A Study on Secondary Securities Market in India

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Abstract

The present study was attempted to evaluate the Indian secondary markets and the investment environment prevailing there. The role of secondary market institutions was studied with the help of primary and secondary data which were collected from various sources such as reports, articles, journals, books of financial market, newspapers, various editions of handbook of statistics, NSE fact book, ISMR (Indian Securities Market Review), websites of NSE India and BSE India, etc. and the primary data were collected with the help of structured questionnaire. The collected data were analyzed with the help of various statistical techniques such as cross tabulation statistical technique, graphical presentation, correlation, regression, chi square test which were be suitable for analysis of data and for obtaining the results to satisfy the objectives of the study. The main objectives of the study were to analyze the role of secondary market institutions in the growth and development of the investment environment in India, also to study market with regard to risk return and protection of investors besides this to see the impact of foreign institutional investors on Indian retail investors, to study the causes and impacts of volatility in the secondary market and to analyze the role of genuine investors and pure speculator in the secondary securities market.

Keywords: *NSE Fact Book, ISMR, NSE India, BSE India.*

Introduction

Economic development to great extent depends on the rate of investment or capital formation which, in turn, depends on whether finance is made available in time, and the quantity of it, and the terms on which it is made available. In any economy, in a given period of time, there are some persons (corporate, households, government) whose current expenditure are less than their current incomes, while there are others whose current expenditures exceed their current incomes. In current terminology, the former are called the ultimate savers or surplus spending units, and the later are called the ultimate investors or the deficit spending units. In corporate sector joint stock companies or corporations required the funds to carry on their activities. In order to raise funds, these organizations issue various types of securities such as equity shares, preference shares, debentures, bonds, treasury bills, etc. Such types of investments are illiquid and investors are bound to have these securities till their redemption by companies. In case of equity shares the investors cannot get back their invested amount

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during the life time of the company. If after investment the investor feels that their investment decisions are not viable or they want money to fulfill their present needs, they are not in a position to be sold their investment and get the money. Because of this investment in corporate sector was not encouraging for the among surplus spending units. In such a scenario the financial growth or efficiency of production would linger behind.

Literature Review

Eyshell (1995) investigated the impact of suitable and timely disclosures of information on protecting the interests of investors. The study was found that Information should be disclosed when it is valuable to the market. The companies should, therefore, be made to disclose routine information on a periodic basis and price sensitive information on a permanent basis. It was found that the secondary market regulator and stock exchanges have played a significant role to play in ensuring that such information is accessible by all market participants rather than a few selected market players. The study further found that the use of modern technology, internet, and computers, should be enabled to enhance the efficiency of the disclosure process. It should be possible to submit and propagate financial and non-financial information by electronic means.

The law should ensure a revelation regime that compels companies to disclose substantial information on a continuous and timely basis.

Gokarn (1996) assessed the contribution of SEBI to the growth and development of secondary market institutions in the securities markets in India during the 1992-96 periods. It develops a theory of regulation which may be summarized as follows regulation is required to ensure that securities markets achieve the four main dimensions of efficiency. The working of the securities markets in predicated on the activity of three broad sets of stakeholders, namely, investors, issuers and intermediaries. The study was found that the regulation is essential to concentrate on three potential sources of market failure namely information asymmetry, transaction costs and imperfect competition.

Shah (1999) focuses on how four key developments relating to trading have changed the Indian secondary securities markets into being one of the largest and the most competitive in the world in terms of expenditure and have enhanced the informational efficiency of the market. The institutional developments it focuses on are the electronic limit order book, matching system, rolling settlement, dematerialized trading and innovation through a clearing corporation. The study further takes the view that with these developments the Indian secondary securities market mainly the equity market, has achieved nearly all the institutional development that is required for the scope of further development in the areas of investigation and enforcement.

Chakraborty (2001) studied in his research paper that since the beginning of liberalization FIIs flow to India has steadily grown its importance. The study analyzed foreign institutional investors flow and their relationship with other variables. The study further revealed that FIIs are the major players in the Indian stock market and their impact on the domestic market are increasing. Trading activities of FIIs and the domestic stock market turnover indicates that FIIs? are becoming more important source of finance.

Machiraju (2002) studied the role of retail investors in the Indian secondary securities market and found that retail investors are not only the backbone of securities market but also determine the level of economic activity in the economy. Increase in the number of retail investors in the economy enhances the scope of secondary market. The study suggested that the growth in the number of retail investors in secondary market should be encouraged for the growth and development of investment environment in the country.

Gordon and Gupta (2003) investigated through their study the causes behind the FII inflows and return in BSE and NSE. The study observed that FIIs act as market makers and book profits by investing when prices are low and selling when they are high meaning thereby that they are market manipulators and hence, there are contradictory findings by various researchers regarding the causal relationship between FII net inflows, market capitalization and returns of BSE and NSE. Consequently, there is a need to investigate whether FIIs are the cause or effect of secondary market fluctuations in the country or they effect the volatility of the market.

Kumar (2005) examined the role of institutional investors, foreign institutional investors and mutual funds in Indian secondary market. The main findings of the study shows that the Indian stock market had improved from last 25 years as so many developments takes place which make Indian secondary market at par with developed economies of world. Indian secondary market consist investments of institutional investors, foreign institutional investors and mutual funds.

Though foreign institutional investors and mutual funds affect the market but now institutional investors also start playing an active role in the market movements.

Uchida (2006) analyzed the role of futures and options in stock market. The study found that the majority of Indian retail investors are like to trade in equities than in future or options. People mainly invest their money in share market followed by mutual funds and fixed deposits. This shows there is a need to create education and awareness among investors regarding profitability of investment in futures and options of stock market.

Dhamija (2007) described that the increase in the volume of foreign institutional investment (FII) inflows in recent years has led to concerns regarding the volatility of these flows, threat of capital flight, its impact on the stock markets and influence of changes in regulatory regimes.

The study suggested that as the pace of foreign investment began to accelerate, regulatory policies have changed to keep up with changed domestic scenarios.

Sethi (2008) evaluated the impact of international capital flow on economic growth, trends and composition and suggested the policy implication thereof. The study further observed that the foreign institutional investors (FIIs) have negative impact on growth, but it is very negligible. The study concluded that India should move to influence both the size and composition of capital flows, strengthened their banking system rather than promoting financial market, banks can provide the surest vehicle for promoting long term growth and industrialization.

Saha (2009) investigated the participation of foreign institutional investors and the other financial institutions in India and the performance of the Indian stock markets and she concluded that Indian stock market is regarded at par with the developed markets Moreover, it had a very unique economic model and is based on strong economic growth with huge liquidity and it is not depended on the US economy for its GDP growth.

Kumar (2010) examined that an investor while operating in corporate securities has to face various types of risks associated with secondary market. An investor has to identify and manage these risks properly to maximize his returns. A clear perception of risk is necessary to have a control over them. Risk is the potential loss a portfolio is likely to suffer. As most losses proceed from ignorance, they could be avoided by understanding them properly. Risk management aims at identifying and understanding the various risks an investor has to face. Future return is an expected return and may or may not be actually realized. Risk management measures the various probabilities that may arise in a particular investment. It can show the strengths and weaknesses of an investment. The study found that to reduce the risk in the market an investor should strictly follow the Stop-Loss method.

Bohra, Singh and Dutt (2011) studied the behavioral pattern of FII in India and figure out the reasons for indifferent responses of BSE and NSE index due to FII inflows. The study found the correlation between FII investment and turnover of different individual groups at BSE and NSE index. The study concluded that there is a positive correlation between FII investment and stock market but in year 2005 and 2008, it was also observed that positive or negative movement of FII?s investment leads to a major shift in the sentiments of domestic or retail investors in market.

Abraham (2012) concluded that the regulatory institution is under duress and under severe attack from powerful corporate interests operating concertedly to undermine SEBI. He specially said that Finance Minister's office, and especially his advisor Omita Paul, were trying to influence many cases before SEBI, including those relating to Sahara Group, Reliance, Bank of Rajasthan and MCX.

Harshesh (2014) analyzed the role of self-regulatory organizations in the growth and development of investment environment in the country. The study further examined that SEBI?s efforts are to create effective surveillance mechanism for the securities market, and encourage responsible and accountable autonomy on the part of all players of the market, who should discipline themselves and observes the rules of the game. This would be possible, if the intermediaries set themselves up as effective self-regulatory bodies. Self-regulation is therefore the cornerstone of the regulatory framework advocated by SEBI, which like management by exception would result in regulation by exception. However, self-regulation can work only if there is an effective regulatory body overseeing activities of self-regulatory organizations.

Objectives of the Study

- To analyze the role of secondary market institutions in the growth and development of the investment environment in India.
- To study the secondary market with regard to risk return and protection.
- To study the impact of foreign institutional investors on Indian retail investors.

Methodology

The research design of the present study is exploratory cum descriptive in nature as the researcher has to study Risk, Return and Protection, Growth and Development in Investment environment, effect of FIIs, on retail investors, Causes and impacts of volatility and relation between genuine investors and pure speculators. The purpose of exploratory study is to achieve new insights in to the phenomenon and generate new ideas. Descriptive study is fact finding investigation with adequate interpretation or describes the state of affairs as it is present. In descriptive researcher has no control over the variables he can only report what has happened or what is happening. Methods used in descriptive research are all kinds of surveys.

Results

Investors are the backbone of the securities market who not only determines the level of activity in the securities market but also the level of activity in the economy. There is a continuous growth in the number of retail and domestic institutional investors? in India. They also gradually are beginning to regain the confidence in the capital markets that had been shaken consequent to the stock market scams during the past decade. It is imperative for the healthy growth of the corporate sector that this confidence is maintained. However, many investors may not possess adequate expertise or knowledge to take informed investment decisions and some of them may not be aware of the complete risk-return profile of the different investment options, hence, may not be fully aware and familiar with the market mechanism and the practices, as well as, their rights and obligations regarding the precautions they should take while dealing with market intermediaries and dealing in different securities. The corporate systems and processes need to be reliable and transparent, so that the interests of the investors may be safeguarded in a manner that enables them to exercise their choice in an informed manner while making investment decisions, and also providing them with a fair exit option. The Securities and Exchange Board of India (SEBI) has been mandated to protect the interests of investors in securities and to promote the development and regulate the securities market so as to establish a dynamic and efficient securities market contributing to Indian Economy. The securities market promotes economic growth. More efficient is the securities market, the greater is the promotion effect on economic growth. It is, therefore, necessary to ensure that our securities market is efficient, transparent and safe. In this direction, SEBI has been working since its inception and would continue to work to continuously improve market design to bring in further efficiency and transparency to market and make available newer and newer products to meet the varying needs of market participants, while protecting investors in securities. The aim is to make Indian securities market a model for other jurisdictions to follow and make SEBI the most dynamic and respected regulator globally.

Discussion

In earlier times the task of using these surplus funds and utilized for capital formation were used by much less specialized agency than the secondary market. But as the time passes business and industry expanded and the economy assumed more complex nature, it required a more permanent source of finance. Businessman needed money for long term but investors demanded liquidity. To overcome this problem secondary market came into form. Since the securities are listed and traded in the stock exchange, the secondary market is also called the stock market. The main objective of the secondary market is to provide liquidity, negotiability, marketability, control of dealings and protection of the interest of investors. According to securities contracts (regulations) Act, 1956, stock exchange means anybody of individuals, whether incorporated or not, constituted for the purpose of assisting, regulating or controlling the business of buying and selling or dealing in securities." These securities include:

(i) Shares, scrips, stocks, bonds, debentures stock or other marketable securities in or of any incorporated company or other body corporate;

(ii) Government securities; and

(iii) Rights or interest in securities.

Nature and Functions of Secondary Market

Economic barometer secondary market acts as an economic barometer of a country's economic health. It reflects market direction and indicates day to day fluctuations in prices. Cyclical fluctuations are also reflected by the index of prices of various securities maintained by the stock exchange.

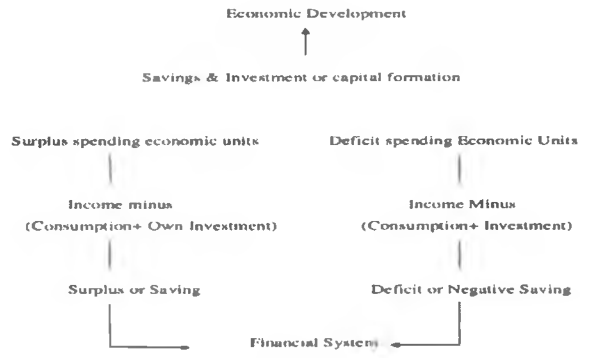
Pricing of Securities: The forces of demand and supply work freely in the secondary market so prices of securities traded on the stock exchange are fairly determined and they are recorded and public in the form of market quotations which help the investors to know current market prices of securities.

Safety of transactions secondary market is an organized market it fully protects the interest of investors. Each member of secondary market has to follow the rules and byelaws of it, if any member is found violating them, his membership is cancelled. Contributes to economic growth secondary market plays a vital role in the economic growth of a country as they provide capital to the companies easily which helps in the production. Spreading of equity cult feeling of ownership as securities are freely traded in the secondary market so anybody can purchase the securities and become the owner of the company up to its stake in the company. Providing scope for speculation when securities are traded with a view to getting profit as a result of change in their market price, it is called speculation. It is allowed or permitted under the provisions of the act. It is accepted that in order to provide liquidity to securities some scope for speculation must be allowed. The secondary market provides this facility.

Liquidity it is a market where already issued securities are traded on routine basis whenever required investor can invest in the market and can reconvert this investment into cash.

Availability of ready market for sale and purchase of securities increase their marketability and enhance liquidity. Better allocation of capital the shares of profit-making companies are quoted at higher prices in the stock exchange and are actively traded. The new issues of such companies are sought after by the investors. Thus, companies with better performance can easily raise fresh capital from the market. General public is reluctant in investing in loss making companies so; secondary market facilitates allocation of investors? funds to profitable channels. Inculcates the habits of saving and investment secondary market inculcates the habit of saving and investment in Indians. As people want higher returns and secondary market promises to give them good return in comparison if they keep their savings at home as ideal. Reforms in the Secondary Market Reforms were undertaken to widen and deepen the secondary market. A dynamic secondary market is a prerequisite for the growth and development of an investment environment in the economy. Secondary market reforms were undertaken to have a positive impact on volatility, liquidity, size and transaction cost. An efficient and effective capital market acts as the technique of measuring the conditions and wellness of an economy. Though the Indian stock market is very volatile during past due to various reasons but every time it regained its good position due to strong fundamentals and dealing mechanism which are free from drawbacks.

Figure 1



Source: Bhole L.M. (2010). Financial Institutions and Markets.

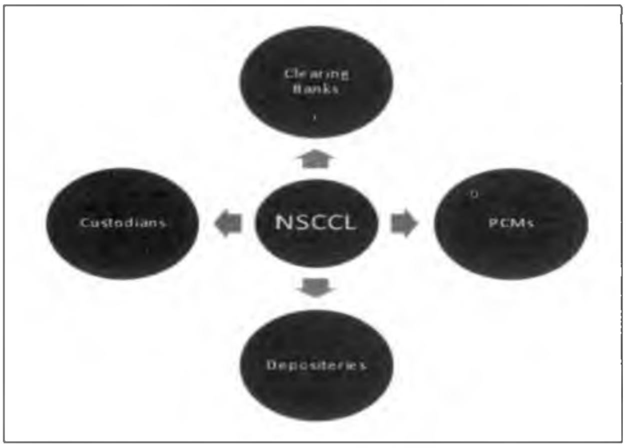
After the initiation of reforms in 1991, The Indian Secondary Market has four tier forms

- Regional Stock Exchanges
- The National Stock Exchange (BSE and NSE)
- The Over-the-Counter Exchange of India (OTCEI)
- The Inter connected Stock Exchange of India (ISE)

Clearing or Settlement of Transactions

Due to the increased number of actively traded shares, the stock exchange has established a clearing house which functions on the same principles on which the clearing houses of banks functions. The clearing house acts as the common agent of the members for clearing contracts between members and from delivering securities to and receiving securities from members and for receiving and paying any amounts payable by such members in connection with any of the contracts and to do all the things necessary or proper for carrying out these purposes.

Figure 2: Cycle of Clearing Corporations



Online or Electronic Trading System

Before liberalization trading on the stock market in India was based on the open outcry into the era of electronic trading or online trading which refers to trading through internet it is superior than the open outcry system, the number of stock exchanges in India has grown from 7 exchanges in 1946 to total 24 stock exchanges till 2015. There is no denying the fact that internet trading offered investors convenience of trading along with reduced cost. It increases operational efficiency like elimination of time, cost, which results in low transaction costs, risk of error, fraud and elimination of chain of brokers and jobbers it increases the large number of participants in every part of the country to trade with one another with full confidence therefore improves the depth and liquidity of the market. it also helps in integration of different trading centers spread all over the country to a single trading platform. But Indian investors? have not yet fully realized the importance of using technology for stock trading. But even till day online trading is not much popular among investors for which a list of factors can be blamed. Over the past two years, the value of all trades executed through internet on NSE has grown from less than Rs.100 Cr. to over Rs.350 Cr. in June 2015.

Corporatization and Demutualization of Stock Exchanges

On 16th October, 2008 a major reform in stock exchange took place, that is, corporatization and demutualization of stock exchanges. Before it, all stock exchanges came under the purview of body of individuals (BOI) and Association of persons (AOF) but now they become a corporate entity means come (under the Companies? Act 1956,) according to which they have to publish their financial statements, get audited their accounts along with issue their shares to the public. It brings out greater transparency in the functioning of secondary market. Now stock exchanges can become a profit making and taxpaying entity. Dematerialization means separation of ownership and control of stock exchanges, from trading rights of its members. This reduces the conflict of interest between the exchange and the brokers and the chances of using stock exchanges by brokers for their own self-interest.

Dematerialization of Securities

Dematerialization or Demat means conversion of physical share certificates into electronic format which eliminates various types of problems such as theft, fake and forged documents, transfer, delay and paper work associated with physical certificates. Currently almost 99 per cent of shares traded in Indian stock exchanges are in demat mode. The investors are required to open a demat account to buy or sell stocks, just like a bank account where actual money is replaced by shares, the account allows them to buy, sell and transact shares without the endless paperwork and delays.

Rolling Settlement

Rolling settlement was introduced by SEBI in January 2000 by T+5 settlement system where T is the trade date and 5 is number of business days after the trade date on which delivery of securities and cash payment is due for settlement. Rolling settlement system replaced the carry forward badla system. The rolling settlement system of share transactions prevents speculation in between the settlement periods. Now SEBI is moving towards T+1 system, of securities. Rolling settlement is simple as the investor has only to keep record of the sale/ purchase of securities. It eliminates arbitrage opportunities. Rolling settlement improves the price discovery process as the settlement is standardized and participants can focus more on the market outcomes. It also helps in settlement of risks as difference between the bid and offer prices narrows due to its transparent nature. Wider participation is possible because investors enjoy the speedy settlement of transactions. It eliminates fluctuations of prices which takes place around settlement dates. With the setting up of Clearing Corporation rolling settlement educes the working capital requirement of brokerage firms. Finally retail investors benefit as it shortens the delay of converting securities into cash and vice versa.

Table 1: Comparison of Secondary Market in between 1992 and 2015

Features	*1992*	*2014*
Regulator	No specific regulator but central government looks after the matters.	A specialized regulator for securities market (SEBI) vested with powers to protect investors? interest and to develop and regulate securities market SROs strengthened.
Intermediaries	Some of the intermediaries (stock brokers, authorized clerks and remisiers) regulated by the SROs.	A variety of specialized intermediaries emerged. They are registered and regulated by SEBI (also by SROs). They as well as their employees are required to follow a code of conduct and are subject to a number of compliances.
Access to Market	Granted by Central Government	Eligible issuers access the market after complying with the issue requirements.
Pricing of Securities	Determined by Central Government	Determined by market, either by the issuer through fixed price or by the investors through book building.
Access to International market	No access to the international market	Corporate allowed issuing ADRs / GDRs and raising ECBs. ADRs/GDRs have two-way fungibility. FIIs allowed trade in Indian market. MFs also allowed to invest overseas.

Features	*1992*	*2014*
Corporate Compliance	Very little emphasis on disclosures, accounting standards and corporate governance Mutual Funds Restricted to public sector	Open to private sector and emergence of a variety of funds and schemes.
Trading mechanism	Open outcry system, Available at the trading rings of the exchanges, Opaque, Auction/ negotiated deals	Screen based trading system, Orders are matched on price- time priority, Transparent, Trading platform accessible from all over country
Aggregation order flow	Fragmented market through geographical distance. Order flow unobserved.	Order flow observed. The exchanges have open electronic consolidated limit order book (OECLOB).
Anonymity in trading	Absent	Complete
Settlement Cycle	14-day account period settlement, but not adhered to always	Rolling settlement on T+3 basis
Counterparty risk	Counterparty risk in settlement of transactions exist	Counterparty risk in settlement of transactions Absent
Basis of settlement	Bilateral Netting	Multilateral Netting
Transfer of securities	Cumbersome. Transfer by endorsement on security and registration by issuer	Securities are freely transferable. Transfers are recorded electronically in book entry form by depositories.
Risk Management	No focus on risk management	Comprehensive risk management system encompassing capital adequacy, limits on exposure and turnover, VaR based margining, client level gross margining, on-line position monitoring etc.
Derivatives Trading	Derivatives trading is absent in 1992	Exchange traded Futures and Options available on two indices and select securities

Regulations for Secondary Market

The Government has framed rules under the Securities Control and Regulation Act (SCRA) (1956), the SEBI Act (1992), and the Depositories Act (1996), Disclosure of Investors Protection Act (DIP) 2000. SEBI has framed regulations under the SEBI Act and the Depositories Act for the registration and regulation of all market intermediaries, and for the prevention of unfair trade practices, insider trading, etc Under these Acts, the Government and SEBI issue notifications, guidelines, and circulars that the market participants need to comply with. The SROs, like the stock exchanges, have also laid down their own rules and regulations.

Causes and Impacts of Volatility

Volatility of a stock measures the frequency with which changes in its market price takes place over a period of time if a stock is higher volatile means there are large fluctuations in its market price, then there is risk and investors avoid these shares hence volatility is a factor which is taken into consideration when assessing the risk return tradeoffs. Moreover, volatility has macro- economic implications in the volatility of the stock market. Volatility in the stock market is a function of information, misinformation (rumors) and sometimes lack of information. It is caused by number of factors such as speculation, trading and settlement system, the government budget, Inflation, interest rates, announcement of corporate results the extent of integration with international market, the regulatory frame work governing the stock market, rumors, the day trading and derivatives trading, crude oil prices, depreciation of dollar and global financial turmoil all these factors directly or indirectly influence movements in the share prices. Secondary market is found to be highly volatile. The volatility of Indian secondary market can be measured in terms of the coefficient of variation (CV). There is need for exchanges and regulators to take swift actions to contain volatility.

Foreign Institutional Investor and Indian Retail Investors

The institutions which are registered or incorporated in countries other than India and want to invest their money in Indian stock market are known as Foreign Institutional Investors (FIIs) means an institution established or incorporated outside India which proposes to make investment in securities in India. They are eligible to purchase shares or convertible debentures issued by Indian companies under the portfolio investment scheme (PIS). In order to remove the confusion that prevails on what is Foreign Direct Investment (FDI) and what is Foreign Institutional Investment (FII), government has proposed to follow the international practice and lay down a broad principle that, where an investor has a stake of 10 per cent or less in a company, it will be treated as FII and, where an investor has a stake of more than 10 per cent, it will be treated as FDI. Since economic liberalization FII flows to India have steadily grown its importance. Foreign capital inflows have been acknowledged as one of the important sources of funds for developing economies that would grow at a rate higher than what domestic savings can support. This resulted in the integration of global financial markets. As a result, capital started flowing freely across national borders seeking out the highest rate of return. India is considered as one of the best investment destinations for foreign institutional investors in spite of political differences and lack of infrastructure facility etc. Since Indian market have vast potential, so it alluring and encouraging foreign investors continuously foreign portfolio inflows through FIIs, in India, are important from the policy perspective, especially when the country has emerged as one of the most attractive investment destinations in Asia. They changed the face of Indian secondary market screen-based trading and depository is possible in India only because of FIIs?. Pressure on domestic currency also can also be eased only through FIIs?, corporate governance can also be adopted by Indian companies which is benefitted to domestic investors. FIIs? are driving force behind the movements of stock indices in the Indian stock market. Rolling settlement was introduced at the insistence of FIIs? as they were not comfortable with badla system. Foreign Institutional Investors? are regarded as the trend setters in Indian market. As, they were the first one to identify the potential of Indian technology stocks.

There are three routes which are followed by FIIS? for investment in India. Direct route, Through Participatory notes, FIIs? sub accounts. Indian investors (investors in equity, large institutional investors, foreign institutional investors, qualified institutional buyers, small investors/deposit holders, etc.) are rational savers but unfortunately not wise investors. In India, people do not plan for long-term future and keep away from investing in long-term instruments, though they save for long-term goals such as emergencies, education and old age. The book, 'How India Earns, Spends and Saves' launched by Montek Singh Ahluwalia, Deputy Chairman, Planning Commission, Government of India, contains the findings of the survey, reveals that this phenomena is not just confined to just poor or middleclass households, but is prevalent in rich households too and further, that most Indians prefer keeping 65 per cent of their savings in liquid assets like bank or post office deposits and cash at home, while 23 per cent investing in physical investments like real estate and gold and only 12 per cent in financial instruments; for getting secure return on their earnings, the investment in post offices and other guaranteed return schemes and plans gets minor part of total savings; and only 5 per cent of total families put their money in post offices, while 2 per cent buy insurance policies and 0.5 per cent invests in equities. Though, life insurance is among the most popular financial instruments (about 78 per cent of the households are aware of life insurance), yet only 24 per cent of households have a life insurance policy and the ownership is 38 per cent among urban households but a very low 19 per cent among rural households. The survey found that Indian households have a strong saving habit and the income level is an important factor in influencing the saving patterns of households, variations in savings behavior are equally decided by education level and occupation. Investors are the backbone of the securities market who not only determines the level of activity in the securities market but also the level of activity in the economy. There is a continuous growth in the number of investors in India and trends reveal that in addition to FIIs and Institutional Investors, small investors also gradually beginning to regain the confidence in the capital markets that had been shaken consequent to the stock market scams during the past decade. It is imperative for the healthy growth of the corporate sector that this confidence is maintained. However, many investors may not possess adequate expertise/knowledge to take informed investment decisions and some of them may not be aware of the complete risk-return profile of the different investment options, hence, may not be fully aware and familiar with the market mechanism and the practices, as well as, their rights and obligations regarding the precautions they should take while dealing with market intermediaries and dealing in different securities.

The corporate systems and processes need to be reliable and transparent, so that the interests of the investors may be safeguarded in a manner that enables them to exercise their choice in an informed manner while making investment decisions, and also providing them with a fair exit option. The Securities and Exchange Board of India (SEBI) has been mandated to protect the interests of investors in securities and to promote the development and regulate the securities market so as to establish a dynamic and efficient securities market contributing to Indian Economy. The securities market promotes economic growth. More efficient is the securities market, the greater is the promotion effect on economic growth. It is, therefore, necessary to ensure that our securities market is efficient, transparent and safe. In this direction, SEBI has been working since its inception and would continue to work to continuously improve market design to bring in further efficiency and transparency to market and make available newer and newer products to meet the varying needs of market participants, while protecting investors in securities. The aim is to make Indian securities market a model for other jurisdictions to follow and make SEBI the most dynamic and respected regulator globally.

Brief Profile of Securities Exchange Board of India (SEBI)

The Indian securities markets have a very long history in comparison to various developing nations of the world. The market grew substantially during 1980s because of the interest of corporate in equity however the volume of transactions used to be very low during the previous decade therefore the need for setting up of an independent Government agency to regulate and develop the secondary and capital market in India was recognized. After the Sixth Five Year Plan was initiated in (1985) when some major industrial policy changes like opening up of the economy to outside world and greater role to the Private Sector were introduced. Various bad and wrong practices were observed in the Secondary and Capital Market which were used by companies, brokers and merchant bankers who dealt in stock market and hence there was a dire need to abolish these practices from the country to improve the investment. environment. Due to the same problem the foreign investments remained at low volumes and the total transactions also remained limited. Earlier there was a provision for the companies that they had to seek the permission of the government for price fixation of the securities before raising the capital. It was aimed at providing fair value to the investors on their investments. Generally, the IPOs? were underpriced due to their prevailing laws and consequently the rate of securities used to be very high at the time of opening up of securities. Keeping in view the various problems the government of India established the Securities Exchange Board of India in April, 1988.

Brief Profile of Bombay Stock Exchange (BSE)

The Bombay Stock Exchange (BSE) was established in 1875 which was called "The Native Share & Stock Brokers' Association" at that time. It is thought to be the first and the Fastest Stock market throughout the globe having a speed of 6 micro seconds and hence a leading stock market of the country. BSE is a corporate entity with a very large number of shareholders and having Deutsche Bourse and Singapore Exchange as its strategic partners. BSE provides opportunities in dealing in shares, debt instruments, derivatives, mutual funds and handles the transactions very efficiently and in a transparent manner. It also gives chance to small and medium organizations to sell and purchase their equities. it is number one stock market in the world with more than 5500 companies are listed members having a total market capitalization of USD 1.64 Trillion on Sept, 2015. BSE provides a host of other services to capital market participants including risk management, clearing, settlement, market data services and education. It has a global reach with customers around the world and a nation-wide presence. the stock exchange is designed in such a manner that provides overall safety of the shareholders and hence acts as in growth engine of the secondary market. It is India?s first and globes seconds to obtain an ISO 9001:2000 certificate, Information Security Management System Standard BS 7799- 2- 2002 certification for the On-Line trading System (BOLT). It commands a respect in the minds of the people because of its effective service delivering system. It has won several awards till date due to its vibrant effective services and foolproof mechanism providing base for the growth and development in the economy by providing a wide base for the investors.

Brief Profile of National Stock Exchange (NSE)

The National Stock Exchange of India (NSE) came into being in April 1994, with the objectives of establishing a nationwide trading facility for all types of securities; providing equal access to all investors throughout the country with the help of an appropriate communication network; giving a fair, efficient, and transparent securities market using an electronic trading system, helping shorter settlement cycles and book entry settlements; and meeting the international benchmarks and standards. It has helped in shaping the Indian stock market into a modern one by introducing innovative ideas and mechanism. The exchange has set up an infrastructure that serves as a role model for the securities industry in terms of trading systems, and clearing and settlement practices and procedures. The standards set by NSE in terms of market practices, products, technology, and service standards have become industry benchmarks, and are being replicated by other market participants. The national stock exchange of India links with the investors online through automatic trading system which is quite transparent and easily accessible in all geographical areas. It also provides variety of information in different forms to the investors and other shareholders which are helpful in making decisions and act as guide. The plans and policies of the exchange are designed in such a manner that helps in creating and maintaining cordial relations among various parts. These are transparent and unbiased. Anyone can make transactions through the exchange from one's home / office with the help of internet connection. Settlement risks have been eliminated with NSE?s innovative endeavors in the area of clearing and settlement, namely, the reduction of the settlement cycle, professionalization of the trading members, a fine-tuned risk management system, the dematerialization and electronic transfer of securities, and the establishment of a clearing corporation. Consequently, the market today uses state-of-the-art technology to provide an efficient and transparent trading, clearing, and settlement mechanism. NSE provides a trading platform for of all types of securities-equity capital, borrowed capital, and derivatives.

Following its recognition as a stock exchange under the Securities Contracts (Regulation) Act, 1956 in April 1993, it commenced operations in the Wholesale Debt Market (WDM) segment in June 1994, in the Capital Market (CM) segment in November 1994, and in the Equity Derivatives segment in June 2000. Now the Exchange also started providing its services in retail debt of government securities in January 2003, trading in currency futures in August 2008, trading in currency option in October 2010 and launched futures & options contracts based on global indices S&P 500 and DJIA in August 2011. The WDM segment provides the trading platform for the trading of a wide range of debt securities. NSE?s Capital Market segment offers a fully automated screen-based trading system, known as the National Exchange for Automated Trading (NEAT) system, which operates on a strict price/time priority. It enables members from across the country to trade simultaneously with enormous ease and efficiency. NSE?s Equity Derivatives segment provides the trading of a wide range of derivatives such as Index Futures, Index Options, Stock Options, Stock Futures, and futures on global indices such as S&P 500 and DJIA.

Important initiatives of SEBI

- Introducing exchange traded interest rate derivatives
- Promoting an index to comprehensively reflect the level of corporate governance

- Setting up a central listing authority to dynamize listing requirements
- Building a cadre of securities market professionals through training and certification
- Constructing a central registry of securities market participants and professionals
- Rationalizing margin trading, securities lending and short selling
- Promoting secondary market for corporate debt securities
- Implementing market wide straight through processing from trade initiation to settlement
- Operationalizing T+1 rolling settlement
- Reviewing all regulations of SEBI and code of conduct for intermediaries
- Providing a legal framework for central counter party
- Consolidation of exchanges and other market participants
- Benchmarking Indian securities market with best in the World

Conclusion

Since all type of investors irrespective of their age, gender, occupation status, investment period, type of investors, residential status endorsed through their opinions with a high mean score that secondary market institutions helps in the growth and development of investment environment in the country. It is suggested that the secondary market institutions should further be improved by providing them more capital base latest technology and the required authorities clubbed with a strong controlling mechanism so that the secondary market may become more effective and efficient with regards to their delivery mechanism in the interest of all the investors in general and the small investors in particular. The study exposed with a high score of responses of the respondents that the secondary market of the country is risky irrespective of the type of respondents hence, it is essential that the factors affecting the returns of the investor should be categorized into controllable and uncontrollable factors, and the controllable factors in particular be advertised more and more so that the same may be learnt and adopted by all sorts of investors particularly the retail ones to reduce the risk on investments and to have the maximum gains out of their investments. The role of Securities Exchange Board of India has been commended by the respondents through their responses bearing high scores but yet there is a further scope of improvement in its functioning. The SEBI should be provided with more autonomy in its functioning wedded with certain more effective instruments forcing the corporates to adopt the required rules and principles in toto disclosing the real facts and avoiding the misappropriations. If it is done it may help the investors significantly in general and the small investors in particular. Though the SEBI is doing well in resolving the grievances of investors but yet a lot more is needed to be done particularly by bridging the gap between the investors and small markets, corporates and against trading members.

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A Study on the Operational Framework of Depository System

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Abstract

A depository, in the simplest way, refers to a place where something is deposited/ kept for storage and/ or security. However, from the perspective of securities market, Depository is defined as an organization like a Central Bank where-in the securities of a shareholder are, at his request, held in electronic form, through the medium of a Depository Participant. Depository is a company that has been formed and registered under the Indian Companies Act, 2013 & has been granted a certificate of registration by SEBI, subsequent to registration under the Depositories Act, 1996. A Depository, in order to act as such should obtain a certificate of commencement of business from SEBI. Furthermore, a registration under SEBI (Depositories and Participants) Regulations, 1996 is also mandatory. In order to utilize the services offered by a Depository, the investor has to have an account with the Depository through his participant called as a Demat Account. The process is quite similar as that of opening of a bank account, with any of its branches, so as to utilize the services of the said bank. All the securities held by the Depository shall be in dematerialized & fungible form only.

Keywords: *Depository, Participant, Depositories Act, Demat Account*

Introduction

Financial sector reforms started in India in 1991. While earlier reforms facilitated faster growth, the later one concentrated on strengthening the functioning and operations of the Capital Market. Depository services are the product of secondary market reforms in India. The electronic technological revolution has brought about a number of changes in the functioning of Indian Capital Market. The most revolutionary change that was brought in the entire history of Indian capital market is the depository system. Depositories have helped in smooth transition to the electronic movement of securities. They work as custodians and inter link investors with primary and secondary market. Dictionary meaning of depository is 'A place for safe- keeping of things, which may be funds or securities' Thus it can be equivalent to a bank but not a banker of money but of securities. Depository is an important intermediary in the securities market that is scrip- less or moving towards such a state. The Depositories Act defines a depository to mean 'a company formed and registered under the Companies Act,

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1956 and which has been granted a certificate of registration under the sub-section (IA) of section 12 of the Securities and Exchange Board of India Act, 1992'*. The principal function of a depository is to dematerialize securities and enable their transactions in book-entry form. The securities are transferred by debiting the transferor's demat account and crediting the transferee's demat account only at the instructions of account holder. All securities of a company in the depositories are identifiable and interchangeable as they do not bear any distinguish numbers. The ownership records of securities are maintained in an electronic form and the transfer of ownership takes place on instructions of investors who are the customers in this system and are known as beneficial owners (BOs). This rids the capital market of the danger and risks of handling huge volume of papers. A depository can provide any service connected with recording of allotment or transfer of ownership of securities in the record of a depository through its Depository Participants.

All the operational procedures and functions of depository system are regulated by Business Rules of depositories. As per the NSDL Bye Laws (2.1 -3), Business Rules include such manuals notices, circulars containing the practices, procedures and administrative requirements relating to the operations and functions of the depository system as may be notified from time to time by the Board of Directors of the depository. In simple terms, Operational framework of depository system is concerned with conversion of securities from physical to electronic form (dematerialization), settlement of trades in electronic segment (rolling segment), transfer of ownership of shares (in case of Transmission and Nomination) and electronic custody (safe-keeping of securities on investors' behalf) of securities. Pledge and Hypothecation of electronic securities, Stock Lending and Borrowing, Initial Public Offers (IPO) and non-monetary Corporate Actions in already issued securities also come in the boundary of operational framework of depository. All operations under depository system are performed by Depository with the help of its constituents. In that manner we can say that depository system is an amalgam of various depositories and their business partners who include Depository Participants (DPs), Issuing companies and their Registrars and Transfer Agents (RTAs), Clearing Corporations / Clearing Houses of Stock Exchanges. Depository is electronically linked to each of these business partners via satellite links.

Literature Review

Bhatt & Bhatt (2012) in their paper entitled "Financial Performance Evaluation of depositories in India (A comparative study of NSDL & CDSL)" explores the fact that the trend of electronation of the operations of the securities market, particularly, Dematerialization, has enabled the Indian capital market to move leaps and bounds and scale to unexampled heights. Securities market in India has witnessed growth, exponentially. The analysis of the growth and progress of NSDL & CDSL in economic terms, clearly reveals that both the depositories have shown a remarkable jump in the terms of demat accounts opened; demated value & quantity of securities, settlement values and quantity and the number of depository participants. The study reflects that both the depositories have been working financially smoothly and efficiently over a period of last eight financial years.

Chaudhary & Malik (2011) in their paper "Depository system in India: An appraisal" supports the views that majority of the participants in the Indian Securities Market are resided with NSDL with a stake of 57%. It, therefore, acts as the primary organization with a holding of majority of participants in the system. The paper also states the fact based on its findings, that the majority of respondents were comfortable with the prevailing fee structure of depository which is an indicator that the existing fee structure followed by NSDL is benevolent.

Kaur (2013) in her paper "Investor's preference between DEMAT & REMAT and awareness regarding depository & its various laws" explains the depository system of India with special focus on the reasons for investors preferences between REMAT & DEMAT of securities. To conclude, she adds that the growth rates of DEMAT account holder has been substantially increasing over a period of few years. The Indian Government allows holding securities in any form i.e., either in physical mode or in electronic (DEMAT) form, though with its latest circulars, SEBI has made it mandatory for all the public limited companies to have their securities in demat mode only. The respondents, in her research reveal that dematerialization supports excellent services & it is convenient to operate as well. Majority of the investors are now shifting towards dematerialization owing to the immense benefits it offers and the ease of operation it supports.

Olekar & Talwar (2013) in their paper "Online trading & DEMAT account in India - Some issues" observed the fact that banks normally levied a lower service charge as against the charges by Depository Participants.

George (1996) in his article "Towards a paperless settlement system" examines the role of the National Securities Depositories Limited in revolutionizing the paperless stock settlement system across the country. He has explained the steps taken by the depositories and its participants to ensure that the scrip-less trading system be a success. He has also stressed the rational and importance of the role of a regulatory body so as to ensure that the depository system be successful.

Objectives of the Study

- To analyze the various aspects of working of depository system.
- To analyze and search that how effectively the new system is implemented and accepted by Investors, DPs and Issuers/ RTAs of securities.

Methodology

The study is based mainly on primary data collected through well-designed Questionnaires and Personal Interviews. Use of secondary data has been made wherever it was available and necessary. All depositories' operations are performed by depositories with the help of its constituents who are also known its business partners, therefore, data has been collected from all the five constituents of depositories to have a complete picture of all aspects of operations under demat system.

Results

SEBI is the regulatory body regarding all matters concerning depository system. In exercise of the powers conferred by section 30 of the SEBI Act, 1992 read with section 25 of the Depositories Act, SEBI has issued (Depositories and Participants) Regulation, 1996 to carry out the purposes of the Depositories Act. The Regulations of SEBI provide for eligibility criteria for depositories and depository participants (DPs), process of their registration, commencement of business, rights, obligations and functions. The regulation also specifies the records, communication systems, and the control mechanism to be maintained by the depositories and participants. Before commencing operations, all depositories should obtain a certificate of registration and a certificate of commencement of business from SEBI.

All the operations of the depository system are primarily governed by the Depositories Act, 1996, SEBI (D&P) Regulations, 1996, Bye-laws approved by SEBI and Business Rules framed in accordance with the Regulations and Bye-laws. Only a company registered under the Companies Acr, 1956 and sponsored by the specified categories of institutions can set up a depository in India. The Depository Act, 1996 was passed to provide for the establishment of depositories in securities with the objective of ensuring free transferability of securities with speed, accuracy and security by (a) making securities of public limited companies freely transferable subject to certain exceptions; (b) dematerializing the securities in the depository mode; and (c) providing for maintenance of ownership records in a book entry form. In order to streamline the stages of settlement process, the Act envisages transfer of ownership of securities electronically by book entry without making the securities move from person to person. The Act has made the securities of all public limited companies freely transferable, restricting the company's right to use discretion in effecting the transfer of securities the transfer deed and other procedural requirements under the Companies Act have been dispensed with. The operations of the depositaries are carried out in accordance with the regulations made by SEBI in this behalf and the be- laws and business rules framed by the depository as per the powers given under the Depositories Act.

The central govt, also has the power to make rules for carrying out the provisions of depositories. Basically, in terms of the provisions of the depositories Act, 1996, holding of securities in dematerialized from is at the option of the holder of securities. But by virtue of the powers vested in the Central Govt, and SEBI, this has become illusory and securities in listed companies have to be compulsory held in dematerialized form as delivery in such form only is recognized in stock exchanges.

Discussion

'Since the beginning of liberalization process in 1991, the size of Indian capital market expanded manifold. The traditional system of settlement through physical transfer of securities failed to cope up with the requirements of growing capital market and hindered further growth of the market. Minimization of settlement risks and shortening of settlement cycles were the basic requirement for greater depth and expansion of markets by upgrading the existing trading system into a modern internationally competitive one. Inability of clearing and settlement infrastructure to efficiently manage the flow of paper work made it difficult for the exchanges to shorten the settlement cycles and move to rolling settlement. The Depositories System has paved the way for instituting an infrastructure for eliminating various risks associated with capital market transactions and increased the efficiency of clearance and settlement systems.'. Prior to introduction of this system so many operational in efficiencies were breeding into the Indian Capital Market due to traditional paper-based trading and settlement system. 'It was a market lacking in transparency, and which offered brokerage and commissions that enriched intermediaries.

Some of the disease areas in physical form of securities:

- Fake and mutilated securities
- Bad and improper deliveries of securities
- Delays in registration and transfer of scripts
- Fake signatures and signatures mismatches
- Delays in receipts of funds orders and allotment letters
- Large settlement period for trade done in exchanges
- Less liquidity
- Low volume of trade due to hurdles of post trading operations
- Problem of selling and buying of odd lots

These problems were the root-cause for the introduction of Depository System in India. Basically, introduction of demat system was an answer to all those entry barriers which restrained investors to participate in secondary market operations.

Features of Indian Depository System

The depository system in every country is designed keeping in view its specific legal and business environment. Indian depository system has the following features:

- Multi-Depository System- The Depository model in India is a Competitive Multi Depository system. There can be various entities providing depository services. The aim behind having multiple depositories is to encourage a healthy competition among the depositories, which would benefit the users of the depository system.
- Inter Depository Transfer- Transfer of securities from an account in one depository to an account to another depository is termed as an inter-depository transfer. As per SEBI Regulations, 1996, the depositories in India must be inter-connected to enable inter-depository transfers for those securities that are available for dematerialization on both the depositories.
- Dematerialization as Against Immobilization- The model provides only for dematerialization of securities wherein the securities are cancelled as against the system of immobilization in which securities are kept in custody in physical form. Dematerialization is a significant step in the direction of achieving a completely paper-free securities market.
- Depository Services Through DPs- A depository cannot directly open accounts and provide services to its clients i.e., investors. DPs are the intermediaries between the depositories and investors. They are the agents of Depository who provide all depository related services.
- Fungibility- The securities held in dematerialized form are fungible. They do not bear any distinguishable features like distinctive number, folio number or certificate number. Once the securities are dematerialized.' Title to the securities owned is in terms of number of securities and not in terms of distinctive numbers.

- Registered Owner/ Beneficial Owner (BO)- Depository is registered owner of dematerialized securities while investors are the beneficial owners of the dematerialized securities. The actual owners of securities (BOs) retain the right to receive all the benefits arising out of the securities.
- Free Transferability of Securities- In demat system, all transfers are affected without any interference of the issuer company. These features are basic concepts of Indian depository system. Constituents of Depository System There are five constituents of the depository system. These constituents are also termed as Business Partners or Players of depository. These are

  — Depository

  — Depository Participants (DPs)

  — Companies (Issuers / RTAs)

  — Clearing House/ Clearing Corporation and Clearing Members

  — Investors or demat accountholders or BOs

  - **Depository:** Depository is the main contributing factor in the whole system of the depository. It acts as a tunnel through which each and every service and activity of depository system passes through. The depository registers investors or the shareholders as the beneficial owners ofthe securities held by it and registers all transfers, transmission and other actions with the help of its DPs network all over the country. Depository is linked to each partner of depository system through electronic linkage.
  - **Depository Participants (DPs):** DPs act as intermediaries between the investors and the depository. Investors have no direct access to the depository and they are always represented by their DPs who act as agents of Depositories. Such participant, (as per the provisions ofthe Depository Act), can be only the banks, financial institutions or the corporate brokerage firms which have credibility and standing to act as fiduciary for investors. All transfers and transactions in demat accounts are affected only through the DPs. They are, in fact, depository interfaces for investors and provide numerous services related with electronic securities. These services are provided to investors in relation to their private securities investment portfolio management. The services are that of electronic custody of securities and in form of entries regarding registration of transfer of securities to or from depository accounts of investors only on receipt of instructions from the investors. Only those securities, which are formally admitted to the depository system to enable the Depository to provide its services to the investors are eligible securities under demat system.
  - **Companies (Issuers / RTAs):** The issuer who intend to offer a demat facility to his shareholders has to establish a connectivity directly or through its Registrar & Transfer Agent (RTA). RTA provides electronic connectivity between the depository and the issuer company. After the company joins the depository, the dematerialization of shares is done by registrar on behalf of the company and Registrar keeps the electronic data of beneficiary owners. The Issuer Company shares the maximum benefits of the depository system as it is relived of keeping individual accounts of each shareholder with distinctive

numbers. The books of the Issuer Company depict the depository as the registered holder of the issued securities and the company deals with the depository alone.

- **Clearing House/ Clearing Corporation and Clearing Members:** A Clearing Corporation or Clearing House of a Stock exchange may be admitted as a user under Depository subject to its entering into an agreement as laid down in the Bye-laws of Depository. Although technically, CC/CH is not a Participant of the Depository yet it acts like the one for limited purpose of settling trades done on respected stock exchanges. It ensures payment against delivery or guarantees settlement. It also co-operates depositories at all times to redress the grievances of the clients and participants in respect of their operations relating to Depository. Clearing Members are the persons admitted as members by a Clearing Corporation that has been admitted as a user by the depository. They are important contributors in the system as without them settlement of trade done in electronic segment is not possible. They facilitate setting off the trades done in securities with the help of clearing house. To avail the facilities of a depository, Stock Exchange in India needs to approach either NSDL or CDSL and to become a DP in the category of Clearing House or the Clearing Corporation. Then the members of that particular stock exchange which is registered with the depository open an account with the same depository in their trade names. These members are called as Clearing Members in the depository segment and depository accounts opened by them to facilitate electronic transactions are called as 'Clearing Members Accounts (CMs).' These accounts can only be used for carrying out the clearing and settlement business of the brokers' clients. These accounts are called as transit accounts where securities move just for settlement purposes. These CMs' accounts can never be used by them for their private investment portfolios. CMs are identified in the system through their CM-BP ID. All pay- in and pay-out transactions are carried out through their accounts opened with different DPs.

- **Investors or Demat Account Holders or BOs:** Investors are main constituent of depository system and they carry all the benefits as holders of securities originally available to them as the shareholders of a company viz. right to vote, right to receive the dividend or interest income on the securities lying in their demat accounts with the DPs. They have the right to pledge the securities in the safe custody of the depository or to dispose of these holdings as and when they desire so. They deal with the depository through the agents known as participants (DPs) and have no direct dealings with the Issuer Company. Their rights and privileges remain the same under depository system as they were having with physical securities in their hands. An investor who intends to hold his scrips in depository system, has to first open an account with any DP of his choice to get these services. Account holders of depository services are termed as beneficial owners (BOs) of securities while the Depository attains the status of registered owner of securities in the books of the Issuer Company. As per the Depositories Act, 1996, BOs are the members of the company and will continue to be entitled to all rights of members as prescribed by the Company Act, 1956.

Existing Depositories in India

- NSDL (National Securities Depository Limited) - NSDL was formed and Registered under the Companies Act, 1956 during December 1995 and commenced Operations during November 1996. NSDL is the first depository in India and has the infrastructure of international standards and handles a major portion of the trading and settlement in dematerialized form in Indian Capital Market. It is promoted by IDBI -the largest development bank of India, UTI- the largest mutual fund in India and NSE- the largest stock exchange in India.

- CDSL (Central Depository Services Limited) -CDSL commenced operations during February 1999. CDSL was promoted by Stock Exchange, Mumbai in association with Bank of Baroda, State Bank of India and HDFC Bank. It is second depository in India which was promoted with an object of accelerate growth of demat system and also to compete with NSDL.

Table 1: Existing Depositories at a Glance

Particulars	*NSDL*	*CSDL*
Establishment	Set up in Nov. ,1996 with 3 DPs and 3 companies	Set up in August 1998
Objective	To give birth to a depository system	To accelerate growth of scripless trading in India
Initial Promoters	IDBI, UPI and NSE were original sponsors	BSE, Bank of India, Bank of Baroda, and SBI were original sponsors
Regulator	SEBI	SEBI
No. Of investors accounts as on 31/3/06	75.60 lakh	19.89 lakh
No. Of DPs with their 223 DPs with 3017 branches 322 DPs Branches as on 31/3/06	223 DPs with 3017 branches	322 DPs
No. Of companies joining the system as on 31/3/06	6022	5349
Quantity of shares dematerialized as on31/03/06	17472 crores	2797 crore
Newsletter published	Nest Update (monthly bulletin)	CDSL Infoline (quarterly)
Address of website	www. nsdl.co.in	www. cdslindia.coin
Address of Regional office, Delhi	409/410, Ashoka Estate 26, Barakhamba Road Connaught Palace, New Delhi 110001 Tel.: 01 1-23353815, 23353817	Northern Region Office 514, New Delhi House, 5th floor 27, Barakhma Road, New Delhi 110001 011-30970188

Source: Annual reports of NSDL and Nest Updates and CDSL Infoline for the relevant periods.

Functions of Depository

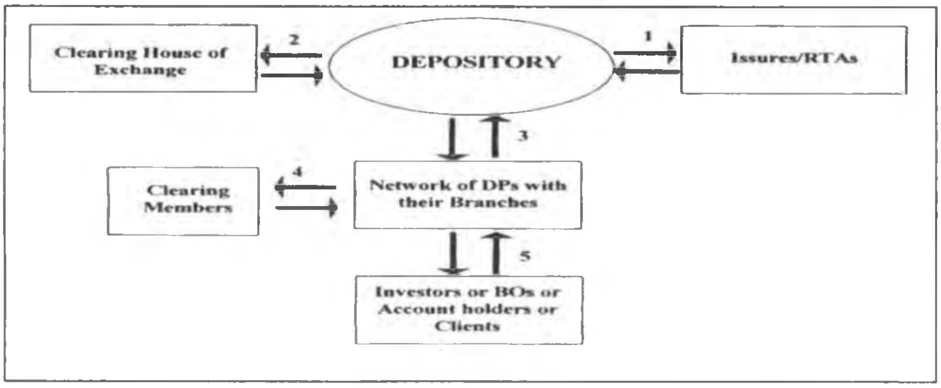
The functioning of Depository and its constituents in India is primarily governed by the Depository Act 1996, SEBI (Depository & Participant) regulations, bye- laws and business rules of respective depositories. The operational and functional issues relating to depository system have been discussed in this chapter to give an idea of the practical implications of various statutory and regulatory provisions. Through depository and its constituents or business partners perform numerous functions, this chapter deals with the functions performed by them exclusive for investors regarding depository operations. This chapter also pinpoints that function of 'Investor- Education and Awareness' regarding depository operations has not been given much weightage by depository and its constituents. How to drag the investors into demat system- is a big challenge before depositories. NSDL is making efforts in this direction for expansion of services through Investors-Depository Meets (IDMs). These IDMs suffer with the disease of thin presence of investors. The chapter discusses in detail about the materiality of efforts of NSDL regarding awakening people and dragging them into depository system. All the efforts have been evaluated from practical point of view and in the end of the chapter, some easy to implement operational suggestions have also been prescribed to manage the efforts of NSDL in more successful, effective and fertile manner

Functional Relationship among Different Constituents of Demat System

All the players of the demat system are interlinked and have functional linkage too. Depository system comprises Depository and its constituents i.e., Depository Participants (DPs), Issuers/ RTAs (Registers and transfer agents) and Clearing Members of Clearing Corporation of Stock Exchange. The given diagram presents the functional relationship among different constituents of Depository System.

Issuers / RTAs - Depository Linkage between both of them is very important. The Depository provides the total securities balances in electronic form as free balance, pending dematerialization and rematerialize balances to the Issuer or its RTA on a daily basis for reconciliation purposes. The depository also provides the entire shareholders details on a particular fix date to the Issuer or its RTA in case of Corporate actions or for internal reconciliation of records whenever demanded by the issuer company.

Figure 1



Functional Relationship Among Different Constituents of Depository

For getting this linkage, Issuer of securities or company must enter into an agreement with Depository either directly or through its RTA for getting their securities in demat mode. The name of the depository is substituted for the name of the shareholders in the Register of Members (ROM) as and when the shareholders dematerialize their shareholdings. The number of entries on the ROM reduces progressively with the acceptance of demat system by more and more shareholders. The service obligation gets shifted away from the company to the DP with whom the shareholders hold the accounts. Thus, the organic link between the company and shareholders gets weak. As per the requirement of the SEBI (Depositories and DPs) Regulations, 1996, the depository is required to furnish beneficial holders' information to the company at reasonable frequency.

Clearing Corporation/Clearing House of Stock Exchanges - Depository

The depository allots a unique identification number to the Clearing Corporation (CC) once it gets admitted as a User on the Depository. Depository also opens CC Transit account and CC Settlement Account for the use of the CC. The CC too opens one special account known as CC Account with itself. This CC account consists of:

- a Pool Accounts
- a Delivery Account
- a Receipt-in Account.

These three accounts have all the characteristics of a Clearing Member account and movement of securities for pay-in and pay-out is permitted in the Pool account of the CC to the Pool account of CM, CC/CH enter into an agreement with Depository for the limited purpose of settlement of trade done on exchange. For effecting fast and efficient settlement of market trades done on exchanges, this relationship is very important. Off market trades are settled outside clearing corporation. Whenever any market trade is made, to give effect to settlement oftrade investors issue delivery instruction to their respective DPs to transfer securities into their CM accounts. DPs forward these requests to Depository from where they are transferred to Clearing Corporation through CC Transit account. Once the trade is settled through CC Settlement account of depository, transfers are made to CMs accounts from there they are routed to the demat accounts of the investors by the DPs. In this manner the relationship between CC/ CH and Depository is important for flow of securities for pay-in and pay-out.

Network of DPs:

Depository is the most important functional relationship between two participants in demat system. Any intermediary cannot function as DP unless it enters into an agreement with the concerned Depository in a prescribed form. The DP maintains continuous electronic communication with the depository and is required to reconcile its records with the depository on a daily basis. The Depositories Act defines the relationship between the depository and its DPs as agency relationship, technically, it is a special relationship governed by the statute and different from the traditional principle -agent relationship. DPs are agents of Depository and in this capacity each and every information is exchanged between both the constituents. All the depository operations are performed for investors because of this relationship.

Dematerialization of securities, Settlement of trade in electronic securities, pledge of securities, corporate actions and all services to investors regarding depository operations are routed through DP to Depository and investors.

Clearing Members:

Depository any CC or exchange which is registered as a User with any depository take help of CMs for settlement of trade done on exchange. CM must also be the registered member of the CC having a unique CC-CM-Id. After receiving this identification number, he should get a CM BP-Id from the depository. Only after getting these particular numbers, CM is authorized to open CM account with DP of his choice. CM can open only one CM account. CM is interlinked to Depository through his DP for the purpose of getting the trade settled on exchange. No CM can move securities from its Pool account to the Pool account of another CM.

DPs and Investors (BOs):

Depository Both are closely linked to each other. Any investor intending to avail demat services has to enter into an agreement with a DP of his choice. The standard agreement is approved by SEBI and form's part of NSDL's Bye-laws. This agreement sets out in contractual from the nature of services to be provided, rights and obligations of the DP as well as the Client (demat account holder), and the fees/charges payable for the services. All the functions of Depository System are performed by DPs for investors. All the services for investors are provided by DPs only through their linkage with Depository. Investors give instruction physically and electronically to their DPs regarding movement of securities only. DPs forward all their requests to Depository and entries are made in the accounts of investors. There is maximum flow of information between these two participants. All the above constituents of depository system perform various operations which come under the category of demat services. For providing functional linkage among different constituents, computer systems are required having connectivity. All the computers installed by DPs (DPMDP). Issuers (DPM-SHRs), and stock exchanges (DPM-CC) are connected to depository central system (DM) through V-SAT (very small aperture terminal) or leased lines. They are collectively called Business Partner Systems. Any transaction conducted by any computer system in the depository system which is targeted to reach any other computer system first gets recorded in DM and then reaches the target. No two business partners' systems can communicate to each other without passing through the DM.

Functions of Different Constituents of Demat System

- **Key Functions of Depository**

  A depository is very much like a bank in many of its operations. To have a better understanding of the depository system, an analogy between bank and depository has been made:

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Table 2: Depositories and Banks-an Analogy

Depositories	*Analogy*
They hold securities in their accounts.	They hold funds in their accounts.
They transfer securities between demat accounts on the instruction of account holders	They transfer funds between accounts on the instruction of the account holders
They facilitate transfer of ownership without having to handle securities	They facilitate transfer without having to handle money
They provide safekeeping of securities.	They provide safekeeping of money
They try to give quality services to their clients. They also provide the facility to monitor the demat account through Internet.	They also try to give quality services to their clients. Most of the banks provide Internet banking facility to their clients.
They make entries in electronic accounts on the basis of Delivery Instruction Slips.	They make entries in accounts on the basis of Cheques and Pay-in-Slips
Besides keeping records, they also facilitate functions like pledge and hypothecation, corporate actions and stock lending and borrowing.	They also perform various other functions like credit creation, lending, project financing and agencies job etc.

Source: Handbook for NSDL Depository Operations Module 1, page 21 (modified and enlarged form)

Table 3: Depositories-Banks-the Differences

Depositories	*Bankers*
All joint holders are required to sign instructions while operating a Joint demat account	Either of holders can sign instructions while operating a Joint Bank account
Interest can be earned only by participating in stock lending scheme	Depending upon the type of account, clients are entitled for interest.
They do not move balances in account without account holder's authorization	They use balances held in clients' accounts
Signature and photograph of nominee is to be provided by accountholder	Nomination is kept confidential by the banks.
Demat services have limited spread and acceptance among people	Banking services are accepted universally by the people.
Demat services are governed by SEBI	Banking services are governed by RBI.
They do not have any right to rectify an error or omission committed by DPs without pre- consent of beneficial owners.	They have the right to rectify an error or omission committed by then without consent of account holders.

Source: Handbook for NSDL Depository Operations Module-1 (modified & enlarged form)

Principal functions of a depository are to dematerialize securities and enable their transaction in book entry form. Apart from that it performs the following functions:

— To work as Custodian of electronic securities.

— To enable the transactions in securities in book entry form by debiting transferor DP AJc and crediting the transferee DP A/c

— To record the allotment in case of IPOs, originally allotted in electronic form by the issuers to the beneficial owners.

— All the services provided by DPs for investors are facilitated through depository only

— To handle corporate actions in two ways:

— It merely provides information to the issuer about the persons entitled to receive corporate benefits (monetary and non- monetary both)

— It itself takes the responsibility of distribution of non- cash benefits.

— To provide information about the voting rights to the Issuers and the beneficial owners of the securities.

— To maintain a linkage with Clearing Corporation or Clearing House of a stock exchange to give effect to Clearance and Settlement System for trades done in securities by the investors. Basically Depository is main constituent which interlinks all concerned constituents for all types of depository services. It acts as a tunnel from where each and every act of demat service passes and it does not permit direct linkage between its different constituents.

- **Functions of DPs.**

The primary function of DPs is to provide securities related services offered by depository to its business partners including investors. All the operational procedures under Depository System are performed with the help of DPs. DPs are Depositories' interfaces for investors. As per Section 4 of the Depository Act, 1996, 'A DP is an agent of the depository who provides various services of the depository to investors. Any investor who likes to avail the services of a depository has to enter into an agreement with any DP of his choice. The DP will then make the depository services available to that investor in strict legal sense, Depository Participant is an entity which is registered as a DP with SEBI under the provisions of SEBI Act. As per the provision of the SEBI Act, a DP can function regarding depository related services only after obtaining a certificate of registration from SEBI. On the basis of the prescribed eligibility criteria, Depository Participant may be of any of the following categories:

— Institutional participants e.g., banks and financial institutions

— Broker participants

— Clearing Corporation

— Custodian participants

— Registrar and Share Transfer Agents

— Non- Banking Financial Companies

Table 4: Functions of DPs

To act as service providers to investors, as they are Depository inter-faces for investors				
	Core Services	*Special Services*	*Other Services*	*Hidden Services*
1	Account Opening for an investor	Pledge and Hypothecation of securities	Rematerialzation at the option of investor	To maintain records of all the transaction entered between Depository and investors for a period of five years.
2	Dematerialization of securities	Stock lending and Borrowing as approved intermediary of SEBI	Facility to operate demat account through Internet	To preserve details of securities dematerialized and rematerialized on behalf of beneficial owners.
3	To give effect to transfers in demat accounts in case of trade of securities	Non- monetary Corporate benefits/ actions for investors	Account freezing and de freezing facility	To maintain records of instructions received from beneficial owners and statement of account provided to beneficial owners.
4	Settlement of Off- market trade	Allotment in case of electronic securities of Public Issues (IPO) in demat form	Daily updating the data base of all beneficial accounts	To maintain records of approval, notice, entry and cancellation pledge hypothecation.
5	Transmission and Nomination		To issue Transaction Statements/ Holding statements at regular intervals	
6	Distribution of cash corporate benefits only for government securities.			

For providing all these services, DPs perform the different functions which are listed below:

- They give effect to dematerialization, i.e., getting physical securities converted into electronic from.
- They convey request of investors for dematerialization, i.e., getting electronic securities balance held in a BO account converted into physical form.
- They maintain record of holdings in the electronic form.
- They give effect to Settlement of trade by delivering/ receiving underlying securities from/ in BO accounts with the help of transfer entries.

- They facilitate settlement of off- market trades i.e., transactions between BOs entered outside the stock exchange.
- They provide electronic credit in respect of securities allotted by Issuers under IPO.
- They receive (on behalf of demat account holders) non-cash corporate benefits, such as. allotment of bonus and rights shares, securities ensuing upon consolidation, stock split or merger/ amalgamation of companies. After receiving these benefits, DPs distribute these benefits into the eligible investors' accounts.
- They facilitate pledging of dematerialized securities on behalf of BO.
- They facilitate securities lending and borrowing, if the DP is registered as an 'Approved Intermediary" for this purpose.
- Transmission of securities in case of death of an investor.
- They undertake the responsibility of distribution of cash corporate benefits in case of govt, securities only.
- They maintain and preserve records of all the transactions with investors for a minimum period of five years for future references.

Functions Performed by Issuers/ RTAs

Registrar to an issue and share transfer Agent is a critical link in the Capital Market between Issuer (company), stock trades and Investors. Whether it is a primary Public Issue or a Secondary Market Trade, role of RTAs is important. Most of the issuer companies engage services of RTAs for all type of demat services for their shareholders. RTAs presence is important in a depository setup for performing following functions:

- Dematerialization of Securities -Issuers/ RTAs verify the validity of the securities as well as the fact that the demat request has been made by the person recorded as a member in Register of members. After such verification the Issuer/ RTA intimates Depository and authorizes an electronic credit for those securities in favor ofthe investor. On receipt of such intimation, DP makes the credit entries in the account of the concerned investors. No credit of any securities to the accounts of any investor can be made unless Depository has received an intimation from Issuers/ RTAs. In this way they play a key role in the process of dematerialization.
- Reconciliation of electronic holdings held with depository- RTAs are involved in updating of data downloaded from Depository on a periodical basis. Proper records are kept in the books of RTAs about all the beneficial owners of securities. Whenever any corporate action is taken place, they reconcile holdings in demat accounts of investors with the records maintained by them. If there is any mismatch of records them non-monetary corporate benefit in relation to that beneficial owner is suspended to be paid through DP. Later on, that benefit is directly sent by the RTA to respective beneficial owners of securities.
- Corporate Benefits/Actions- They inform Depositories about the corporate actions relating to securities and prescribe date for book closures, record dates, dates of conversion of debentures, dates for redemption or maturity of securities, call money dates and such other actions from time to time.

- Initial allotments in demat form - They provide DPs list of eligible investors with specified number of securities to be transferred into the demat accounts of eligible investors who are willing to have securities directory in their demat accounts.
- Confirmation of beneficiary holdings- Depository updates the data on daily basis regarding accounts of beneficial owners. RTAs also up-date data downloaded by Depository on a periodical basis. Thus, the records maintained with the Depository as well as with RTA are reconciled. Whenever required, RTA assists in confirmation of beneficial holding of investors with the Depository.
- Rematerialization of holdings-They issue physical securities when an investor requests through its DP for rematerialization. The Issuers/ RTAs after validating the rematerialization request, dispatch the securities certificates to the investor within the period of 30 days from the date of request.

Important Function they also Performed these Functions Related with Investors-

- They distribute dividend, interest or other monetary benefits directly to the eligible BOs on the basis of the list provided by Depositories.
- They take decision regarding rejection of any Dematerialization request on some genuine ground and intimate electronically to the Depositories regarding such rejection within a period of 15 days.
- They authorize Depositories for transfer and all other related actions concerned with securities once any company joins Depository System.

Functions Performed by CC/CH of Stock Exchange and Clearing Members(CC/CH Performs these Functions in Depository Environment)

- It ensures payment against delivery and guarantees settlement of trade done on exchange by investors.
- It co-operates at all times to redress the grievances of investors and DPs in respect of its operation in relation to Depository System.
- It verifies all the trades, consolidates all the transactions and then make settlement of money and securities through netting of transactions.

Investors are attached to CMs through DPs for settlement and Clearance of trades done by them on stock exchanges. Clearing members play vital role in settlement process through CM accounts opened with any DP to facilitate settlement of trades executed by investors. These CM A/cs are only transit accounts where securities can be kept only for the purpose of delivering for pay-in or distribution to buying investors after payout. They perform following functions in depository environment

- They ensure settlement of trades executed through registered stock- brokers or sub brokers.
- They inform about settlement deadlines to selling clients to safe guard them against auctions of securities in case of bad deliveries.
- They complete the pay-in (both for securities as well as for fund) before the deadline prescribed by the stock exchange. CMs role is very important in settlement of trade in rolling segment.

Conclusion

Depository system has been gradually implemented in a planned and systematic manner in India starting from voluntary acceptance for investors towards a compulsory requirement prescribed by SEBI for trading in demat securities only. Although the system has been welcomed by investors, DPs and companies yet there is lack of desired popularity of the demat services in India. A large number of investor population is still outside the demat system. How to drag the outside investors into demat system- is a big challenge before the depositories. Retail investors are undoubtedly benefited in terms of improved services, greater protection, strong elements of accessibility, efficiency and transparency in operations concerning securities market due to advent of entry based computerized depository system. On the ground of 'Investors' Education and Awareness', although depositories are trying their best but their efforts are not much fruitful and rewarding. DPs should also join hands with depositories for accelerating level ofawareness among present and prospective users of demat system. In the context of cost of demat comfort, the system is costly for investors who want to hold securities in their demat accounts for a long period and are not regular traders in securities market. There is an urgent need for a 'Standard Legal Performa of Demat Charge Structure' for retail investors to solve the mystery of complicated and non-comparable demat changes. Specimen given in the present study can be applied as suggested standard Performa. The system has, undoubtedly, proved effective and efficient in ruling out the possibilities of early evils of physical mode of securities. It has facilitated shorter settlement cycles and faster movement of securities irrespective of geographical locations. There are numerous clauses and provisions for safeguarding the interests of demat accountholders under Depositories Act, SEBI (D&P) regulations and Bye-laws of depositories. But retail investors find it difficult to have knowledge of so many acts rather it would be too much to expect them to be aware about all the provisions, by-laws, regulations and rules available for implementation of their rights and protection against any negligence or fraud committed by the DPs. 'Investors' Charter of Rights- for demat account holders' will be helpful in safeguarding demat accountholders against negligence and frauds committed by the DPs.

Specimen Charter of Rights prescribed in the present study can be utilized as base for framing such type of Charter for demat accountholders. Demat is a public utility service. Self-education, alertness, activeness and attentiveness of beneficial owners are the basic mantras under operational framework of Depository System.

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