Demat : Surging Ahead

C.B.Bhave
Managing Director
National Securities
Depository Ltd.

Introduction :
The 90s have seen rapid modernisation of the Indian Capital Market. The setting up of a central electronic market with connectivity through a satellite network by the National Stock Exchange of India Limited (NSE) revolutionized trading systems in India. Other stock exchanges followed suit and soon, the floor based open outcry system gave way to electronic trading. The market opened up to foreign institutional investment and the local mutual fund industry was widened through private asset management companies being allowed to float mutual fund schemes. Greater participation by institutional investors in the market gave rise to the demand for an efficient solution to the problems relating to presence of paper and paper related frauds. The setting up of the National Securities Depository Limited (NSDL) in November 1996 signified the beginning of the move towards scripless and faster (rolling) settlement.

NSDL is promoted by :

- Industrial Development Bank of India (IDBI), the largest development financial institution in India,
- Unit Trust of India (UTI), the largest mutual fund in India, and
- National Stock Exchange of India Limited (NSE), the largest stock exchange in India.

Subsequently, the State Bank of India, the largest Indian commercial bank, took a stake of 4.76 % in NSDL.

Legal Framework:
The legislative framework governing the operations of NSDL essentially comprises :

- the Depositories Act, 1996,
- Securities and Exchange Board of India (Depositories and Participants) Regulations, 1996,
- NSDL Bye-laws and
- NSDL Business Rules.

This framework provides for dematerialisation (and not immobilisation). The Depositories Act does not mandate a single depository. The legal framework makes securities freely transferable in the depository and transfers of equity instruments in the depository are free from stamp duty (50 basis points). Holding securities in the depository is at the option of the investor, not mandatory. NSDL is regulated by the Securities & Exchange Board of India (SEBI), the capital market regulator in India.

Performance Review:
The depository system has gained acceptance amongst different segments in the market. 436 companies (issuers) have signed up with NSDL for providing depository services to their shareholders. These companies represent 83% of the market capitalisation of the Indian market. They include all the companies in the S & P CNX nifty index and BSE sensitive index.

The number of Depository Participants through whom investors hold accounts in the depository stands at 97. **All** custodians providing services to local and foreign investors have joined the NSDL. Banks and brokers who expect to service the retail market have also joined. These DPs are servicing investors from 925 centres across India.

Mutual funds, financial institutions, and foreign institutional investors have dematerialised a significant part of their holdings. 857.98 crore shares valued at about Rs. 1,52,900 crore have been dematerialised so far. In about 150 companies, dematerialisation as a % of market capitalisation (of the company) has crossed the 25% mark.

Nine of the most active stock exchanges in India viz., the National Stock Exchange of India Limited (NSE); the Stock Exchange, Mumbai, (BSE); the Calcutta Stock Exchange Association Limited (CSE); the Delhi Stock Exchange Association Limited (DSE); the Bangalore Stock Exchange Limited (BgSE); the Madras Stock Exchange (MSE); the Inter-connected Stock Exchange of India Limited (ISE); the Over the Counter Exhange of India (OTCEI) and the Ludhiana Stock Exchange Assoociation Limited (LSE), have established electronic connectivity with NSDL to facilitate settlement in respect of dematerialised securities.

The retail investor base is growing rapidly. More than 7.75 lac retail investors from 1553 cities/ towns in India and 40 cities abroad have joined the NSDL.

Trading :
SEBI - the capital market regulator, has been actively pushing the market towards settlement in dematerialised form.

- Institutions to mandatorily sell only in dematerialised form in respect of a select basket of securities. Starting with eight, on January 15, 1998, SEBI has mandated that this basket comprise 360 securities on May 31, 99.
- With effect from April 06, 1998, dematerialised shares to be treated as good delivery in the physical (unified) segments of stock exchanges connected to NSDL.
- Effective from May 31, 1999, settlements of all trades done on any stock exchange connected to NSDL, with respect to 104 scrips is in dematerialised form only.

In June, 1999, a total quantity of more than 40 crore shares worth more than Rs. 8000 crore were settled in dematerialised form in the stock exchanges connected to NSDL.

Pledging :

The Reserve Bank of India (RBI) has been advocating the use of the depository. The Reserve Bank of India (RBI) has suggested to banks to consider joining the depository as a DP. The RBI has also stipulated that the limit of raising loans against shares in dematerialised form for retail investors will be twice as compared to the limit in respect of shares in physical form. Further, the hair-cut applicable in respect of dematerialised shares would be lower. The NSDL pledge module has become popular and now more than Rs. 2500 crore worth shares have been pledged in the depository system.

Primary Issues :

While NSDL is engaged in the task of dematerialising the existing shares, it naturally follows that the presence of paper should be tackled at the issue stage itself. NSDL has, therefore, made it possible for issuers who have joined NSDL to issue shares only in demat form. This facility has been extensively used for the past two years. Recently companies like Infosys Technologies and NIIT for the issue of bonus shares and ACC for reduction in the face value of shares from Rs.100 to Rs.10 used this facility and received a good response from the investors.

Issue of shares in demat form is beneficial for all concerned. The company avoids the expenditure of printing share certificates and posting them. The investor is saved the botheration of waiting for the postal delivery of shares to him. He is not sure till then as to whether his entitlement has been processed. It also avoids subsequent correspondence by investors who on account of wrong postal address or misplacements in the postal system do not receive their shares. For the system, it avoids the expense of first creating physical shares and then dematerialising the same.

NSDL facilitates allotment of shares in a primary issue as well. The past trend indicates that issue of shares in demat is becoming increasingly popular. Capital market intermediaries and issuers have experimented to a very limited extent with book building process in the primary market. NSDL believes that some of the impediments of the book building process such as subsequent distribution will be removed in the depository environment. We expect that in the next 12-18 months the capital market will use the NSDL facility in innovative ways for primary issues.