

Dematerialization

The traditional method of possessing shares involved holding a physical share certificate. Dematerialized securities are securities that are not on paper and a certificate to that effect does not exist. They exist in the form of entries in the book of depositories.

This system works through a depository who is registered with the Securities and Exchange Board of India (SEBI) to perform the functions of a depository as regulated by SEBI. The Companies Act, 1956 makes it mandatory for any Company making an Initial Public Offer of Rs. 10 crore or more to issue shares in a dematerialized form alone. (Section 68B, Companies Act, 1956). Thus, it is clear that Dematerialization refers to conversion of a share certificate from its physical form to electronic form. The Depositories Act, 1996 enacted by the Indian Parliament has now facilitated paperless trading by way of dematerialisation of shares. As per the available statistics at BSE and NSE, 99.9% settlement takes place in demat mode only. Therefore, in view of the convenience in settlement through demat mode, it is advisable to have a beneficiary owner (BO) account to trade at the exchanges.

Why Demat?

Share certificates were sometimes lost in transit. In that scenario, the investors had to give an indemnity bond to the Company, which involved a cost to the investor, besides depriving him of the opportunity to sell the shares at the opportune time.

Time taken to receive the shares was also quite long compared to the present dematerialized environment. Secondary market operations were fraught with bad paper due to signature differences, forged and fake certificates, stolen certificates and delayed transfer resulting in low confidence in the market place. Apart from the above problems which were faced by the Investors, there was another problem which was identified from the Issuers perspective. In public issues, Companies were / are incurring several costs in distributing the share certificates to the investors.

Advantages:

1. A safe and convenient way to hold securities;
2. Immediate transfer of securities;
3. No stamp duty on transfer of securities;
4. Elimination of risks associated with physical certificates such as bad delivery, fake securities, delays, thefts etc.;
5. Reduction in paperwork involved in transfer of securities;
6. Reduction in transaction cost;
7. No odd lot problem, even one share can be sold;
8. Nomination facility;
9. Change in address recorded with DP gets registered with all companies in which investor holds securities electronically eliminating the need to correspond with each of them separately;
10. Transmission of securities is done by DP eliminating correspondence with companies;
11. Automatic credit into demat account of shares, arising out of bonus/split/consolidation/merger etc.
12. Holding investments in equity and debt instruments in a single account.

Disadvantages:

1. Trading in securities may become uncontrolled in case of dematerialized securities.
2. It is incumbent upon the capital market regulator to keep a close watch on the trading in dematerialized securities and see to it that trading does not act as a detriment to investors. The role of key market players in case of dematerialized securities, such as stock-brokers, needs to be supervised as they have the capability of manipulating the market.
3. Multiple regulatory frameworks have to be confirmed to, including the Depositories Act, Regulations and the various Bye Laws of various depositories. Additionally, agreements are entered at various levels in the process of dematerialization. These may cause anxiety to the investor desirous of simplicity in terms of transactions in dematerialized securities.

Excess Demat:

In terms of section 9 (1) of the Depositories Act, 1996, all securities held by a depository shall be dematerialised and shall be in a fungible form. In the past, SEBI had come across some cases where the listed companies had dematted more securities than their listed/issued capital. As the securities in the dematerialized environment are fungible, once these fungible securities enter the market, it has been found to be almost impossible to distinguish these securities from the other securities. This has enabled duplicate or fake securities to find way into the system. This is a matter of concern for the regulator and therefore, has been engaging the attention of SEBI for quite some time.

Depository

A depository is an organisation which holds securities of investors in electronic form at the request of the investors through a registered Depository Participant. It also provides services related to transactions in securities. At present two Depositories viz. National Securities Depository Limited (NSDL) and Central Depository Services (I) Limited (CDSL) are registered with SEBI.

Statutory Definition

S. 2 (1)(e) of the Depositories Act, 1996

“depository” means a company formed and registered under the Companies Act, 1956 and which has been granted a certificate of registration under sub-section (1A) of section 12 of the Securities and Exchange Board of India Act, 1992;

S. 2(1)(m)

“service” means any service connected with recording of allotment of securities or transfer of ownership of securities in the record of a depository.

S.3 of Depositories Act

“No depository shall act as a depository unless it obtains a certificate of commencement of business from the Board.”

A certificate granted shall be in such form as may be specified by the regulations. The Board shall not grant a certificate unless it is satisfied that the depository has adequate systems and safeguards to prevent manipulation of records and transactions :

no certificate shall be refused under this section unless the depository concerned has been given a reasonable opportunity of being heard.

Depository Participant

A Depository Participant (DP) is an agent of the depository through which it interfaces with the investor. A DP can offer depository services only after it gets proper registration from SEBI. Banking services can be availed through a branch whereas depository services can be availed through a DP. The DP acts as the link between the investor and the Depository. The DP is the representative of the investor and the agent of the Depository. According to SEBI guidelines, financial institutions, banks, custodians, stockbrokers, etc. are eligible to act as DPs. A list of DP's and their addresses can be downloaded from SEBI website. 700+ are working.

Statutory Definition

S. 2(1)(g) "participant" means a person registered as such under sub-section (1A) of section 12 of the Securities and Exchange Board of India Act, 1992;

Working:

The physical share certificates of an investor are taken back by the Company and an equivalent number of securities are credited in electronic form at the request of the investor. An investor will have to first open an account with a Depository Participant and then request for the dematerialisation of his share certificates through the Depository Participant so that the dematerialised holdings can be credited into that account. This is very similar to opening a Bank Account. To avail the services of a depository an investor is required to open an account with a depository participant of any depository.

Dematerialization (S. 6):

Any person who has entered into an agreement shall surrender the certificate of security, for which he seeks to avail the services of a depository, to the issuer in such manner as may be specified by the regulations. The issuer, on receipt of certificate of security shall cancel the certificate of security and substitute in its records the name of the depository as a registered owner in respect of that security and inform the depository accordingly. A depository shall, on receipt of information, enter the name of the person referred to subsection (1) in its records, as the beneficial owner Options to receive security certificate or Hold Securities with Depository. Every person subscribing to securities offered by an issuer shall have the option either to receive the security certificates or hold securities with a depository. Where a person opts to hold a security with a depository, the issuer shall intimate such depository the details of allotment of the security, and on receipt of such information the depository shall enter in its records the name of the allottee as the beneficial owner of that security.

Rematerialization: Option to Opt Out (s. 14)

If a beneficial owner seeks to opt out of a depository in respect of any security he shall inform the depository accordingly. The depository shall on receipt of intimation under subsection make appropriate entries in its records and shall inform the issuer. Every issuer shall, within thirty days of the receipt of intimation from the depository and on fulfillment of such conditions and on payment of such fees may be specified by the regulations, issue the certificate of securities to the beneficial owner or the transferee, as the case may be.

If one wishes to get back his securities in the physical form one has to fill in the RRF (Remat Request Form) and request his DP for rematerialisation of the balances in his securities account. One makes a request for rematerialisation. Depository participant intimates depository of the request through the system. Depository confirms rematerialisation request to the registrar. Registrar updates accounts and prints certificates. Depository updates accounts and downloads details to depository participant. Registrar dispatches certificates to investor.

Section 9

Dematerialised shares do not have any distinctive numbers. These shares are fungible, which means that all the holdings of a particular security will be identical and interchangeable.

Selling

After you have sold the securities, you would instruct your DP to debit your account with the number of securities sold by you and credit your broker's clearing account. This delivery instruction has to be given to your DP using the delivery instruction slips given to you by your DP at the time of opening the account. Procedure for selling securities is given here below:

You sell securities in any of the stock exchanges linked to NSDL through a broker; You give instruction to your DP to debit your account and credit the broker's [clearing member pool] account; Before the pay-in day, your broker gives instruction to its DP for delivery to clearing corporation; Your broker receives payment from the stock exchange [clearing corporation] ; You receive payment from the broker for the sale of securities.

Buying:

For receiving demat securities you may give a one-time standing instruction to your DP. This standing instruction can be given at the time of account opening or later. Alternatively, you may choose to give separate receipt instruction every time some securities are to be received. The transactions relating to purchase of securities are summarised below:

You purchase securities through a broker ; You make payment to your broker who arranges payment to clearing corporation on the pay-in day ;Your broker receives credit of securities in its clearing account (clearing member pool account) on the pay-out day; Your broker gives instructions to its DP to debit clearing account and credit your account; You receive shares into your account. However, if standing instructions are not given at the time of opening the account, you will have to give 'Receipt Instructions' to your DP for receiving credit,.

You should ensure that your broker transfers the securities from its clearing account to your depository account, before the book closure. If the securities

remain in the clearing account of the broker, the company will give corporate benefits (dividend or bonus) to the broker. In that case, you will have to collect the benefits from your broker.

Registered Owner and Beneficial Owner (Section 10):

A depository shall be deemed to be the registered owner for the purposes of effecting transfer of ownership of security on behalf of a beneficial owner. The depository as a registered owner shall not have any voting rights or any other rights in respect of securities held by it. The beneficial owner shall be entitled to all the rights and benefits and be subjected to all the liabilities in respect of his securities held by a depository.

Dividend Interest Bonus

The concerned company obtains the details of beneficiary holders and their holdings as on the date of the book closure / record date from Depositories. The payment to the investors will be made by the company through the **ECS (Electronic Clearing Service)** facility, wherever available. Thus the dividend / interest will be credited to your bank account directly. Where ECS facility is not available dividend / interest will be given by issuing warrants on which your bank account details are printed. The bank account details will be those which you would have mentioned in your account opening form or changed thereafter.

You can dematerialize debt instruments mutual fund units , government securities in one demat account; You can pledge your demat securities ; You can lend and borrow securities;