Introduction to Depository and its Business Partners

Need for depository system

A Depository System is a mechanism by which we transfer our financial instruments electronically from one trader to another. The Depository System is also known as the "Scripless Trading System" because financial instruments are not kept here in physical form.

For the electronic transaction of shares, bonds, and stocks in different trading sectors such as equities, derivatives, mutual funds, currencies, commodities, and so on, depositories serve as four fundamental pillars for the transaction of securities.

The main pillars of a depository system are :

- Central Depository
- Share Registrar Transfer Agent
- Clearing and Settlement Corporation
- Depository Participant

Functions of the Depository System
1. Dematerialization
Dematerialisation is a process in which physical share certificates are converted electronically, and the same amount of electronic shares are transferred to the Demat account of the beneficiary owners. The beneficial owners receive a statement of holding the shares.

2. Corporate Actions
The depository is responsible for digitally transferring cash, dividends or bonus shares, etc., into the shareholder's account. This helps speed up the process of transferring securities and reduces the amount of paperwork.

3. Pledge & Hypothecations
The beneficiary owners can use security as collateral security to borrow money from the banking system.A depository provides a collateral account in which pledge securities are kept until borrowed money remains unpaid.

4. Linkage with Clearing System
Clearing systems and depositories are linked together, and the actual trade settlement between the buyer and seller only occurs through the depository system.

Constituents of Depository System

- Depository
- Depository Participants
- R&T Agents
- Beneficiary Owners

The Benefits of A Depository System

The shares are traded on the exchange but not by physical transfer—however, the earlier shares circulated from one hand to the other while trading. However, since the Depositories were initiated, the shares are distributed electronically.

These are the following benefits of a Depository System
Elimination of Risks
Shares are traded in electronic form. Therefore the risk associated with a physical share certificate, i.e., loss by theft, forged share certificate and damage to the share certificate, etc., does not exist.

Easy to update Info
Inform depository along with the relevant documents and the regard charges, i.e., A/C number, Name, etc., are affected in the database of all the companies where an inventor is a registered holder of the securities.

Quick Transfer of Ownership
Depository settles investors, accounts with the help of the Internet, and ownership of share charges in a fraction of a second just by changing the book entries, which is less time-consuming.

Less Costly
Dematerialisation has reduced the back-office cost, i.e., less use of paper by the broker.

Disbursement of Corporate benefits
The right issue or bonus issue immediately credits the account of the investors.

A depository is an organisation that allows investors to store their financial instruments, such as equity/shares, mutual funds, bonds, and other similar instruments, in electronic form.

A Depository's primary purpose is to offer an electronic financial product platform. Further, providing a dematerialisation facility converts physically held financial items into electronic financial instruments.

Legal Framework

The depository framework is guided by the Depository Act 1996. The contents are :

SECTIONS 1. Short title, extent and commencement. 2. Definitions.

CHAPTER II CERTIFICATE OF COMMENCEMENT OF BUSINESS 3. Certificate of commencement of business by depositories.

CHAPTER III RIGHTS AND OBLIGATIONS OF DEPOSITORIES, PARTICIPANTS, ISSUERS AND BENEFICIAL OWNERS 4. Agreement between depository and participant. 5. Services of depository. 6. Surrender of certificate of security. 7. Registration of transfer of securities with depository. 8. Options to receive security certificate or hold securities with depository. 9. Securities in depositories to be in fungible form. 10. Rights of depositories and beneficial owner. 11. Register of beneficial owner. 12. Pledge or hypothecation of securities held in a depository. 13. Furnishing of information and records by depository and issuer. 14. Option to opt out in respect of any security. 15. Act 18 of 1891 to apply to depositories. 16. Depositories to indemnify loss in certain cases. 17. Rights and obligations of depositories, etc.

CHAPTER IV ENQUIRY AND INSPECTION 18. Power of Board to call for information and enquiry. 19. Power of Board to give directions in certain cases. 19A. Penalty for failure to furnish information, return, etc. 19B. Penalty for failure to enter into an agreement. 19C. Penalty for failure to redress investors‟ grievances. 19D. Penalty for delay in dematerialisation or issue of certificate of securities. 19E. Penalty for failure to reconcile records. 19F. Penalty for failure to comply with directions issued by Board under section 19 of the Act. 19FA. Penalty for conduct business in a fair manner. 19G. Penalty for contravention where no separate penalty has been provided. 19H. Power to adjudicate. 19-I. Factors to be taken into while adjudging quantum of penalty. 2 SECTIONS 19-IA. Settlement of Administrative and Civil Proceedings. 19-IB. Recovery of amounts. 19-IC. Continuance of proceedings. 19J. Crediting sums realised by way of penalties to Consolidated Fund of India.

CHAPTER V MISCELLANEOUS 20. Offences. 21. Contravention by companies. [OMITTED.]. 22. Cognizance of offences by courts. 22A. Composition of certain offences. 22B. Power to grant immunity. 22C. Establishment of Special Courts. 22D. Offences triable by Special Courts. 22E. Appeal and revision. 22F. Application of Code to proceedings before Special Court. 22G. Transitional provisions. 23. Appeals. 23A. Appeal to Securities Appellate Tribunal. 23B. Procedure and powers of Securities Appellate Tribunal. 23C. Right to legal representation. 23D. Limitation. 23E. Civil Court not to have jurisdiction. 23F. Appeal to Supreme Court. 23G. Powers of Board not to apply to International Financial Services Centre. 24. Power of Central Government to make rules. 25. Power of Board to make regulations. 26. Power of depositories to make bye-laws. 27. Rules and regulations to be laid before Parliament. 28. Application of other laws not barred. 29. Removal of difficulties. 30. [Repealed.] 30A. Validation of certain acts. 31. Repeal and saving.

Depository Participants

They are the intermediaries between the depository and the investors. The relationship between the DPs and the depository is governed by an agreement made between the two under the Depositories Act. In a strictly legal sense, a DP is an entity who is registered as such with SEBI under the sub section 1A of Section 12 of the SEBI Act. As per the provisions of this Act, a DP can offer depository-related services only after obtaining a certificate of registration from SEBI. As of 2012, there were **288 DPs of NSDL** and **563 DPs of CDSL** registered with SEBI. Depository Participants acts as a bridge between depositories and its clients / investors.

The Depository System works functions through the Depository which is recognized as Central Depositories Services India Ltd.(CDSL) and National Securities Depository Ltd. (NSDL). Since they are based in Mumbai, they cannot provide many transparent services all around the country. Furthermore, it would be inconvenient to communicate with people living in the corners or amidst.

Hence to curb this problem NSDL has appointed an agent who is known as Depository Participant (DP) and is the actual Trading member of NSDL called Broker and they actually provide service to their customer and the same services are provided by a Sub-Broker. Though they work the same for a customer like a broker since there is a slight difference between them where a Broker buys and sells securities related to stocks for clients through exchanges while DP holds stocks of investments in Demat form.

Depository participants are the agents of a depository such as NSDL or CDSL. They are given license to operate by a depository, under the provisions of The Depositories Act, 1996. An investor, new to the stock market, needs to approach a depository participant to open a demat account. Shares purchased by the investor are held in that account with the depository participant, but the investor remains the sole beneficial owner of the shares. Whenever there is a buy or sell transaction, the depository participant credits or debits the demat account accordingly. A depository participant offers several services, such as pledge and unpledge of shares, corporate action handling, etc.

Depository participants earn income by charging fees to their clients for services such as account opening, transfer of shares and pledging of shares or annual maintenance charge.Most of the time, the brokerage or depository participant determines the depository participant fees.

- The depositary participant is responsible for paying the depositary the money associated with each purchasing or selling operation.
- The depository participant charges a minimum of Rs. 5 per transaction and a maximum of Rs. 25 per transaction, depending on the kind of transaction and the depository participant.

The primary role of DPs is to act as a link between investors and depositories. Other roles are based on the following functions:

1. Help investors in opening accounts with the registered depository.
2. Facilitate transfer of securities.
3. Settlement of trades are done on the exchange connected to the depository.
4. Dematerialization of securities
5. Rematerialization of securities
6. Pledge and un-pledge securities for a loan.

An important benefit of a depository participant is that it gives investors quick and easy access to depository services. By serving as an intermediary, a depository participant makes it easier for investors to open accounts, dematerialize securities, invest, trade, and access other related services.

Working with a depository participant comes with various benefits:

- **Seamless Transactions:** With a DP, investors gain easy access to the depository system, ensuring seamless transactions.
- **Efficiency:** DPs enable quick transaction processing, saving investors valuable time.
- **Enhanced Security:** DPs mitigate the risks associated with physical share certificates, such as theft, forgery, or damage, by maintaining securities in an electronic format.

  The main difference between a depository and a depository participant is that a depository is a centralized facility that holds securities on behalf of investors. In contrast, a depository participant is an entity authorized to offer depository services and acts as an intermediary between the depository and the investors.

Parameters	Depository	Depository Participant
Definition	A centralized facility that holds securities in an electronic form on behalf of investors	An entity authorized by the depository to offer depository services to investors
Role	Provides a secure electronic infrastructure for holding and transferring securities	Acts as an intermediary between the depository and investors, facilitating transactions and providing related services
Services	Safekeeping, settlement, and transfer of securities	Account opening, dematerialization of securities, transaction processing, and other related services
Ownership of Securities	Holds securities on behalf of the investors	Investors retain ownership of the securities held in their accounts
Relationship	The depository interacts directly with investors, as well as depository participants	The depository participant serves as a link between the depository and investors
Regulatory Oversight	It is governed by securities regulations and regulatory bodies	Subject to regulatory oversight by securities commissions or regulatory authorities
Examples	NSDL (National Securities Depository Limited), CDSL (Central Depository Services Limited)	Banks, financial institutions, and stockbrokers acting as depository participants

The DPs registered with NSDL can be obtained from the following link :

https://www.sebi.gov.in/sebiweb/other/OtherAction.do?doRecognisedFpi=yes&intmId=19

The DPs registered with CDSL can be obtained from the following link:

https://www.cdslindia.com/DP/dplist.aspx

Registration and Transfer Agents

Following the public offering of securities by an issuer, the primary responsibility of the Share Registrar is to safeguard the records of the investors who have purchased such securities. In addition, a Transfer Agent is responsible for overseeing and monitoring the transfer of securities throughout the purchasing and selling operations.

Once the transfer of shares between buyer and seller is completed, a clearing and settlement company is formed to handle the transaction. It checks the transactions to see whether they are carried out smoothly and efficiently. It also governs the settlement and delivery of transactions between buyers and sellers, among other things.

1. Registrar To an Issue
An agent handles all the activities in terms of an Issue. And the Registered Owner keeps a watch on the books of accounts lying in a company. Because all the shares are now beheld to a company that has been a custodian with it and that company issues a jumbo certificate to the depository.

The process of converting the materialized shares into a Dematerialised state is quite confidential. A Depository is introduced for even services in order to maintain the records accurately without any misplacement.

The IPO's of companies are initially issued in the market. Investors later tend to purchase them if they expect the company would be giving them good returns on future dates. The details of the whole process are further maintained by the Registrar Agent. The Registrar Agent is the key to the maintenance from start to end during the IPO process.

2. Share Transfer Agent
Share Transfer Agent is an agent who on behalf of an issuer (company) maintains records of holders of securities issued by the company and deals with the process of transfer and redemption of securities.

The transfer agent records transactions, cancels and issues certificates, processes investor mailings, and handles a host of other investor problems, including reissuing lost or stolen certificates. Transfer agents work closely with registrars to ensure investors receive their due interest and dividend payments in a timely manner. Transfer agents likewise oversee the mailing of monthly investment statements to mutual fund shareholders. A transfer agent plays a vital role in acting as a liaison between a company's registrar and an investor.

Registrar and Transfer Agents (RTA) are SEBI-registered entities that provide services related to share registry maintenance and share transfer activities on behalf of companies that have issued shares to the public. The functions of the RTAs are as follows:

1. Collecting the applications from investors in respect of any issue.
2. Keeping a proper record of the applications and money from investors or paid to the seller of the securities.
3. Assisting the corporate body:
   a) To determine the basis of allotment of securities in consultation with the stock exchange.
   b) Finalising the list of persons entitled to the allotment.
   c) Processing and dispatching the allotment letters, refund orders or certificates, and other related documents regarding an issue.

Simply speaking RTAs refer to an agent appointed by a company to maintain records of security owners. A transfer agent's principal functions are to issue and cancel certificates to reflect changes in ownership of the securities of an entity and to act as an intermediary for the company. A registrar's function is to maintain the register of the issuer for each issue of securities. The registrar records the name, address PAN number of each individual and entity that owns the securities of a company. It is rare that the transfer agent and registrar are not the same entity. While this is not a requirement, generally companies want to retain only one entity to provide both services because it is more time-effective and cost-effective.

RTAs according to SEBI are :
https://www.sebi.gov.in/sebiweb/other/OtherAction.do?doRecognisedFpi=yes&intmId=10

Clearing Corporation

As per sub-clause (d) of Regulations 2 of securities contracts (Regulation) (Stock Exchanges and Clearing Corporations) Regulation., 2018 “clearing corporation” means an entity that is established to undertake the activity of clearing and settlement of trades in securities or other instruments or products that are dealt with or traded on a recognized stock exchange and includes a **clearinghouse.**

Clearing corporation has to do the activity of clearing and settlement of trading securities and other products which are traded at the stock exchange. Along with this in the regulation, the clearing corporation has to do “netting”.

“Netting***”*** means the determination by clearing corporation of net payment or delivery obligations of the clearing members of a recognized clearing corporation by setting off or adjustment.

Clearing corporation has played a vital role for the clearing and settles the trade which is more than crore or above turnover are doing on a day to day base, therefore, SEBI has enacted the strict regulations for the Clearing corporation such as for the incorporation of any clearing corporation has to maintain minimum 100 Crore, reference can be taken of rule 14(2) of the regulations .

Furthermore, the clearing corporation has to create a Fund to settle trades. for each segment, to guarantee the settlement of trades executed in the corresponding segment of recognized stock exchange. In the event of a clearing member failing to honour his settlement obligations, the Fund shall be utilized to complete the settlement.

Example : *Let's take an example that One Share Broker Namely "QIB" is registered with a clearing corporation at the time of registration. The broker had agreed to deposit 20 lakh for the trading purpose on behalf of the broker and his client. But one day the market will hit down very badly and all transactions are done by QIB and its client will be in loss and the loss is more than 30 lakh and the said QIB became a defaulter and QIB is not able to pay the remaining 10 lakh to the exchange. In this scenario, the clearing corporation has utilized its fund which was created under rule 37(1) and 37(2) at that time the said corporation paid to the other parties and settled the trade.*

To cure the risk the clearing corporation has collected two types of margin from its members. One is Initial Margin and the second one is Market to the Market margin. **Initial Margin** means to secure future adverse Movement of the price of concern security. **Market to Market** Means to cover the notional loss.

NSE Clearing Limited (formerly known as National Securities Clearing Corporation Limited), NSE Clearing, a wholly owned subsidiary of NSE is responsible for clearing and settlement of all trades executed on NSE and deposit and collateral management and risk management functions. NSE Clearing was the first clearing corporation to be established in India and we introduced settlement guarantee before it became a regulatory requirement. NSE Clearing has maintained a credit rating of "AAA" from CRISIL since 2008.

It was set up with the following objectives:

- to bring and sustain confidence in clearing and settlement of securities;
- to promote and maintain, short and consistent settlement cycles;
- to provide counter-party risk guarantee, and
- to operate a tight risk containment system.

NSE Clearing commenced clearing operations in April 1996.
