

COMPANY LAW

UNIT 3 : Share Capital

TOPIC- DEMAT SYSTEM

D-MAT\Depository System

The transfer of securities in physical form suffers from many limitations such as

- Huge cost because of postal charges, stamp duty, paper- work, stationery, odd lots
- Inconveniences associated with transportation , despatch ,safe custody of securities
- Bad deliveries due to faulty compliance of paperwork ,mismatch of signatures etc.
- Risks involved due to theft, forgery, mutilation of certificates
- Undue delays due to procedural lags , frequent following up with company\ brokers etc.

In order to remove the above shortcomings associated with physical delivery of securities ,the Government of India has enacted the Depositories Act, 1996 to provide for legal framework for setting up of Depositories and effecting transfers of securities through book entry only.

Depository System - It is a system whereby the transfer of securities takes place by means of book entry in the ledgers of the Depository and not through transfer deeds and physical movement of scrips.It is also known as" Scripless Trading System ". The main objective of this system is is to minimize paperwork involved with the ownership, trading and transfer of securities. The depository system works very much like a banking system.

Similarities between a banking system & depository system

BANK

- Holds funds in accounts
- Transfers funds between accounts on the instruction of account holders
- Facilitates transfer of funds without having to handle money
- Accountable for safe keeping of the money
- Eg. PNB, SBI

DEPOSITORY

- Holds securities in accounts
- Transfers securities between accounts on instruction of account holders
- Facilitates transfer of securities without having to handle securities
- Accountable for safe keeping of securities
- Eg. NSDL, CDSL

Depository- It is an organisation where securities of an investor are held in electronic form and securities transactions are carried out by means of book entry through the medium of a Depository Participant. The depository must be formed and registered as a company under the Companies Act and must also seek registration with SEBI by fulfilling prescribed conditions. Following are the important Depositories in India and companies can enlist their shares with either or both of them-

1. National Securities Depository Limited(NSDL)- operational since November, 1996
2. Central Depository Services Limited (CDSL)- operational since February, 1999

Depository Participant(DP)- They are the agents of the depository and act as a crucial link \ interface between the investors and the depository. As per SEBI Guidelines, financial institutions, banks, stock brokers, stock exchange, clearing house etc. can become DP on obtaining a Certificate of Registration after following prescribed conditions under "SEBI(Depositories and Participants) Regulations, 1996" and having adequate infrastructure. If depository is like a bank, a DP is like branch of that bank.

Processes in Depository System

Account Opening- Any investor who wants to avail services of a Depository cannot open demat account directly with the depository .It has to open a demat account with the depository participant of the depository. Steps are

- Investor should fill up an Account Opening Form and submit it to DP along with copies of proof of identity(POI) and proof of address (POA) as specified by SEBI. He should also sign an agreement with DP wherein the rights and duties of investor as well as DP are specified.
- DP will verify the documents with originals and if in order, it will open the demat account in the system and give the investor - Beneficiary Owner Identification Number(BOID), copy of agreement and schedule of charges.
- One account is sufficient for holding the dematerialized shares of various companies. However, one can open more than one account with the same DP and also with different DPs.

Processes in Depository System

Dematerialization- It is a process by which physical certificates of securities of an investor are converted into an equivalent number of securities in electronic form and credited into his account with the DP. Normally, this whole process takes 30 days . Steps are

- Investor should fill up Dematerialization Request Form (DRF) provided by the DP in this regard and submit it to DP along with the respective share certificates.
- The DP then intimates Depository about the dematerialization request of the investor, and surrenders the DRF and the share certificates to the concerned company .
- The company will cancel the share certificates of that investor and substitute in its Register of Members, the name of the Depository as **Registered Owner** of those shares and inform the Depository accordingly.
- The Depository ,then enters the name of the investor concerned in its records as **Beneficial Owner** and the no. of shares held by him. The Depository will inform the DP electronically.
- The DP will credit the client's demat account with equivalent no. of shares of that company ,which the investor will hold in electronic form. He will also issue a statement of transactions to the client.

Processes in Depository System

Payment\ Credit of dividends\ interest\ Bonus\ Rights shares. Steps are

- The company declaring dividend\ interest\ Bonus\ rights obtains the details of the beneficiary owners and their holdings as on the record date from the Depositories.
- On the basis of information provided, the company issues them warrants for dividends\ interest .
- Bonus\ Rights shares will be credited by the company to their demat accounts with the depository , directly.

Selling \ Buying dematerialized shares - It is possible when both the parties - buyer as well as seller of securities - have demat account and the sale\ purchase was through a stock broker. Further ,for transferring shares held in demat form, no transfer deed and no stamp duty is required. Steps are

- The client has to send to his DP a **Delivery Instruction Slip (DIS) in case of sale \ Receipt Instruction Slip (RIS) in case of purchase of securities**. These slips are duly signed and contain the details of securities sold or purchased.
- The DP will convey the information to the Depository electronically.
- The Depository will register the transfer of the security in the name of the transferee only after it is satisfied that payment for such transfer has been made. It will debit the account of the transferor and credit the account of the transferee with the number of shares transferred.
- The DP will also make appropriate book entries in its records to effect the transfer of securities.
- The client will be provided with the updated statement of accounts within 15 days of the transaction.

Processes in Depository System

Rematerialization- It is a process by which securities held in demat form are converted into an equivalent number of securities in physical form. This process is completed within a period of 30 days .Steps are:

- Investor should fill up Rematerialisation Request Form (RRF) to the DP
- The DP will forward the request to the Depository after verifying that client has the necessary securities in balance.
- The depository will forward the same to the company
- The company issues security certificates to the investor , substitutes the name of investor as registered owner in place of the depository and sends electronic confirmation to the depository
- The depository updates the account , intimates the DP who then informs the client about changes in his account balance due to rematerialization of his shares.

Features of the Depository System

- **Scope of Depository System-**
 - ✓ Public offer of shares has to be in Demat form
 - ✓ Shares of unlisted public companies have to be converted into Demat form for enabling transfer of shares
 - ✓ Shares of a private company (except Small Company) shall be transferred /subscribed to in Demat form only
- **Dematerialization of securities not compulsory-** Investor has the option to hold securities either in physical form or in dematerialized form. Investors holding securities in dematerialised form can convert them in physical form through rematerialisation.
- **Securities shall be fungible** – Securities in electronic form have no distinctive identifiable number. All the shares would be identical and can be exchanged for one another.
- **Ownership bifurcated into Registered Owner and Beneficial Owner-** On the dematerialization of securities, the Depository would appear as a registered owner in the books of the issuer company whereas the investor would be beneficial owner in the records of the Depository . It means that all the economic benefits like dividends, interest, bonus, etc will be enjoyed by the investor only
- **Securities would become freely transferable-** In the demat mode, transfer of shares takes place freely through electronic book entry system and the companies enjoy no discretion in effecting transfer of securities. Further, the concept of market lot is also eliminated as market lot becomes one share.
- **No stamp duty** - In case of depository system, there is no need of any transfer deed or stamp duty on transactions of sale\ purchase .

Benefits of Depository system \ Dematerialization (STEEL)

Safety

- No risk of loss of securities due to theft/ fire/ mutilation /loss in transit / forgery etc.
- No need of maintaining bank vaults for safe custody of share certificates

Transparency

- DP provides the updated statement of accounts to their clients on a regular basis
- Bonus\ Rights shares credited directly by company in shareholders demat account

Efficiency

- Change of address recorded with the DP gets registered with all companies in which investor holds securities electronically eliminating the need to inform each of them separately
- Transmission formalities for securities held in demat account can be completed by submitting documents(like death certificates, succession certificate etc.) to the DP alone and no need of corresponding with each of the companies.

Economy

- No stamp duty payable on transfer of securities
- Chances of bad deliveries is eliminated as securities cannot be fake or forged.

Liquidity

- Share transfers can be effected immediately without any need to follow up with brokers \ company\ registrar etc.
- Abolition of odd lots as market lot is one share. Shares in any numbers can be bought\ sold.