

Dematerialization of Securities

A Sign of Prosperity of Capital Market

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ABSTRACT

A significance development of the 20th century particularly in its later part is expansion of financial market especially capital market world over which mostly was driven by globalization, technology, innovations and increasing trade volume. India has not been an exception with probably largest number of listed companies with a very large investor population and ever increasing volumes of trades. The increase in trade volumes lead to exponential rise in the back office operations thus limiting the growth potential of the broking members. The inconvenience faced by investors in settlement of trade also limits the opportunity for such investors, especially in participating in auction trading. The physical form of holding and trading in securities also acted a bottleneck for community in capital market operations. Thus the system of security transaction is not as investor-friendly as it ought to be. In this scenario dematerialized trading under depository system is certainly a welcome move.

1. INTRODUCTION

Dematerialization of securities aims at eliminating the voluminous and cumbersome paper work involved in the scrip-based system and offers scope for 'paperless' trading through state-of-art technology. Dematerialization or "Demat" is a process where by investor securities like shares, debentures, etc. are converted into electronic data and stored in computers by a Depository. Securities registered in investor's name are surrendered to depository participant and these are sent to the respective companies who will cancel them after "dematerialization and credit investor's depository account with DP.

The securities on dematerialization appear as balances in one's depository account. These balances are transferable like physical shares. A demat account is just as one open an account with a bank if he want to save his money, make cheque payments etc. In the same way it is

necessary to open a demat account if any body want to buy or sell stocks.

For example, if any body is having a portfolio of shares which look like this: 100 shares of Infosys, 150 of Wipro, 200 of HLL and 200 of ACC, all these will show in his demat account. All the above shares are held electronically in investor account. As any body buy and sell the shares, they are adjusted in his account. Just like a bank passbook or statement, the DP will provide account holder with periodic statements of holdings and transactions.

2. WHY DEMATERIALIZATION?

One of the methods for preventing all the problems that occur with physical securities is through dematerialization (Demat). Dematerialization is a process in which the physical form of holding securities is replaced with electronic (book-entry) form of holding them. The securities held in dematerialized form are fungible and they do not bear any distinguishable features like

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distinctive number, folio number or certificate number. Once the shares are dematerialized, they lose their identification features in terms of share certificate distinctive numbers and folio numbers. Title to the securities owned is in terms of number of securities and not in terms of distinctive numbers, certificates numbers, etc. dematerialization of securities makes the market more systematic and disciplined.

On many fronts this system is appreciated. With this system depositories pass on the benefits and rights to the transferee quickly since the whole system is efficient and automated. Time lost in communication too is very low. Fraudulent encashment of dividend warrants and loss of bonus or rights can be avoided. Since depository is to have scrip-less capital market, exchange of physical scrips is not desired. Thus the risk of loss, mutilation: theft and forgery of security certificates is nil.

3. SECURITIES THAT CAN BE DEMATERIALIZED

The entire depository system in India is governed by the rules made by the market regulator - SEBI. According to the SEBI (Depositories and Participants) Regulations, 1996, the following securities are eligible for holding in dematerialized form.

1. Shares, scrips, stocks, bonds debentures, debenture stock or other marketable securities of similar nature of any incorporated company or body corporate including underlying shares of ADRs and GDRs.
2. Units of mutual funds, rights under collective investment schemes and venture capital funds, commercial paper, certificate of deposit, securitised debt, money market instruments and unlisted securities.

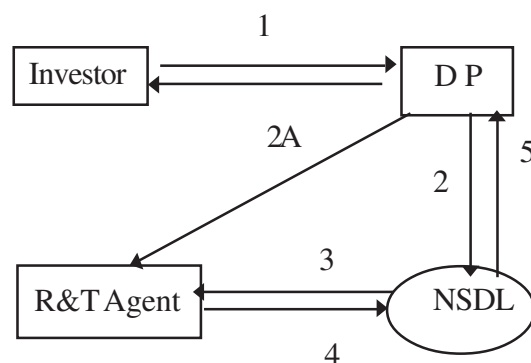
A list of securities available for demat in NSDL depository is made known to all DPs by way of circulars sent through email. The information is also put up on NSDL's Website - www.nSDL.co.in and in the monthly information bulletin NEST Update.

Physical form of securities can be converted into book entry form in NSDL depository system only if the company which has issued the securities, has entered into an agreement with NSDL to offer demat facility.

4. THE DEMAT PROCESS

Demat is a process by which investors share certificates are taken back by company through DP, verified and if found in order demat is confirmed by the company and then an equivalent number of shares are credited by the DP to investors account as electronic holding. The entire process of dematerialization as required by SEBI has to be completed with in a period of 15 days. A holder of depository eligible securities may get his physical holding converted into electronic form by making a request through the DP with whom he has his beneficiary account. The entire process of Dematerialization can be better understood with the help of figure no. 1

Figure - 1
Process of Dematerization



1. Client/ Investor submit the DRF (Demat Request Form) and physical certificates to DP. DP checks whether the securities are available for demat. Client defaces the certificate by stamping 'Surrendered for Dematerialisation'. DP punches two holes on the name of the company and draws two parallel lines across the face of the certificate.

2. DP enters the demat request in his system to be sent to NSDL. DP dispatches the physical certificates along with the DRF to the R&T Agent.

3. NSDL records the details of the electronic request in the system and forwards the request to the R&T Agent.

4. R&T Agent, on receiving the physical documents and the electronic request, verifies and checks them. Once the R&T Agent is satisfied, dematerialization of the concerned securities is electronically confirmed to NSDL.

5. NSDL credits the dematerialized securities to the beneficiary account of the investor and intimates the DP electronically. The DP issues a statement of transaction to the client.

5. MARKET SETTLEMENT OF DEMAT SHARES/ SECURITIES

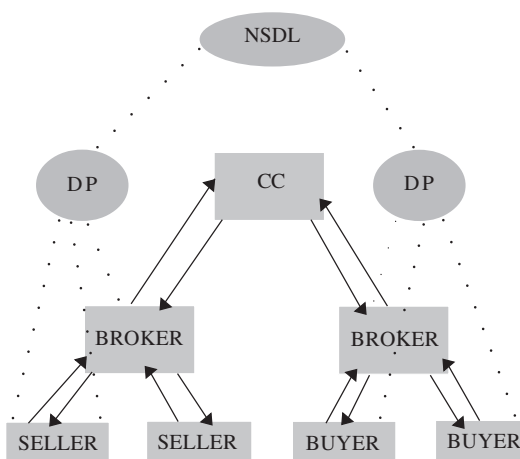
A market trade is one that is settled through participation of a Clearing Corporation. In the depository environment, the securities move through account transfer. Once the trade is executed by the broker on the stock exchange, the seller gives a delivery instruction to his DP to transfer securities to his broker's account.

The broker has to then complete the pay-in before the deadline prescribed by the stock exchange. The broker removes securities from his account to CC/CH of the stock exchange concerned, before the deadline given by the stock exchange.

The CC/CH gives pay-out and securities are transferred to the buying broker's account. The broker then gives delivery instructions to his DP to transfer securities to the buyer's account. The movement of funds takes place outside the NSDL system.

Figure - 2

Market Settlement-Demat Shares



1. Seller gives delivery instructions to his DP to move securities from his account to his broker's account.
2. Securities are transferred from broker's account to CC on the basis of a delivery out instruction.
3. On pay-out, securities are moved from CC to buying broker's account.
4. Buying broker gives instructions and securities move to the buyer's account.

6. BENEFITS OF DEMAT

Transacting the depository way has several advantages over the traditional system of transacting using share certificates. Some of the benefits are as under

1. Trading in demat segment completely eliminates the risk of bad deliveries, which in turn eliminates all cost and wastage of time

associated with follow up for rectification. This reduction in risk associated with bad delivery has lead to reduction in brokerage to the extent of 0.5% by quite a few brokerage firms.

2. In case certificates are lost in transit or when the share certificates become mutilated or misplaced to obtain duplicate certificates, one may have to spend at least Rs. 500 for indemnity bond, newspaper advertisement etc, which can be completely eliminated in the demat form.
3. One can also expect a lower interest charge for loans taken against demat shares as compared to the interest for loan against physical shares. This could result in a saving of about 0.25% to 1.5%. Some banks have already announced this.
4. In case of transfer of electronic shares, one saves 0.5% in stamp duty. Cost of courier/notarization/the need for further follow-up with broker for shares returned for company objection is also saved.
5. One can also receive bonuses and rights into depository account as a direct credit, thus eliminating risk of loss in transit.
6. RBI has increased the limit of loans against dematerialized securities as collateral to Rs.2 mn per borrower as against Rs.1 mn per borrower in case of loan against physical securities.
7. RBI has also reduced the minimum margin to 25% for loans against dematerialized securities as against 50% for

loans against physical securities.

7. CONCLUSION

In this way we can say that by adopting the method of dematerialization we can protect our securities from all those harm which may occur when they are in physical form. Moreover this process prove the factual position of securities with the help of a simple click on keyboard of a computer, as the total system is connected with net and all information is available online. The demat account reduces brokerage charges, makes pledging/hypothecation of shares easier, enables quick ownership of securities on settlement resulting in increased liquidity, avoids confusion in the ownership title of securities, and provides easy receipt of public issue allotments. It also helps you avoid bad deliveries caused by signature mismatch, postal delays and loss of certificates in transit. Further, it eliminates risks associated with forgery, counterfeiting and loss due to fire, theft or mutilation. This is beneficial for both the buyers and seller of the securities and help in preventing scams related with fake transfer of securities. Hence we can say that there is a great significance of Dematerialized form of securities in present scenario as it saves money and time and reduce risk on the other side. Hence it can be said that the emergence of depository system is a sign of prosperity of financial market system specially capital market.

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