Chapter I

INTRODUCTION

“You’re neither right nor wrong because other people agree with you. You’re right because your facts are right and your reasoning is right—and that’s the only thing that makes you right.”

—Warren Buffett, the world’s most successful investor.

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\textsuperscript{1}. 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 unparallelled 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.

**Indian Capital Market**

Transfer of resources from those with idle resources to others who have a productive need for them is perhaps most efficiently achieved through the securities markets. A financial market\textsuperscript{2} consists of investors (buyers of securities), borrowers (sellers of securities) and regulatory bodies.

**The Indian financial market is illustrated in the figure 1.1**
Capital Market

The capital market has two interdependent and inseparable segments, the new issuers (the primary market) and stock (secondary) market. The primary market is 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; on the other hand the secondary market provides liquidity to these instruments, through trading and settlement on the stock exchanges. An active secondary market promotes the growth of the primary market and capital formation, since the investors in the primary market are assured of a continuous market where they have an option to liquidate their investments. There are several major players in the primary market. These include the merchant bankers, mutual funds, financial institutions, foreign institutional investors (FIIs) and individual investors. In the secondary market, there are the stock exchanges, stock brokers (who are members of the stock exchanges), the mutual funds, financial institutions, foreign institutional investors (FIIs), and individual investors. The Registrars and Transfer Agents, Custodians and Depositories are capital market intermediaries which provide important infrastructure services to both the primary and secondary markets.

In secondary market, stock exchanges are medium for buying and selling of securities which are already issued in the market. There are 22 stock exchanges in India, the first being the Bombay Stock Exchange (BSE), which began formal trading in 1875, making it one of the oldest in Asia. Over the last few years, there has been a rapid change in the Indian securities market, especially in the secondary market. Advanced technology and online-based transactions have modernized the stock exchanges. In terms of the number of companies listed and total market capitalization, the Indian equity market is considered large relative to the country’s stage of economic development. The number of listed companies increased from 5,968 in March 1990 to about 10,000 by May 1998 and market capitalization has grown almost 11 times during the same period.
The debt market, however, is almost nonexistent in India even though there has been a large volume of Government bonds traded. Banks and financial institutions have been holding a substantial part of these bonds as statutory liquidity requirement. The portfolio restrictions on financial institutions’ statutory liquidity requirement are still in place. A primary auction market for Government securities has been created and a primary dealer system was introduced in 1995. There are six authorized primary dealers. Currently, there are 31 mutual funds, out of which 21 are in the private sector. Mutual funds were opened to the private sector in 1992. Earlier, in 1987, banks were allowed to enter this business, breaking the monopoly of the Unit Trust of India (UTI), which maintains a dominant position. Before 1992, many factors obstructed the expansion of equity trading. Fresh capital issues were controlled through the Capital Issues Control Act. Trading practices were not transparent, and there was a large amount of insider trading. Recognizing the importance of increasing investor protection, several measures were enacted to improve the fairness of the capital market. The Securities and Exchange Board of India (SEBI) was established in 1988.

Despite the rules it set, problems continued to exist, including those relating to disclosure criteria, lack of broker capital adequacy, and poor regulation of merchant bankers and underwriters. There have been significant reforms in the regulation of the securities market since 1992 in conjunction with overall economic and financial reforms. In 1992, the SEBI Act was enacted giving SEBI statutory status as an apex regulatory body. And a series of reforms was introduced to improve investor protection, automation of stock trading, integration of national markets, and efficiency of market operations. India has seen a tremendous change in the secondary market for equity. Its equity market will most likely be comparable with the world’s most advanced secondary markets within a year or two. The key ingredients that underlie market quality in India’s equity market are:
• Exchanges based on open electronic limit order book;
• Nationwide integrated market with a large number of informed traders and fluency of short or long positions; and
• No counterparty risk.

Among the processes that have already started and are soon to be fully implemented are electronic settlement trade and exchange-traded derivatives. Before 1995, markets in India used open outcry, a trading process in which traders shouted and hand signaled from within a pit. One major policy initiated by SEBI from 1993 involved the shift of all exchanges to screen-based trading, motivated primarily by the need for greater transparency. The first exchange to be based on an open electronic limit order book was the National Stock Exchange (NSE), which started trading debt instruments in June 1994 and equity in November 1994. In March 1995, BSE shifted from open outcry to a limit order book market. Currently, 17 of India’s stock exchanges have adopted open electronic limit order.

**Capital Market Reforms and Developments**

Over the last few years, SEBI has announced several far-reaching reforms to promote the capital market and protect investor interests. Reforms in the secondary market have focused on three main areas: structure and functioning of stock exchanges, automation of trading and post trade systems, and the introduction of surveillance and monitoring systems. Computerized online trading of securities, and setting up of clearing houses or settlement guarantee funds were made compulsory for stock exchanges. Stock exchanges were permitted to expand their trading to locations outside their jurisdiction through computer terminals. Thus, major stock exchanges in India have started locating computer terminals in far-flung areas, while smaller regional exchanges are planning to consolidate by using centralized trading under a federated structure. Online trading systems have been introduced in almost all stock exchanges. Trading is much more transparent and quicker than in the past. Until the early 1990s, the trading and settlement
infrastructure of the Indian capital market was poor. Trading on all stock exchanges was through open outcry, settlement systems were paper-based, and market intermediaries were largely unregulated. The regulatory structure was fragmented and there was neither comprehensive registration nor an apex body of regulation of the securities market. Stock exchanges were run as “brokers clubs” as their management was largely composed of brokers. There was no prohibition on insider trading, or fraudulent and unfair trade practices. Since 1992, there has been intensified market reform, resulting in a big improvement in securities trading, especially in the secondary market for equity.

Most stock exchanges have introduced online trading and set up clearing houses/corporations. A depository has become operational for scrip less trading and the regulatory structure has been overhauled with most of the powers for regulating the capital market vested with SEBI. The Indian capital market has experienced a process of structural transformation with operations conducted to standards equivalent to those in the developed markets. It was opened up for investment by foreign institutional investors (FIIs) in 1992 and Indian companies were allowed to raise resources abroad through Global Depository Receipts (GDRs) and Foreign Currency Convertible Bonds (FCCBs). The primary and secondary segments of the capital market expanded rapidly, with greater institutionalization and wider participation of individual investors accompanying this growth. However, many problems, including lack of confidence in stock investments, institutional overlaps, and other governance issues, remain as obstacles to the improvement of Indian capital market efficiency.

**Role of Capital Market in India:**

Markets exist to facilitate the purchase and sale of goods and services. 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 distinction between capital market and money market is that 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
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 saving for investment)\(^4\). Thus, the savings normally flow from household sector to business or Government sector, which normally invest more than they save. A vibrant and efficient capital market is the most important parameter for evaluating health of any economy.

**Secondary Market**

The stock exchanges in the country offer screen-based trading system. There were 10,268 trading members registered with SEBI\(^5\) at the end of March 2012. The market capitalization has grown over the period, indicating that more companies are using the trading platform of the stock exchange. The market capitalization across India was around 62,191 billion (US $ 1,215 billion) at the end of March 2012. Market capitalization ratio is defined as the market capitalization of stocks divided by the GDP. It is used as a measure that denotes the importance of equity markets relative to the GDP. It is of economic significance since the market is positively correlated with the ability to mobilize capital and diversify risk. The all-India market capitalization ratio decreased to 70.2 percent in 2011–2012 from 89.2 percent in 2010-11\(^6\).

**Stock Market**

Stock Market is a place where the trading takes place. A place where lots of money is invested to buy stocks and lots of money is earned while selling stocks. Some people go with profit and some people carries losses\(^7\). But still for a trader it’s an everyday game. And in games there are certain rules and regulations
to be followed then only you can’t make strategies and plans and play the game according to it and win it. For a new trader the first thing to know about is where to invest, how to invest, how much to invest and win the game of investment.

How to invest?
When an investor starts investing in the stocks or the commodity market he has some prominent exchanges to invest in. Few important ones are as follows:

- **BSE (Bombay Stock Exchange):**
- **NSE (National Stock Exchange):**
- **MCX (Multi Commodity Exchange):**

**Regulatory Frame work for Indian Capital market**

The securities market transactions are subject to regulations under the four main legislations\(^8\) viz.,

- The Securities and Exchange Board of India Act, 1992;
- The Securities Contracts (Regulation) Act, 1956;
- The Depositories Act, 1996; and
- Certain provisions of the Companies Act, 1956.

**Depository**

The Bank for International settlements (BIS)\(^9\) defines depository as “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)”. “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\(^10\) 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”. It is understood from the above definitions that the depository is a place where securities are stored, recorded in the books on behalf of the investors. In recent times, the volume of
securities and the size of the business handled have increased manifold. Hence, the present day depositories are fully automated to serve the customers faster and with accuracy.

A depository is a nominee who keeps the scrips on behalf of the investors. He undertakes the custodian role. The depository leads the capital market towards scrip less system through immobilization and dematerialization of share certificates. Immobilization of securities means stopping the physical movement. The number physical certificates that pass between company and customers become negligible as lodged and the immobilized certificates are registered in the name of depository nominee. Dematerialization means issue of one certificate in favour of the depository Nominee or not issuing the certificates. The depository operates the computerized book entry transfer for the securities. This results in a speedier and more liquid trading environment. The depository also undertakes the trade and settlement processing through its subsidiary as a part of its function.

**Objectives of a Depository**

A depository enables the capital market to achieve the following the objectives:

- Reduce the time for transfer of securities.
- Avoid the risk of settlement of securities.
- Enhance liquidity and efficiently.
- Reduce cost of transaction for the investor.
- Create a system for the central handling of all securities.
- Promote the country’s competitiveness by complying with global standards.
- Provide service infrastructure in a capital market.

**Functions of the Depository**

The main functions /activities of the depository are as follows:

- Accepting deposit of securities for custody.
- Making computerized book entry deliveries of securities which are immobilized in its custody.
• Creating computerized book entry pledges of securities in its custody.
• Providing for withdrawal of securities.
• Undertaking corporate actions like distribution of dividend and interest.
• Redemption of securities on maturity.
• Dematerialization is converting physical certificates to electronic form.
• Rematerialisation is reverse of demat, getting physical certificates from the electronic securities.
• Transfer of securities, change of beneficial ownership.
• Settlement of trades done on exchange connected to the Depository.
• Electronic credit in public offering of the companies.
• Non-cash benefits like Bonus/Rights-direct credit into the electronic form

A Depository is an organization where the securities of share holders are held in the electronic format the request of the share holder through the medium of a depository participant. In September, 1995 the Government have accepted in principle the proposed law for settling up of depositories and of a central depository for immobilization of physical certificates. The central depository is to be set up as trust to hold the physical custody of shared and effect transfers by book entries without the need to deal and transfer the physical certificates between parties. This is to be sponsored by public financial institutions and banks and will have a minimum net worth of ` 50-100 crores as proposed by the SEBI. This central depository can be connected to a number of share depositories for effecting transfer in book entries. The Foreign financial institutions agencies, NRI’s and OCBs have for long required the depository of this type for facilitating their trade in the Indian stock markets. These foreign security firms who were linked by the SEBI are operating in India, but physical custody of the Indian securities has to be handled by Indian custodian such as a bank which taken converted into depository participants. The guidelines and regulations in aspect of the operations of depository participants will help smooth operations among participants and their operations with the central depository. A national securities depository corporation was set up in November, 1996.
The Central Depository system aims at immobilization of physical certificates. This is done by means of book entries with central depository who keeps custody of all physical certificates as a first step. As a next step, new issues will be made as book entries only and not as physical certificates. Book entries transfers will lead to quicker transfers and at lower costs. It meets the increasing work load of investment activity and dealings to increasing volume of transfer work. In the Depository system, the Depository extends its services to investors through intermediaries called depository participants (DP) who as per SEBI regulations could be organizations involved in the business of providing financial services like banks, broker, custodians and financial institutions. Realizing the potential in this market all the custodians in India and a number of banks, financial institutions and major brokers have already joined as DPs and they are providing services in a number of cities. Many more organizations are in various stages of establishing connectivity with Depositories.

The admission of the DPs involve an evaluation by Depository of their capability to meet with the strict services standards of Depository and a further evaluation and approval by SEBI. Towards, the end of the twentieth century three was two interesting prognostications about India’s potential. The first was by a professor of business management in the United States (Rosenweig, 1998). He estimated that by 2025, India would be the third largest economy in the world (After the US and China). The second projection was by a well-known Indian Economist (Parikh, 1999). It was projected that India would reach a per capita income of U.S. $ 30,000 or higher by 2047, making it one of the fastest growing countries in the world. Indian capital market has been linked to the International Financial Market, and the standard has been increased in terms of efficiency and transparency through Dematerialization of the Indian Capital Market. In this context dematerialization is one of the right steps taken by the Government to make the share transfer process easier and on other hand the earlier demerits of the paper transfer process can be rectified. Dematerialization is a process in which
the company takes the physical certificates of an investor back and equivalent number of shares is credited in the electronic holdings of the investor.

The Indian Capital Market has been showing rapid growth in the recent past this can be observed from the key indicators of the capital market. But this growth has not matched with the supporting infrastructure to handle the growing volume of paper that has flooded the market choking in our existing system this has caused a lot of problems like delay in transfer of shares, settlement of claims high level of failed trade, bad deliveries and high systematic risk exposure etc. The problem of Indian Capital Market is not its size but the lack of infrastructure services to handle its present size and potential growth in the future with the entry of foreign investors and the institutionalization of markets. There had been tremendous pressure on the stock market. For its smooth operations the capital market regulator, SEBI, mandated that stock exchanges must begin the phased introduction of compulsory trading in dematerialized shares by all investors, with effect from January 4, 1999. By April 2005, 60 stocks comprising 77 percent of the market capitalization was traded through D-mat. Today most of the traded shares have changed their states from paper to D-mat form. Dematerialization of securities is a major step for improving and modernizing our markets and enhancing the level of investor protection.

A depository is very much like a bank in many of its operations. We can draw an analogy between the two in order to get a better understanding of the depository system. (See Fig 1.1)

**Fig 1.2: An Analogy of NSDL and Bank**

<table>
<thead>
<tr>
<th>NSDL</th>
<th>BANK</th>
</tr>
</thead>
<tbody>
<tr>
<td>Holds securities in accounts</td>
<td>Holds funds in accounts</td>
</tr>
<tr>
<td>Transfers securities between account</td>
<td>Transfers funds between accounts</td>
</tr>
<tr>
<td>Transfers without handling physical securities</td>
<td>Transfers without handling cash</td>
</tr>
<tr>
<td>Safekeeping of securities</td>
<td>Safekeeping of Money</td>
</tr>
</tbody>
</table>
In a bank the medium of exchange is money, whereas a depository deals in securities. In a bank, money is given for safe-keeping. In a depository, securities are kept safely. Banks hold and transfer funds; depositories perform the same function with securities. Banks can transfer funds from one account to another without handling cash; a depository can do the same with physical securities. Just as in a bank an account is opened to avail of the banking services, any account has to be opened with a DP for holding scrips in the depository.

**Fig 1.3: The Differences between NSDL and Bank**

<table>
<thead>
<tr>
<th></th>
<th>Bank</th>
<th>NSDL</th>
</tr>
</thead>
<tbody>
<tr>
<td>Either of holders can sign instruction</td>
<td>All joint holders to sign instruction</td>
<td></td>
</tr>
<tr>
<td>Minimum balance to be maintained</td>
<td>No minimum balance required</td>
<td></td>
</tr>
<tr>
<td>Entitled for interest</td>
<td>Interest can be earned only by participating in stock lending scheme</td>
<td></td>
</tr>
<tr>
<td>Uses balance in accounts</td>
<td>Does not move balances in account without account holder’s authorization</td>
<td></td>
</tr>
<tr>
<td>Nomination is kept confidential</td>
<td>Signature and photograph of nominee to be provided</td>
<td></td>
</tr>
</tbody>
</table>

In case of transactions in a bank account, any one of the joint holders can sign the instructions (cheques), whereas in the depository, all joint holders are required to sign all the instructions. Minimum funds balance prescribed by the bank has to be maintained in the bank account; no minimum balance of securities is required to be maintained in a depository account. A bank uses the funds held in a bank account for lending purposes. The securities maintained in a depository account by an investor can be moved from the account only on basis of a proper authorization from the account holder. A depository cannot use the client's security balances\(^12\). Nomination is kept confidential in case of bank accounts. The photograph and signature of the nominee is required to be affixed on the nomination form for registering the nomination for a depository account.
Depository System in India

The earlier settlement system on Indian stock exchanges was very inefficient as it was unable to take care of the transfer of securities in a quick/speedy manner. Since, the securities were in the form of physical certificates; their quick movement was again difficult. This led to settlement delays, theft, forgery, mutilation and bad deliveries and also to added costs. To wipeout these problems, the Depositories Act 1996 was passed. It was formed with the purpose of ensuring free transferability of securities with speed, accuracy & security. It has been able to do so by:

- Making securities of public limited companies freely transferable, subject to certain exceptions;
- Dematerializing the securities in the depository mode; and
- Providing for maintenance of ownership records in a book entry form.

For performing the above tasks, two depositaries viz, National Securities Depository Limited (NSDL) & Central Depository Services Limited (CDSL) have come up.

Capital Markets Performance

Indian stock markets mirrored the global sentiments with the indices sliding during 2011-12. The BSE Sensex closed at 17,404 on March 30, 2012 compared to the close of 19,445 on March 31, 2011. S&P CNX Nifty closed at 5,296 on March 30, 2012 compared to close of 5,834 on March 31, 2011. The percent decrease in BSE Sensex recorded as on end-March 2012 over end-March 2011 was at 10.5 percent while that for the S&P CNX Nifty during the same period stood at 9.2 percent. The market capitalization of BSE stands at `62,14,941 crore as of end-March 2012 compared to `68,39,084 in end-March 2011, while its ratio to GDP stood at 70 percent for 2011-12. The number of demat accounts at the two depositaries has risen up sharply and the process of dematerialization is still in progress. Simultaneously the number of listed
companies at both NSE and BSE has raised steadily acting as a strong indicator of favorable market sentiments\(^\text{13}\). (Table 1.1 & 1.2)

### Table 1.1 Shares in Demat

<table>
<thead>
<tr>
<th>Years</th>
<th>NSDL</th>
<th>CDSL</th>
</tr>
</thead>
<tbody>
<tr>
<td>2008-09</td>
<td>2,82,870</td>
<td>70,820</td>
</tr>
<tr>
<td>2009-10</td>
<td>3,51,138</td>
<td>77,950</td>
</tr>
<tr>
<td>2010-11</td>
<td>4,71,304</td>
<td>1,05,310</td>
</tr>
<tr>
<td>2011-12</td>
<td>5,79,801</td>
<td>1,33,570</td>
</tr>
</tbody>
</table>

*Note: Indicates as on last day of March 12\(^\text{15}\)*

*Source: NSDL\(^\text{14}\) and CSDL\(^\text{15}\)*

#### Fig 1.4 Shares in Demat

![Graph showing shares in Demat from 2008-09 to 2011-12 for NSDL and CDSL](image)

### Table 1.2 Listed Companies in NSE and BSE

<table>
<thead>
<tr>
<th>Years</th>
<th>NSE</th>
<th>BSE</th>
</tr>
</thead>
<tbody>
<tr>
<td>2008-09</td>
<td>1,432</td>
<td>4929</td>
</tr>
<tr>
<td>2009-10</td>
<td>1,470</td>
<td>4975</td>
</tr>
<tr>
<td>2010-11</td>
<td>1,574</td>
<td>5067</td>
</tr>
<tr>
<td>2011-12</td>
<td>1,646</td>
<td>5133</td>
</tr>
</tbody>
</table>

*Source: NSE and BSE*
Turnover in Indian Stock Market

The turnover in the equity derivative segment has risen from 2, 92, 48,375 crore in 2010-11 to 3, 21, 58,208 crore in 2011-12. The currency derivative segment too has seen a rise in its turnover from being 76, 43,805 crore in 2010-11 to 98, 96,413 crore in 2011-12 (Table1.3).

Growth of Indian Stock Market

Over the past few years, the financial markets have become increasingly global. The Indian market has gained from foreign inflows through the investment of Foreign Institutional Investors (FIIs). Following the implementation of reforms in the securities industry in the past few years, Indian stock markets have stood out in the world ranking. As per Standard and Poor’s Fact Book 2012, India ranked 11th in terms of market capitalization, 17th in terms of total value traded in stock exchanges, and 30th in terms of turnover ratio, as of December 2011.
Table 1.3 Growth of turnover in various segments of Indian stock market

<table>
<thead>
<tr>
<th>Years</th>
<th>Cash Segment (All India)</th>
<th>Equity derivatives (NSE+BSE)</th>
<th>Currency Derivatives (NSE+MCX+USE)</th>
<th>Interest Rate Derivatives (NSE)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2009-10</td>
<td>55,16,833</td>
<td>1,76,63,899</td>
<td>37,27,262</td>
<td>2,975</td>
</tr>
<tr>
<td>2010-11</td>
<td>46,82,437</td>
<td>2,92,48,375</td>
<td>76,43,805</td>
<td>62</td>
</tr>
<tr>
<td>2011-12</td>
<td>34,78,391</td>
<td>3,21,58,208</td>
<td>98,96,413</td>
<td>3,959</td>
</tr>
</tbody>
</table>

Source: Exchanges

National Stock Exchange, MCX-SX and United Stock Exchange of India feature in the top-30 derivatives exchanges, ranked by the number of contracts traded and/or cleared, at positions 5, 9, 13 respectively. Nifty index options have been ranked the world’s second most traded option in calendar year 2011 as per Futures Industry Association while Nifty index futures rank at number 12. As per the 2011, Annual Volume Statistics published by the Futures Industry Association, National Stock Exchange (NSE) has seen an increase of 36 percent in the number of contracts traded in the equity derivatives segment and is ranked fifth worldwide as compared 2010. The foreign investments in India contributed by the FII and FDI at the end of March 2012 stood at ₹ 13, 39,240 crore up from ₹ 12,52,781 crore at the end of March 2011.

DPs and Turnover of NSDL and CDSL

A Depository (NSDL & CDSL) is an organization like a Central Bank where the securities of a shareholder are held in the electronic form at the request of the shareholder through the medium of a Depository Participant. If an investor wants to utilize the services offered by a Depository, the investor
has to open an account with the Depository through a Depository Participant it make all turnover impacts in Indian security market.

### Table 1.4 DPs and Turnover of NSDL and CDSL

<table>
<thead>
<tr>
<th>Years</th>
<th>NSDL DP’s</th>
<th>CDSL DP’s</th>
<th>Capital Market Turnover</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td>Cash Segment (All India)</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2007-08</td>
<td>420</td>
<td>239</td>
<td>51,30,816</td>
</tr>
<tr>
<td>2008-09</td>
<td>468</td>
<td>258</td>
<td>38,52,579</td>
</tr>
<tr>
<td>2009-10</td>
<td>497</td>
<td>279</td>
<td>55,16,833</td>
</tr>
<tr>
<td>2010-11</td>
<td>544</td>
<td>288</td>
<td>46,82,437</td>
</tr>
<tr>
<td>2011-12</td>
<td>567</td>
<td>297</td>
<td>34,78,391</td>
</tr>
</tbody>
</table>

Source: SEBI Annual Reports, NSDL, CDSL Annual Reports.

### Assets under the Custody of Custodians

The value of securities held in the custody of depository witnessed a tremendous growth of any depository. Higher value of demat stock shows the higher growth of the depository. Therefore, every depository wants to increase their value of dematerialization stock with the help of increase in the number of participants and increase the number of accounts of the investors.

### Table 1.5: Assets under the Custody of Custodians

<table>
<thead>
<tr>
<th>Years</th>
<th>FIIS/SAs</th>
<th>Foreign Depositories</th>
<th>FDI Investment</th>
<th>Foreign Venture Capital Investment</th>
</tr>
</thead>
<tbody>
<tr>
<td>2009-10</td>
<td>9,00,869</td>
<td>1,56,616</td>
<td>1,45,555</td>
<td>17,604</td>
</tr>
<tr>
<td>2010-11</td>
<td>11,06,550</td>
<td>1,85,931</td>
<td>1,46,231</td>
<td>24,002</td>
</tr>
<tr>
<td>2011-12</td>
<td>11,07,399</td>
<td>1,43,370</td>
<td>2,31,841</td>
<td>35,041</td>
</tr>
</tbody>
</table>

Source: SEBI

Note: As on last trading day of respective financial year

The securities market has essentially three categories of participants—the issuer of the securities, the investors in the securities, and the intermediaries. The issuers are the borrowers or deficit savers, who issue securities to raise funds. The investors, who are surplus savers, deploy their savings by subscribing to these securities. The intermediaries are the agents who match the needs of the users and the suppliers of funds for a commission. These intermediaries function to help both the issuers and the investors to achieve their respective goals.

There are a large variety and number of intermediaries providing various services in the Indian securities market. This process of mobilizing the resources is carried out under the supervision and overview of the regulators. The regulators develop fair market practices and regulate the conduct of the issuers of securities and the intermediaries. They are also in charge of protecting the interests of the investors. The regulator ensures a high service standard from the intermediaries, as well as the supply of quality securities and non-manipulated demand for them in the market.

Table 1.6 Market Participants in Security Market

<table>
<thead>
<tr>
<th>Market Participants</th>
<th>2010-2011</th>
<th>2011-2012</th>
<th>2012-2013$</th>
</tr>
</thead>
<tbody>
<tr>
<td>Stock Exchanges (Cash Market)</td>
<td>19</td>
<td>19</td>
<td>20</td>
</tr>
<tr>
<td>Stock Exchanges (Derivatives Market)</td>
<td>2</td>
<td>2</td>
<td>2</td>
</tr>
<tr>
<td>Stock Exchanges (Currency Derivatives)</td>
<td>4</td>
<td>4</td>
<td>4</td>
</tr>
<tr>
<td>Brokers (Cash Segment)*</td>
<td>10,203</td>
<td>10,268</td>
<td>9,995#</td>
</tr>
<tr>
<td>Corporate Brokers (Cash)</td>
<td>4,774</td>
<td>4,877</td>
<td>4,987#</td>
</tr>
<tr>
<td>Segment</td>
<td>2011</td>
<td>2012</td>
<td>2013</td>
</tr>
<tr>
<td>---------</td>
<td>------</td>
<td>------</td>
<td>------</td>
</tr>
<tr>
<td>Brokers (Equity Derivative)</td>
<td>2,111</td>
<td>2,337</td>
<td>2,797</td>
</tr>
<tr>
<td>Brokers (Currency Derivatives)</td>
<td>2,008</td>
<td>2,173</td>
<td>2,287</td>
</tr>
<tr>
<td>Sub-brokers (Cash Segment)</td>
<td>83,808</td>
<td>77,141</td>
<td>70,536</td>
</tr>
<tr>
<td>Foreign Institutional Investors</td>
<td>1,722</td>
<td>1,765</td>
<td>1,760</td>
</tr>
<tr>
<td>Sub-accounts</td>
<td>5,686</td>
<td>6,322</td>
<td>6,331</td>
</tr>
<tr>
<td>Custodians</td>
<td>17</td>
<td>19</td>
<td>19</td>
</tr>
<tr>
<td>Depositories</td>
<td>2</td>
<td>2</td>
<td>2</td>
</tr>
<tr>
<td>Depository Participants</td>
<td>805</td>
<td>854</td>
<td>868</td>
</tr>
<tr>
<td>Merchant Bankers</td>
<td>192</td>
<td>200</td>
<td>199</td>
</tr>
<tr>
<td>Bankers to an Issue</td>
<td>55</td>
<td>57</td>
<td>57</td>
</tr>
<tr>
<td>Underwriters</td>
<td>3</td>
<td>3</td>
<td>3</td>
</tr>
<tr>
<td>Debenture Trustees</td>
<td>29</td>
<td>31</td>
<td>31</td>
</tr>
<tr>
<td>Credit Rating Agencies</td>
<td>6</td>
<td>6</td>
<td>6</td>
</tr>
<tr>
<td>KYC Registration Agency (KRA)</td>
<td>NA</td>
<td>NA</td>
<td>5</td>
</tr>
<tr>
<td>Venture Capital Funds</td>
<td>184</td>
<td>212</td>
<td>211</td>
</tr>
<tr>
<td>Venture Capital Funds</td>
<td>153</td>
<td>174</td>
<td>182</td>
</tr>
<tr>
<td>Alternative Investment Funds</td>
<td>NA</td>
<td>NA</td>
<td>27</td>
</tr>
<tr>
<td>Registrars to an Issue &amp; Share Transfer Agents</td>
<td>73</td>
<td>74</td>
<td>72</td>
</tr>
<tr>
<td>Portfolio Managers</td>
<td>267</td>
<td>250</td>
<td>250</td>
</tr>
<tr>
<td>Mutual Funds</td>
<td>51</td>
<td>49</td>
<td>51</td>
</tr>
<tr>
<td>Collective Investment Schemes</td>
<td>1</td>
<td>1</td>
<td>1</td>
</tr>
<tr>
<td>Approved Intermediaries (Stock Lending Schemes)</td>
<td>2</td>
<td>2</td>
<td>2</td>
</tr>
</tbody>
</table>

# Stock Brokers registered on Hyderabad Stock Exchange are not included, as the said stock exchange has been granted exit vide order Dated January 25, 2013.

NA: Not Applicable

Including brokers on Mangalore SE (57), HSE (298), Magadh SE (189), SKSE (388)

Source: SEBI

**Depository Participant**

Depository Participant is the agent of the Depository and is the interface between the depository and the investor. According to SEBI guidelines, financial institutions, banks, custodians, stockbrokers etc can become Depository Participants. SCHIL is the first participant registered with NSDL. In order to avail
the services of a depository, an investor has to open an account with a depository through a DP just like a person opening an account with the branch of a bank. A DP is responsible for maintaining the securities accounts of the investors and handling it in accordance with the investor’s instructions. Depository Participant is the key player in the system, which acts as an agent of the Depository and is in fact the customer interface of depository. It opens the accounts of the investors, facilitates dematerialization, settle trades and effects corporate actions.

**Eligibility for being a depository participant**

As per SEBI\(^{17}\) (Depositories and Participants) Regulations, 1996, the following categories are eligible to become DP’s.

- Public Financial Institution as defined in section 4A of the companies Act, 1956.
- Bank included in the Second Schedule of the RBI Act, 1934.
- RBI approved foreign banks operating in India.
- State Financial Corporation established under section 3 of SFC Act, 1951.
- Institution engaged in providing financial services, promoted by any of the institutions mentioned above, either jointly or separately.
- Custodian of Securities who has been granted certificate of registration under section 12 (1A) of SEBI Act.
- Clearing Corporation or Clearing house of Stock Exchange.
- The Stockbroker, who has been granted certificate of registration under section 12 (1) of SEBI Act, provided that:
  
  (a) They have a minimum net worth of Rs.50lakh.
  
  (b) Aggregate value of the Portfolio of securities held in dematerialized form in a depository through each stockbroker should not be more than 25 times his net worth.
- Non-banking Finance company provided that:
  
  (a) They have a minimum net worth of Rs.5lakh, if they wish to act as a DP only on behalf of themselves and not on behalf of any other person.
(b) They have a minimum net worth of Rs.50crore in addition to the net worth specified by any other authority, if they wish to act as DP on behalf of any other person.

The Regulations empower CDSL to set its own selection criteria in the Byelaws.

Thus the applicants must also comply with the following admission criteria stated in the Byelaws:

- The applicant should have a minimum net worth of Rs.1.5crore.
- The applicant should not have been convicted in any of the five years immediately preceding the filing of the application in any manner involving misappropriation of funds and securities, theft, embezzlement of funds, fraudulent conversion or forgery.
- The applicant should not have been expelled, barred or suspended by SEBI, self-regulatory organization or any stock exchange.

**The segments in DP business include five main businesses**

- **Account Opening**
- **Dematerialization**
- **Rematerialization**
- **Trading and Settlement**
- **Pledge and Hypothecation**

**Clearing Corporation**

The clearing corporation provides clearing services and is responsible for the clearing and settlement system for its clearing members and investors to settle the trade of Depository System. The National Securities Clearing Corporation Limited (NSCCL) is a wholly earned subsidiary of NSE. It coordinates between the exchange for executed trades, clearing members and custodians for bringing in the necessary funds and securities for settlement.

Clearing banks for settlement of funds.

Depository for security settlement.

**Registrar and Transfer Agent**
The registrar and transfer agent (RTA) is a critical link between Issuer Company, Stock trader and Investor. Whether it is a primary market, public issue or a secondary market trade, role of RTA is important as issue of securities or transfer of securities is done through this agency. The scope of work for registrars to issue and share transfer agents for securities admitted in the depository system are under:

- Maintaining of folios in the depository.
- Updating of data downloaded by the depository on a periodical basis.
- Confirmation of updating to depository on a daily basis.
- Scanning of front and back of share certificate before dematerialization.
- Issue of certificates on rematerialization.
- Jobs relating to public issues.

**Dematerialization of physical stock**

In case of primary issues, the investor may opt for allotment of securities in electronic form. In order to exercise this option, the investor needs to have an account with a participant. While filling up the application form for the issue the investor has to mention its account number with the participant and also the identification number of the participant with NSDL. On receiving electronic intimation from the issuer/R&T agent simultaneously informs the investor of the allotment by post. 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 beneficiary account.

**Procedure for Dematerialization of Physical Stock**

No requests for Demat should be entertained for a person other than the registered shareholder in the books of the company. The client will submit a request to the Depository Participant in the dematerialization request form for dematerialization along with the certificates of securities to be dematerialized. Before submission, the client to deface the certificates by writing “surrendered for Demat”.

23
The Depository Participant will verify that the form is duly filled in and the number of certificates, number of shares and the security type (Equity, Debentures etc) are given in the DRF (Demat Request Form). If the form and security count is in order, the participant will scrutinize the form and the certificates which involve the following:

- Verification of client’s signature on the Dematerialized request with the specimen signature (the signature on the account opening form). If the signature differs, the Participant should ensure himself of the identity of the client
- Compare the names on DRF & the certificates with the client account.
- paid-up status
- ISIN
- pari passu status
- lock-In status
- distinctive numbers

**Rematerialisation**

Rematerialisation\(^{19}\) is the process of issuing physical securities in place of the securities held electronically in book-entry form with depository. Under this process, the depository account of a beneficial owner is debited for the securities sought to be rematerialized and physical certificates for the equivalent number of securities are issued.

A beneficial owner holding the securities with a depository has a right to get his electronic holding converted into physical holding at any time. The beneficial owner desiring to receive physical security certificates in place of the electronic holding should make a request to the issuer or it’s R&T Agent through his DP in the prescribed Rematerialization Request Form (RRF).
Trading and Settlement in Depository System

Trading in Dematerialized securities is different from trading in physical securities and trade in one form cannot be settled in another form. However, SEBI has announced that with effect from 6th April, 1998, dematerialized securities can be delivered against obligation in the physical market of both NSE and BSE. This means an investor who has sold securities in physical market can deliver either physical or dematerialized securities. But physical securities cannot be delivered against obligation in the market for dematerialized securities. Currently; dematerialized securities can be traded on NSE and BSE. All trades done in Depository segment with effect from 15th January, 1998 should follow Rolling Settlement Cycle.

Rolling Settlement (T+3)

In case of Rolling Settlement Cycle, the accounting period is reduced to one day. This means that if the broker executes the transaction on Monday, settlement of the same will be on Thursday. Similarly, for trades executed on Tuesday, settlement will be on Friday and so on.

Procedure for Selling Demat Securities

The procedure for selling Demat securities is very simple. After selling the securities one would instruct his/her DP to debit his/her account with the number of securities sold by him and credit his/her broker’s account. This delivery instruction has to be given to his/her DP using the delivery instruction slips given to him/her by his DP at the time of opening the account.

Legal Framework for Depository and Depository Participants

The operations of depositories in India are regulated primarily under the following legal framework:
• The Depositories Act, 1996
• SEBI (Depositories and Participants) Regulations, 1996
• Bye-laws approved by SEBI, and
• Operating Instructions of the depository
• Prevention of Money Laundering Act, 2002

References:
5. www.sebi.gov.in
14. www.nsdl.co.in
15. www.cdsl.co.in