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## Role and Growth of NSDL in Indian Depository System

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*Abstract: Depository system where a place to deposit something for safekeeping as bank in which funds or securities are deposited by other under the terms of depository agreements. The principal function of depository is to dematerialize securities and enable their transactions in book-entry form. The securities are transferred by debiting the transferor's depository account and crediting the transferee's depository account.*

*The present study is an attempt to know the role of NSDL in Indian depository system, analyze the performance and growth of NSDL for a period of 7 years, i.e. 2006-2012. On the basis of results, it is concluded that number of beneficiary accounts, depository participants growth, number of companies available for DEMAT, DEMAT custody and number of depository participants service centers in NSDL.*

*Keywords: Depository, Depository participants, Dematerialization, Depository System, Beneficiary accounts, DEMAT custody, Growth, Performance.*

### I. INTRODUCTION

A vibrant and efficient capital market, which ensures an orderly development and contains measures for protection of the investor's interest, is the most important parameter for evaluating health of any economy. The practice of physical trading imposed limits on trading volumes and hence the speed with which new information was incorporated into prices system.

Dematerialization is the processes by which a client can get physical certificates converted into electronic balances maintained in its account with the participant in the depository system securities held in dematerialization form are fungible, i.e., they do not bear any distinguishing features. The financial market exists to facilitate sale and purchase of financial instruments and comprises of two major markets namely the capital Market and the money market. The capital market mainly deals in medium and long – term investments (maturity more than a year) while the money market deals in short- term investments (maturity up to a year).

Capital market can be divided into two segments viz., primary and secondary. The primary market is mainly used by issuers for raising fresh capital from the investors by making initial public offers or rights issues or offers for sale of equity or debt. The secondary market provides liquidity to these instruments through trading and settlement on the stock exchanges. Capital market is, thus important for raising funds for capital formation and investments and forms a very vital link for economic development of any country. The capital market provides a means for issuers to raise capital from investors. (Who have surplus money available from savings for investments). Thus savings normally flow from household sector to business or government sectors that normally invest more than they save.

A major problem however continued to plague the market. The Indian markets were literally weighed down by the need to deal with shares in the paper form. There were problems galore with handling documents-fake and stolen shares, fake signatures and signatures mismatch, duplication and mutilation of shares, and transfer problems etc. so the institutions and the stock exchanges experiences that the paper certificates are the main cause of investor disputes and arbitration cases.

Thus, the Government of India decided to setup a fully automated and high technology based model exchanges, which could offer screen, based trading and depositories as the ultimate answer to all such reforms. Therefore, the government of India promulgated the Depository Ordinance in 1995. However, both houses of Parliament passed the Depositories Act in 1996. The unparalleled success of the introduction of the depository concept in Indian capital markets is reflected in the on-going successful reaction in the period between trading and settlement.

## II. OBJECTIVES OF THE STUDY

- 1) To study the Organizational frame work, role and benefits of NSDL in depository system.
- 2) To know the various checks and measures in the depository system to ensure safety of the investor holdings.
- 3) To analyse the growth of NSDL in Indian depository system through performance over the years.

## III. DATA COLLECTION AND ANALYSIS

The present study is of analytical nature, therefore the use is made of secondary data collected from various websites, publications and brochures of depository participants, research papers/articles published in various journals/magazines/newspapers and annual reports of NSDL for a period of 7 years i.e. from 2006-2012.

## IV. MEANING OF DEPOSITORY

“A Depository is a file or a set of files in which data is stored for the purpose of safe keeping or identity authentication”, defined by Germany Depository.

In India, the Depositories Act, 1996 defines a depository to mean “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 Exchanges Board of India Act, 1992”.

As per The Bank for International settlements (BIS), depository is “a facility for holding securities which enables securities transactions to e - processed by book entry, physical securities may be immobilized by the depository or securities may be dematerialized (so that they exist only as electronic records)”.

## V. DEPOSITORY SYSTEM IN INDIA

India has adopted the Depository System for securities trading in which book entry is done electronically and no paper is involved. The physical form of securities is extinguished and shares or securities are held in an electronic form. Before the introduction of the depository system through the Depository Act, 1996, the process of sale, purchase and transfer of securities was a huge problem, and there was no safety at all.

### **Key Features of the Depository System in India:**

**1. Multi-Depository System:** The depository model adopted in India provides for a competitive multi-depository system. There can be various entities providing depository services. A depository should be a company formed under the Company Act, 1956 and should have been granted a certificate of registration under the Securities and Exchange Board of India Act, 1992. Presently, there are two depositories registered with SEBI, namely:

- National Securities Depository Limited (NSDL) and

- Central Depository Service Limited (CDSL)
2. **Depository services through depository participants:** The depositories can provide their services to investors through their agents called depository participants. These agents are appointed subject to the conditions prescribed under Securities and Exchange Board of India (Depositories and Participants) Regulations, 1996 and other applicable conditions.
  3. **Dematerialisation:** The model adopted in India provides for dematerialization of securities. This is a significant step in the direction of achieving a completely paper-free securities market. Dematerialization is a process by which physical certificates of an investor are converted into electronic form and credited to the account of the depository participant.
  4. **Fungibility:** The securities held in dematerialized form do not bear any notable feature like distinctive number, folio number or certificate number. Once shares get dematerialized, they lose their identity in terms of share certificate, distinctive numbers and folio numbers. Thus all securities in the same class are identical and interchangeable. For example, all equity shares in the class of fully paid up shares are interchangeable.
  5. **Registered Owner/ Beneficial Owner:** In the depository system, the ownership of securities dematerialized is bifurcated between Registered Owner and Beneficial Owner. According to the Depositories Act, 'Registered Owner' means a depository whose name is entered as such in the register of the issuer. A 'Beneficial Owner' means a person whose name is recorded as such with the depository. Though the securities are registered in the name of the depository actually holding them, the rights, benefits and liabilities in respect of the securities held by the depository remain with the beneficial owner. For the securities dematerialized, NSDL/CDSL is the Registered Owner in the books of the issuer; but ownership rights and liabilities rest with Beneficial Owner. All the rights, duties and liabilities underlying the security are on the beneficial owner of the security.
  6. **Free Transferability of shares:** Transfer of shares held in dematerialized form takes place freely through electronic book-entry system.

#### VI. ABOUT NSDL (NATIONAL SECURITIES DEPOSITORY LTD.)

NSDL carries out its activities through service providers such as depository participants (DPs), issuing companies and their registrars and share transfer agents and clearing corporations/ clearing houses of stock exchanges. These entities are NSDL's business partners and are integrated in to the NSDL depository system to provide various services to investors and clearing members. The investor can get depository services through NSDL's depository participants. An investor needs to open a depository account with a depository participant to avail of depository facilities.

It is possible for a clearing member to open a special account in the depository system to settle trades completed on stock exchanges. The clearing account helps the clearing member to get securities from its clients for delivery to the clearing house/clearing corporation and to distribute the pay-out to its customers. An issuer can offer demat services to its shareholders by means of an agreement with NSDL. The clearing corporations/houses of stock exchanges also need to be electronically linked to the depository to enable them to electronically receive and give securities from and to clearing members.

An investor intending to dematerialize its securities needs to have an account with a DP. The client has to deface and surrender the certificates registered in its name to the DP. After intimating NSDL electronically, the DP sends the securities to the concerned Issuer/ R&T agent. NSDL in turn informs the Issuer/ R&T agent electronically, using NSDL Depository system, about the request for dematerialization. If the Issuer/ R&T agent finds the certificates in order, it registers NSDL as the holder of the securities (the investor will be the beneficial owner) and communicates to NSDL the confirmation of request electronically. On receiving such confirmation, NSDL credits the securities in the depository account of the Investor with the DP.

**Role of NSDL in Depository System:** In the depository system, the ownership and transfer of securities takes place by means of electronic book entries. At the outset, this system rids the capital market of the dangers related to handling of paper. NSDL provides numerous direct and indirect benefits like:

- **Elimination of bad deliveries** In the depository environment, once holdings of an investor are dematerialized, the question of bad delivery does not arise i.e. they cannot be held "under objection". In the physical environment, buyer was required to take the risk of transfer and face uncertainty of the quality of assets purchased. In a depository environment good money certainly begets good quality of assets.
- **Elimination of all risks associated with physical certificates-** Dealing in physical securities have associated security risks of theft of stocks, mutilation of certificates, loss of certificates during movements through and from the registrars, thus exposing the investor to the cost of obtaining duplicate certificates etc. This problem does not arise in the depository environment.
- **No stamp duty** for transfer of any kind of securities in the depository. This waiver extends to equity shares, debt instruments and units of mutual funds.
- **Immediate transfer and registration of securities** - In the depository environment, once the securities are credited to the investors account on pay out, he becomes the legal owner of the securities. There is no further need to send it to the company's registrar for registration. Having purchased securities in the physical environment, the investor has to send it to the company's registrar so that the change of ownership can be registered. This process usually takes around three to four months and is rarely completed within the statutory framework of two months thus exposing the investor to opportunity cost of delay in transfer and to risk of loss in transit. To overcome this, the normally accepted practice is to hold the securities in street names i.e. not to register the change of ownership. However, if the investors miss a book closure the securities are not good for delivery and the investor would also stand to lose his corporate entitlements.
- **Faster settlement cycle** - The settlement cycle follow rolling settlement on T+2 basis i.e. the settlement of trades will be on the 2nd working day from the trade day. This will enable faster turnover of stock and more liquidity with the investor.
- **Faster disbursement of non cash corporate benefits like rights, bonus, etc.** - NSDL provides for direct credit of non cash corporate entitlements to an investors account, thereby ensuring faster disbursement and avoiding risk of loss of certificates in transit.
- **Reduction in brokerage by many brokers for trading in dematerialized securities** Brokers provide this benefit to investors as dealing in dematerialized securities reduces their back office cost of handling paper and also eliminates the risk of being the introducing broker.
- **Reduction in handling of huge volumes of paper**
- **Periodic status reports** to investors on their holdings and transactions, leading to better controls.
- **Elimination of problems related to change of address of investor** - In case of change of address, investors are saved from undergoing the entire change procedure with each company or registrar. Investors have to only inform their DP with all relevant documents and the required changes are effected in the database of all the companies, where the investor is a registered holder of securities.
- **Elimination of problems related to transmission of demat shares** - In case of dematerialized holdings, the process of transmission is more convenient as the transmission formalities for all securities held in a demat account can be completed by submitting documents to the DP whereas, in case of physical securities the surviving joint holder(s)/legal heirs/nominee has to correspond independently with each company in which shares are held.
- **Elimination of problems related to selling securities on behalf of a minor** - A natural guardian is not required to take court approval for selling demat securities on behalf of a minor.

- **Ease in portfolio monitoring** since statement of account gives a consolidated position of investments in all instruments.

There are various checks and measures in the depository system to ensure safety of the investor holdings. These include:

- A DP can be operational only after registration by SEBI, which is based on the recommendation from NSDL and their own independent evaluation. SEBI has prescribed criteria for becoming a DP in the regulations.
- DPs are allowed to affect any debit and credit to an account only on the basis of valid instruction from the client.
- Every day, there is a system driven mandatory reconciliation between DP and NSDL.
- All transactions are recorded at NSDL Central System and in the databases maintained by business partners.
- There are periodic inspections into the activities of both DP and R&T agent by NSDL. This also includes records based on which the debit/credit is affected.
- All investors have a right to receive their statement of accounts periodically from the DP.
- Every month NSDL forwards statement of account to a random sample of investors as a counter check.
- In the depository, the depository holds the investor accounts on trust. Therefore, if the DP goes bankrupt the creditors of the DP will have no access to the holdings in the name of the clients of the DP. These investors can transfer their holdings to an account held with another DP.
- The data interchange between NSDL and its business partners is protected by protection measures of international standards such as encryption hardware lock. The protection measures adopted by NSDL are more than what is prescribed in the SEBI Regulations.
- **Freeze Facility:** A depository account holder (beneficiary account) may freeze securities lying in the account for as long as the account holder wants it. By freezing the account, account holder can prevent unexpected debits or credits or both, creeping into its account. The following types of freeze facility available in the NSDL system may be availed of by submitting freeze instruction to the DP in the prescribed form.
  - Freeze for debits only
  - Freeze for debits as well as credits
  - Freeze a particular ISIN in the account
  - Freeze a specific number of securities held under an ISIN in an account
- **Certification in Depository Operations:** NSDL has introduced a Certification Programme in Depository Operations (popularly known as NCFM certification), and it has been made compulsory for all DPs to appoint a person qualified in this certification in each of its branches. This way, NSDL wants to ensure that each branch of a DP that services investors has at least one person who has thorough knowledge about depository system.
- **Investor grievance:** All grievances of the investors are to be resolved by the concerned business partner. If they fail to do so, the investor has the right to approach NSDL.
- **Insurance Cover:** NSDL has taken a comprehensive insurance policy to help DP to indemnifying investors for the loss accrued to them due to errors, omissions, commission or negligence of DP.
- **Computer and communication infrastructure:** NSDL and its business partners use hardware, software and communication systems, which conform to industry standards. Further, the systems are accepted by NSDL only after a

rigorous testing procedure. NSDL's central system comprises an IBM mainframe system with a back-up facility and a remote disaster back-up site.

- **Machine level back-up:** The IBM mainframe in which the data is processed has adequate redundancy built into its configuration. There is a standby central processing unit (CPU) to which processing can be switched over to in case of main system CPU failure. The disk has RAID implementation, which ensures that a failure of hard disk will not lead to loss in data. System has spare disk configuration where data is automatically copied from the main disk upon encountering the first failure (due to RAID implementation - first failure does not result in loss of data).

**NSDL offers the following facilities: -**

- Dematerialisation i.e., converting physical certificates to electronic form;
- Rematerialization i.e., conversion of securities in demat form into physical certificates;
- Facilitating repurchase / redemption of units of mutual funds;
- Electronic settlement of trades in stock exchanges connected to NSDL;
- Pledging/hypothecation of dematerialized securities against loan;
- Electronic credit of securities allotted in public issues, rights issue;
- Receipt of non-cash corporate benefits such as bonus, in electronic form;
- Freezing of demat accounts, so that the debits from the account are not permitted;
- Nomination facility for demat accounts;
- Services related to change of address;
- Effecting transmission of securities;
- Instructions to your DP over Internet through SPEED-e facility. (Please check with your DP for availing the facility);

## VII. GROWTH OF NSDL IN INDIAN DEPOSITORY SYSTEM

The below tables show that, the development of de-materialization with reference to NSDL during the period 2006-2012 under the study.

**Table No: 1**  
**Beneficiary Accounts Growth in NSDL during 2006-2012**

Year	Investors Accounts Value in Lakhs	Annual Growth Rate
December -2006	77.51	-
December -2007	82.82	6.85%
December -2008	95.59	15.41%
December -2009	102.62	7.35%
December -2010	111.89	9.03%
December -2011	117.78	5.26%
December -2012	125.06	6.18%
Average Annual Growth Rate		8.35%

**Table I** shows that the beneficiary accounts continuously increased from 77.51 lakhs accounts to 125.06 lakh accounts as absolute figures and in relative terms. The percentage of growth was high in 2008 at 15.41% and lowest at 5.26% in 2011. The highest growth is recorded in 2008 and lowest in 2011 this can be attributed to the world economic crises and its impact on new

capital issues in the IPO market. The noteworthy point is that inspite of the crises the annual average growth in accounts in NSDL during 2006-12 is 8.35%.

**Table No: II**  
**Depository Participants Growth in NSDL during 2006-2012**

Year	Depository Participants	Annual Growth Rate
December -2006	234	-
December -2007	251	7.26%
December -2008	266	5.97%
December -2009	285	7.14%
December -2010	290	1.75%
December -2011	284	(2.06%)
December -2012	283	(0.35%)
Average Annual Growth Rate		3.28%

**Table II** discloses that the depository participants was increasing from 234 in 2006 to 290 in 2010 and after that it declined to 284 in 2011 and 283 in 2012 which is a marginal decline of (2.06%) and (0.35). The average annual growth rate of DP's is 3.28%. The range of growth in DP's was high in 2007 and 2009, the reason being no impact of world economic crises but in 2010 there was marginal increase of 1.75% (only 5 participants were added in that year).

**Table No: III**  
**Companies Available for DEMAT in NSDL during 2006-2012**

Year	Available Companies for DEMAT	Annual Growth Rate
December -2006	6,334	-
December -2007	7,095	12.01%
December -2008	7,755	9.30%
December -2009	7,919	2.11%
December -2010	8,631	8.99%
December -2011	9,366	8.51%
December -2012	10,397	11.00%
Average Annual Growth Rate		8.65%

**Table III** reveals the companies with de-materialization with NSDL during the period 2006-2012, the no of companies converted into de-materialization were 6334 in 2006 and 10397 in 2012 with an average annual growth rate of 8.65% during the period. Except during 2009 the increase was marginal at 2.11% only 164 companies converted in to de-materialization form. The other years it was above 8.5%.

**Table No: IV**  
**DEMAT Custody in NSDL during 2006-2012**

Year	DEMAT Custody Value in Crores	Annual Growth Rate
December - 2006	30,58,523	-
December - 2007	51,54,793	68.53%
December -2008	28,15,797	(45.37%)
December -2009	49,61,331	76.19%
December -2010	65,71,570	32.45%
December -2011	64,91,906	(1.21%)
December -2012	78,01,981	20.18%
Average Annual Growth Rate		25.12%

**Table IV** discloses that DEMAT custody in NSDL during the years 2006-12 showed initial increment of 68.53% in 2007, but in the next year it fell drastically indicating a negative growth of (45.37%), this is an indication that the impact of Global

Crisis is significant with respect to custodial accounts with the DP's, but the overall average annual growth rate shows that there is an increase of 25.12% during the period, which is a positive indication.

**Table No: V**  
**DP Service Centers Growth with NSDL during 2006-2012**

Year	DP Service Centres	Annual Growth Rate (%)
December -2006	3,219	-
December -2007	6,812	111.61%
December -2008	8,201	20.39%
December -2009	10,395	26.75%
December -2010	12,330	18.61%
December -2011	13,832	12.18%
December -2012	14,406	4.14%
Average Annual Growth Rate		32.28%

Depository Services centers are presented in **table V**. In 2006 the number of DP service centers was 3219 and in 2012 they were 14406 with an average annual growth rate of 32.28%. In the 2007 the number of DP service centers increased by more than 100% with around 3600 new DP service centers.

### VIII. CONCLUSION

To sum up, there is an increase in the terms of number of beneficiary accounts, number of companies available for demat, number of depository participants service centers. And there is positive annual average growth rate for DEMAT custody and depository participants growth in NSDL.

The benefit of the depository system is significant. Introduction of depositories will improve the market efficiency through adopting criterion for describing scripts depositories' eligibility. The paper management substantially reduced. This helps in saving in time for allotment transfers of scripts. This improves internal system effectively.

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