

**INVESTOR'S SAVIOUR - ANALYSIS OF THE DEPOSITORIES ACT***Jatin Budhiraja & Zaara Zia*

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**INTRODUCTION**

The primary and secondary markets for Corporate and Government securities in India are regulated by the Government itself and regulations of Securities and exchange board of India. The regulations exist for the purpose of providing adequate protection to the interests of the investors with regards to trading of shares. One of the acts that the legislature enacted for giving effect to speedy and accurate transferability of shares is the Depository act<sup>1</sup>. The Depositories Act came into force in 1996, it aims at regulation of depositories in securities and for other related matters like rights and obligations of depositories, offences and penalties, dematerialization etc. The term depository has been defined as the institution receiving a deposit. One with whom anything is lodged with trust. A depository holds securities of the investors in electronic form and he is under an obligation to keep the shares with reasonable care and restore the same on request of the investor<sup>2</sup>. In India there are two depositories which are National Securities Depositories Limited (NSDL) and Central Securities Depositories Limited (CSDL). The act also provides for the concept of dematerialization. Mitigating the risks associated with share trading has been top most priority for the legislature. The risks associated with trade sharing are multifarious and one of the risks is of doing it in paper format, that is why for the legislature made it mandatory for the dematerialisation of shares. Dematerialisation is nothing but the process through which the physical share certificates of the shareholders gets converted to electronic form which is maintained in an account by the Depository participant<sup>3</sup>. India has adopted the demat system and it has been successfully operating in the country. The depository act is not free from lacunas while it has been lauded for the multifarious benefits it provides to the investors, agencies, companies etc. it has disadvantages like manipulations by the stock brokers, multiple regulations etc. But undoubtedly the benefits that it has outweighs the disadvantages.

**DEMATERIALISATION: MEANING AND PROCESS**

<sup>1</sup>[http://shodhganga.inflibnet.ac.in/bitstream/10603/23191/9/09\\_chapter%202.pdf](http://shodhganga.inflibnet.ac.in/bitstream/10603/23191/9/09_chapter%202.pdf)

<sup>2</sup> <http://www.rna-cs.com/an-insight-into-the-depositories-act-1996/>

<sup>3</sup> [http://www.business-standard.com/article/pf/what-is-dematerialisation-of-shares-113072500477\\_1.html](http://www.business-standard.com/article/pf/what-is-dematerialisation-of-shares-113072500477_1.html)

The Indian Capital market, has witnessed phenomenal growth in terms of number of stock exchanges, investor population etc. this has been possible due to introduction of demat account<sup>4</sup>. The traditional method of possessing a share certificate to the effect of ownership of shares, has been replaced by demat system. Dematerialisation is a process of converting physical form of shares into an electronic form. With technological developments and the gradual shift to electronic mode, the enactment of dematerialisation has been a remarkable step on the part of the legislature. Prior to dematerialisation, problems like delay in transfer of certificates of shares, forgery of shares, etc. were dominating the securities market. The converted electronic data is stored with the depository from where they can be traded. Depository is an entity which holds securities of the investors such as shares, debentures, bonds, government securities, mutual funds etc.<sup>5</sup> In India the term demat, refers to account of Individual investors, to trade in listed stocks or debentures, as required by the Securities Exchange Board of India.<sup>6</sup> An investor will first have to open an account with the Depository participant, who is the market intermediary, registered with the Securities Exchange Board of India and have to fill a form i.e. Demat Request Form. Every security has a separate International Securities Identification Number and separate demat request forms have to be filed for each International Securities Identification Number. All these have to be submitted along with physical shares for conversion. Maximum three persons can open a join demat account in their names. Amount of balance of securities to be maintained in the account has not been laid down. The Depository Participant gives the investor a copy of agreement and schedule of charges for his future reference. The Depository Participant open the account, and the investor gets a unique account number known as Beneficiary Owner Identification Number. The dematerialised securities will appear as balances in the depository account. The securities in the demat account can be converted into physical form which is called as rematerialisation. Depository participant submits the certificates to the registrar of the Issuer of Company. Registrar confirms the dematerialisation request from depository. After dematerialising the certificates, registrar updates accounts, and informs depository of the completion of dematerialisation.

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#### PREREQUISITES FOR DEMATERIALISATION

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- 1) Investors should have a depository account
- 2) The securities should be from the eligible list of securities issued by the depository
- 3) Separate demat requisition form is essentially required for each issuer company.
- 4) Securities have to be in the name of the investor

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<sup>4</sup> <https://www.charteredclub.com/demat-account-benefits-and-process-of-dematerialisation/>

<sup>5</sup> <http://www.flame.org.in/KnowledgeCenter/Whatisdematerialisationofsecurities.aspx>

<sup>6</sup> <http://www.yourarticlelibrary.com/accounting/share/dematerialisation-meaning-opening-and-conversion-process/56797>

- 5) Demat Request form has to be signed by the investor<sup>7</sup>

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### ADVANTAGES

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- 1) **Safety to the investor-** The Depository participant will be registered under Securities Exchange Board of India. The investors account will be credited/ debited by the depository participant, only on the basis of valid instruction from the client. The National Securities Depositories Limited conducts regular inspections of both the depository participant and agents. A statement of account is received periodically by the investors. The investors have the right, to approach National Securities Depositories Limited in case of grievances which are not resolved by the Depository Participant<sup>8</sup>.
- 2) **Less risks-** Mitigation of risks because the traditional trading system which involves physical transfer of shares has been replaced by the electronic form<sup>9</sup>.
- 3) **Speedy Transfer of shares –** Purchase and sale of securities between persons living far off has been made possible due to electronic form.
- 4) **Low Brokerage Costs-** In case of transfer of physical transfer of shares amounts to 1.5 % while in dematerialisation it amounts 0.75%<sup>10</sup>
- 5) **Saving of time and cost –** Cost and time effective as the requirement for physical certificates gets replaced<sup>11</sup>.
- 6) **Elimination of other problems-** Problems like bad delivery of certificates, fake certificates, signature difference of transferor etc. gets eliminated

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### DISADVANTAGES

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- 1) Trading securities in electronic mode may become uncontrolled
- 2) The actions of stock brokers have to be kept in check because they have the capability of manipulating the market.
- 3) Multiple regulations have to be complied with which might reduce the ease of access for the investors and becomes inconvenient for them<sup>12</sup>.

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### DEPOSITORIES ACT, 1996

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<sup>7</sup> <http://www.legalserviceindia.com/article/1119-Concept-of-Demat-Shares.html>

<sup>8</sup> [http://www.indianmba.com/Faculty\\_Column/FC435/fc435.html](http://www.indianmba.com/Faculty_Column/FC435/fc435.html)

<sup>9</sup> [http://shodhganga.inflibnet.ac.in/bitstream/10603/23191/9/09\\_chapter%202.pdf](http://shodhganga.inflibnet.ac.in/bitstream/10603/23191/9/09_chapter%202.pdf)

<sup>10</sup> [http://shodhganga.inflibnet.ac.in/bitstream/10603/23191/9/09\\_chapter%202.pdf](http://shodhganga.inflibnet.ac.in/bitstream/10603/23191/9/09_chapter%202.pdf)

<sup>11</sup> <http://www.legalserviceindia.com/article/1119-Concept-of-Demat-Shares.html>

<sup>12</sup> <http://www.legalserviceindia.com/article/1119-Concept-of-Demat-Shares.html>

It laid down provisions for the regulation of depositories in securities and matters connected to it. Initially, it came into force as an ordinance. The Act provides a legal framework of depositories to accommodate holding of securities which includes shares in the demat form (electronic form) and to effect transfer of securities through book entry. Depository system is established by this Act as it provides setting up of one or more depositories which accredit the investors to hold securities in a non-physical form, also known as dematerialized form. The system also affects the transfer of securities in the form of book entries in accounts that are maintained by the depository. It is required of every depository to be registered with the Securities and Exchange Board of India (SEBI) and to obtain a certificate of commencement of business. The main purpose of a depository is to dematerialize the securities and to enable their transaction in book entry form.

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## **RIGHTS AND OBLIGATIONS OF ISSUERS, PARTICIPANTS, BENEFICIAL OWNERS AND DEPOSITORIES UNDER THE DEPOSITORY ACT, 1996**

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### **1. Agreement between Participant and Depository**

A depository shall enter into an agreement with one or more participants as its agent in the form as prescribed by the bye-laws.<sup>13</sup>

### **2. Services of Depository**

Any person may enter into an agreement through a participant in a way prescribed by the bye-laws with any depository in order to avail its services.<sup>14</sup>

### **3. Surrender of Certificate of Security**

Any person who has entered into an agreement with the depository is required to surrender the certificate of security, for which he seeks to avail the services of a depository, to the issuer.<sup>15</sup> The issuer shall cancel the certificate of security on receipt of certificate of security and the name of the depository shall be substituted in its records as a registered owner in the respect of that security and inform the depository accordingly.<sup>16</sup> After that, the name of the person shall be entered as the beneficial owner by the depository.<sup>17</sup>

### **4. Registration of Transfer of Securities with Depository**

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<sup>13</sup> Depositories Act, 1996, Section-4.

<sup>14</sup> Id., Section-5.

<sup>15</sup> Id., Section-6(1).

<sup>16</sup> Id., Section-6(2).

<sup>17</sup> Id., Section-6(3).

On receipt of intimation from a participant, every depository shall register the transfer of security in the name of the transferee.<sup>18</sup> The issuer shall be informed by the depository if a transferee or a beneficial owner of any security seeks to have custody of such security.<sup>19</sup>

#### **5. Options to Receive Security Certificate or Hold Securities with Depository**

Every person subscribing to securities offered by an issuer shall have the option either to hold the securities with a depository or receive the security certificates.<sup>20</sup>

#### **6. Securities in Depositories to be in Fungible Form**

All securities held by a depository are required to be dematerialized and shall be in a fungible form.<sup>21</sup>

#### **7. Rights of Depositories and Beneficial Owner**

A depository shall be deemed to be the registered owner for the purposes of effecting transfer of ownership of security on behalf of a beneficial owner.<sup>22</sup> In respect of the securities held by the depository as a registered owner, it is deprived of voting or any other rights.<sup>23</sup> However, the beneficial owner shall be entitled to all the rights and benefits and be subjected to all the liabilities in respect of his securities held by a depository.<sup>24</sup>

#### **8. Register of Beneficial Owner**

Every depository is required to maintain a register and an index of beneficial owners in the manner provided in the Companies Act, 1956.<sup>25</sup>

#### **9. Pledge or Hypothecation of Securities Held in a Depository**

With the previous approval of the depository, a beneficial may create a hypothecation or pledge in respect of a security owned by him through a depository.<sup>26</sup> Such pledge or hypothecation shall be intimated by every beneficial owner to the depository and such depository shall thereupon make entries in its records accordingly.<sup>27</sup>

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<sup>18</sup> Id., Section-7(1).

<sup>19</sup> Id., Section-7(2).

<sup>20</sup> Id., Section-8.

<sup>21</sup> Id., Section-9.

<sup>22</sup> Id., Section-10(1).

<sup>23</sup> Id., Section-10(2).

<sup>24</sup> Id., Section-10(3).

<sup>25</sup> Id., Section-11.

<sup>26</sup> Id., Section-12(1).

<sup>27</sup> Id., Section-12(2).

## 10. Furnishing of Information and Records by Depository and Issuer

Every depository is required to furnish to the issuer information about the transfer of securities in the name of beneficial owners at such intervals as may be specified by the bye-laws.<sup>28</sup> Moreover, every issuer has to make available to the depository copies of the relevant records in respect of securities held by such depository.<sup>29</sup>

## 11. Option to opt out in Respect of any Security

If a beneficial owner seeks to opt out of a depository in regard of any security, the depository shall be informed by him accordingly.<sup>30</sup> The depository will then make appropriate entries in its records and shall inform the issuer.<sup>31</sup>

## 12. Depositories to Indemnify Loss in Certain Cases

Indemnification to be done by the depositor of any loss caused to the beneficial owner due to its negligence or of the participant.<sup>32</sup> However, where the loss due to the negligence of the participant is indemnified by the depository, the depository shall have the right to recover the same from such participant.<sup>33</sup>

## 13. Systems and Procedures

Systems and procedures are to be present with every depositor which will enable it to coordinate with the issuer or its agent, and the participants in order to reconcile the records of ownership of securities with the issuer or its agent, as the case may be, and with participants, on a daily basis.<sup>34</sup>

## 14. Internal and External Monitoring, Review and Evaluation of Systems and Controls

Adequate mechanisms shall be laid down by every depository for the purposes of reviewing, monitoring and evaluating the depository's systems, controls, safeguards and procedures. Furthermore, every depository shall conduct an inspection of the same annually and forward a copy of the report to the SEBI.

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## PROVISIONS OF PENALTY UNDER THE DEPOSITORIES ACT, 1996

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<sup>28</sup> Id., Section-13(1).

<sup>29</sup> Id., Section-13(2).

<sup>30</sup> Id., Section-14(1).

<sup>31</sup> Id., Section-14(2).

<sup>32</sup> Id., Section-16(1).

<sup>33</sup> Id., Section-16(2).

<sup>34</sup> Regulation- 30 of SEBI (Security and Exchange Board of India).

Depositories Act prescribes penalty for violation of provisions of the act under Sections-19, 20 and 21.

**1. Penalty for failure to furnish information, return, etc.**

If any person who is required to furnish any information, document, books, returns or report to the Board, fails to furnish the same within the specified time shall be liable to a penalty of one lakh rupees for each during which such failure continues or one crore rupees, whichever is less.<sup>35</sup>

**2. Penalty for Failure to Enter into an Agreement**

Any person, who is registered as an intermediary with the SEBI, is required under this Act to enter into an agreement, fails to enter into such agreement, such person shall be liable to a penalty of one lakh rupees for each during which such failure continues or one crore rupees, whichever is less.<sup>36</sup>

**3. Penalty for Failure to Redress Investor's Grievances**

If any depositor, participant or issuer or its agent fails to redress the grievances of investors within the specified time, such depository, participant or issuer or its agent shall be liable to a penalty of one lakh rupees for each during which such failure continues or one crore rupees, whichever is less.<sup>37</sup>

**4. Penalty for Delay in Dematerialization or Issue of Certificate of Securities**

Any person who is registered as an intermediary fails to dematerialize or issue the certificate of securities on opting out of a depository by the investors, within the specified time, that person shall be liable to a penalty of one lakh rupees for each during which such failure continues or one crore rupees, whichever is less.<sup>38</sup>

**5. Penalty for Failure to Comply with Directions Issued by the SEBI**

Any person who fails to comply with the issued directions within the specified time period shall be liable to a penalty of one lakh rupees for each during which such failure continues or one crore rupees, whichever is less.<sup>39</sup>

**6. Penalty for the Contravention of the Act**

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<sup>35</sup> Depositories Act, 1996, Section-19(A).

<sup>36</sup> Id., Section-19(B).

<sup>37</sup> Id., Section-19(C).

<sup>38</sup> Id., Section-19(D).

<sup>39</sup> Id., Section-19(F).

Any person who contravenes or attempts to contravene or abets the violation of the provisions of this Act or any of its regulations or bye-laws shall be liable for imprisonment for a term which may extend to five years or fine which may extend to twenty-five crore rupees, or both.<sup>40</sup>

### 7. Offences by Companies

Where an offence under this act has been committed by a company, every person at the time of the commencement of the company was in charge of or was responsible to, the company for the conduct of its business, as well as the company shall be deemed to be guilty of the offence and shall be liable to be proceeded against and punished accordingly.<sup>41</sup> Furthermore, where any offence has been committed with the consent of, or neglect on the part of, any director, manager, secretary or other officer shall also be deemed to be guilty and shall be liable to be punished accordingly.<sup>42</sup>

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<sup>40</sup> Id., Section-20.

<sup>41</sup> Id., Section-21(1).

<sup>42</sup> Id., Section-21(2).