of dematerialisation takes a maximum of 15 days -however, for those cases where a very large amount of certificates are submitted for dematerialisation, additional time may be required.*

Another service provided by NSDL is rematerialisation of securities. The rematerialisation of securities implies converting the electronic holding of securities to the physical form. That means, it is reverse process, which allows an investor to convert its securities in electronic mode to physical form, if he/she does not wish to continue to hold their securities in depository mode. The Depositories Act comprises of specific provision, which allows investor to convert their securities in depository mode to physical form. This can be done, in case; investor is willing to withdraw its security from the account of the depository.²²

Before initiating the process of rematerialisation of securities, investor needs to approach the NSDL through the agent of the depository and make request for the conversion of its securities into physical mode. After satisfying with the request of the investor, the agent of the depository forward such request to the registrar. The registrar after confirming with the NSDL and check the account balance of the investor, issues the certificate of such request. After the acceptance of such request by the registrar, the account of NSDL, as the registered owner on the behalf of investor, has been struck off from the registrar.²³

The process of rematerialization explained can be covered in few steps. These steps are as follows:²⁴

- *Beneficial owner requests for rematerialisation.*
- *Depository participant intimates NSDL of the request through the system.*
- *NSDL confirms rematerialisation request to the registrar.*
- *Registrar updates accounts and prints certificate.*
- *NSDL updates accounts and downloads details to depository participant.*
- *Registrar dispatches certificates to investor.*

3.2.4.3 Effect account transfers for settlement of trades

Trading in securities has been generally carried out on exchange whereas trades initiated in off-market can be settled with the account transfers in depository system. The trade settlement in any exchange can be done with the help of clearing corporation. The role of the clearing corporation is crucial as depository has to interact with such corporation. Every stock exchange

²² National Securities Depository Limited, “Rematerialisation”, <https://nsdl.co.in/services/remat.php>, (visited on August 29, 2021).

²³ *Ibid.*

²⁴ *Supra* n.16.

has to conclude the process of trade settlement through clearing corporations.²⁵

The framework provided for the settlement of trade, NSDL does not need to move securities from the members who have been delivered its securities to the receiving members unless the clearing corporation acknowledges the receipt of the funds. The same has to intimate to the depository. The clearing corporation has an essential role in the process of settlement of trades, and it is expected out of them to ensure that no participant at any time, has received any fund without getting their securities delivered or has received any security, without paying the funds, whatever the case may be. The function of settling of funds is not within the power of NSDL.²⁶

3.2.4.4 Allow for receipt of allotment in the electronic form

When the applicant is opting for the depository mode, in case of fresh public issue of securities, he/she has the option to specify the arrangement in which he/she wishes to get the allotment. This implies that the allotment herein indicates that whether he/she wants the securities in physical mode or in depository mode i.e. electronic or depository mode. As soon as issuing securities by any company, it can opt for allotment of securities in depository mode.²⁷

3.2.4.5 Provide pledging/hypothecation facilities for stocks held with it

Depository like NSDL provides an option to investor to pledge/hypothecate their securities, which has got dematerialised by the investor. These securities got dematerialised through the agent of the depositories i.e. Depository Participants. These pledged securities will hold by the agent of the depositories and can consider themselves as its own account or it can be referred as “client sub-accounts”.²⁸

3.2.4.6 Provide stock lending and borrowing when the legal framework permit

NSDL has an intention to make investor avail stock lending and borrowing facilities to the investors, provided that the regulations pertaining to lending and borrowing have been introduced²⁹.

3.2.4.7 Receive and Disburse Corporate Actions related to Securities

All the details and other information will be provided by NSDL to the investor or beneficial owner on the date, which is referred to as the record date. This has been done to aid the issuer or registrar so that they can assess the benefits, which will be arise out of the holdings of the investors accounts. It is the duty of the registrar to update all the accounts of investor, which are on record

²⁵ RK Dash and J Panda, CONTEMPORARY ISSUES ON FINANCIAL MARKET, 1st ed. 1998, p. 197.

²⁶ *Ibid.*

²⁷ *Supra* n. 25, p. 197.

²⁸ Handbook for NSDL Depository Operations Module, “Special Services”, Vol.4, <https://nsdl.co.in/downloadables/pdf/special-services.pdf>, (visited on August 30, 2021).

²⁹ *Supra* n.25, p. 198.

date and accordingly, he has to assess the entitlements pending in account of investors³⁰.

For instance, entitlements arising out of holdings of investors can be bonus, rights of shareholders, their holdings of securities are in demat form, in this case, all the entitlements have to be credited to the account of NSDL. The distribution of these entitlements by NSDL will have to be distributed into respective accounts of the agents of the depository i.e. depository participants. Depository participants will forwards these entitlements to the client accounts. This will be informed to the client by the agent of the depositories and cash, benefits, if any, received by the registrars.³¹

Though, the Depositories Act has provided legal framework to protect the interest of investors and has incorporated many legal provisions, which in support in line with the principles of financial system of our country. The role of depositories like NSDL plays a very crucial in ensuring the implementation of such legal provisions. The operating system and software developed to maintain the accounts of investors along with ensuring safety are a major and core principle in which any system has to work upon. To a large extent, NSDL is successful in achieving the purpose of SEBI to create investor-friendly capital market of India. Depository system has been introduced to create a paperless trading system where transaction of securities can be done in electronic form and trade settlement can be fast, quick and easier. To some extent, depositories are playing a crucial role and turning it into a reality.³²

3.3 Role of Central Depository Services (India) Limited

CDSL is another depository system, which allows the feature of instantaneous transfer of securities to investors. It was promoted and supported by Bombay Stock Exchange Limited (BSE) along with other financial institutions such as *State Bank of India, Bank of India, Bank of Baroda, HDFC Bank, Standard Chartered Bank, Union Bank of India and Centurion Bank*.³³ The aim of setting up another depository like CDSL is to provide depository services, which can be considered to be dependable, and convenient for the investors and they can easily afford the same at lower cost. Likewise, in the case of NDSL, the account of investors has to be maintained with depository like CDSL through the agent of the depository called Depository participant. DP is under an obligation to provide statement of account, providing the details of the investors such as

³⁰ *Supra* n.18.

³¹ *Supra* n. 20.

³² *Supra* n. 16.

³³ Central Depository Services (India) Limited, *Introduction*, <https://web.cdslindia.com/myeasi/Resource/AboutUs.html> (visited on September 1, 2021).

details regarding holding of transaction of securities.³⁴

BSE has 45 % stake in CDSL whereas banks have 55% stake. Since 1999, CDSL is working and operating in the Indian Financial Market. In the year 1999, many stock exchanges have made their ties with CDSL for trading in demat securities and around 765 companies have tied up with CDSL for getting their securities in demat form. CDSL in total has around net worth of Rs. 104 crores, and has plans for providing facilities to investors, which are *inter-depository transfers and linking of accounts through cell phones*, which will make the transaction easier and convenient for them. Different stock exchanges have made different connections with CDSL. Some of them are National stock Exchange, Calcutta Stock Exchange, Delhi Stock Exchange and The Stock Exchange, Ahmedabad.³⁵

Government often prefers CDSL as depository for transaction of shares of government companies in demat form. CDSL a uniform digital centralized system, which has the purpose to keep constant watch on transaction of demat securities. Apart from the above, CDSL has membership of Asia-pacific Central Securities Depository Group (ACG). This organization has the aim to aid members and provide them facilitation in information exchange. Also, it promotes the assistance among different depositories and clearing corporations. This organization is aiding CDSL in improving the knowledge and also promote the international practices being followed at the global level. In this manner, CDSL can attract the foreign investors in Indian securities market and expand its scope of business.³⁶

Many investors for holding their securities have also preferred CDSL. Like NSDL, it also provides different services to investors. These are provided hereinunder:

- *Maintenance of individual investors' beneficial holdings in an electronic form;*³⁷
- *Dematerialization and re-materialization of securities;*³⁸
- *Account transfer for settlement of trades in electronic shares;*
- *Allotments in the electronic form in case of initial public offerings;*
- *Distribution of non-cash corporate actions;*
- *Facility for freezing/locking of investor accounts;*
- *Facility for pledge and hypothecation of securities.*³⁹

3.3.1 Benefits of CDSL

³⁴ S Gurusamy, CAPITAL MARKETS, 2nd ed. 2009, p. 467.

³⁵ Bharti V Pathak, INDIAN FINANCIAL SYSTEM, MARKETS, INSTITUTIONS AND SERVICES, 3rd ed. 2010, p. 208.

³⁶ *Ibid*, p. 239.

³⁷ Pravesh Kumar Mann, "Structure of The Indian Depository System", JMME, Vol. 9, No. 04, 2019, p. 57.

³⁸ *Ibid*.

³⁹ *Supra* n. 15, p. 1153.

CDSL has been appreciated and also got recognition at the global level. This has been considered as the second depository, providing services regarding transaction of demat securities to investors. Certain benefits of adopting CDSL are discussed as under:

- *Unique centralized database of CDSL enables DPs to debit/credit securities instantaneously to the BO's account.*
- *CDSL allots a unique number to each demat account, which ensures debit/credit of securities only to the intended account. Thus, if an account number is keyed in incorrectly, CDSL system will not effect the transaction.*
- *CDSL offers a settlement facility to its BO's under which securities sold or purchased by them, through any broker on BSE/NSE, can be directly debited/credited in their BO account without routing it, through the broker's pool account.*
- *The cost for settlement of securities through CDSL is lower in most cases. Thus, BOs can expect a lower charge in respect of securities held in CDSL accounts.*
- *Investors can monitor and access their holding and the status of their transactions in their accounts through CDSL's internet based facility 'easi'. Further, using CDSL's internet based facility 'easiest' BOs can also submit settlement instructions through the internet.⁴⁰*

CDSL has been listed on June 30, 2017 with National Stock Exchange. Since it is having a facility of centralized system, it provides online services to its investors. These are⁴¹:

- Investors have an option to access its information, data digitally; and
- It has been found by various studies that it provides easy execution of transaction of demat securities.

As of this year 2021, CDSL has more than 3 crore investors, companies etc. as its clients, who has opened its demat accounts.⁴² Companies are biggest contributor to growth of CDSL. CDSL aids and facilitate companies in different activities in which they are engaged from time to time. Some of the activities, in which CDSL is aiding companies,⁴³ are as follows -

- CDSL aid companies to conduct their AGM (Annual General Meeting) by providing facility of video conference and other digital tools;
- CDSL facilitate companies to maintain their shareholders information such as email-ids and other data so that they can communicate easily.

⁴⁰ "Demat Account Opening- CDSL",

<https://www.cdslindia.com/downloads/Investors/FAQs/20%20Demat%20CDSL%20Way%20-II%20-%20Audit%20%20Compliance%20FAQs-as-on%20January-2019.pdf>, (visited on September 2, 2021).

⁴¹ Central Depository Services (India) Limited, "Annual Report 2020-21",

<https://www.cdslindia.com/downloads/IPO/CDSL%20Annual%20Report%202020-2021.pdf>, (visited on September 5, 2021).

⁴² *Ibid.*

⁴³ *Supra* n. 41.

- CDSL provides with centralized electronic system which comprises of *stockbrokers, depository participants* etc.
- Moreover, CDSL aids companies to pass their resolutions in the company meetings held from time to time. These meeting are conducted through paper less voting for the convenience of investors.
- It provides the option to beneficiary owners to keep a watch on their CDSL demat account from anywhere in the world.
- It also provides them with beneficiary owners to get access to data such as security information etc. and also ensure that the transactions can be executed in secure manner.
- It has a mobile application, which are having flexible technology such as smart phones, tab screen, which are for the purpose of doing security transactions.
- Other features provided by CDSL are e-kyc (Know Your Customer), UIDAI service (Unique Identification Authority of India), which provides proof of anyone identity and address.

CDSL charge the investor for debit transaction done by DPs. Further, DP has the option to charge their clients, which has already been informed to their clients by them beforehand. As per guidelines of SEBI, all the agents of the depositories i.e. Depository Participants are expected to provide the tariff structure on the website of CDSL, i.e. www.cdslindia.com. Investors can access the tariff rate from website and has an option to analyse the rates before opening any demat account with CDSL.⁴⁴

3.4 Demat fee structure in depository system

The structure followed for charging demat fees by two depositories operate at two levels. That is, firstly, the depository will charge Depository Participants and in turn, DPs would charge the investor for availing depository services. In view the above, SEBI has changed the aforesaid demat structure on the basis of recommendations given by Secondary Market Advisory Committee. This has been done on 28th January 2005. The change brought by this recommendation was waiver of certain charges, which includes demat custody charges, paid by investors. But the companies are required to make the payment of custody charges as prescribed by SEBI. The manner in which companies made the aforesaid payment to demat custody charges is comprised of two options before the companies:⁴⁵

⁴⁴ CDSL, “*Settlement of Securities in Demat Mode*”, <https://www.cdslindia.com/downloads/Investors/FAQs/06%20Demat%20CDSL%20Way%20-%20VI%20-%20Settlement%20January%202020.pdf>, (visited on September 8, 2021).

⁴⁵ Mahavir Lunawat, “*Changes in Demat Charge Structure - An Analysis*”, [2005] 3 CAT 954.

- *One-time payment to NSDL and annual payment to CDSL or*
- *Annual payment to both NSDL and CDSL.*

Both the aforesaid options have to be analysed and companies are expected to do a proper evaluation to reach a final prudent conclusion as they have to prefer the alternative which is cheaper for them. Apart from these options, the other alternatives are available with the companies such as *administrative convenience, industry practice, state of the company, cash position of the company, likelihood of corporate restructuring, etc.*, so it is required of them to consider these options along with the above options.⁴⁶

Before making these changes by SEBI to the structure of demat charges, at the initial phase of introduction of depositories, the depositories charge on *advalorem* basis and collect both transaction as well as custodial charges. At that time, investors do not find the demat charge structure very suitable and appropriate and the charges were too high. The services offered by depositories were disproportionate with the demat fees charged by them. In view of the aforesaid grievances of the investors, the depositories switched the fee structure to Flat Fee Structure (FFS), herein; charges are applicable on the basis of total number of transactions. Depositories have started charging depository participants on flat fee structure basis. In turn, DP charges the fees from investors.⁴⁷

The criticism faced by this structure is that small investors found it very expensive. Under the FFS system, custodial charges are levied in accordance with the ISIN numbers. This does take into consideration the value of shares kept in custody. For instance, if the value of holding securities is small, the fess paid against the value of holding securities proved to be very high. This system favours investors and institutions that have business of high networth and willing to trade in large number of quantity of securities. On the other hand, the small investors trade on long-term basis so the aforesaid stricture was not feasible for them. There was a need of cost-effective system favouring the small investors,⁴⁸ who are the crucial contributors of Indian capital market.

3.4.1 Steps of SEBI towards reduction of demat charges

Investors have brought the grievance of high fees for demat services charges by depositories before SEBI. They asked SEBI to reduce the demat charges paid for availing depository services. In light of the aforesaid grievance and other research reports of various institutions, SEBI decided to set up an internal group for the purpose of studying, analyzing the aforesaid issue of high fees

⁴⁶ *Ibid.*

⁴⁷ Securities and Exchange Board of India, “*Report of the Group on Reduction of Demat Charges*”, https://www.sebi.gov.in/sebi_data/commondocs/dematrep_p.pdf, (visited on September 10, 2021).

⁴⁸ *Ibid.*

charged by depositories. In view of the above step taken by SEBI, it has provide with some measures to reduce the demat charges incurred by investors. The group has to analyse major issues involved and accordingly provided their recommendations. The issues identified by the group are:⁴⁹

- *Whether small investor is over charged on account of shift in method of charging? Is the present method and procedure of charging justified? Is there any better alternative?*
- *What were the charges under paper based share certificate environment? Who bore the burden and who benefited?*
- *How demat charges were levied and collected in the early stages of demat?*
- *Need for shifting to the present system (FFS).*
- *Explore who benefited (savings) on account of changes in post-trade activities?*
- *How to reduce the burden on small investors?*
- *Any other matter.*

3.4.2 New structure of demat charges

On the basis of the report of internal group of Secondary Market Advisory Committee and its recommendations, SEBI has issued circular MRD/DoP/SE/Dep/Cir-4/2005, dated 28th January, 2005. Vide this circular, SEBI has brought new structure of demat charges. The same was notified by SEBI to be effective from 1st February, 2005. Some of the key points mentioned in the circular are:⁵⁰

- *No investor shall be required to pay any charge towards opening of a Beneficiary Owner (BO) Account except for statutory charges as may be applicable;*
- *No investor shall be required to pay any charge for credit of securities into his/her BO Account; and*
- *No custody charge shall be levied on any investor who would be opening a BO Account on or after February 1, 2005.*

Further, the custody charges would not be applicable on investor from April 1, 2005. Moreover, in the circular it was also mentioned that depository are at the discretion to levy custody charge at the rate of Rs.5/- per folio, from companies on the date of 31st March every year, which will be subjected to a minimum fee. The minimum fee payable to the depository is provided in the table mentioned as under:⁵¹

⁴⁹ *Supra* n. 45.

⁵⁰ Securities and Exchange Board of India- Circular, "MRD/DoP/SE/Dep/Cir-4/2005", https://www.sebi.gov.in/sebi_data/commndocs/cirmrd042005_p.pdf, (visited on September 11, 2021).

⁵¹ *Ibid.*

Table of nominal value of securities and annual fee payable to depositories

Nominal value of admitted securities (Rs.)	Annual Custodial Fee payable by an Issuer to each Depository (Rs.) (*)
Up to 5 crores	4,000
Above 5 crores and up to 10 crores	10,000
Above 10 crores and up to 20 crores	20,000
Above 20 crores	30,000

Source- Data provided by Securities and Exchange Board of India

Companies are required to pay the annual custody charges to the depositories mentioned in the aforesaid table by 30th April of every financial year. If the companies are unable to pay these custody charges, then in that case, the depository can charge penal interest at the rate of maximum 12% p.a.⁵²

Further, on 21st February 2005, NSDL has issued different circular No. NSDL/JS/005/2005. In accordance with the terms of the aforesaid circular, some of the key points are as under:⁵³

- *Listed companies will be required to pay custody fee as above.*
- *The fee will be charged on a financial year basis and payable by April 30 every year.*
- *The custody fee will be payable on all securities, i.e., equity, debt, mutual fund units, certificate of depo-sits, commercial papers, etc.*
- *In case the issued capital or ISIN positions increase during the financial year due to issue of further shares, by way of public offer, the custody fee would be charged on a pro rata basis, at the time of such issue.*
- *In case of failure to pay custody fee, NSDL apart from charging interest @ 12% p.a., may stop providing details of client/clearing members/clearing corporation/intermediary to the company and/or R&Ts and may not permit the company to use its infrastructure to issue further securities in electronic form.*
- *In respect of unlisted securities, custody fee at the rate of Re.1 per quarter (Rs.4 per annum) for securities held under each ISIN in each and every account, maintained with the DP, will be charged to the DP, on a quarterly basis. In case an account has no security balance, such an account will also be charged at the rate of Re.1 per quarter.*

⁵² *Supra* n. 50.

⁵³ *Supra* n. 45.

Apart from the aforesaid features, another feature exists in the depository system, which is, one-time payment of custody charge to NSDL. The aforesaid charge is payable at the rate of 0.05% on the market capitalization of any company. The key points are discussed herein as:⁵⁴

- *The market capitalisation of a company will be determined on the basis of the average market price for a period of 26 weeks preceding the date on which the company agrees to make such payment.*
- *Consequent upon such payment, NSDL will not levy any custody charge on the participants.*
- *A company which has opted for the one-time payment route and paid custody charge accordingly, will not be required to pay annual custody fee.*
- *If a company opts to pay the aforesaid one-time custody fee, it will also be required to agree to pay on the newly issued shares, a custody fee at the rate of 0.05% (five basis points) on the value of shares calculated on the basis of issue price of newly issued shares. However, the company will not be required to pay any custody fee on any subsequent issue of bonus shares.*

On the other hand, as far as CDSL is concerned, there is no such feature, which exists, if any investor has preferred CDSL for holding its securities. CDSL levy annual issuer's fee on the investor as prescribed in the circular of SEBI.⁵⁵

3.5 Investor's Satisfaction towards NSDL and CDSL

Both the depositories NSDL and CDSL play a very active and crucial role in the working of the depository system. The number of investors increases gradually in both the depositories every year. NSDL is the first depository in Indian security market and numbers of investors preferred Internet based Demat Account Statement (IDeAS), one of the features exists in the NSDL system.⁵⁶ The studies conducted regarding the number of investors in NSDL and CDSL changes every year. Some studies shows that number of investors in CDSL has surpass the number in NDSL.⁵⁷

The phase of Covid-19 has provided opportunity to the investors in the financial market to use digital platform. Not only the financial market, but also every other such as banking, education

⁵⁴ *Supra* n. 50.

⁵⁵ Central Depositories Services Limited, "CDSL Issuers Tariff Structure as on March 2019", <https://www.cdslindia.com/Downloads/IssuerCompanies/How-to-become-issuer/CDSL%20Charges/CDSL-Issuers-Tariff-structure%20as%20on%20March%202019.pdf>, (visited on September 14, 2021).

⁵⁶ National Securities Depository Limited Annual Report 2019-20, "Number of Investors Registered for IDeAS", <https://nsdl.co.in/downloadables/pdf/Annual%20Report%202019-20.pdf>, (visited on September 14, 2021).

⁵⁷ Central Depositories Services Limited, "CDSL Annual Report 2019-20", <https://www.cdslindia.com/Downloads/InvestorRels/AnnualReports/CDSL%20Annual%20Report%20%20FY2019-20.pdf>, (visited on September 14, 2021).

etc. has been made available in digital platform. The figure of 3 crore investors in CDSL is a landmark achievement for the Indian financial market and this is possible only in the period of Covid-19. When the growth in the CDSL has been compared to the previous years of 2011 or earlier, then it can be implied that profits have been increased at a double rate in the year 2020. Studies conducted shows that net worth return is more in 2020 than in previous year.⁵⁸

This depository has been providing *investors, depository participants, registrars, and transfer agents* etc. with convenient business methods. The demat service provided by CDSL is safe and secure and also facilitates transaction of securities in quick and easier manner. It is considered to be one of the crucial tools of Indian financial market ensuring safe transaction of securities of investors.⁵⁹

The studies conducted on the working of the both depositories have shown positive results regarding the performance of both the depositories. Though CDSL is the second depository and has been introduced at a later stage in the depository system, its growth is at par with NSDL. Both the depositories together have been attracting investors towards the depository system and the dependency of the investors on the depository system is vital for utilizing demat services.⁶⁰

Both the depositories have made huge progress and contributed to the growth of Indian financial market. Each and every step has been taken by both depositories to make the demat services available to each and every investor willing to utilize demat services i.e. providing services in remote areas of country. In the new changes phase of the securities market, these depositories are using different softwares to provide different features to investors, so that they can hold their securities in convenient manner. The market efficiency and the transaction of securities have been made easier and convenient due to the advanced technologies used by these depositories.⁶¹

With the commencement of the dematerialization period, the Indian stock market has undergone a different phase. The main test of any stock market can be analyzed with the percentage of return to the investors. Any investor, before investing in the stock market, will predict or analyze the returns, he/she get from that investment. Dematerialization of securities plays a very crucial role in this case, as it tries to ensure that every investor having demat accounts have higher volatility and higher liquidity. Each and every problem or grievance faced by the investor in paper based settlement system by the investor has been worked upon in the depository

⁵⁸ C. Nithya1 and P. Maheswari, "A Study on Central Depository Services (India) Limited", *TURKISH JOURNAL OF PHYSIOTHERAPY AND REHABILITATION*, Vol. 32, No. 3, 2021, p. 52.

⁵⁹ *Ibid*, p. 58.

⁶⁰ *Supra* n. 1, p. 7.

⁶¹ *Supra* n. 4, p. 97.

system. Paper based settlement system can only handle limited number of investors as the limited transactions can be only dealt with in the case of physical delivery of shares or other securities. There was a lot of paperwork to deal with in the case of physical delivery of securities. Due to this reason, it was difficult to handle lot of investors simultaneously in the case of paper based settlement system.⁶².

3.6 Conclusion

The financial market of India has undergone tremendous growth with the coming of dematerialization phase. Both the depositories has handled large number of investors simultaneously and with the different number of technologies and softwares, are handling crore of transactions in easier and quick manner. These depositories have provided investors with various numbers of different numbers of options and services. All these services are at par with the international practices being followed in their depositories. With the different policies and bye-laws issued by SEBI, number of investors has been increased gradually and registered with different depositories. Though SEBI has made the dematerialization service mandatory for every company, which has been criticized by most of the academicians and scholars, the stakeholders and investors were provided with an option for rematerialization, providing for conversion of securities in electronic mode to physical securities. Whether such solution or alternative provided to investors is cost effective or not is debatable.

One of the criticisms faced by these depositories is the excess fee charged for utilizing demat service. Time and again, SEBI has issued circulars to lower the demat charges. Also, NSDL has issued circulars regarding the applicability of demat charges on investors. As far as issue of demat charges are concerned, NSDL provides features favouring investors such as option of *one-time payment custody charge*, which does not exists in CDSL. In spite of all the efforts made by SEBI and depositories to lower the demat charges, they failed to attract the small investors as the existing demat charge structure is not cost-effective for them. Apart from this, in terms of growth, CDSL is at par with NDSL and provided investors with all the features, which are investor-friendly. Both the depositories made efforts to ensure transaction of securities are safe and secure and thus NDSL and CDSL have made huge progress and crucial contributors of Indian securities market.

⁶² *Supra* n. 4, p. 98.



CHAPTER-IV

Legal framework for Depository System in India

4.1 Introduction

Earlier in India, stock exchanges followed the traditional method for trading of securities i.e. trading through physical transfer of share certificates. This system was not proved to be beneficial for Indian security market as investors often have complaints about delay in delivery of share certificates, and other issues, which includes theft etc. Also, the paper based trading system is a time consuming and tedious process. In India, there are many listed companies, which have developed to a great extent in a short span of time. Since these companies are at the developing stage and aims to become a global competitor, therefore adopting paper based trading system is a cumbersome process for them.¹

The Nadkarni Committee has provided the recommendations that the investors in the securities market will be the members of the centralized agency. This agency will work as an electronic based clearance system and act as a Depository (or commonly referred as National Clearing and Depository System).²

Thus, with the growth of the capital market, market regulator SEBI has introduced the Depository system, as one of the reforms in the securities market, which allowed the investors to adopt electronic-based trading system. A draft Depository Bill was brought by the government to ensure free transfer of shares and other securities through depositories.³

4.2 Definition of Depository

The term depository has been defined under Section (1A) of section 12 of the Securities and Exchange Board of India Act, 1992. It 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 an Exchange Board of India Act, 1992*”.⁴ Vide circular dated 10.09.2018, MCA has notified the Companies (Prospectus and Allotment of Securities) Third Amendment Rules, 2018. In the context of aforesaid rules, depository can be defined as any entity,

¹ Atul Billore and Garima Tiwari, “*Concept of Demat Shares*”, <https://www.legalserviceindia.com/article/l119-Concept-of-Demat-Shares.html>, (visited on September 16, 2021).

² Samir K Barua and V Raghunathan, “*Analysis of Indian Securities Industry:Market for Debt*”, https://www.researchgate.net/publication/46435767_Analysis_of_the_Indian_Securities_Industry_Market_f_or_Debt (visited on September 16, 2021).

³ Kavita Sachwani, “*Scriptless trading - Depositories Ordinance, 1996*”, [1996] 8 SCL 89 (MAG).

⁴ Section 2(e) of Depositories Act, 1996.

organisation, bank, or a financial institution that hold the financial securities in dematerialized or electronic form thereby aiding the investor in trading of its securities.⁵

SEBI Act 1992 provides for the commencement of business to the depositories. No depository can be registered without obtaining the certificate from SEBI.⁶ Before providing any registration certificate to any depository, SEBI will ensure that these depositories are not indulged in any malpractices and satisfy itself that they had taken adequate safeguards to prevent themselves from indulging in any malpractices such as manipulation of any financial transactions etc.⁷

4.3 Constituents of Depository System

In India, there are two depositories Central Depository Services Limited (CDSL) and National Securities Depository Limited. The objective of the depositories is to make the handling and holding of securities more easier and convenient for the investors in securities market and thus attract more and more investors in Indian security market. The role assigned to NSDL is to act as custodian and it is accountable for legally transferring the beneficial ownership and secondly to ensure the paperless trading so as to reduce the risk of settlement of securities.⁸

Under the depository system, there are various players who are responsible for the whole functioning of the depository system. These are:

- Depository Participant
- Issuer
- Beneficial Owner (BO)

4.3.1 Depository Participant

Depository Participant works as the agent of the depositories. He/she can only act as agent after registering themselves with SEBI. Participant can include under the following categories⁹:

- *A public financial institution as defined in section 4A of the Companies Act, 1956.*
- *A bank as per Schedule II of the RBI Act, 1934.*
- *A foreign bank operating in India.*

⁵ Bhumes Verma, “Dematerialisation of Unlisted Public Companies’ Shares”, (2018) PL (CL).

⁶ Section 3(1) of Depositories Act, 1996.

⁷ Section 3(3) of Depositories Act, 1996.

⁸ ITI Jain, “Dematerialisation of Securities in India”, [2008] 87 SCL 69 (MAG).

⁹ Section 6 of Securities and Exchange Board of India (Depositories And Participants) Regulations, 1996.

- *A State Financial Corporation.*
- *An institution promoted by any of the institutions mentioned above.*
- *A custodian of securities recognized by the SEBI.*
- *A clearing corporation or clearing house of a Stock Exchange.*
- *A stock-broker registered with the SEBI having networth as prescribed.*
- *A non-banking finance company as specified.*
- *A Registrar or share transfer agent as specified.*

As per the guidelines of SEBI, Depository Participants can be financial institutions, stock-brokers, banks, custodians etc. Any investor needs to open a demat account for keeping its securities in dematerialized form or for purpose of transfer of securities. Depository system envisages a deposit of securities of various investors. Once the securities are being registered with the depository, transfer of these securities would be through mode of book-entry (electronic form via dematerialization mode) i.e. similar to the accounts maintained by the depository. The main purpose of the depositories recognized by the Board is to maintain the securities in dematerialize form.¹⁰

4.3.2 Issuer

The issuer can be defined as the company issuing the securities¹¹ to the investors. According to Clause 2.1-5 of Securities and Exchange Board of India (Disclosure and Investor Protection) Guidelines, 2000¹², the company is under an obligation to enter into an agreement with a depository it issues any share whose value exceeds 50 lakhs or it is a public issue for dematerialization of shares or any other securities.¹³

4.3.3 Beneficial Owner

The third participant is the Beneficial Owner, who is member of a company holding shares and share certificates in physical form. On the other hand, if we are considering the case of dematerialization of securities, then the case is different from the aforesaid situation. In the legal context, depository is the registered owner of share whereas Beneficial Owner is the one to whom the share has been allotted.¹⁴ Further, the Beneficial owner has been defined under the Depositories Act, 1996 as “a person whose name is recorded as such with a depository”.¹⁵ The power has been given to the depositories to affect the transfer of shares without intimating the

¹⁰ Investor Education and Protection Fund Authority, “*Depository Account (DEMAT)*”, http://iepf.gov.in/IEPF/Depository_Account_CDSDL.html, (visited on September 27, 2021).

¹¹ Section 2(1)(f) of Depositories Act, 1996.

¹² Clause 2.1.2 of SEBI (Disclosure, Investors Protection) Guidelines, 2000.

¹³ Neetu Prakash, “*Role of SEBI in Investor Protection*”, [2007] 75 SCL 139 (MAG).

¹⁴ *Ibid.*

¹⁵ Section 2(a) of Depositories Act, 1996.

matter to the issuer so that the process of transfer can be done easily. Apart from this, the beneficial owner holds the same rights and obligations which member of any company has been entitled to under the Companies Act.¹⁶

4.3.3.1 Rights and Obligations of Beneficial Owner

Under the Depositories Act, 1996, Beneficial Owner has the right to be indemnified by the depository, if in case, due to negligence of depository or depository participant, any loss has been caused to the beneficial owner.¹⁷ Later, the depository has the right to recover the same if the loss has been caused to the beneficial owner due to the negligence of the depository participant. The purpose behind Section 16 is to protect the interest of the beneficial owner of the securities and thus it is required from the depository to indemnify the loss of the beneficial owner caused by them in any manner. It is evident from the aforesaid provision that element of 'negligence' has to be proved by the beneficial owner to claim compensation from the depository.¹⁸

In a recent circular dated 14.06.2017, SEBI has directed the depositories to comply with the directions and made the necessary amendments to the relevant rules, regulations, bye-laws related thereto.¹⁹ The aforesaid direction was regarding the registration of Beneficial owner and Beneficiary (in whose favour the Non Disposal Undertaking is created) with the same depository. These are required to have demat account. As soon as NDU is created, Beneficial Owner and Beneficiary has to make an application to the depository through the agent i.e. depository Participant for opening of the demat account.²⁰

NDUs are undertakings, given by shareholder to the other person. These are not to be transferred or alienate the securities, which are held by shareholders in a particular company.²¹ The intention of SEBI behind requirement for demats account from BO and Beneficiary is not settled. When it has been looked upon from the context of pledge, where the pledgee has been provided with the right to pledge and take over the security or can transfer its shares, then the aforesaid requirement does hold some rationale. In case of NDU, the Beneficiary holds very limited right i.e. either it can approve for transfer of shares or disposal of the same. Therefore, the

¹⁶ *Supra* n. 13.

¹⁷ Section 16(1) of Depositories Act, 1996.

¹⁸ Section 16(2) of Depositories Act, 1996.

¹⁹ Securities and Exchange Board of India-Circular, "CIR/MRD/DP/56/2017", <https://ww1.cdslindia.com/downloads/SEBI-Circular%20Recording-of-Non-Disposal-Undertaking-in-Depository-System.pdf>, (visited on September 28, 2021).

²⁰ *Ibid*, Clause 5.3.

²¹ Swati Sharma, "SEBI introduces recording on Non-Disposal Undertaking", <https://www.mondaq.com/india/securities/611236/sebi-introduces-recording-on-non-disposal-undertaking>, (visited on September 29, 2021).

requirement from the Beneficiary to have demat account with the same depository is not required. The legal provision contemplates the execution of an NDU.²²

The legal provision in the circular states that as soon as the NDU is recorded which means that shares are being freeze in the system, the depository would not assist beneficiary or *facilitate any transfer, pledge, hypothecation, lending, rematerialization or alienation in any manner or otherwise dealing in such shares, till receipt of instruction from both parties for the cancellation of NDU*. If there is requirement of cancellation of NDU, the involved parties are expected to make a joint application stating simultaneous requests for cancellation of NDU and unfreezing of shares.²³ It may be presumed that mechanism for creation of any NDU is similar to that of pledge, where the pledger and the pledgee execute an agreement, and later filings with depositories are made thereon. The previously mentioned Circular of SEBI has expected that while dealing with any of the securities against which an NDU has to be recorded earlier can be done only after taking the prior consent of BO and Beneficiary. The privilege of alienating shares by the beneficiary in the case of pledge cannot be done as it can be done in the case of dealing with NDU. It is only the BO, which can transfer/alienate the shares after taking the consent of the Beneficiary as per the contractual terms agreed in the NDU.²⁴

Under the Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 (commonly referred as “Takeover Code”), it is expected out of promoters to reveal or disclose details regarding holding any encumbered shares. Under the Takeover regulations, encumbrance includes any “*pledge, lien, or any such transaction, by whatever name called.*” Therefore, the term encumbrance does not imply only a pledge or lien but it also comprises of any other transaction entailing a risk attached with the shares held by promoters being associated with a third party. This would cover under the meaning of “NDU”. Due to lack of any effective legislation to regulate the creation of NDU on dematerialized shares, depository are not able to track the shares, especially which are the subjects of NDU, and due to such issues, NDUs are not being disclosed in depository system. The Circular is only confined to the matter of recording of NDUs on dematerialized shares and it is one-step taken by SEBI in this regard which is not sufficient to regulate the functioning of NDUs. Although from the circular, not only listed companies but unlisted companies shares in dematerialized form would also be recorded.²⁵

It is pertinent to understand the relationship between Depository Participant and depository

²² *Ibid.*

²³ *Supra* n. 19, Clause 5.10.

²⁴ *Supra* n. 21.

²⁵ *Supra* n. 21.

for getting better clarity of the functioning of the depository system. Any depository has to enter into an agreement with one or more agents i.e. depository participants. The manner of the agreement has to be complied as specified in the bye-laws. Also, to avail any depository services, a person has to enter into an agreement with the depository.²⁶ As per Section 4(1) of the Depositories Act, 1996, the relationship between depository and its agent has been regulated by an agreement.²⁷

The concept of dematerialization was considered to be major reform in the capital market and it was highly appreciated in this field. The primary legislation Depositories Act, 1996 came into existence in 1996 and puts a heavy obligation on the market regulator SEBI to respond to legislative requirements specified in the Act. Thereafter, SEBI issues various guidelines, circulars, bye-laws, rules and regulations for the functioning of depositories and participants. One such legislation is SEBI (Depositories and Participants) Regulations, 1996, comprising of 58 regulations, including *operation and functioning of depositories, form for application, schedule of fees for participants etc.* Also, it includes provision for *registration of depository and its agents, rights and obligation of users and various constituents, procedure for inspection and action in case of default.*²⁸

Under Regulation 26 of the SEBI (Depositories and Participants) Regulations, 1996, it has been provided that depositories, participants, issuers and issuers agent are entitled to rights in addition to what has been already laid down under Depositories Act, 1996. These rights, which are in addition, shall arise from the agreement entered into between them.²⁹

Before discussing the legislations governing depository system in India, it is pertinent to discuss about the mode of dematerialization. In this process, the securities are being allotted to the investors quickly and the funds of the investors are not at stake for a longer period of time. As soon as the process of issuance of securities is completed, the investors received the liquidity. Thus, the cost of the investor is low i.e. the cost applicable to the public issue of securities. As a result, the participation of investors in the securities market has been increased in the case of public issue of securities. Till 2001, SEBI has made dematerialization mandatory for all issuers and IPOs. In its annual report of SEBI, the dematerialization process can only be functioned if it is made compulsory for the investors in the securities market.³⁰ Later on, the specific legislation

²⁶ Manohar Samal, "A Guide to the Depositories Act, 1996", FinTech Law, <https://www.asianlaws.org/blog/a-guide-to-the-depositories-act-1996/>, (visited on September 30, 2021).

²⁷ Section 4(1) of Depositories act, 1996.

²⁸ V Arun Roy, "Half a decade of dematerialisation: a review", [2000] 28 SCL 12 (MAG.).

²⁹ Reg. 26 of SEBI (Depositories and Participants) Regulations, 1996.

³⁰ G Sabarinathan, "SEBI's Regulation of the Indian Securities Market, A critical review of the major developments",

governing the depository system i.e. The Depositories Act, 1996 has been brought by SEBI with an aim to incorporate the concept of dematerialization of securities in India.

4.4 Legislations governing Depository System in India

There are numerous legislations governing the depository system in India. Among these, the primary legislation governing depository system is The Depositories Act, 1996. This legislation will be discussed elaborately in later part of this chapter. Apart from this, the other legislations governing the electronic based trading system are the Companies Act, 1956, The SEBI (Depositories and Participants) Regulations, 2018³¹, Securities Contract Regulation Act, 1956³² etc. Time and again, SEBI has amended various legal regulations and issued circulars and notifications, for smooth transfer of securities in the securities market. Out of which, some of the provisions of different legislations are discussed herein under:

4.4.1 Transfer and Transmission of Securities

Free transferability of shares is a cardinal principle applicable in the case of public limited company. Under Companies Act and Securities Contract Regulation Act, 1957 there are legal provisions, which allow shares or any other movable property to be freely transferred in accordance with the articles of association of company. For instance, in the case of *Western Maharashtra Development Corpn. Ltd. v. Bajaj Auto Limited*³³ under the Companies Act, 1956, in the case of public limited company, shares are freely transferrable unlike private limited companies (restriction on freely transferable of shares is expressly mentioned under the Act).³⁴ The aforesaid provision was emphasized by the Apex Court in one of the landmark judgments i.e. *V B Rangaraj v. V B Gopalakrishnan*³⁵ stating that private company could restrict its shares to the extent allowed in the article of association of company.

There is specific provision provided in the Companies Act, 2013 which allows for transfer of shares under depository system. The aforesaid provision states that if any company has opted to transfer the shares through a depository, then that particular company should intimate the details

https://www.researchgate.net/publication/318950140_SEBI's_Regulation_of_the_Indian_Securities_Market_A_Critical_Review_of_the_Major_Developments, (visited on September 17, 2021).

³¹ Abhishek Vaidya, "Depositories and the Regulations Governing them in India- An Analysis", ASIA PACIFIC LAW AND POLICY REVIEW, Vol.4 (Annual), 2018, p.262.

³² Surya Prakash, "The Securities Contract Regulation Act", <https://www.rna-cs.com/the-securities-contracts-regulation-act-1956/>, (visited on September 18, 2021).

³³ (2010) 154 Comp Cas 593 (Bom).

³⁴ Section 3(1)(iii)(a) of Companies Act, 2013.

³⁵ (1992) 73 Comp Cas 201 (SC).

regarding the allotment of shares or securities to the depository whom it has transferred to.³⁶ A separate procedure has been followed in the case of transfer of shares has been done through depository system.

4.4.1.1 Procedure for transfer of shares

Section 56 to 59 of the Companies Act 2013 provides for procedure for transfer of shares. Section 56 of the Companies Act, 2013 states that transfer of shares or securities can be registered by a company when there is proper instrument for transfer of shares i.e. share transfer form. This form is required to be duly stamped with proper date for execution of transfer of shares. The aforesaid form needs to be sent to the company within 60 days from the execution of the share transfer agreement. Along with this agreement, a 'No Objection Certificate' is required from the buyer within two weeks (should be from date of receipt of notice).³⁷

If a company refuses to register the shares (exercising power provided by Article of Association or otherwise), then, it can do so within period of 30 days from the instrument of transfer delivered to the company. The intimation of such notice must be given to the transferor providing the reasons for refusal of such registration.³⁸ In furtherance to the above, SEBI has a power to make regulations for issues relating to capital, transfer of securities etc. This power has been given under Section 11A(1) of the SEBI Act, 1992. Proviso of Regulation 40(1) of Securities and Exchange Board of India (listing Obligations and Disclosure Requirements) Regulations, 2015 states that transmission or transfer of securities cannot be completed unless the securities hold by the investors are in dematerialized form with any of the depositories.³⁹

Whereas under the provisions of Companies Act, 1956 it is evident that a shareholder of any company can hold the property either in movable or immovable form. To balance the aforesaid two provisions and to ensure that the SEBI Regulations and Companies Act are not in derogation with each other, Section 8(1) of the Depositories Act, 1996 provides that holder of the securities have been given an option either to receive security certificate or hold it in dematerialized form with any depository.⁴⁰

On the other hand, the Companies Amendment Act, 2019 has introduced new sub-section 1A under Section 29 of the Act, which states that in case of unlisted companies securities shall only be held or transferred in dematerialized form. This is to be done in the manner laid down under

³⁶ Section 56(4) of Companies Act, 2013.

³⁷ Section 56 (1) of Companies Act, 2013.

³⁸ Section 58(1) of Companies Act, 2013.

³⁹ Reg.40 of Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations, 2015.

⁴⁰ T V Narayanaswamy, "Securities and Exchange Board of India's Regulations – Are they binding on Investors", [2021] 162 CLA (Mag.).

the Depositories Act, 1996. Also, Ministry of Corporate Affairs amended the Companies (Prospectus And Allotment Of Securities) Rules, 2014 dated 10th September 2018 introduced Rule 9A.⁴¹ The aforesaid rule states “*every unlisted public company shall hold the securities only in dematerialized form; and (b) facilitate dematerialization of all its existing securities*”.⁴²

Rule 9 of the Companies (Prospectus and Allotment of Securities) Rules, 2014 (referred to as “PAS Rules) provides promoters of the public company to hold any convertible security only in dematerialized form. If any promoter holds any of its convertible security in physical form up to date of the initial public offer of the company, then the aforesaid convertible security shall be converted in dematerialized form.⁴³

Thus, it is beyond one’s capability to comprehend the intention of the legislator behind the aforesaid provisions and how these provisions can act together in a harmonious manner.

In any company, before any share transfer, prior approval of Board of Directors is pertinent. It is the discretion of the Board of Directors of company to decide whether the share transfer should be allowed or rejected as per Section 111 of the Companies Act and Section 22A of the Securities Contract Regulation Act, 1956 and the board can reject the transfer of shares if the transfer of shares is prejudicial to the interest of the company. In the aforesaid context, in the case of depository also, the law has to be changed in accordance with the interest of the company and to ensure that on its own discretion no company is allowed to intervene in changes of beneficial ownership as recorded by depositories.⁴⁴

The previously mentioned provision Section 22 A of Securities Contract Regulation Act, 1956 has been removed i.e. at the present context, the board of directors cannot exercise the power to refuse the registration of transfer of shares. This was done at the time of enacting legal framework on depositories. Apart from this, the right of company which has been incorporated in Section 22(3) of the Act, which is the right to refuse registration of transfer of shares if instrument of transfer is not duly stamped or the certificate has not been delivered to the company or any other requirement whatsoever has not been complied with⁴⁵ which has been clearly specified in the aforesaid provision.

If any company has any reservation about the acceptance or admissibility of process of share acquisition and is in conflict with provision of SEBI (Substantial Acquisition of Shares and

⁴¹ *Ibid.*

⁴² Rule 9A of Companies (Prospectus and Allotment of Securities) Rules, 2014.

⁴³ *Ibid*, Rule 9.

⁴⁴ Naresh Kumar, “*Need for a Depository System In India*”, [1995] 5 SCL 145 (MAG).

⁴⁵ V. Niranjan and Umakanth Varottil, “*Enforceability of Contractual Restrictions on the Transfer of Shares*”, THE PRACTICAL LAWYER, 2012, https://www.supremecourtcases.com/index2.php?option=com_content&itemid=99999999&do_pdf=1&id=24505, (visited on September 25, 2021).

Takeover) Rules and Regulations or the listing obligations of stock exchanges, or any other statutes thereto, company has been allowed to make an application before Company Law Board regarding the correction/rectification of the records of ownership i.e. register of members of company etc. registered with depository. The whole purpose behind the aforesaid provisions is deemed as that the transaction as complete as soon as the necessary entries have been recorded in the books of depository though there can be scope for correction/rectification of membership records which can be done by Company Law Board.⁴⁶

4.4.2 Members of Company

Section 41 of the Companies Act, 1956 defines the members of the company. It states that to qualify for membership of a company, person must be holding equity share capital of company and their name is to be entered as beneficial owner in the records of depository. These people shall be deemed as member of that particular company.⁴⁷

Section 41(3) of the Companies Act has been widely discussed in the case of *Northern Projects Ltd. v. Blue Coast Hotels and Resorts Ltd.*⁴⁸ It has been contended that those persons who are holding equity shares of company are considered to be members of the company. This contention was rejected by Company Law Board by stating that 41(3) is to be read along with Section 41(1) and (2) of the Act and not in derogation of these two sub-sections. The words ‘shareholder’ and ‘member’ mentioned in the aforesaid provision is used in the same connotation whereas the words ‘equity shareholders’ are mentioned only in section 41(3) of the Act and it has not been used by previous two sub-sections i.e. equity shareholders cannot be contemplated as subscribers nor covered under names entered in register of members.⁴⁹

In the case of *Probir Kumar Misra v. Ramani Ramaswamy*⁵⁰, Court held that after the primary legislation Depositories Act, 1996 came into existence, the depositors who holds equity share capital of the company and whose names are being entered as beneficial owners are deemed to be members of the company and they are considered as ‘members’ under the Depositories Act, 1996.⁵¹

4.4.3 Role of SEBI

⁴⁶ *Supra* n. 44.

⁴⁷ Section 41(3) of Companies Act, 1956.

⁴⁸ (2008) (88) SCL 74.

⁴⁹ *Ibid.*

⁵⁰ [2010]154 Comp Cas 658 (Mad).

⁵¹ *Ibid.*

SEBI is the primary institution to regulate the security markets. The registration as well as the working of the depositories are controlled and regulated by the Securities and Exchange Board of India.⁵² All the significant statutes such as the Companies Act, 1956, Capital Issue (Control) Act, 1947 and Securities Contracts (Regulations) Act failed to handle the securities market and unable to protect the interest of investors. One of the reasons were the fraud committed by merchants, stock-brokers and companies in 1991. Therefore, there was a need to introduce effective legislation to deal with the issue. Market regulator SEBI was constituted under the resolution of the Government of India in the Department of Economic Affairs No. I(44) SE/86, dated 12.04.1988. As a result, in 1992, Securities and Exchange Board of India (SEBI) Act was brought into force, under which SEBI was given statutory recognition, to protect the interest of investors and to ensure the capital market can grow at a faster pace. SEBI management was in the hands of few persons comprises (i) Chairman (ii) two members from officials of Ministries of Central government dealing with Finance and Law (iii) one member from amongst the officials of Reserve Bank of India (iv) two others members appointed by Central Government. Later on SEBI Act, 1992 was amended in 1995 to provide wider powers to SEBI so that it can regulate new participants in the capital market i.e. custodians, depositories, venture capital funds, credit rating agencies, foreign institutional investors etc. At present, SEBI is controlling all the intermediaries who are connected or associated with securities market in any manner thereto.⁵³

From the period of 1992, the attitude of foreign investors towards Indian capital market changes drastically. As a result, large number of foreign investors attracted towards Indian market and foreign investment increase at a higher rate. However, in 1995, the trading was only 8% of the market capitalization, but after the Indian government promulgated Depository Ordinance in 1995, the trading rate increases. The first depository National Securities Depository Limited was registered in 1996 and this move was highly appreciated, as it was a major step taken by the government to boost the capital market of India.

4.4.4 Protection of investors

SEBI can make an order, after satisfy itself that it is necessary to do so in the favour of public interest or investors, in writing. The relevant provision is being provided as:

“(a) call upon any issuer, depository, participant or beneficial owner to furnish in writing such information relating to the securities held in a depository as it may require; or (b) authorise any person to make an enquiry or inspection in relation to the affairs of the issuer, beneficial owner, depository or participant, who shall

⁵² Section 11(2)(ba) of Securities and Exchange Board of India Act, 1992.

⁵³ *Supra* n. 13.

submit a report of such enquiry or inspection to it within such period as may be specified in the order.”

Moreover, SEBI may issue such directions necessary to protect the interest of investors in the security market and also prevent the depository matters being conducted, which is detrimental to the interest of investors. These are pertinent to (a) to any depository or participant or any person associated with the securities market; or (b) to any issuer as may be appropriate in the interest of investors or the securities market.⁵⁴

In furtherance to protect the interest of investors in the security market and also since dematerialization system requires lot of attention from SEBI regarding the fulfillment of requirement mentioned in the rules and regulations etc. SEBI has passed various laws regarding the regulation of depositories. In 1996 Security and Exchange Board of India (Depositories and Participants) Regulations, 1996 was passed, governing the issues like registration of depositories, certificate of commencement of business to be granted, depository participants registration, rights and obligations of depositories, manner of registration etc.⁵⁵

In this manner, SEBI has passed various circulars, bye-laws, rules and regulations time to time to regulate the demat system in controlled manner and prevent any of the participants involved in the depository to commit any frauds and other type of malpractices etc. These stringent provisions has keep the fraudsters in check and thus to a large extent is aiding investors in the security market.

4.5 Remedies available to the investor

The investor plays a crucial role in the security market. In the case of Depository system, the investor is in direct link and has to face with agents of the depository i.e. depository participants and both are bound by the laws and regulations and the rights and obligations specified in the agreement between them thereto. The Depositories function is mainly regulated by the primary legislation of Depositories Act, 1996 and apart from this, the market regulator SEBI.⁵⁶ The aforesaid agreement between Depository participant and investor provides that the party has the right to receive the securities which are recorded in the Depository, and is in dematerialized form in accordance with the manner specified in bye-laws, rules and regulations. Apart from the above, they have to comply with the other laws thereto such as arbitration and conciliation procedure, if

⁵⁴ Section 18 of Depositories Act, 1996.

⁵⁵ National Institute of Securities Markets Workbook for NISM-Series-VI, “*Depository Operations Certification Examination*”, https://www.bseindia.com/downloads/Training/file/16122011_NISM-Series-VI-DOCE%20Workbook.pdf, (visited on September 30, 2021).

⁵⁶ *Ibid.*

any issue arises between Depository participant and party involved in the agreement.⁵⁷

The concern of investors related to dematerialization of securities is generally related to the delays in transfer of securities etc. Clause 9 of NSDL bye-laws deals with this issue. In such cases, the role of DP is crucial and it is expected out of him/her to forward the request of investor to the issuer or its transfer agent within seven days from the registration of complaint. Unless or until the depository has not receive such intimation from issuer, no amount is to be credited against any security has been made to the client's account.⁵⁸

SEBI regulations put an obligation on the depositories to make a proper mechanism for scrutiny, reviewing and evaluation of depository control mechanism, its procedures have been complied with or not, whether safeguards have been taken by these depositories or not. It is also expected from the depositories to take appropriate measures, which includes insurance etc. in favour of protecting the interest of the beneficial owners and investors against the risk likely to be faced by them on encountering with the transactions under the depository system.⁵⁹

There is a provision for investors to raise their grievance before the concerned depository and file for claim against the losses suffered by them. Thereafter, it is the depository's concern to recover the damages from the party-in-default i.e. issuer or DP etc.⁶⁰ The investor has also an option to file complaint before SEBI, in return, SEBI can initiate enquiry and investigation against any depository, issuer or DP. If the problem or complaint is still not resolved, investor can file an appeal before Securities Appellate Tribunal.⁶¹ Apart from the above remedies, SEBI has the provided the power to depositories to make bye-laws which can provide for cancellation of agreement with the depository if in case, the depository participant has acted against any of the rules, regulation or any such provision provided in the depositories act.⁶²

The safeguards and regulations set by SEBI for the depositories is kept high and it is expected of them to follow adequate procedure and standards which can protect the interests of the beneficial owners against the risks taken by the investors on account of their participation in the depository system. In view of the above, SEBI has provided them with provision to file complaint

⁵⁷ Central Depository Services (India) Limited, "*Rights and Obligations of Beneficial Owner and Depository Participant as prescribed by SEBI and Depositories*", https://www.sebi.gov.in/sebi_data/commndocs/may-2019/rightsandobligationsciranndec2013_p.pdf, (visited on September 30, 2021).

⁵⁸ National Securities Depository Ltd, "*Bye Laws*", <https://nsdl.co.in/downloadables/pdf/Bye-Laws%20%28Amended%20upto%20May-2016%29.pdf>, (visited on September 30, 2021).

⁵⁹ R & A Associates, "*An Insight into the Depositories Act, 1992*", <https://rna-cs.com/an-insight-into-the-depositories-act1996/#:~:text=The%20Depositories%20Act%2C%201996%20was,in%20effecting%20the%20transfer%20securities>, (visited on September 30 2021).

⁶⁰ Section 16 of Depositories Act, 1992.

⁶¹ Section 23A(1) of Depositories Act 1992.

⁶² Section 26(2)(o) of Depositories Act, 1992.

before the specific depository against the losses suffered.⁶³

Depository Participant is a crucial participant and the main connected person between the investor and depository or issuer. Investor can face the issues like deficiency in services provided by the depositories and he can raise his grievance on basis of that issue. The investor can approach civil court only if the Securities Appellate Tribunal is not competent or empowered to provide remedy to them otherwise only Tribunal has the power to take any action against the grievance raised by the investor.⁶⁴

4.5.1 Delay in issuance of certificate

It is expressly mentioned under the Depository Act *if any issuer or agent, who is registered as intermediary under the provisions of section 12 of the Securities and Exchange Board of India Act, 1992 (15 of 1992), is unable or fails to dematerialise or issue the certificate of securities, if in case, investor has opt out for depository mode, within the time frame prescribed or mentioned under this Act or any relevant regulation or other bye-laws thereto, or in any matter has abetted in delaying the dematerialization process or in issuing the securities certificate, such issuer or its agent or intermediary are liable to pay one lakh rupees as penalty for each day during which such failure continues or one crore rupees, whichever is less.*⁶⁵

4.6 Legal Implications of Dematerialization on Companies

The concept of dematerialization of shares is a technical process and it has been introduced for the investor to participate more and more in the financial market. On the other hand, if we are persuading private companies to dematerialize their shares then it is not making the business convenient for them. Moreover, they have to borne additional charges for using the depository services, Registrar and share Transfer Agent fees, require compliance certificate of professionals, charges of filing certificates before Registrar of Companies etc. Under the Companies Act there is restriction on transfer of shares, especially in case of private companies. Keeping in mind these factors, if the Government is making the mandate for private companies to dematerialize their shares on account of bringing *transparency, accountability, and strict enforcement to strengthen the corporate governance norms and compliance management in corporate sector*⁶⁶, then there is

⁶³ *Supra* n. 60.

⁶⁴ Section 23E of Depositories Act, 1992.

⁶⁵ Section 19D of Depositories Act, 1992.

⁶⁶ Gaurav Pingle, “*Whether Companies Amendment Act, 2019 contemplates dematerialization of Shares for Private Companies*”, Vol. 108, No. 114, 2019.

problem with such mandate and it will make difficult for the private companies to bear such financial burden unlike public companies.

Section 29 of the Companies Act is making mandatory for every company issuing public offer, to issue their securities in dematerialized form. Vide notification dated 14.08.2019, there has been made amendment under Section 29 of the Act, and omitted the word “public” from Section 29(b) of the Act.⁶⁷

4.6.1 Dematerialization of securities in Public Companies

Rule 9A of Companies (Prospectus and allotment of Securities) Rules, 2014 provides for the mandate of dematerialization of shares in case of issuing of securities by unlisted public companies. The aforesaid relevant provision is provided hereunder:⁶⁸

“(1) Every unlisted public company shall -

(a) Issue the securities only in dematerialised form; and

(b) Facilitate dematerialisation of all its existing securities

in accordance with provisions of the Depositories Act, 1996 and regulations made there under

(2) Every unlisted public company making any offer for issue of any securities or buyback of securities or issue of bonus shares or rights offer shall ensure that before making such offer, entire holding of securities of its promoters, directors, key managerial personnel has been dematerialised in accordance with provisions of the Depositories Act 1996 and regulations made there under.

(3) Every holder of securities of an unlisted public company, -

(a) who intends to transfer such securities on or after 2nd October, 2018, shall get such securities dematerialised before the transfer; or

(b) who subscribes to any securities of an unlisted public company (whether by way of private placement or bonus shares or rights offer) on or after 2nd October, 2018

⁶⁷ Corporate Law Reporter, “Section 29 of the Companies Act, 2013- Public offer of Securities to be in Dematerialized Form”, http://corporatelawreporter.com/companies_act/section-29-of-companies-act-2013-public-offer-of-securities-to-be-in-dematerialised-form/#down5, (visited on October 1, 2021).

⁶⁸ “Companies (Prospectus and Allotment of Securities) Rules, 2014, Third Amendment Rules, 2018 dated 10.09.2018”, <http://ebook.mca.gov.in/notificationdetail.aspx?acturl=6CoJDC4uKVUR7C9F14rZdatyDbeJTqg3JBqXFllMpiXva/pjb4DVXdxgStgW6sZnkTVe9EhdhZpDI3tO58Haf3Xgu5QvwbO2>, (visited on October 1, 2021).

shall ensure that all his existing securities are held in dematerialized form before such subscription.

(4) Every unlisted public company shall facilitate dematerialisation of all its existing securities by making necessary application to a depository as defined in clause (e) of sub-section (1) of section 2 of the Depositories Act, 1996 and shall secure International security Identification Number (ISIN) for each type of security and shall in-form all its existing security holders about such facility.

(5) Every unlisted public company shall ensure that _

(a) it makes timely payment of fees (admission as well as annual) to the depository and registrar to an issue and share transfer agent in accordance with the agreement executed between the parties;

(b) it maintains security deposit at all times, of not less than two years, fees with the depository and registrar to an issue and share transfer agent in such form as may be agreed between the parties; and

(c) it complies with the regulations or directions or guidelines or circulars, if any, issued by the securities and Exchange Board or Depository from time to time with respect to dematerialisation of shares of unlisted public companies and matters incidental or related thereto.

(6) No unlisted public company which has defaulted in sub-rule (5) shall make offer of any securities or [buyback](#) its securities or issue any bonus or right shares till the payments to depositories or registrar to an issue and share transfer agent are made.

(7) Except as provided in sub-rule (8), the provisions of the Depositories Act 1996 the securities and Exchange Board of India (Depositories and participants) ³[Regulations, 2018] and the securities and Exchange Board of India (Registrars to an Issue and share Transfer Agents) Regulations, 1993 shall apply mutatis mutandis to dematerialisation of securities of unlisted public companies.

⁴[(8) Every unlisted public company governed by this rule shall submit [Form PAS-6](#) to the Registrar with such fee as provided in Companies (Registration Offices and Fees) Rules, 2014 within sixty days from the conclusion of each half year duly certified by a company secretary in practice or chartered accountant in practice.

(8A) The company shall immediately bring to the notice of the depositories any difference observed in its issued capital and the capital held in dematerialised form.]

(9) The grievances, if any, of security holders of unlisted public companies under this rule shall be filed before the Investor Education and protection Fund Authority.

(10) The Investor Education and protection Fund Authority shall initiate any action against a depository or participant or registrar to an issue and share transfer agent after prior consultation with the securities and Exchange Board of India]

2[(11) This rule shall not apply to an unlisted public company which is:-

(a) a Nidhi;

(b) a Government company or

(c) a wholly owned subsidiary.]”

Therefore, the aforesaid rules has made mandatory for the unlisted public companies to issue and transfer their securities in dematerialize mode within the time frame prescribed under the Depositories Act, 1996. The obligation of the unlisted companies is to ensure that securities of all members such as promoters, key personnel etc. convert their securities in dematerialize form. Neither unlisted public companies can make any defaults in making payment of fees to depository/registrar/share transfer agent. All the bye-laws and rules made by SEBI in this regard have to be complied with by these unlisted public companies⁶⁹.

4.7 Amendment made in the Companies Act, 1956 under the garb of Depository System

Certain major amendments were made in the Companies Act, 1956 when the Ministry of Finance introduced the Depository Ordinance in 1995. Some of them are discussed hereunder:

- Section 41(3) of the Companies Act has been widened and the definition of member read as “*every person holding equity share capital of a company whose name is entered as beneficial owner in the records of the depository shall be deemed to be a member of the concerned company*”⁷⁰.
- Section 49 has been amended to promote the investment in the name of depositories by making company issuing their securities in dematerialize form⁷¹.

⁶⁹ Manish Kumar Sharma and Ankita Singh, “*Keeping securities mandatorily in dematerialised form - applicability to companies*”, <https://www.lexology.com/library/detail.aspx?g=f5e3b15c-a288-4257-b40e-49213b2cb98e>, (visited on October 21, 2021).

⁷⁰ *Supra* n. 47.

⁷¹ Section 49 of Companies Act, 1956.

- *Section 51 provides special treatment to beneficial owners holding securities in depository, as the depository will serve the records to the company in electronic mode⁷².*

Thus the above amendments made the obligation on the companies to work in co-ordination with the depositories.

4.8 Other statutes governing Depository system

There are different legislations governing the depository system. These are being discussed herein under:

4.8.1 Securities Contract Regulation Act, 1956

This act was enacted in 1956 with an aim to promote securities market in India. It was introduced with an objective to control directly and indirectly all the aspects of securities trading and different stock exchanges to prevent any malpractices practiced by brokers or investors while trading in securities market. The above statute also comprises of legal provisions, which provides power and regulatory jurisdiction to Central Government/SEBI over (a) stock exchanges vide process of recognition and supervision (b) different contracts entered into during trading in securities (c) listing of securities on stock exchanges⁷³.

4.8.1.1 Amendments made in the Securities Contracts (Regulation) Act, 1956

Section 2 of the said Act has been amended to provide that—

“(i) spot delivery contract means a contract which provides for—

(a) actual delivery of securities and the payment of a price therefor either on the same day as the date of the contract or on the next day, the actual period taken for the despatch of the securities or the remittance of money therefor through the post being excluded from the computation of the period aforesaid if the parties to the contract do not reside in the same town or locality; and

(b) transfer of the securities by the depository from the account of a beneficial owner to the account of another beneficial owner which such securities are dealt with by a depository.”

4.8.2 Indian Stamp Act, 1899

⁷² Section 51 of Companies Act, 1956.

⁷³ *Supra* n. 3.

Indian Stamp Act makes it mandatory to pay stamp duty⁷⁴. Section 8A of the Indian Stamp Act has been inserted, providing for exemption for certain kind of transactions from stamp duty. The aforesaid section is read as under⁷⁵:

“8A. Securities not liable to stamp duty —Notwithstanding anything contained in this Act—

(a) an issuer, by the issue of securities to one or more depositories shall, in respect of such issue, be chargeable with duty on the total amount of security issued by it and such securities need not be stamped;

(b) where an issuer issues certificate of security under sub-section (3) of section 14 of the Depositories Ordinance, 1995, on such certificate duty shall be payable as is payable on the issue of duplicate certificate under this Act;

(c) transfer of registered ownership of shares from a person to a depository or from a depository to a beneficial owner shall not be liable to any stamp duty; and

(d) the transfer of beneficial ownership of shares, such shares being shares of a company dealt with by a depository shall not be liable to duty under article 62 of Schedule I of this Act.

Explanation: For the purposes of this section the expressions 'beneficial owner', 'depository', 'issuer' and 'records' shall have the meanings respectively assigned to them in clause (a), clause (e), clause (f), and clause (i) of subsection (1) of section 2 of the Depositories Ordinance, 1995.”

Under the Finance Bill, 1999 the Finance Minister has clearly indicated that to boost the capital market in India, the stamp duty needs to be abolished which is applicable on the transfer of debt instruments. This was done in case of transactions took place under the depository mode⁷⁶.

The aforesaid provision of the Finance Bill is incorporated in clause 137 of the Finance Bill, 1999. The aim of the clause is to exempt the stamp duty while trading in debt instruments along with the shares. But Section 8A of the Indian Stamp Act, 1999 grants exemption to the dematerialization (transfer of registered ownership to the depository from the holder of security) i.e. in the case of trading of shares and not the debentures and debt instruments. As a result, stamp duty would be applicable on the process of the dematerialization of debt instruments. The intention of the provision (Clause 137) was comprehended otherwise and it was brought by the Finance

⁷⁴ *Supra* n. 30.

⁷⁵ Section 8A of The Indian Stamp Act, 1899.

⁷⁶ Prem N Mittal, “Finance Bill 1999 and the Capital Market-two steps forward and one step back”, Vol. 32, No. 137, 1999.

Minister with an aim to provide boost to the secondary market. This issues need to be fairly addressed by the Legislature⁷⁷.

4.8.2.1 Application of Stamp Duty Act

Stock exchange, Clearing Corporation or depositories are the authorities responsible to take stamp duties from persons liable to pay the stamp duty. These are mentioned under Section 29 of the Indian Stamp Act⁷⁸.

The relevant provisions/clauses in relation to transaction in security or the charges borne against the stamp shall be incurred as follows⁷⁹:

“(h) in the case of sale of security through stock exchange, by the buyer of such security;

(i) in the case of sale of security otherwise than through a stock exchange, by the seller of such security;

(j) in the case of transfer of security through a depository, by the transferor of such security;

(k) in the case of transfer of security otherwise than through a stock exchange or depository, by the transferor of such security;

(l) in the case of issue of security, whether through a stock exchange or a depository or otherwise, by the issuer of such security; and

(m) in the case of any other instrument not specified herein, by the person making, drawing or executing such instrument.”

4.9 Conclusion

With the introduction of Depository system in Indian financial market, the market has undergone a drastic change. The depository ordinance by Ministry of Finance is a revolutionary step taken to promote and increase the quantum of investments from domestic as and foreign investors. As it is already discussed, earlier investors have to undergo so many issues like delay in issuing securities etc. which has been resolved by this depository system.

SEBI is making every effort to make Indian financial system stable and investor-friendly. It cannot be denied that more and more investors are attracted towards holding their securities in demat form. They are finding it safe to do so and moreover the process takes less time as compared to physical trading of securities. Still the system put many obligations on the investor before

⁷⁷ *Ibid.*

⁷⁸ *Supra* n. 76.

⁷⁹ Section 29 of The Indian Stamp Act, 1899.

opening any account with any depository such as requirement of agreement with the depository etc. The role of depository, depository participant are very crucial in the system but if any small investor is opening an demat account who is not aware of technical formalities required then he/she has to completely rely on DP or issuer to maintain its demat account. Due to more and more reliance on DP and stock-brokers, frauds and scams are increasing at an alarming rate. Though SEBI has made provisions for these investors to resolve their grievances and made system like SCORES (SEBI Complaints Redress System)⁸⁰. Still some activities of depository and DP got unwatched by market regulator.

The private companies have got advantages with the introduction of depository system. But the fact that companies has to issue their securities in demat form is restricting the freedom of companies and some face paying higher charges for using depository services. The provision making it mandate for private as well as public company to issue securities in demat form does not hold any rationale. Such laws will restrict the choice of investors to invest in the market and depository might hold a monopoly position in the capital market. There is no specific legal provision regarding charging fixed depository fees and often investors raise grievances against DP charging higher fees.

These issues have to be looked upon by SEBI and withdraw compulsory provision such as mandate of issuing securities in demat form by companies. To make stable financial system, the interest of companies has to be taken into consideration, as they are also the major investors in the Indian capital market.

80 Securities and Exchange Board of India, “Redressal of investor grievances against Depository participants in SEBI Complaints Redress System (SCORES)”, CIR/MIRSD/20/2011, https://www.sebi.gov.in/legal/circulars/sep-2011/redressal-of-investor-grievances-against-depository-participants-dps-in-sebi-complaints-redress-system-scores-_20618.html, (visited on October 21, 2021).

CHAPTER-V

ISSUES AND CHALLENGES IN THE DEPOSITORY SYSTEM

5.1 Introduction

The market regulator Securities and Exchange Board of India (SEBI) has been established with an aim to protect the interest of investors and ensure that Indian securities market is running in a smooth manner. All the efforts and attempts made by SEBI i.e. passing bye-laws, rules, regulations etc. to fulfill this aim has been successful or not depends on many criteria. These can be whether such laws are competent to handle financial scams happened in the Indian capital market. These scams are affecting the development of the Indian capital market and the interest of investors is at stake. Consequently, these factors lead to failure of confidence of investors on the stock market. The scams are the crucial factors, which prevent the investors from making any investment in the stock market¹.

The Indian capital market is a largest segment and it is not easier and convenient for market regulator to monitor each and every segment. This holds true for Indian market regulator i.e. SEBI. Then, the question, which arises in relation to this issue, is what steps market regulator should take to prevent such scams from taking place in the market? What are the obligations of SEBI towards protecting the interest and restoring the confidence of the investors in Indian security market? From these scams, the investors are affected the most, which made SEBI to make every effort and attempt to protect the interest of investors. Addressing the grievances of every investor is the most uphill and challenging task for any regulator of market. Most of the market regulators including SEBI adopt the remedy of obtaining disgorged money from fraudsters and providing the same to investors as compensation².

5.2 Transparency in dematerialisation of Securities

Trading of securities vide physical transfer of shares involved lot of paperwork and is a very tiring and cumbersome process. The depository system has been introduced to remove all the

¹ Amit Bhaskar, "Disgorgement in Indian Financial Markets – A Critical Study", [2013] 112 Cla (Mag.) 32.

² Sanjay Chatterjee, "Protection of The Investors by SEBI: - Expanding the horizon of the Investors", <https://www.legalserviceindia.com/article/I334-Protection-Of-The-Investors-By-Sebi.html>, (visited on October 21, 2021).

difficulties, which are faced by the investors in the old trading system. This new trading system is investor friendly and involves safe and secure transactions. Under the depository system, depositories has been established, screen based trading system has been introduced for the first time in Indian capital market. Other features of the depository system include *enforcement of capital adequacy ratio, segregation of member and client accounts, issue of contract note etc.* The oldest stock exchange Bombay Stock Exchange has made possible for the investors to trade their securities in huge numbers and in less time, it has taken a lead in the Indian capital market.³

Trading of securities is a very complex task and it is expected out of investors to made themselves aware of peculiar details about the transactions such as when trading took place, at what price such transaction took place etc. One of the most common problems faced by investors is delay in their securities settlement. The investors in the traditional trading system of securities have already faced this problem. This problem has been referred as “bad delivery” of securities. At that period of time, there was no effective remedy to deal with this problem and prevent such bad delivery of securities from taking place in the market. Operation and regulation of stock exchanges were in the hands and control of few stock brokers i.e. they all function in accordance with the policy of stock brokers⁴.

In the old traditional trading system of securities, bad delivery of securities was the biggest challenge to deal with and is one of the most crucial risks, which investors have to undergone before making investments in the secondary market. In absence of an effective grievance redressal cell, investors have to wait for longer period of time to get the defects rectified. These defects caused to the investors were proved to be in favour of previous shareholders. It was expected from the concerned authorities that till the time the aforesaid defect are rectified, all the securities of investors must be freeze. If the aforesaid defect involves any defect in transfer deed of securities, then in that case, companies are required to approach the seller for raising any objections, if any, regarding the transfer deed. If no valid objections are made against the transfer deed, the securities are required to be transferred, which must be in the name of the purchaser of securities⁵.

Stakeholders regarding the transparency in the depository system pointed out various opinions, as the trading system is electronic-based. The regulators of market are required to be more cautious and vigilant to regulate such trading system. The purpose of SEBI is to enhance transparency in the existing trading system via issuing respective guidelines for regulating depository to inspect agents of depositories (depository participants) etc. to improve risk

³ Shiv Kedia, “A Blue Print for Capital Market Reform”, [1995] 6 SCL 8 (MAG.).

⁴ *Ibid.*

⁵ *Supra* n. 3.

enforcement and prevent the risks such as manipulation of investor accounts etc.⁶

5.2.1 Provision for shortening of 'Trading Settlement Cycle'

In the paper based traditional trading system of securities, the processing of orders, making payment and clearing the trading settlement of investors was a very tiring and cumbersome process. In this system, investors often have to face delays in clearing their trade settlement process, which makes them lose their confidence to built trust in the trading system of Indian securities market. Global or foreign investors were used to clear their trade settlement in easier manner and quickly. This system prevents foreign investors from participating to trade in Indian security market. Depository system has made the clearing trade settlement process quicker and easier. In 2003, SEBI provides the settlement cycle from T+3 to T+2⁷.

In the recent year, market regulator SEBI from various stakeholders regarding the shortening of trading settlement cycle has received many requests. After considering the opinions of the various *stock exchanges, clearing corporations and depositories*, SEBI decided to provide stock exchanges with two options i.e. either to follow T+1 or T+2 trading settlement cycle. This was left at their discretion to provide more flexibility to them⁸.

It was believed that this step would benefit the retail investors and it will take less time to receive cash or securities after the process of trading has been completed. In accordance with the above, SEBI has given directions to all stock exchanges, clearing corporations and depositories to take necessary action to for the incorporation of T+1 trading settlement cycle in the depository system⁹.

Association of National Exchanges Members of India (ANMI) criticized this step of SEBI regarding shortening of trading settlement cycle from T+2 to T+1. They believed that time is too short for the borrowing and lending of securities and there could be scope of haphazard work. Before incorporating this system, SEBI has to consider various technical challenges. Moreover, this system requires more capital for stock brokers, depository participants and banks have to give

⁶ Anirudh laskar, "Sebi puts out guidelines or risk-rating of depository participants", <https://www.livemint.com/Money/ZNLLiEimTkgDifJWEihrbM/Sebi-puts-out-guidelines-for-riskrating-of-depository-parti.html>, (visited on October 22, 2021).

⁷ Nasrin Sultana, "SEBI to shorten trade settlement cycle to one day, starting 2022", <https://www.livemint.com/market/stock-market-news/sebi-to-shorten-trade-settlement-cycle-optional-for-stock-exchanges-11631029025665.html>, (visited on October 23, 2021).

⁸ The Hindu, "SEBI to allow T+1 settlement cycle on an optional basis from January 1", <https://www.thehindubusinessline.com/markets/stock-markets/sebi-introduces-t1-settlement-cycle-on-optional-basis/article36342765.ece>, (visited on October 24, 2021).

⁹ *Supra* n. 6.

more time as soon as the aforesaid trading system is implemented¹⁰.

Further, the association also indicated that foreign investors would prevent them from making investment in the Indian security market, if T+1 settlement cycle is implemented. As they will find such system more complex and cumbersome, as the same would require coordination among different market participants *including fund managers, global and local custodians, brokers, clearing members, and exchanges*. The association further pointed out that adoption of T+1 settlement cycle would make the MSCI country classification view this system in a negative manner. This system will make the Indian stock market viewed as *pre-funded market*. This action of SEBI will make the Indian stock market have a lower rank in market index¹¹.

5.3 Risks faced by investors in Electronic-based Trading System

It is for the first time that the Indian stock market is having a screen-based trading system, which is electronic-based and associated with various risks. Some of them are discussed herein:

➤ **Vulnerable protection to Investors' data:** This electronic-based trading system associates itself with most of the risks. One of these risks can be that holding of shares in dematerialised form implies data is stored in a computer and it might be the case in some situations that data can be lost or cannot be stored due to any failure of the technical system in a computer. The Depository Ordinance has not provided with any technical criteria whatsoever for preventing destruction of data etc. There should be mechanisms for recovery of data so that data of investors can be restored¹².

In view of the above, Cyber-X9, Chandigarh-based company, revealed that there is less protection in the existing dematerialization trading system as in one of the cases involving the largest depository of India, CDSL has revealed sensitive personal and financial data of many investors which were around 4.39 crores in number approximately. In this regard, CDSL has revealed the data from their KYC (Know your Customer/Client) operation conducted in 2005. These investors were having a net worth of over 1000 crores. It was believed that the depository system often faces technical failures and data of investors are vulnerable and often get stolen or accessed by the third person.¹³

¹⁰ Kirti Sharma, "SEBI to abridge trade settlement cycle to one day, starting 2022", <https://truthunfold.com/business-and-economics/sebi-to-abridge-trade-settlement-cycle-to-one-day-starting-2022/>, (visited on October 24, 2021).

¹¹ PTI, "Anmi expresses concern over T+1 settlement proposal", <https://www.financialexpress.com/market/anmi-expresses-concern-over-t1-settlement-proposal/2320479/>, (visited on October 25, 2021).

¹² Kavita Sachwani, "Scripless trading - Depositories Ordinance, 1996", [1996] 8 SCL 89 (MAG.).

¹³ Regina Mihindukulasuriya, "Data breach at India's biggest demat depository exposed 4.39 cr investors' E-security firm", <https://theprint.in/tech/data-breach-at-indias-biggest-demat-depository-exposed-4-39-cr-investors-e-security-firm/757806/>, (visited on October 25, 2021).

➤ **Loss of trust of Investors:** This is another risk of using electronic based trading system i.e. property of shareholders kept in depositories was not kept in secrecy. The depositories already exposed the aforesaid property of shareholders to them at the earlier stage. These risks would make the investors of the Indian stock market lost their confidence and can make them stop making investments and involved in trading of securities transactions. Thus, it can be implied from the above that the depository system was unable to restore confidence of the investors in Indian stock market. It cannot be denied that lot of investors has made their entry in the Indian stock market after the introduction of dematerialization of securities. But if these risks were not looked upon by the regulators and concerned authorities, then soon it will be the case investors will lose their confidence soon in the depository system¹⁴.

5.3.1 Transfer of Securities by Beneficial Owner from one depository to another depository

As far as investors or two beneficial owners are holding the securities in the same depository, there is no issue or concern for them. This is due to the balance maintained in the action of transfer of securities, which took place in the same depository. On the other hand, when the transaction of a beneficial owner having a sub-account with one depository in NSDL is taking place to another depository CDSL (having another sub-account of beneficial owner), then the process becomes more complex and cumbersome¹⁵.

The aforesaid transaction of beneficial owner from one depository to another depository would lead to transfer of registered ownership. This process would require both the depositories to play their respective roles. Firstly, CDSL would be required to credit the securities in its own record and then the other depository NSDL is required to debit sub-account, to provide effect to beneficial ownership. Also, the issuer company has a role to provide effect and made changes in its register of shareholders. This would ensure that transfer of registered ownership has been done from NSDL to CDSL. Moreover, state government would often interfere in to charge stamp duty etc.¹⁶

In the aforesaid case, the depository can raise another concern for the investors that such stamp duty comprises of “*liabilities in respect of the securities*” and are liable to be paid. The stamp duty has to be paid by the beneficial owner in this case. This is in total contradiction with the purpose of scripless trading¹⁷. In view of the above, the depositories act provides that *beneficial owner are entitle to all rights, which would be subjected to all the liabilities in the liabilities in respect of his securities held by a depository*.¹⁸

¹⁴ *Supra* n. 12.

¹⁵ Somasekhar Sundaresan, “Multiple Depository System - Need for Clarifications”, [1999] 20 SCL 17 (MAG.).

¹⁶ *Ibid.*

¹⁷ *Supra* n. 15.

¹⁸ Section 10(3) of Depositories Act, 1996.

All the transactions done by the investors who are holding securities in dematerialised form, has to complete the transfer process in accordance with the Companies Act. It requires the execution of duly stamped transfer deed give effect to transfer of securities transaction¹⁹. This would not be applicable to transferor and transferee, whose names are recorded as beneficial owners in the depository²⁰. The different interpretation is quite argued that is transfer deed with duly stamped have to be executed in the case of transfer of securities done by beneficial owners. In this case, it is argued that transferor and transferee have recorded their names in different depositories and not in a single depository, as mentioned in Section 108 of Companies Act.²¹

5.3.1.1 Escape Clause for depository

The depositories act has to be amended to prevent investors from paying stamp duty. The depository can make use of phrase in Section 8(c) of the Depositories Act, 1996 i.e. “*transfer from a person to a depository*”²². The same has been included in the Depositories Act. The term ‘person’ has been defined under General Clauses Act as it includes “*any company or association or body of individuals, whether incorporated or not*”²³.

*“Every depository shall, on receipt of intimation from a participant, register the transfer of security in the name of transferee”*²⁴. In accordance with the above, the agent of the depository i.e. Depository Participant is required to intimate another depository regarding the sale by any sub-account holder. In this case, another depository would be required to change the details immediately in the records of its own. Moreover, there is no legal provision, which facilitates another depository to get registered as shareholder in the register of issuer²⁵.

5.3.2 Losses caused to beneficial owners

There is no effective legal provision that can prevent manipulation of data stored in electronic based devices; data transfers between two different depositories can often result in mismatch of records of investors etc. these can cause loss to the beneficial owners involved in transaction of securities while using depositories. Depositories Act provides that if any negligence has been caused on the part of depository or its agent then in that case, depository would indemnify the beneficial owners from any losses caused to them²⁶.

¹⁹ Section 108(1) of Companies Act, 1956.

²⁰ Section 108(3) of Companies Act, 1956.

²¹ *Supra* n. 15.

²² Section 8A(b) of Depositories Act, 1996.

²³ Section 3(42) of The General Clauses Act, 1897

²⁴ Section 7(1) of Depositories Act, 1996.

²⁵ *Supra* n. 15.

²⁶ Section 16 of Depositories Act, 1996.

These issues often involve the litigation and allow the beneficial owners to raise their claims against depositories before the appropriate forum. These issues has to be handled by SEBI immediately as soon as the claims has been raised on the part of beneficial owners as its aim is to list more and more stocks in the stock exchanges along with the compulsory trading in demat form. Legislations like SEBI (Depositories and Participants) Regulations, 1996, do not provide for any effective remedy to resolve these issues. If these issues would remain unaddressed by government, then, the investors would lose their confidence in the Indian securities market and this new paperless trading would provide us with no positive results²⁷.

Clause of Finance Bill, 1999 also provides for exemption of stamp duty on trading in debt instruments. The sub-clause (1) of section 8A of Indian Stamp Act has been provided as hereinunder²⁸:

"transfer of beneficial ownership of securities being debentures of a company formed and registered under the Companies Act, 1956 or a body corporate established by a Central Act, dealt with by a depository, shall not be liable to duty under this Act."

The aforesaid provision would provide for major contribution to the economy and the secondary market. This is due to the exemption of stamp duty on trading in debt instruments. On the other hand, Section 8A(c) of the Depositories Act, 1996 provides for exemption of stamp duty on transfer of registered ownership from holder to the depository through the dematerialisation. This provision is applicable on securities i.e. *shares and not debentures or debt instruments*. In the case of trading in debt instruments through dematerialization, the transaction would attract stamp duty²⁹.

Lastly, the issue is regarding the non-incorporation of features of multi-depository system. In the case of transfer of beneficial ownership from beneficial owner, who is having account in one depository to another who is having account in other depository, would attract stamp duty from state government. These issues require the attention of government and SEBI. As far as application of debt instruments are concerned in the case of paperless trading, there is no provision for investor to trade in debt instruments³⁰. This would not benefit them in any form.

²⁷ *Supra* n. 15.

²⁸ Section 8A(c)(ii) of The Indian Stamp Act, 1899.

²⁹ Section 8A(c) of Depositories Act, 1996.

³⁰ Regulatory Insights from India Tax & Regulatory Services, "*Stamp duty on securities transactions effective from 1 July 2020*", https://www.pwc.in/assets/pdfs/news-alert-tax/2020/pwc_news_alert_3_july_2020_stamp_duty_on_securities_transactions_effective_from_1_july_2020.pdf, (visited on October 26, 2021).

5.4 Legal inadequacies in Depositories Act, 1996

During the period of 1990s, in the case of stock markets, structural changes were made to promote the liberalization of economy. The paper based trading of securities was a serious concern for the investors and SEBI. With the participation of more and more investors in the Indian securities market, SEBI decided to introduce paperless trading of securities vide Depositories Act, 1996. Necessary changes have been made in the Companies act, 1956 by the Depositories Act, 1996. The same was having retrospective effect from 20 September 1995, which was the date of promulgation of Depository Ordinance. Some of the changes, which were incorporated after Depository Act, 1996 came into existence, are being discussed hereinunder:

- Companies Act provides for free transfer of securities in the case of public company³¹. With the coming of the Depositories Act, right of company to approve transfer of securities has no more with them.
- The names of beneficial owners entered into the register, has to be maintained by the depository. The aforesaid register of the beneficial owners is deemed to be the register of the members of the relevant company.³²

All the transfer of securities done is required to be registered electronically by the depositories. Companies only receive the periodic intimation from the depositories. The company only acknowledges the registration of transfer of securities *post facto*. If the aforesaid transfer of securities is not in accordance with the law, then, in this case, the remedy for the investor is to approach the Tribunal asking for *order for rectification of its members*. If there is any breach committed by any of the parties involved in transaction of transfer of securities, then, the agent of the depository i.e. Depository participant would have to record the aforesaid act and intimate the depository about the same³³.

5.4.1 Legislative requirements in Depository System

As soon as the depositories has started their operation, it is expected of them to promulgate the relevant bye-laws, rules and regulations, which would govern the internal operations of depository and other external stakeholders like companies, shareholders etc. who avail their services. This process is of longer duration and would take time to get completed. Depositories act as guardian for the investors, still the ordinance do not include any provision or any of the safeguards providing financial stability. Minimum networth requirement of any investor or company has been set to Rs. 100 crores by SEBI. This criterion has not been made mandatory

³¹ Section 111A of Companies Act, 1956.

³² Section 152 A of Companies Act, 1956.

³³ *Supra* n. 12.

through any specific legislation but through bye-laws made by the depository³⁴, which are not subjected to any scrutiny by rest of the SEBI legislations.

Further, any capital requirement for the agent of the depositories has not been specified in the Depositories Ordinance. These depositories bye-laws have been taking care of the eligibility criterion for qualifying as the agent of the depository. Though, these bye-laws came into effect after the approval of the SEBI, but DPs are the crucial participants of the Depository system and their working and functioning related aspects are required to be included in the Depositories Act. The paperless trading system is a new concept for the people living in the remote areas. If the depository system is willing to attract such investors in remote areas, then, it is required from the SEBI and other market participants of the depository system to educate these shareholders about the paperless trading system. This task would require much effort of market participants. These are the difficulties before the depository system, still the same came into existence with purpose to facilitate smooth functioning of the *financial institutions, Non-banking Finance Companies (NBFCs) and FIIs (Foreign Institutional Investors)*, these institutions deal in trading of bulk of securities³⁵.

5.5 Issues in Depository System: An Investor's perspective

National Council of Applied Economic Research (NCAER), New Delhi has conducted research, in which survey of approximately 60,000 households have been taken. The aforesaid research provided that in India, people are not attracted towards the investments in stock market. That does not imply that they are not concerned about other long-term life-goals such as education, elder age insurance, medical claims etc. But making long-term investments in the stock market is not a common thing for people here. Criterion of investment depends on various factors and the same would be different for 25-year-old youngster and 40-year-old elder. Both would invest in different sectors as one might invest in the equity component and the other real estate, fixed deposits etc. would be best return for investment³⁶.

After 1991, Indian securities market has foresee many changes. With the entering of different companies through Initial Public Offerings (IPOs) in the Indian securities market, increase in the

³⁴ Sneha Mishra, "Role of depository and participants", <https://timesofindia.indiatimes.com/readersblog/myblogpower/role-of-depository-and-participants-sebi-1992-35190/>, (visited on October 27, 2021).

³⁵ *Supra* n. 12.

³⁶ Rajeev Jain, "Investor's Attitude towards Secondary Market Equity Investments and Influence of Behavioral Finance", *International Journal on Emerging Technologies*, <https://citeseerx.ist.psu.edu/viewdoc/download?doi=10.1.1.668.6969&rep=rep1&type=pdf>, (visited on October 28, 2021).

market capitalization, mutual funds has totally changed the scope of investment in Indian capital market. The wider scope of investment in the Indian securities market has also attracted retail or small investors. These investors are not much attracted towards the trading of securities in demat system. With the compulsion of trading of securities in demat form by market regulator SEBI, has created problem for then retail investors and in this case, SEBI has not considered the socio-economic condition. As a result, many of the investor have raised their complaints regarding excessive demat charges for utilizing the demat services³⁷.

It is often considered by various academicians and scholars that the demat system introduced by market regulator is in favour of large investor such as corporates, large market participants having large amount of capital, and not supporting or favouring small investors in any manner. This can lead to non-participation of retail investors in the Indian capital market. Even not in one country be it U.S or U.K., the demat service has been made compulsory for the investors. In these countries, investors have been provided with time to adapt themselves with this paperless trading system and gradually they adapt themselves to this system. This proved to be successful in these countries and is beneficial and economical for the investors.

Overall performance of trading of securities through process of dematerialization, is not successful in attracting small investors. The demat system is proved to be quite beneficial for large investors such as large corporates etc. It cannot be denied that volume of trading has been increased at an alarming rate with the coming of the depository system. Small investors often trade for long-term securities, as this must be considered to be economical for them, but the demat charges and other issues in depository system prevent them from utilizing demat services for trading in securities³⁸.

5.5.1 Issues faced by investors with Depository participants

Agents of the depositories i.e. Depository Participants plays a crucial role in the working and functioning of the depository system. Investors can only open a demat account through the depository participants. They are responsible for handling the account of investors on behalf of them. While opening the demat account, investor has to undergo certain steps. These are³⁹:

➤ Firstly, the investor is required to choose a depository participant through whom he/she can open a demat account. There are 115 depository participants in total. Out of these 115 DPs, every

³⁷ *Ibid.*

³⁸ *Supra* n. 36.

³⁹ Sanjiv Agarwal, "Depository System - Investor's Concerns", [2000] 28 SCL 5 (MAG.).

one has a different expertise and background. Some of them are working part time and also work in other public and private sectors. Along with acting as DP, they are engaged in different activities. Some of them are private sectors, banking industry etc.

➤ The private sector emphasis on activities of DP but the banking industry does not provide priority to DPs due to involvement in higher capitalization on retail banking business. Agents of depositories come from different backgrounds such as *merchant banking, registrar and transfer agents, banking, non-banking business, stock-brokers* etc. It is the discretion of DP to have their own procedure, fee structure regarding handling of investor demat accounts. These are considered to be non-reliable persons as these persons can switch to another job anytime or merge with a different company or entity.

➤ Different DPs provide different service standards. Each DP has its own standard and some of them run their operation in accordance with specific standard while providing services to investors while others function at its own discretion i.e. in absence of any specific procedure or standard. NSDL and CDSL are two depositories, which are presently running in the depository system. Both of them have different business rules, which are proved to be not very beneficial for the investors. Therefore, this make the investors left with no alternative but to co-ordinate with the inefficient functioning of these depositories.

➤ In India, DP system has been established to make the depository system more transparent and accountable. The transactions can take place smoothly. Whereas the reality has shown some other picture as DPs infrastructure is proved to be inefficient, less accountability between head office and any branch of DP, no response has been received form the companies etc. These disadvantages make the investors deprived of availing any benefit from the depository system.

➤ DPs from the banking sector make the investors open demat account along with saving and current account in their bank. Moreover, they ask the investors for debiting the fees directly in their account. It has been also pointed out that DPs charge rates and have different fee structure from the investors for providing services to the investors, who are account-holders in their bank. If any investor has to take loan against the holding of securities in demat account, it is difficult for them to receive loans from the bank as first these banks ask them for opening the saving account. This issue can be resolved through switching to another DP, as various options are available to investors.

➤ The market regulator should keep a check and balance on DPs and ensure that they are not expecting investors to engage in a lot of paperwork, the transactions of securities must be completed in prescribed frame of time. DPs take longer period of time in confirming the status of

dematerialisation of shares of an investor. These take 1 year to complete the process. In this regard, NSDL has given the timeline of 30 to 90 days to DP to complete the process. In the case of *transfer-cum-demat* facility, the situation is more complex due to absence of co-ordination between balancing two functions i.e. transfer and dematerialization. This facility is available only for selected scrips. If there is any delay in the process of dematerialization of shares and scrip price is also low, before the dematerialisation of shares got confirmation from DP, then in that case, DP or depository is not held accountable for the financial loss caused to the investor.

➤ It has been recommended that NSDL and CDSL must have strong vigilance system and a system-built surveillance, for monitoring any delay in the process of dematerialisation of shares. The market regulator and the depositories should ensure that infrastructure of DP meets some specific standards which includes regular internal audit, independent reporting to specific depository as well as SEBI along with a copy forwarded to the regional stock exchange for facilitation of taking action against the companies in default.

➤ It is suggested that there must be uniformity in procedures, services standards, fee structure, and these should not be changes anytime at the discretion of DP. Also, it is pointed out that the DPs should engage adequate staff, maintain proper infrastructure. In this regard, conducting regular meetings with investor by DPs to increase their awareness and education regarding the functioning, working of the depository system would increase the confidence of the investor to open demat account with the DPs.

➤ Fee structure of DPs should be worked upon as the same should be reasonable and systematic in form. This would create healthy competitive environment among different DPs to provide standard services to investors⁴⁰.

➤ Different data of research conducted on perspective of investors regarding the depository system reveals different results. It is pointed out that investors have less confidence on agents of the depositories. They seek to search for DP, who is honest and sincere i.e. committed towards his work. In the current scenario, the investors have fear when they are engaged in trading of securities in the market due to less trust and confidence on the market participants. Also, some of them have opined that DPs are not trustworthy and anytime they have the option to leave investors account and only engaged themselves in earning the maximum revenue out of such business⁴¹.

⁴⁰ G.Maheswari and S.Mabel Latha Rani, "A Study on Investors Perception and Satisfaction of Depository Services", JETIR, Vol. 5, No. 5, 2018, p. 151.

⁴¹ Aravind, "Trading with Financial Derivatives: Investors Aspiration on Depository Participants", MADRAS UNIVERSITY JOURNAL OF BUSINESS AND FINANCE, Vol. 3, No. 2, 2015, p. 113.

➤ Further, it has been pointed out that investors residing in semi urban areas are satisfied with the financial performance provided to them in the particular area. Therefore, the stock-broking companies should put its emphasis more on infrastructure criterion, and engaged themselves in providing financial assistance at liberalized maintenance margin, competitive brokerage etc⁴².

5.5.1.1 Grievances of Retail Investors

With the coming of globalization, the term ‘small’ holds no importance or meaning in the market. The small companies whose name has not been listed in stock exchanges, has been deprived of right to seek correction of wrongful information provided in register of members of company under Section 111(4) of the Companies Act, 1956. The Depositories Act, 1996, has deleted section 83 of the Companies Act, 1956⁴³.

The aforesaid action was unnecessary on the part of concerned authorities as modifying the aforesaid section with the exclusion of the applicability of securities in depository can solve the purpose. Further, it is expected from market regulator to take effective steps for preventing circulation of forged certificates, reducing time in process of registration of transfer of securities. These all steps must be taken while considering the interest of small investors. It is the duty of SEBI to protect the interest of small as well as large investors. A different perspective has been drawn by SEBI against the interest of small investors as no provision in the depository system favours the interest of small investors. On the other hand, the interest of big investors have been considered while enacting the provisions in depository system, such as exemption of stamp duty, preventing delay in transfer of securities etc. have been incorporated in system to encourage more of such investors in the stock market⁴⁴.

5.5.1.2 Perception of the term “Small Investors” in the Market

It is believed that small, retail investors do hold much importance in the equity market. The meaning of the term “retail” has been changed over a period of time. In accordance with the SEBI (Disclosure and Investor Protection) Guidelines, 2000, till 2003, the term retail investor has been defined as “*an individual investor applying for allotment of 10 or less marketable lots in a fixed issue or up to 1000 units in a book built issue*”. The meaning of the retail investors has been changed and defined in accordance with the status hold by them in the stock market⁴⁵.

⁴² *Ibid.*

⁴³ K Srinivasan, “*Sebi Consultative Paper On Proposed Depository Regulations*”, [1995] 19 CLA 45 (Mag.)

⁴⁴ *Ibid.*

⁴⁵ C. P. Chandrasekhar, “*The elusive retail investor: How deep can (and should) India’s stock markets be*”, https://www.sebi.gov.in/sebi_data/DRG_Study/elusiveretailinvestor.pdf, (visited on October 30, 2021).

5.6 Remedies available to the Investor

The market regulator SEBI has put efforts to increase the participation of small investors in the market by promoting their activities and conducting investors' education or awareness from time to time. It has taken certain steps to promote financial literacy. Various collaborations have been done by SEBI with different stock exchanges, depositories and different trade bodies such as Association of Mutual Funds of India (AMFI), etc. It has conducted different activities to increase the awareness of the investors such as organizing campaigns, (Collective Investment Scheme). Collective Investment Schemes are broadcasted through different mediums such as TV, radio. Its aim is to asking for mobilization of capital for profitable purpose, and it provides profitable returns⁴⁶.

In 2011-12, SEBI has conducted regional seminars to increase the awareness of investors, which sought to provide information regarding the aforesaid schemes. In the area of financial education, there is need of conducting workshops comprising of trained professionals such as teachers, lecturers etc., who must be expert for such purposes. In recent times, a process has been initiated by SEBI for drafting a *National Strategy for Financial Education under the aegis of the Financial Stability and Development Council (FSDC)*. Another initiative of SEBI is making a web-based centralized redressal cell for investors, which came to be known as SCORES (SEBI Complaints Redressal System)⁴⁷.

Other remedies available to the investors against their grievances in relation to deficient services provided by the agents of the depositories, depositories etc. discussed hereinunder⁴⁸:

- The depositories are regulated by primary legislation Depositories Act and all the other relevant legislations under the aegis of SEBI. Among these, SEBI (Depositories & Participants) Regulations, 1996, is the legislation provides for regulation of depositories, depository participants and the issuers. The depositories are having different business rules and bye-laws.
- The grievances of the investors are in direct relation with agent of the depositories. They are required to act within the limits prescribed by the agreements entered between them.
- The aforesaid agreement entered between agent of the depository and investor provides that *client shall have the right to get the securities, which have been admitted on the depository, dematerialised in the form and manner laid down under the bye-laws and business rules*. Further, it provides that DP and the client must act in accordance with the *arbitration and conciliation*

⁴⁶ *Ibid*, p.7.

⁴⁷ *Supra* n. 43.

⁴⁸ *Supra* n. 40, p. 153.

procedure, which is mentioned in the bye-laws of the depositories. Also, this procedure has to be applied in case, there arises any dispute between agent of the depository and the client.

➤ NSDL bye-laws have their own specific bye-laws. Clause 9 is in relation with dematerialization of securities. This is the crucial area and involves issue of delays in transfer of securities. In view of the above, there arises the need of DP to forward the request of investor to the *issuer or its transfer agent within 7 days*. Credit of the securities is to be made when the depository from the issuer has received the intimation of such request.

➤ SEBI rules provide that depositories must have an adequate mechanism for the purpose of monitoring, reviewing etc. They are required to protect the interest of beneficial owners.

➤ Deficient services provided by DP to the investors are a cause of concern for the investors. Aggrieved investor can raise its grievance before the appropriate forum to seek for redressal. As per the agreement entered between DP and investor, the remedy of arbitration and conciliation can be provided to the aggrieved investor. The other option is filing of civil suit or complaint before the Consumer Forum. In this case, investor can ask for specific redressal available under the relevant act and regulation.

5.7 Need of Investor's education and awareness

Various incidents and scams took place in our country, which pointed out towards lack of awareness among investors regarding the rights and safeguards one should adopt while trading in securities in the market. One of the steps that SEBI should take is conducting campaigns to increase the awareness of the investors. This would further prevent scams and other frauds from taking place in the market. Also, there is need of highly qualified training professionals, who will make the investors educate about the rights and safeguards that they should consider while trading in the securities market. Especially, these steps must take by SEBI in remote areas, where small investors reside and are totally unaware about the trading activities in securities market. SEBI should not only target large investors but also the middle class investors so that they can also participate in the financial market of the country. Further, there is need of separate budget allocation, which has to be provided to SEBI for fulfilling the purpose of acting in interest of investors and development of healthy competitive financial market in country⁴⁹.

The statistical data collected through research conducted shows that awareness of the investors is not appropriate i.e. most of the investors are unaware about different demat services provided

⁴⁹ *Supra* n. 1.

by the depository. Therefore, in light of the same, it has been pointed the need of investor awareness and education regarding the market functioning, obligation and rights of the market intermediaries like agent of the depositories i.e. Depositories Participants, functioning of depository system, risks involved in trading of securities⁵⁰ etc.

In light of the issue of investor awareness regarding the role played by market intermediaries in depository system, it is desirable to discuss the case of disgorgement order passed by SEBI.

SEBI in its disgorgement order dated 21.11.2006 has provided directions to market intermediaries i.e. depositories and depository participants. NSDL and CDSL along with eight depository participants were involved in the case and were asked to submit Rs. 115.81 crores in 6 months. These Depository Participants includes *Karvy, HDFC Bank, Khandwala Securities, IDBI Bank, Jhaveri Securities, ING Vysya Bank, PR Stock Broking and Pratik Stock Vision*. In the aforesaid case, few of the market operators has opened various demat accounts in the forged name for the purpose of earning revenue from shares of retail investors in a public issue. In light of the above, the extract of the observation of SEBI's order has been provided herein⁵¹:

“It is well established worldwide that the power to disgorge is an equitable remedy and is not a penal or even a quasi-penal action. Thus, it differs from actions like forfeiture and impounding of assets or money. Unlike damages, it is a method of forcing a defendant to give up the amount by which he or she was unjustly enriched. Disgorgement is intended not to impose on defendants any demand not already imposed by law, but only to deprive them of the fruit of their illegal behaviour. It is designed to undo what could have been prevented had the defendants not outdistanced the investors in their unlawful project. In short, disgorgement merely discontinues an illegal arrangement and restores the status quo ante. Disgorgement is a useful equitable remedy because it strips the perpetrator of the fruits of his unlawful activity and returns him to the position he was in before he broke the law. The order of disgorgement would not prejudice the right of the regulator to take such further administrative, civil and criminal action as the facts of the case may warrant.”

The aforesaid order of SEBI has been challenged before the Securities Appellate Tribunal. It is the first case in which SEBI has realized the *importance of disgorgement and the said money*

⁵⁰ Varsha Damjibhai Virani, “Awareness Level of Services Offered by Depository Participants in Rajkot City, Gujarat”, http://www.pbr.co.in/2011/2011_month/April_June/chapter%203.pdf, (visited on October 30 2021).

⁵¹ Securities and Exchange Board of India, “Order Under Sections 11 And 11b Of The Securities And Exchange Board Of India Act, 1992”, https://www.sebi.gov.in/enforcement/orders/nov-2006/in-the-matter-of-investigation-into-initial-public-offerings_15056.html, (visited on November 2, 2021).

has been distributed to harmed investors. In the financial news and media, this issue has been hotly debated, the specific issuer was related to legal status of disgorgement orders, its rationale, whether the SEBI action against only the violators and not the other profiteers, is correct or not.⁵²

*“The term ‘disgorgement’ is used to refer to an order to give up trading profits, based upon two conclusions: the first, that there has been a violation of law, and second that the violator has profited thereby”.*⁵³

The order of the SEBI was regarding taking action against some of the financiers who has earned the revenue out of illegal cornering of shares of retail investors. As a result, the small investors are deprived of their right to entitlement to their own shares under IPO. The order of SEBI is supported by Wadhwa Committee in 2007 and recommended that providing compensation as remedy to the aggrieved investors⁵⁴.

5.8 Steps taken by SEBI towards investor protection in India

In light of the increase in scams on the part of stock-brokers, National stock exchange has issued some suggestions for investor's protection. Many scams reveal the fraudulent activities of stock-brokers. In light of the issue of investor protection, it is imperative to discuss the case of *Karvy Stock Broking Ltd. v SEBI*⁵⁵. The case was about the unauthorized transactions of securities of investors (clients of Karvy Stock Broking Ltd.). The stock-broking company has misused the Power of Attorney issues by their client for unauthorized transfer of securities. In 2019, SEBI took action against the defaulter stock-broking company for violation of norms, which includes transfer of shares of its client to its own company and pledging of client's shares for its real estate business. Over 2.4 lakhs clients of Karvy have reported before SEBI for the money against the securities has not been credited in their accounts. In one of the reports submitted by National Stock Exchange (NSE), it pointed out that Karvy has misused the POAs of its clients for

⁵² *Supra* n. 1.

⁵³ Rajiv Luthra, *“Is Sebi's disgorgement order fair”*, <https://economictimes.indiatimes.com/perspectives/is-sebis-disgorgement-order-fair/articleshow/609751.cms>, (visited on November 4, 2021).

⁵⁴ *Supra* n.1.

⁵⁵ Securities and Exchange Board of India, *“Appeal No. 6 of 2007”*, https://www.sebi.gov.in/enforcement/orders/may-2008/in-the-matter-of-karvy-stock-broking-ltd_6557.html, (visited on November 4, 2021).

selling its securities in unauthorized manner. These all funds received from selling of securities have been utilized for their own commercial purpose⁵⁶.

In its interim order dated 22.11.2019⁵⁷, SEBI barred the Karvy stock Broking Ltd. from making any new clients. Moreover, an amount of Rs. 1096 crores was transferred from the broking company to Karvy Realty between April 2016 and October 2019. Further, it was observed that in appeal filed before SAT, stock broking company has raised *funds from entities such as Bajaj Finance, ICICI Bank, HDFC Bank and IndusInd Bank by pledging client securities*. It has been reported that around 95,000 clients has been affected and most of them has received their securities back. NSE and BSE suspended the membership of Karvy. Options left with investors can be either to approach investor grievance redressal mechanism of NSE or BSE for receiving their money and also it is required from them to switch the broking firm as soon as possible⁵⁸.

In light of the above, some of the suggestions have been pointed out which should be taken by the market regulator and government to protect the interest of investors in India. Some of them have been discussed herein⁵⁹:

- In USA, there is a separate law providing for protection of investors, and it also deals with right of investors, at the pre and post IPO stage, adequate mechanisms for collecting disgorged money, civil penalty against defaulters etc. there is also a provision for Fair Fund. The disgorged money collected by the market regulator or other relevant authorities, can utilize it for financing the education of investors, providing compensation to the investors against the losses suffered by them etc.
- In view of the above, the Indian capital market also needs some legislation in the same lined to protect the interest of investors in India. Therefore, SEBI is required to amend the SEBI Act and other relevant legislations to ensure that penalty and disgorged amount collected in various scams must be utilized for distribution to aggrieved investors or financing the awareness campaigns among small investors.

⁵⁶ ENS Economic Bureau, "Explained: What is the case against Karvy Broking Limited, What next for its clients", <https://indianexpress.com/article/explained/explained-with-karvy-expelled-from-exchange-what-happens-to-its-clients-7064258/>, (visited on November 5, 2021).

⁵⁷ Securities and Exchange Board of India, "Ex-parte-Ad-Interim Order in respect of Karvy Stock Broking Limited", https://www.sebi.gov.in/enforcement/orders/nov-2019/ex-parte-ad-interim-order-in-respect-of-karvy-stock-broking-limited_45049.html, (visited on November 5, 2021).

⁵⁸ Ashish Rukhaiyar, "Explained: Why SEBI banned this Hyderabad-based firm from taking on new clients", <https://www.thehindu.com/business/markets/what-is-the-karvy-stock-scandal-all-about/article30233018.ece>, (visited on November 6, 2021).

⁵⁹ Amit Bhaskar, "How SEBI Should Deal With Disgorged Money", <https://www.legalserviceindia.com/article/I272-How-SEBI-Should-Deal-With-Disgorged-Money.html>, (visited on November 7, 2021).

➤ In case of the former issue, if aggrieved investors cannot be identified or the compensation amount is not quantifiable, then the said amount must be collected by Investors Education And Protection Fund ('IEPF'). The aforesaid body has been established under Ministry of Corporate Affairs should be transferred to SEBI so that the issue of protecting interest of investors can be specifically addressed.

5.9 Conclusion

The issues faced by the investors in the Depository system can be resolved by existing primary legislation like Depositories Act, 1996. SEBI has been provided with wide ambit and powers to tackle these issues but increasing the obligations of SEBI regarding each and every issue is not the practical solution. It cannot be denied that SEBI is making all the attempt and efforts to acting in favour of investors and ensure more and more participation of investors in the Indian capital market. Some of the issues need to be addressed by market regulator to increase the ambit and scope of the depository system.

These are attitude of agent of depositories towards small investors, low standards of DPs in handling transaction of investors, high charges borne by the investors against utilization of DP services. Further, making demat trading of securities compulsory for every company is increasing the demand and scope of depository system but it has to be looked upon whether the infrastructure of depository system is adequate to deal with such increase demand.

There is voluminous number of transactions, which needs to be handled by DPs, but they are incompetent to deal with such number of transactions. The issues of not able to identifying true owners of demat accounts also arise and amount against the securities is credited to the account of stock-brokers instead of its clients. The dividends paid against the client's securities must be directly credited to the account of the client.

In the Karvy stock broking scam, the fraudulent activities of the stock brokers caused losses to many investors and one of the reasons is the non-awareness of investors regarding the working and functioning of the depositories. DPs and depositories are required to be more vigilant and cautious while providing details of investors or adopt any technical software which should provide intimation regarding sharing of such details to their stock brokers. No money should be debited or credited without the permission of investors from the demat account. These investors who are utilizing services of DP and stock brokers would have to borne higher charges against the trading in securities. There are two factors identified against the less participation of small investors in

the dematerialization system are non-awareness towards the working of demat trading system and higher charges of DP services and other maintenance cost.



CHAPTER VI

CONCLUSION AND SUGGESTIONS

The chapter contains the conclusions of all previous chapters and the experience gained by the researcher while dealing with the data and their analysis in the light of considered research objectives and their respective Hypotheses/ research questions. Further, the researcher has also suggested some pragmatic notions to increase the scope and ambit of dematerialization trading system of securities.

6.1. Conclusion

Development of Indian securities market depends on volume of bulk trading of securities in the market. Keeping this thing in mind, the market regulator has introduced the depository system, providing for trading of shares in electronic form. It is for the first time in India, capital market has adopted electronic or screen based trading system. Further, in lines with the international standards, SEBI has introduced demat trading of shares. This trading system also has faster process to for the trading settlement. After introducing this system, stakeholders have observed various foreign institutional investors participating in Indian capital market. This system has resolved the issue of delays in transfer of shares, settlements etc. and provides timely delivery for securities. Investors are the biggest beneficiaries of this system. For the first time, investors can initiate their trading cycle soon after the securities have been allotted in their name. Shares can be transferred immediately to them within 3 days after the closure of trading¹.

The planning to introduce depository system has been started from the period of 1980s. Cabinet ministers have decided to provide for trading of securities in electronic form, but unfortunately at that period of time, due to some obstacles legal framework was not appropriate to regulate such system. Then, in 1986, various financial institutions IDBI, UTI, IFCI, LIC etc. has contributed in promoting Stock Holding Corporation of India (SHCIL)², for the purpose of maintenance of their bulk securities in physical mode. SHCIL make various efforts to introduce a single depository system but failed as received the objectives from SEBI representatives. After some period of time, Finance Minister decided to have multiple depository system favouring the

¹ L L Rajpal, "Depositories Ordinance - Ushering In Scripless Stock Market", [1995] 19 CLA 17 (Mag.)

² Lok Sabha Secretariat, "Report Joint Committee on Stock Market scam and matters relating thereto", http://loksabhaph.nic.in/writereaddata/InvestigativeJPC/InvestigativeJPC_635612541266248975.pdf, (visited on November 10 2021).

competing interest in the securities market. During the discussion, it was also revealed that the expert of World Bank has also observed that the electronic based trading system has been successful in Australia and other Scandinavian countries. As, a result, depository system has been introduced in India³.

Protection for investors is the top priority for the market regulator in India. In light of the fulfilling such objective, SEBI has provided guidelines on Investor Protection Fund (IPF) of depositories. This has been made to fulfill the purpose of encouraging investor education and awareness, providing assistance in research related to Indian capital market etc. The funds would be collected from *penalties received from depository participants*, deposits made on account of *investments made from the fund* etc⁴.

Central Depository Services Ltd. (CDSL) has earned the net profit of Rs. 63.87 crores in June 2021 against the amount of Rs. 46.16 crores in end of June 2020⁵. It shows more and more investors are participating in the stock market and engaged in demat trading of securities.

In Chapter I, the researcher has devised a research problem. To address the problem elaborately and in detail, researcher has devised appropriate methods to find out the reliable and valid data, in an attempt to find answers for the research questions and to verify the hypotheses formulated in the present study. In the light of the objectives framed by the researcher, the content has been classified and concluded by the researcher under following chapters.

After analyzing Chapter II, the researcher concludes that the advantages of depository system have surpassed its disadvantages. It cannot be denied that more and more participation of investors in the stock market is due to the adoption of demat trading system.

The purpose of SEBI to introduce dematerialisation trading system of shares is to protect the interest of investors in the securities market. To a large extent, depository system has provided transparency to the investors and has removed the difficulties of forged transfer certificates, engagement of fraudsters in certain malpractices to disgorge the money of its clients easily, assess the cost and risks in advance to enable the investors to make their decisions regarding trading in

³ The Indian Express, "NSDL and India's move to electronic stocks and trading", <https://indianexpress.com/article/explained/in-fact-nsdl-and-indias-move-to-electronic-stocks-and-trading/>, (visited on November 11, 2021).

⁴ Business Standard, "SEBI issues guidelines for depositories' investor fund", https://www.business-standard.com/article/markets/sebi-issues-guidelines-for-depositories-investors-fund-116060701150_1.html, (visited on November 15, 2021)

⁵ Business Standard, "Central Depository Services (India) consolidated net profit rises 38.37% in the June 2021 quarter", https://www.business-standard.com/article/news-cm/central-depository-services-india-consolidated-net-profit-rises-38-37-in-the-june-2021-quarter-121073100827_1.html, (visited on November 15, 2021).

securities etc. These factors have been incorporated in the depository system in lines with global standards and international regulation of securities market. Various studies conducted in this regard revealed that depository system is a biggest contributor to Indian capital market and make the functioning of the market more transparent and efficient. Moreover, trading under demat system provides more choices to investors to trade from remote areas conveniently unlike the physical trading system.

Based on the analysis of the researcher in Chapter II, it is concluded that the first and second research question have been answered. It states that the Indian securities market has the main issue of trade settlement of securities in paper based trading system. Due to this issue, investors prevent themselves from participation in securities market. These issues were in the form of bad deliveries of securities to the investors, forged transfer certificates, complex registration process etc. These issues have been dealt by SEBI by introducing demat trading system. This crucial factor attracts domestic investors and foreign investment in the securities market as time and again SEBI has made efforts to reduce the time taken in trade settlement of investors and due to this feature, foreign investment has increased and is a good sign for growth of Indian capital market.

In Chapter III, it has been observed that depositories has played crucial role in the development of dematerialisation trading system of securities. This fact cannot be denied that the depositories ensure the safe and sound transactions take place in the market thereby resulting in increasing the efficiency and reducing the risk of investors. Further, due to the technological softwares used by NSDL provides effective solutions for trade settlement, which provides great help to investors to encourage them in participating in the stock market. The second depository CDSL is also convenient in handling bulk volume of trade transactions simultaneously along with addressing grievances of investors. Studies have shown the results that depositories are quite successful in providing cost-effective depository services to investors⁶. However, the demat charge structure is not cost effective for small investors as due to high demat charges various small investors prevent themselves to engage in trading of shares through demat system.

Thus, it can be concluded that second research question is answered as the same provides that the performance of both the depositories shows that they have attracted a large number of investors towards Indian securities market. Also, demat trading system has handled the bulk trading of securities and updating data at regular intervals to enable the process of transfer of securities easier

⁶ Yogesh Garg, "An Exploratory Study On Dematerialization & Depository System In India", INTERNATIONAL RESEARCH JOURNAL OF COMMERCE ARTS AND SCIENCE, Vol. 7, No.12, 2016, p. 38.

and convenient. Due to more and more participation of investors, the quantum of investment has been increased in the Indian securities market. However, considering the positive aspect of the development of the depositories and analyzing the existing demat charges structure, it can be concluded that the second hypotheses is verified, as depositories provide us with cost-effective fee structure against utilization of demat services. The demat charges have been reduced by the market regulator and maintenance and utilizing advanced technological softwares attract high charges.

Analyzing Chapter IV, researcher has observed that the Depositories Act has brought many changes in the Companies Act and other relevant legislations. Various cases of frauds and scams have been reported like Karvy Stock broking Ltd scam, IPO Scam etc. It is accepted fact that SEBI is making every efforts and passing various bye-laws, circulars from time to time to make the demat trading system investor-friendly. Various researchers have highlighted legal provisions, which are neglecting the interest and participation of the company.

One of such instance is Section 7 of the Depositories Act, 1996, provides for compulsory transfer of shares from depository without referring board of directors of target company, only in case, if depository has received any intimation from the agent of the depositories i.e. Depository Participants. These could result in takeover of companies without participation of Board of Directors of company⁷.

The frauds pertaining to transactions in demat accounts have been increasing at an alarming rate. Stock-brokers and Depository Participants are involved in such frauds and without the consent of investors, brokers have transferred ETF units. These were used as collateral for margin funds on trade. The recent incident has been reported in this regard i.e. Allied Financial Services has pledged Dalmia Bharat's MF units. The matter is pending in Supreme Court on the ground of fraud and collusion. All these matters shows that depositories act and relevant legislations are unable to fulfill its objective of ensuring safe demat trading transactions⁸.

Therefore, it can be concluded that though demat trading system has provided Indian securities market stability and flexibility, but the existing frauds and scams and other malpractices practiced by stock brokers and depository participants are the crucial issues responsible for inadequacies in depositories act and relevant legislations. There is need of effective legal provision to prevent

⁷ Chaitanya G.S. and Sujata Iyengar, "Indirect Takeover Controversies", Stud Adv., Vol. 11, No. 103, 1999, p. 105.

⁸ Financial Express, "5 strategies to safeguard against Demat account frauds", <https://www.financialexpress.com/money/5-strategies-to-safeguard-against-demat-account-frauds/1721683/>, (visited on November 16, 2021).

such frauds and scams. In view of the above, third research question has been answered. Also, third hypotheses has been verified as non-awareness of investors regarding the depository system and more reliance on stock brokers will increase the case of frauds and malpractices.

Chapter V deals with the existing issues and challenges in the electronic based trading system. Indian securities market is huge and it is a very tiring and cumbersome task to handle in convenient manner. The dematerialization trading system is electronic-based, which will attract issues such as vulnerable protection to data, easily accessible by third party (in case it is handled by stock brokers etc). Investors are easily attracted towards cost-effective provision of exemption from paying stamp duty etc. But when one analyze these in detail, it will show that engaged in transfers of securities from one to other depository having involvement of two beneficial owners attract stamp duty. Absence of data protection clauses from legislations would keep data of investors at risk and it is difficult to find out the culprit in such cases. These issues are often addressed before Courts, which will be time taking for investors.

The crucial issue is regarding the low participation of retail investors in demat trading system. Demat trading system is attracting large corporates as the capital requirements and other factors have been incorporated in accordance with the need of large corporate investors. The other issue is pertaining to the discretionary standards and fee structure followed by DP against providing depository services. The depositories and SEBI are required to keep check and balance on activities of agents of depositories. Various cases have been reported regarding opening of demat account with fictitious names by these DPs. DPs and depositories share principle-agent relationship and thus depositories can be held liable for acts of its agent⁹.

After analyzing Chapter V, it can be concluded that SEBI and depositories are making efforts towards protection of interest of investors and also quite successful in attracting lot of investors towards demat trading system. The issues and challenges highlighted by the researcher can prevent demat trading system from bringing positive results and fulfilling its objective. This provides answer to fourth research question. The third hypothesis has been verified as the participation of small investors is very low in demat trading system due to high demat charges and requirement clauses incorporation in accordance with large corporates.

6.2 Suggestions

⁹ Fatema Dalal and Murtaza Kachwalla, "An Introduction of A New Concept or a Precedent to a Debacle", http://www.glcumbai.com/lawreview/THE%20LAW%20REVIEW_Vol.6.pdf, (visited on November 18, 2021).

India is still considered to be at the developing stage of net banking mechanism, and lack of education and rural urban divide further acts as a serious issue in potential growth of the system as a whole. As a result, following suggestions are provided, which if considered, can support in creating a desired mechanism of protection and promotion, and would further strengthen the existing relationship between banker and customer.

6.2.1 Accountability for Depositories

6.2.1.1. Adequate protection to investor's data

Demat trading system is based on maintenance of electronic records. The data of investors are stored electronically and thus they are bound to face risk such as loss of data due to technical failure etc. Various cases have been reported in this regard. The data of investors are at stake and if someone got access of the information, it can be misused easily. In such access the data, which got exposed before third parties were name, PAN No., date of birth, email-ids, income tax return, net worth etc.¹⁰

In spite of existence of advanced technological softwares of depositories, the data of investors got breached. NSDL has clearly stated in its Master Circular regarding the protection of confidentiality of investor's data. In fact, the data should not be shared easily with the agent of the depositories i.e. DPs. If any data is being shared with DP or any other person, then in such cases, Depositories are expected to enter confidential agreements with them¹¹ for preventing any loss of data etc.

6.2.1.2. Need of adequate infrastructure

Both the depositories are handling voluminous demat accounts of investors simultaneously. There is insufficient staff and infrastructure to handle the increased demand of demat registrations. The current position is that on the one hand, SEBI is making the demat registration compulsory for every company and on the other hand, there is need of adequate staff and infrastructure to handle demat registrations in large volume. This would defeat the purpose of the depositories act to provide timely delivery of securities to investors¹².

¹⁰ Himanshu Pathak, "CDSL undermining the data exposure issue", <https://www.thehindubusinessline.com/markets/stock-markets/cdsl-undermining-the-data-exposure-issue-himanshu-pathak/article37379449.ece>, (visited on November 19, 2021).

¹¹ Master Circular for Depositories, "SEBI/HO/MRD2/DDAP/CIR/P/2021/18", <https://nsdl.co.in/downloadables/pdf/2021-0009-PolicySEBI%20Circular%20dated%20February%2005,%202021.pdf>, (visited on November 20, 2021).

¹² Sucheta Dalal, "Expedient solutions to market problem",

6.2.2. Adoption of investor's friendly approach

6.2.2.1. *Separate Depository to attract Retail Investors*

It can be analyzed in various studies conducted on working and functioning of the depository system that the depository system is able to attract more and more large investors such as big corporates, multinational companies etc. as they are able to invest large capital and able to afford the higher demat charges. Only the retail investors are affected as due to higher demat charges they would not be able to trade their securities in demat form. In this regard, it is suggested that Reserve Bank of India must assigned the functions pertaining to depository, clearing and settlement in G-secs market to an independent organization, specifically made for ensuring the transparency for all the participants in the security market. This depository formation can prevent the challenges faced by small investors and enable them to participate in demat trading system¹³.

6.2.2.2. *Depositories need to be Cautious and Vigilant*

The electronic based trading system introduced under the Depositories Ordinance. It is required from the beneficial owners who are registered holder of securities that they must sign a confirmation note, which provides the seller to sell the securities. The Depository Participant must verify this note. Otherwise, the seller can sell the securities by just approaching the Depository Participant¹⁴. Thus, it is required from the DPs to be more cautious and vigilant while handling such transactions and to safeguard the interest of investors. There is no uniform standard, which has been followed by every Depository Participant and thus, they often act at their discretion while handling transactions and charging fees against utilization of depository services.

6.2.2.3 *Need of Investor's Awareness*

The market regulator SEBI has taken enormous steps towards the awareness of investors by organizing various campaigns, investor education programmes etc. Still, due to lack of awareness among investors towards working and functioning of depository system, they have to depend more and more on stock-brokers, depository participants etc.

6.2.3. Legal Reforms: Need of the hour

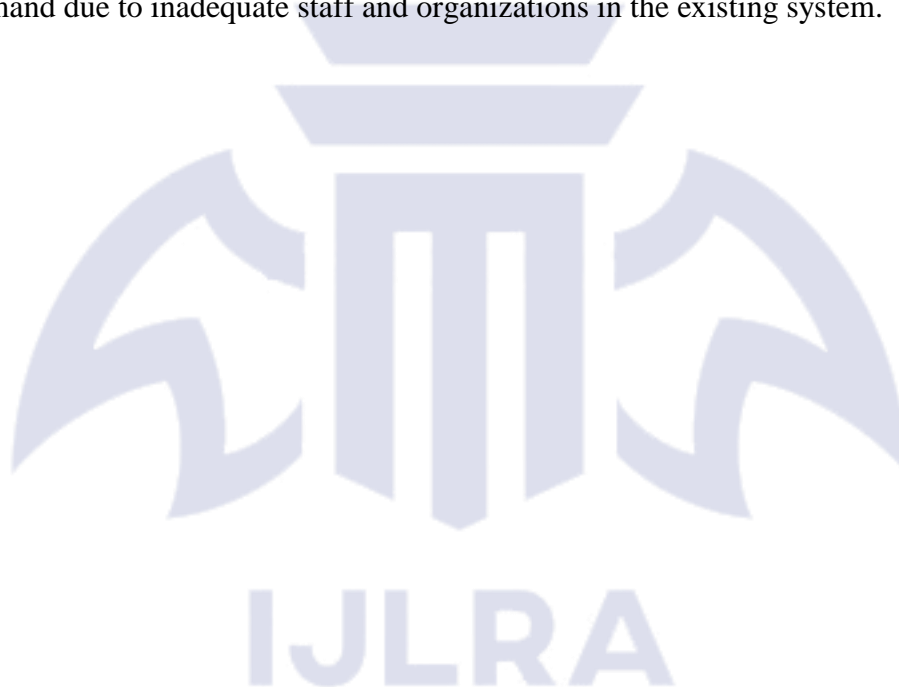
6.2.3.1. *Withdrawal of compulsory registration of Securities in demat form*

<https://www.financialexpress.com/archive/expedient-solutions-to-market-problems/157435/>, (visited on November 21, 2021).

¹³ Rajiv Shastri, "G-secs market needs a separate depository to expand further and attract retail investors", <https://economictimes.indiatimes.com/prime/money-and-markets/g-secs-market-needs-a-separate-depository-to-expand-further-and-attract-retail-investors/primearticleshow/75745833.cms>, (visited on November 22, 2021).

¹⁴ G D Agrawal, "Bad Deliveries In Stock Market", [1995] 19 Cl 32 (Mag.).

According to Rule 9A of Companies (Prospectus and Allotment of Securities) Third Amendment Rules, 2018, provides that unlisted public companies are required to issue their securities in demat form in accordance with the provisions of Depositories Act, 1996. The security holder in unlisted public companies are required to convert their securities in demat form before making any transfer of securities¹⁵. This provision has received various criticisms from companies and stakeholders, as it would restrict the choice of companies to act at its own discretion. For instance, small companies do not find it feasible and economical to convert their shares into demat form. Therefore, SEBI should provide more time to companies to adapt themselves to the depository system. Also, making compulsory for companies would lead to increase in voluminous demat registrations simultaneously, which will make difficult for the depositories to handle such increase demand due to inadequate staff and organizations in the existing system.



¹⁵ HKCL, “Dematerialization of Shares”, <https://hkcl.in/shares.html>, (visited on November 22, 2021).

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