Dematerialization

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The article highlights the step-by-step process involved in the depository systems with particular reference to dematerialization process.

With the liberalization of Indian economy and several pragmatic measures taken by the Government, the capital market has undergone a radical change. There has been a significant increase in the number of investors. Of course, comparing with the growth of population of our country, increase in number of investors is meagre. Market capitalization on the stock exchanges has also increased manifold. In recent times, an unfortunate trend of frequent fraudulent interception of share certificates/dividend warrants in postal transit and forgery of share certificates/signatures on transfer deeds by unscrupulous persons emerged and caused avoidable problems for bonafide investors and the concerned companies. In view of the factors, investor protection/ investor service has assumed a new dimension. In this context many top-level companies, multinational companies, etc. strengthened their share operations and share departments putting in manpower, hardware, software, new techniques and skills and other requisite resources.

Scrip Based System

It is a traditional and long prevalent system in our country that involves an enormous paper work involving share certificates in paper form and transfer deeds (physical form). The process beginning from buying shares through stock exchanges till getting the certificates duly endorsed in the buyer's name in indeed quite complex and time-consuming and is riddled with as variety of problems like bad deliveries, for several reasons, e.g., signature differences of transferors, mistake in completing the details in transfer deeds, litigation/disputes in respect of shares purchased, fake certificates, tearing/mutilation of certificates, loss/fraudulent interception of certificates in transit, delays in postal transit to and from the company, processing time taken by companies in effecting the transfers, cost towards stamp duty @ 0.5 per cent of the market value of shares, and postal/courier charges etc. The system is not an investor friendly and therefore, a revised system is to be implemented.

Concept of a Depository System

Depository system essentially aims at eliminating voluminous and cumbersome paper work involved in the script-based system and offers scope for 'paperless' trading through state of-the-art technology. Depository system enables conversion of physical securities in the electronic form through a process of 'dematerialization' (also known as 'demat') of share certificates and facilitates share transactions and transfers electronically without involving any share certificate or transfer deed. Depository system offers option for converting the shares from electronic form to physical or paper from through a process of 'dematerialization' (also known as

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Depositories in India

1. National Securities Depository Limited(NSDL)

It is an organisation promoted by lOBI, UTI and National Stock Exchange of India Ltd. The aim is to provide facilities for holding and handling securities in electronic form. Subsequently; SBI (acquired a 4.76 per cent in NSDL). HDFC. bank, Deusche bank, Dena Bank, Canara Bank, Global Trust Bank, Standard Chartered bank, Citibank NA and HSBC have acquired stake in NSDL. It commenced its operations in November 1996. Its headquarter is situated at Mumbai. It is holding and handling securities in electronic form. It facilitates faster settlement cycles. It provides services related to transactions in securities. It interfaces with the investors through its agents called depository participant (DPs). As a depository, NSDL (i) acts as a custodian as well as legally transfer beneficial ownership, (ii) reduces settlement risk by minimizing the paper work involved in trading, and settling and transferring securities. NSDL offers the following benefits: (a) dematerialization, (b) rematerialization, (c) electronic settlement trades in stock exchanges connected to NSDL, (d) pledging/ hypothecation of dematerialized securities against bank loan, (e) electronic credit of securities, (f) receipt of non-cash corporate benefits such as bonus in electronic form, (g) other services viz., holding debt instruments in the same account, availing stock lending/ borrowing facility etc.

2. Central Depository Services (India) Ltd. (CDSL).

It is the second depository in the country, after NSDL. It is promoted by the Bombay Stock Exchange (BSE), Bank of India, Bank of Baroda, HDFC Bank, State bank of India. The functions rendered by this depository is almost similar that of the NSDL.

Selection of a Depository Participant

To select a depository participant, one can consider the following factors.

1. Reputation of the institution.
2. Track Record.
3. Strength-as measured by net worth and capital adequacy..
4. Dedicated manpower.
5. Infrastructure
6. Safety
7. Convenience and networking
8. Hidden costs like opening a Savings Bank account with minimum balance.

Role of Depository

Depository is an organization where the securities of an investor are held in electronic form through the medium of Depository Participants (DPs). It enables surrender and withdrawal of securities to and from the depository through the process of demats and remats. Maintains investor's holdings in electronic form. Effect settlement of securities traded in depository made on the stock exchanges. Carries out settlement of traders not done on the stock exchanges (off-market trades)

Role of Depository participants

A depository participant is a representative in the depository system of an investor. As per the SEBI guidelines, financial institutions/banks/custodians/stock brokers etc. can become depository participants provided they meet the necessary requirements prescribed by SEBI. A depository participant is a first point of contact with the investor. The depository participant serves a link between the investor and the company through the depository in dematerialization of shares and other electronic transactions.

De-materialization

It is a process by which company through the depository takes share certificates of shareholders participant, verified and found in order, dematerialization is confirmed by the company. The depository participant credits equal number of shares to the account of shareholder as electronic holding. The entire process of dematerialisation has to be completed within two weeks period of time.

Re-materialization

Rematerialisation is a process of converting the electronic holdings back into share certificates in paper form the process of rematerialization is also carried out through the depositary participant. This process has been completed within a period of 30 days.

Comparison between bank and depository

A depository system functions very much like a banking system. The given chart Table - 1 gives an analogy between the banking and depository system :

In the flow process, various steps involved are:

Step 1

Shareholder/investor approaches to a depository participant of his choice and opens an account just like an account with a bank.. With the opening of account, shareholder gets an identification number called "Client's ID" which serves as a reference point for all transactions and correspondence with the depository participant. The shareholder fills up a Dematerialization Request Form

Table -1

Bank	Depository
Holds funds in accounts	Holds securities in accounts
Transfers funds between accounts	Transfers securities between accounts
Transfers without handling money	Transfers without handing securities
Safekeeping of money	Safekeeping of Securities

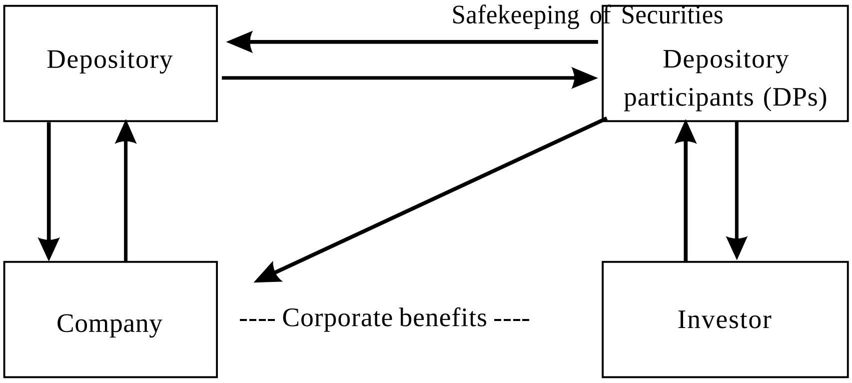

Diagram : Flow process involved in the depository system

(DRF) to be provided by the depository participant and hands it over along with share certificates duly cancelled by writing “Surrendered for dematerialization” to the depository participant for demat. The DP will accept certificates registered only in the name that holds the share certificates.

Step 2

Upon receipt of DRF along with the original share certificates, the DP sends an electronic request to company through Depository for conformation of demat and simultaneously surrenders the shareholdings. DRF and share certificates are accompanied ya standard letter to the company for demat confirmation.

Step 3

A Company should be equipped with the requisite hardware/software facility. It must be linked to the Depository network through a V-Sat connection.

Step 4

On receipt of the DRF and share certificates of the shareholde,:” necessary verification is done and demat is confirmed to Depository.

Step 5

The depository further confirms the demat to the shareholder’s DP

Step 6

DP credits the shareholders’ account with the number of shares so dematerialized and thereafter the shareholder holds the securities in electronic form. DP of the shareholder gives a statements of holdings and updates account after each transaction just like bank account.

Electronic Transactions

Once shareholder opens an account with the depository participant, he can buy or sell shares in electronic form without any paper work. The shareholder need not pay any stamp duty of 0.5% as applicable to scrip based transactions. The depository participants charge the shareholder’s/investor’s acquaintance, a list of service charges appended. A shareholder can open accounts with any number of DPs of his choice just as opening bank account with a number of banks. Shareholder can trade in depository mode through any broker registered with National Stock Exchange.

Pledging Facility

Shareholders can pledge/ hypothecate shares held in electronic form by making an application to his depository participant. Likewise, shareholder can also request for closure of pledge/hypothecation. A number of banks have announced that they will charge lovver interest rates for loans against demate rialized shares. Reserve Bank of India has announced that the maximum amount of advances against pledge of dematerialized securities has been allowed up to Rs. 20 lakhs.

Freezing of Account

At any time, as a security measure, shareholder can stop transaction in his account, he can accordingly advise his depository participant. DP shall ensure the customer shareholders that his account is totally frozen until further instructions from the shareholders.

Option of Rematerialisation

Shareholder has the option of converting his electronic holdings into share certificates by requesting his depository participant for a remat.

Corporate Benefits

1. On announcement of dividend, depository will provide the details of persons having electronic holding of company shares with reference to the record date/book closure.
2. Basing the electronic form, dividend warrants are served by company to the shareholding
3. In case of rights shares issue, the distribution of share entitlements will be done in

electronic form by depository

4. In case of bonus shares issue, the distribution of share entitlements will be done in electronic form.

Changes levied by a Depository

1. Entry Fee
2. Annual Fees
3. Custody Charges
4. Remat Charges
5. Transaction Charges
6. Inter-depository Charges

Benefits of Depository System

- Electronic transactions eliminate the problems and delays out scrip-based system.
- There is no scope of any risk of loss, theft, damage or fraud.
- Bad deliveries are eliminated.
- A lot of paper work involved is avoided.
- There is no hassle of filling a transfer deeds and lodging/ dispatching the transfer documents with the company.
- Shareholder no longer has to wait for the shares transferred in his name. Delay is almost eliminated.
- This system totally eliminates risks associated with loss/ fraudulent interception of share certificates in postal transit.
- Settlement process in case of purchases is very quick.
- Settlement process in case of sale is very fast.
- Shareholder saves stamp duty @ 0.5 per cent of the market value of shares. Of course, he has to incur some service charges charged by the DPs.
- Investment is highly liquid at all times as there is shorter waiting period.
- The marketable lot for transaction in depository mode has been fixed as one share. Therefore, the problem of odd lots is totally eliminated.
- Transmission of shares can be effected immediately.
- Transaction costs are generally lower than the physical segment.
- Genuineness is always prevalent with the documents.

Services Offered by the Depository

- Conversion of physical certificates to electronic form, i.e., dematerialization.
- Rematerialisation facility.
- Transfer of securities.
- Settlement of trades executed in connected stock exchanges with respect to dematerialized securities.
- Pledging/hypothecation of dematerialized securities.
- Electronic credit in public offerings of companies.
- Receipt of non-cash corporate benefits such as bonus, rights in electronic for,

Epilogue

In order to protect the investors, the capital market regulator (SEBI) has taken up a series of steps in India. One of the steps is dematerialization shares and securities of shareholders/ investors giving more protection to them. Due to many benefits of the system, it became more popular in the capital market in India. It is much improved method over the scrip-based system. This system is more flexible in the sense that it can be reconverted into rematerialisation from electronic process to ordinary certificates at the option of the securityholders. It deals with even odd lots of securities.

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