

NiSM

National Institute of Securities Markets

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Workbook for

NISM – Series – VI:  
Depository Operations Certification Examination

**Workbook  
for  
NISM-Series-VI: Depository Operations  
Certification Examination**

**NiSM**  
**National Institute of Securities Markets**  
[www.nism.ac.in](http://www.nism.ac.in)

This workbook has been developed to assist candidates in preparing for the National Institute of Securities Markets (NISM) Certification Examination for Depository Operations.

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NISM certification examinations and educational programs cater to different segments of intermediaries focusing on varied product lines and functional areas. NISM Certifications have established knowledge benchmarks for various market products and functions such as Equities, Mutual Funds, Derivatives, Compliance, Operations, Advisory and Research.

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NISM supports candidates by providing lucid and focused workbooks that assist them in understanding the subject and preparing for NISM Examinations. This book covers all the aspects related to the depository operations in India. Candidates will be able to understand the institutional structure of the depository system in India; processes related to dematerialisation, trading and settlement, pledging and hypothecation. This book will be beneficial to all the candidates who want to learn about the functions of Depositories and Depository Participants.

**Sandip Ghose**  
**Director**

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While the NISM Certification examination will be largely based on material in this workbook, NISM does not guarantee that all questions in the examination will be from material covered herein.

## **Acknowledgement**

This workbook has been developed by NISM in consultation with the Examination Committee for NISM-Series-VI: Depository Operations Certification Examination consisting of representatives from National Securities Depository Limited (NSDL) and Central Depository Services Limited (CDSL). NISM gratefully acknowledges the contribution of all the committee members.

## **About the Author**

This workbook has been developed by the certification team of NISM.

## **About NISM**

National Institute of Securities Markets (NISM) was established by the Securities and Exchange Board of India (SEBI), in pursuance of the announcement made by the Finance Minister in his Budget Speech in February 2005.

SEBI, by establishing NISM, articulated the desire expressed by the Government of India to promote securities market education and research.

Towards accomplishing the desire of Government of India and vision of SEBI, NISM delivers financial and securities education at various levels and across various segments in India and abroad. To implement its objectives, NISM has established six distinct schools to cater to the educational needs of various constituencies such as investors, issuers, intermediaries, regulatory staff, policy makers, academia and future professionals of securities markets.

NISM is mandated to implement Certification Examinations for professionals employed in various segments of the Indian securities markets.

NISM also conducts numerous training programs and brings out various publications on securities markets with a view to enhance knowledge levels of participants in the securities industry.

## **About NISM Certifications**

The School for Certification of Intermediaries (SCI) at NISM is engaged in developing and administering Certification Examinations and CPE Programs for professionals employed in various segments of the Indian securities markets. These Certifications and CPE Programs are being developed and administered by NISM as mandated under Securities and Exchange Board of India (Certification of Associated Persons in the Securities Markets) Regulations, 2007.

The skills, expertise and ethics of professionals in the securities markets are crucial in providing effective intermediation to investors and in increasing the investor confidence in market systems and processes. The School for Certification of Intermediaries (SCI) seeks to ensure that market intermediaries meet defined minimum common benchmark of required functional knowledge through Certification Examinations and Continuing Professional Education Programmes on Mutual Funds, Equities, Derivatives Securities Operations, Compliance, Research Analysis, Investment Advice and many more.

Certification creates quality market professionals and catalyzes greater investor participation in the markets. Certification also provides structured career paths to students and job aspirants in the securities markets.

## **About the Workbook**

This workbook has been developed to assist candidates in preparing for the National Institute of Securities Markets (NISM) Certification Examination for Depository Operations. NISM-Series-VI: Depository Operations Certification Examination seeks to create a common minimum knowledge benchmark for associated persons engaged or employed by a registered depository participant in (a) dealing or interacting with clients; (b) dealing with securities of clients; (c) handling redressal of investor grievances; (d) internal control or risk management; (e) activities having a bearing on operational risk; (f) maintenance of books and records pertaining to the above activities.

The book covers the various functions of depositories and their depository participants, the regulatory framework under which the depository system functions in India.

## **About the Certification Examination for Depository Participants**

The examination seeks to create a common minimum knowledge benchmark for associated persons engaged or employed by a registered depository participant in:

- (a) dealing or interacting with clients;
- (b) dealing with securities of clients;
- (c) handling redressal of investor grievances;
- (d) internal control or risk management;
- (e) activities having a bearing on operational risk; or
- (f) maintenance of books and records pertaining to the above activities

The certification aims to enhance the quality of services as rendered by the Depository Participants.

### **Examination Objectives**

On successful completion of the examination, the candidate should:

- Know the basics of the Indian securities market and the depository system, the need for depository and the key features of the depository system in India.
- Understand the institutional structure of the depository system in India and the business partners of a depository.
- Understand the regulatory framework in which the depositories and its DPs function, their eligibility criteria, registration procedure, rights and obligations etc.
- Know the various functions of the Depository and its Depository Participants (DPs) such as dematerialisation, trading and settlement, pledging and hypothecation.  
Understand how a demat account is opened, documents required to open an account and significance of Power of Attorney (POA).

### **Assessment Structure**

The examination consists of 100 questions of 1 mark each and should be completed in 2 hours. The passing score on the examination is 60percent. There shall be negative marking of 25percent of the marks assigned to a question.

### **Examination Structure**

The exam covers knowledge competencies related to the basics of depository operations, services provided by the depository participants, account opening formalities and maintenance of the account, and the regulatory framework in which the depositories function and the different business partners of a Depository.

### **How to register and take the examination**

To find out more and register for the examination please visit [www.nism.ac.in](http://www.nism.ac.in)

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## Chapter 1: Introduction to the Indian Capital Market

### Learning Objectives:

After studying this chapter, you should know about:

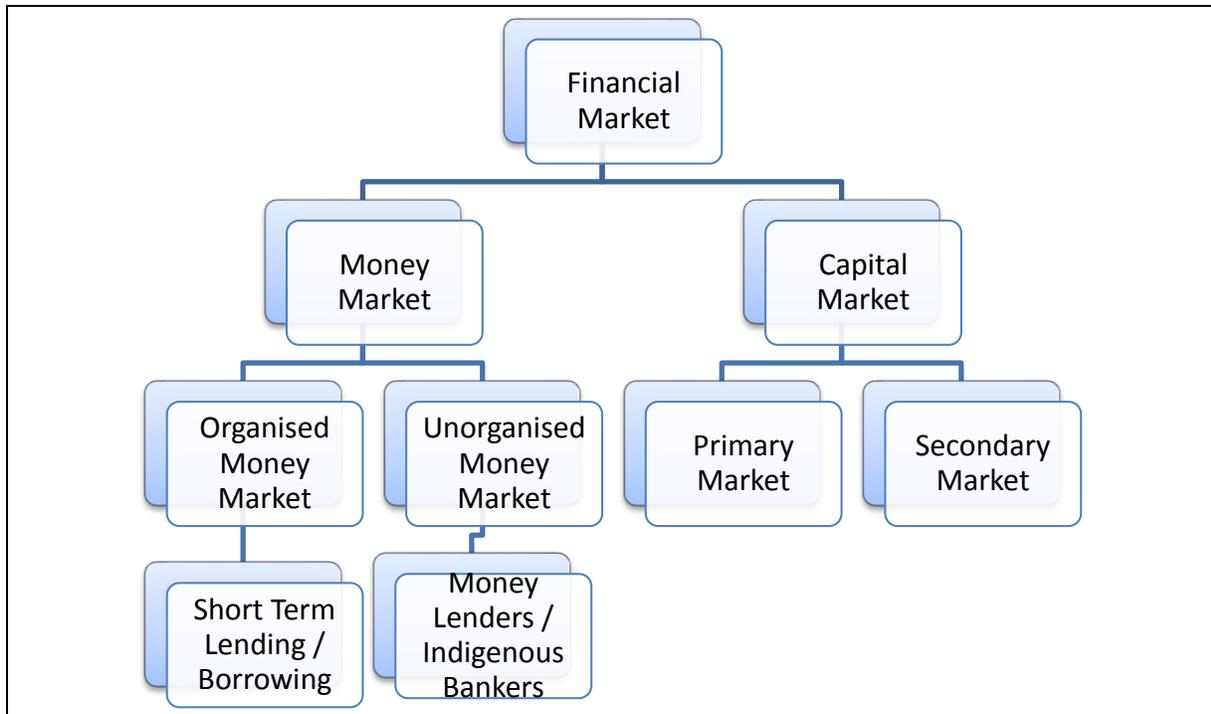
- Capital market and its role in the economy
- Structure and participants of capital market
- Regulators and regulations related to capital market

### 1.1 Introduction

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. To state formally, securities markets provide channels for allocation of savings to investments and thereby decouple these two activities. As a result, the savers and investors are not constrained by their individual abilities, but by the economy's abilities to invest and save respectively, which inevitably enhances savings and investment in the economy.

A financial market consists of investors (buyers of securities), borrowers (sellers of securities), intermediaries and regulatory bodies. The Indian financial market can be best illustrated in the figure 1.1 below:

#### Figure 1.1 Indian Financial Markets



## 1.2 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.

## 1.3 Regulatory Environment

The securities market transactions are subject to regulations under the four main legislations 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 / 2013;
- Prevention of Money Laundering Act.

### **1.3.1 Securities and Exchange Board of India Act, 1992**

The SEBI Act, 1992 vests SEBI with statutory powers for,  
 (a) protecting the interests of investors in securities market,  
 (b) promoting the development of the securities market, and  
 (c) regulating the securities market.

Its regulatory jurisdiction extends over corporates in the issuance of capital and transfer of securities and all intermediaries and persons associated with securities market. It can conduct enquiries, audits and inspection of all concerned and adjudicate offences under the Act. It has powers to register and regulate all market intermediaries and also to penalise them in case of violations of the provisions of the SEBI Act, Rules and Regulations. SEBI has full autonomy and authority to regulate and develop an orderly securities market.

### **1.3.2 Securities Contracts (Regulation) Act, 1956**

The SC(R)A, 1956 provides for direct and indirect control of virtually all aspects of securities trading and the running of stock exchanges and aims at preventing undesirable transactions in securities. It gives the central government and SEBI the regulatory jurisdiction over (a) stock exchanges through a process of recognition and continued supervision, (b) contracts in securities, and (c) listing of securities on stock exchanges. As a condition of recognition, a stock exchange complies with prescribed conditions from the central government. Organised trading activity in securities takes place on a specified recognised stock exchange. The stock exchanges determine their own listing regulations which have to conform to the minimum listing criteria set out in the Securities Contracts Rules.

### **1.3.3 Depositories Act, 1996**

The Depositories Act, 1996 provides for the establishment of depositories in securities market with the objective of ensuring free transferability of securities with speed, accuracy and security by (a) making securities freely transferable subject to certain exceptions; (b) dematerialisation of the securities in the depository mode; and (c) providing for maintenance of ownership records in a book entry form. In order to streamline the settlement process, the Act envisages transfer of

ownership of securities electronically by book entry. The Act has made the securities of all companies freely transferable in the depository mode, restricting the company's right to use its discretion in effecting the transfer of securities. The other procedural and the transfer deed requirements stated in the Companies Act have also been dispensed with.

#### **1.3.4 Companies Act, 2013**

The Companies Act 2013 deals with issue, allotment and transfer of securities and various aspects relating to company management. The Act provides for standard disclosures in public issues of capital, particularly in the fields of company management and projects, information about other listed companies under the same management, and management perception of risk factors. It also regulates underwriting, the use of premium and discounts on issues, rights and bonus issues, payment of interest and dividends, supply of annual report and other information.

#### **1.4 Regulators**

The responsibility for regulating the securities market is shared by the Securities and Exchange Board of India (SEBI), the Reserve Bank of India (RBI), the Department of Economic Affairs (DEA) of the Ministry of Finance, Ministry of Corporate Affairs (MCA).

In 2010, the Financial Stability and Development Council (FSDC) replaced the High Level Coordination Committee on Financial Markets (HLCCFM) which was earlier facilitating regulatory coordination among the above agencies, though informally. The secretariat of HLCCFM was in Ministry of Finance (Capital Market Division, Department of Economic Affairs).

The orders of SEBI under the securities laws are appellable before a Securities Appellate Tribunal. Most of the powers under the SCRA are exercisable by DEA while a few others by SEBI. The powers of the DEA under the SCRA are also con-currently exercised by SEBI. The powers in respect of the contracts for sale and purchase of securities, gold related securities, money market securities and securities derived from these securities and ready forward contracts in debt securities are exercised concurrently by RBI.

The SEBI Act and the Depositories Act are mostly administered by SEBI. The rules under the securities laws are framed by the government and regulations by SEBI, and all these are administered by SEBI. The powers under the Companies Act relating to issue and transfer of securities and non-payment of dividend are administered by SEBI in case of listed public companies and public companies proposing to get their securities listed. The SROs ensure compliance with their own rules as well as with the rules relevant for them under the securities laws.

## Review Questions

### Questions to assess your learning:

1. Which of the following is NOT directly a part of the Primary Market?

- (a) Merchant Bankers
- (b) Mutual Funds
- (c) Exchanges
- (d) Registrars and Transfer Agents

Ans: (c)

2. An active \_\_\_\_\_ promotes the growth of the primary market and capital formation.

- (a) secondary market
- (b) bullion market
- (c) money market
- (d) forex market

Ans: (a)

3. \_\_\_\_\_ aims at streamlining settlement process by transfer of ownership of securities electronically by book entry without making the securities move from person to person.

- (a) Companies Act, 1956/2013
- (b) Depositories Act, 1996
- (c) SEBI Act, 1992
- (d) SCRA, 1956

Ans: (b)

4. \_\_\_\_\_ has powers to register and regulate all market intermediaries in the securities market and also to penalise them.

- (a) RBI
- (b) Depositories
- (c) SEBI
- (d) IRDA

Ans: (c)

## Chapter 2: Introduction to Depository

### Learning Objectives

After studying this chapter, you should know about the:

- Need for a depository system in India
- Key features of depository system in India
- Difference between a bank vis-à-vis a depository
- Indian legal framework which governs the functioning of a depository

### 2.1 Need for a Depository System

The earlier settlement system on Indian stock exchanges was highly inefficient and risky. It was characterized by an increased number of bad deliveries, mutilation of share certificates, slow transfer of securities, theft, forgery, and other irregularities.

There are primarily two legs to the settlement of securities—one is the transfer of securities and funds and second is the transfer of ownership. Both these legs in the earlier settlement system were plagued with irregularities. The transfer of securities was done through physical movement of securities which resulted in delays. The second aspect of the settlement related to the transfer of shares in name of the purchaser in the books of record of the company. However, the system of transfer of ownership was grossly inefficient as every transfer involved physical movement of paper securities to the issuer for registration and endorsement of change in ownership on the security certificate. In most of the cases, this process of transfer took more than the stipulated time in the Companies Act. A significant proportion of transactions were recorded as bad deliveries due to faulty compliance of paper work. All these added to costs and delays in settlement, restricted liquidity and made investor grievance redress procedure quite time consuming and in some cases even intractable.

To obviate these problems, the Depositories Act, 1996 was passed. It provided for the establishment of depositories in securities market with the objective of ensuring free transferability of securities with speed, accuracy and security. It does so by -

- a. making securities of public limited companies freely transferable, subject to certain exceptions;
- b. dematerialisation of the securities for holding and transfer in the depository mode; and
- c. providing maintenance of ownership records in a book entry form.

### 2.1.1 Key Features of the Depository System in India

**Multi-Depository System:** The Depositories Act, 1996 provides for a multi-depository system. There can be various entities providing depository services.

**Dematerialisation:** The model adopted in India provides only for dematerialisation of securities. This was a significant step towards achieving a completely paper-free securities market. Dematerialisation of securities occurs when securities issued in physical form are destroyed and an equivalent number of securities are credited into the security holder(s) beneficial owner's account. India has adopted dematerialisation route through a depository. In a depository system, the investors stand to gain by way of an efficient settlement, lower costs and lower risks of theft or forgery, etc. But the implementation of the system has to be secure and well governed. All the players have to be conversant with the rules and regulations as well as with the technology for processing. The intermediaries in this system have to play strictly by the rules.

**Depository services through depository participants:** The Depositories Act, 1996 provides that the depositories provide their services to the security holder(s) through their agents called Depository Participants (DPs). The appointment of DPs is subject to the conditions prescribed under Securities and Exchange Board of India (Depositories and Participants) Regulations, 1996 and other applicable conditions.

**Fungibility:** In the depository system, the securities in dematerialised form are not identified by distinctive numbers and certificate numbers as in the physical environment. Thus all securities in the same class are identical with each other and are interchangeable. For example, all equity shares in the class of fully paid up shares are interchangeable.

**Registered Owner/ Beneficial Owner:** In the depository system, the ownership of securities dematerialised is vested in the security holder. By a deeming fiction, the depository is recorded in the books of the issuer as a Registered Owner and in the records of the depository the security holder is recorded as the Beneficial Owner. But ownership rights and liabilities rest with Beneficial Owner. All the rights, duties and liabilities underlying the security belong to the beneficial owner.

**Free Transferability of shares:** Transfer of shares held in dematerialised form takes place freely through an electronic book-entry system.

### 2.1.2 Institutional Structure of the Depository System in India

There are several institutions, which facilitate the smooth functioning of the depository system. They enable the issuers of securities to interact with the investors in the primary as well as the secondary market. These institutions are:

- a) Depositories
- b) Stock Exchanges,
- c) Clearing Corporations /Clearing Houses,
- d) Depository Participants (DPs),
- e) Issuers, and
- f) Registrars and Transfer Agents (RT&As)

The role of each institution mentioned here and the inter-linkages would be discussed in depth in the subsequent chapters of this workbook to have a correct and holistic perspective about functioning of the depository system.

## 2.2 What is a Depository?

The Depositories Act **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 (IA) of section 12 of the Securities and Exchange Board of India Act, 1992.*" The principal function of a depository is to provide a facility for investors to hold and transfer securities in dematerialised form and in book-entry form. The securities are transferred by debiting the transferor's depository account and crediting the transferee's depository account.

As per the Bank for International Settlements (BIS), depository is "a facility for holding securities which enables securities transactions to be processed by book entry. Physical securities may be immobilised by the depository or securities may be dematerialised (so that they exist only as electronic records)".

In simple terms, depository is an organisation where securities of an investor are held and transferred in electronic form.

### 2.2.1 Bank vis-à-vis Depository

A depository is very similar to bank in many of its operations. In **table 2.1a**, we draw an **analogy between the two** and **table 2.1b highlights the differences between the two** to get a better understanding of the depository system.

**Table 2.1a: Depository-Bank –An Analogy**

<b>Bank</b>	<b>Depository</b>
Holds funds in accounts	Holds securities in accounts
Transfers funds between accounts	Transfers securities between accounts
Transfers funds without handling cash	Transfers securities without handling physical securities
Safekeeping of Money	Safekeeping of Securities

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, an account has to be opened with a DP for holding securities in the depository segment.

**Table 2.1b: Depository-Bank –The Difference**

<b>Bank</b>	<b>Depository</b>
Either of the holders can sign instructions	All joint holders to sign instructions
Minimum balance to be maintained	No minimum balance required
Interest earned on the deposits	Interest can be earned only by participating in the Stock Lending Scheme
Balance deposits is used by the bank	Does not move balances in its own account without account holder's authorisation

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 authorisation from the account holder. A depository participant cannot use the client's security balances.

## 2.3 Legal Framework

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 of Depository approved by SEBI,
- Operating Instructions of the depository, and
- Prevention of Money Laundering Act, 2002

### 2.3.1 Depositories Act, 1996

The Depositories Act passed by Parliament received the President's assent on August 10, 1996. It was notified in a Gazette on August 12 of the same year. The Act enables the setting up of multiple depositories in the country. This was to ensure that there is competition in the depository services and more than one depository is in operation. The Depositories Act facilitated the establishment of the two depositories in India viz., National Securities Depository Limited (NSDL)<sup>1</sup> and Central Depository Services (India) Limited (CDSL)<sup>2</sup>.

The Depositories Act, 1996, ushered in an era of efficient capital market infrastructure, improved investor protection, reduced risks and increased transparency of transactions in the securities market. It also immensely benefitted the issuer companies, in terms of reduced costs and the effort expended in managing their shareholder populace. Due to the introduction of the depository system, the investors are able to enjoy many benefits like free and instant transferability in a secured manner at lower costs, free from the problems like bad deliveries, odd-lots etc. Today the tradable lot is reduced to “one unit” hence even a common man is able to invest money in one equity share or bond or debenture. The investor is able to save a lot on account of stamp duty as government has exempted stamp duty on transfer of securities in dematerialised form at present compare. Investors are also spared from the problems of preserving the securities held in physical form.

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<sup>1</sup> NSDL is the first depository to be set up in India by well-known financial institutions such as IDBI, UTI etc and the National Stock Exchange of India Limited. Incorporated in December 12, 1995, it commenced operations on November 8, 1996.

<sup>2</sup> CDSL promoted by leading Indian banks and Bombay Stock Exchange (erstwhile The Stock Exchange, Mumbai) was registered in February 1999. It commenced operation on March 22, 1999.

Only a company registered under the Companies Act 2013 and sponsored by the specified category of institutions can set up a depository in India. Before commencing operations, depositories should obtain a certificate of registration and a certificate of commencement of business from SEBI. A depository established under the Depositories Act can provide any service connected with recording of allotment of securities or transfer of ownership of securities in the record of a depository. A depository however, cannot directly open accounts and provide services to clients. Any person willing to avail of the services of the depository can do so by opening a demat account through any Depository Participant of a Depository and need to acknowledge the 'Rights and Obligation Document' provided by the Depository Participant<sup>3</sup>. The rights and obligations of depositories, depository participants, issuers and beneficial owners are spelt out clearly in this Act, SEBI (Depositories and Participants) Regulations, 1996 and the Bye-laws of the Depository.

### ***Who is a Depository Participant?***

A Depository Participant (DP) is described as an agent of the depository. They are the intermediaries between the depository and the investors. The relationship between the DPs and the depository is governed by an agreement made between the two under the Depositories Act, 1996, SEBI [Depositories and Participants] Regulations, 1996 and the Bye laws of the Depository. In a strictly legal sense, a DP is an entity who is registered as such with SEBI under the provisions of the SEBI Act. As per the provisions of this Act, a DP can offer depository related services only after obtaining a certificate of registration from SEBI.

### **2.3.2 Eligibility Criteria for a Depository**

Depositories in India may be promoted by any of the institutions mentioned below. The promoters of a depository are also known as its sponsors. A depository company must have a minimum net worth of Rs. 100 crore. The sponsor(s) of the depository have to hold at least 51percent of the equity capital of the depository company. Participants of that depository, if any, can hold the balance of the equity capital. However, if a stock exchange is a sponsor of any depository then it cannot hold more than 24 percent of the paid up equity share capital of the depository.

However, no single depository participant can hold, at any point of time, more than 5percent of the equity capital of that depository.

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<sup>3</sup> The term Beneficial Owner-Depository Participant Agreements has been replaced with a common document "Rights and Obligations of the Beneficial Owner and Depository Participant" vide SEBI Circular Ref. No. MIRSD/12/2013, dated 4-12-2013.

Also, no person other than a sponsor can hold more than 5 percent of the equity share capital in the depository. The combined holding of all persons resident outside India in the equity share capital cannot exceed 49 percent of its equity share capital (26 percent through the foreign direct investment (FDI) route and 23 percent through the foreign institutional investors). No FII can have any representation in the Board of Directors of the depository. No FII can acquire shares of the depository otherwise than through the secondary market.

### **2.3.3 Registration of a Depository**

As per the provisions of the SEBI Act, a depository can deal in securities only after getting a certificate of registration from SEBI. The sponsors of the proposed depository should apply to SEBI for a certificate of registration in the prescribed form. On being satisfied with the eligibility parameters of a company to act as a depository, SEBI may grant a certificate of registration subject to certain conditions.

For grant of certificate of registration, the sponsor of a Depository should belong to one of the following categories:

1. A public financial Institution as defined in section 4A of the Companies Act, 1956;
2. A bank included in the Second Schedule to the Reserve Bank of India Act, 1934;
3. A foreign bank operating in India with the approval of the Reserve Bank of India;
4. A recognised stock exchange;
5. An institution engaged in providing financial services where not less than 75percent of the equity is held jointly or severally by these institutions;
6. A custodian of securities approved by Government of India, and
7. A foreign financial services institution approved by Government of India

### **2.3.4 Commencement of Business**

A depository that has obtained registration can function only if it obtains a certificate of commencement of business from SEBI. A depository must apply for and obtain a certificate of commencement of business from SEBI within one year from the date of receiving the certificate of registration from SEBI. SEBI grants a certificate of commencement of business if it is satisfied that the depository has adequate systems and safeguards to prevent manipulation of records and transactions. SEBI takes into account all matters relevant to the efficient and orderly functioning of the depository, particularly in examining, that the:

1. Depository has a net worth of not less than Rs. 100 crore;
2. Bye-Laws of the depository have been approved by SEBI;

3. Automatic data processing systems of the depository have been protected against unauthorised access, alteration, destruction, disclosure or dissemination of records and data;
4. Network through which continuous electronic means of communication are established between the depository, participants, issuers and issuers' agents, is secure against unauthorised entry or access;
5. Depository has established standard transmission and encryption formats for electronic communication of data between the depository, participants, issuers and issuers' agents;
6. Physical or electronic access to the premises, facilities, automatic data processing systems, data storage sites and facilities including back-up sites, and to the electronic data communication network connecting the DPs, issuers and issuers' agents is controlled, monitored and recorded;
7. Depository has a detailed operational manual explaining all aspects of its functioning, including the interface and method of transmission of information between the depository, issuers, issuers' agents, DPs and beneficial owners;
8. Depository has established adequate procedures and facilities to ensure that its records are protected against loss or destruction and arrangements have been made for maintaining back-up facilities at a location different from that of the depository;
9. Depository has made adequate arrangements including insurance for indemnifying the beneficial owners for any loss that may be caused to such beneficial owners by the wrongful act, negligence or default of the depository or its participants or of any employee of the depository or participant; and
10. Granting of certificate of commencement of business is in the interest of investors in securities market.

### **2.3.5 Agreement between Depository and Issuers**

When the issuer (the company which has issued securities) or the investor opts to hold the securities in a demat form, the issuer enters into an agreement with the depository to enable the investors to dematerialise their securities. This kind of agreement is not necessary in cases, where the:

- Depository, is the issuer of securities, or;
- State or central government is the issuer (in case of government securities).

Where the issuer appoints a registrar to the issue or share transfer agent, the depository enters into a tripartite agreement with the Issuer and Registrar & Transfer (R&T) Agent, as the case may be, for the securities declared eligible for dematerialisation.

### **2.3.6 Rights and Obligations of Depositories**

Depositories have the rights and obligations conferred upon them under the Depositories Act, the regulations made under the Depositories Act, Bye-Laws approved by SEBI, and the agreements made with the participants, issuers and their R&T agents.

- Every depository must have adequate mechanisms for reviewing, monitoring and evaluating the depository's controls, systems, procedures and safeguards. It should conduct an annual inspection of these procedures and forward a copy of the inspection report to SEBI.
- The depository is also required to ensure that the integrity of the automatic data processing systems is maintained at all times and take all precautions necessary to ensure that the records are not lost, destroyed or tampered with. In the event of loss or destruction, sufficient back up of records should be available at a different place.
- Adequate measures should be taken, including insurance, to protect the interests of the beneficial owners against any risks.
- Every depository is required to extend all such co-operation to the beneficial owners, issuers and issuer's agents, custodians of securities, other depositories and clearing organisations, as necessary for an effective, prompt and accurate clearance and settlement of securities transactions and conduct of business.
- The depository should indemnify beneficial owners of securities for any loss caused to them due to the negligence of the DP. Where the loss however, is caused due to the negligence of a DP, the depository shall have the right to recover it from such DPs.

### **2.3.7 Bye-Laws**

A depository is required to make Bye-Laws governing its operations. The Bye-Laws have to be in conformity with the Depositories Act and the regulations made thereunder, and need to be approved by SEBI before becoming effective.

### **2.3.8 Records to be maintained by Depository**

Every depository is required by SEBI regulations to maintain the below mentioned records and documents for a minimum period of five years. The PMLA, 2002 also requires the documents to be maintained for a period of 5 years.<sup>4</sup>

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<sup>4</sup> The period of maintaining the documents have been reduced from 10 years to 5 years vide Gazette notification dated January 04, 2013.

- Records of securities dematerialised and rematerialised.
- The names of the transferor, transferee, and the dates of transfer of securities.
- A register and an index of beneficial owners.
- Details of the holdings of the securities of beneficial owners as at the end of each day.
- Records of instructions received from, and sent to, participants, issuers, issuers' agents and beneficial owners.
- Records of approval, notice, entry and cancellation of pledge or hypothecation.
- Details of participants.
- Details of securities declared to be eligible for dematerialisation in the depository.
- Such other records as may be specified by SEBI for carrying on the activities as a depository.

## 2.4 Functions of a Depository

- Account Opening / Modification /Closure:** An investor wishing to avail depository services must first open an account with a depository participant registered with a depository. The process of opening a demat account is very similar to that of a bank account. An investor has the option of opening an account with several DPs or opening several accounts with a single DP. The investor while opening the account has to sign and submit an account opening form and acknowledgement of the receipt of the copy of the Rights and Obligation document to the DP. The form and contents of the Rights and Obligation document are specified by SEBI.
- Dematerialisation:** One of the primary functions of a depository is to eliminate or minimise the movement of physical securities in the market. This is achieved through dematerialisation of securities. Dematerialisation is the process of converting securities held in physical form into holdings in book entry form.
- Account Transfer:** The depository gives effects to all transfers resulting from the settlement of trades and other transactions between various beneficial owners by recording entries in the accounts of such beneficial owners.
- Transfer and Registration:** A transfer is the legal change of ownership of a security in the records of the issuer. For effecting a transfer, certain legal steps have to be taken like endorsement, execution of a transfer instrument and payment of stamp duty. The depository accelerates the transfer process by registering the ownership of shares in the name of the depository. Under a depository system, transfer of security occurs merely by passing book entries in the records of the depositories, on the instructions of the beneficial owners.
- Corporate Actions:** A depository may handle corporate actions in two ways. In the first case, it merely provides information to the issuer about the persons entitled to receive

the corporate benefits. In the other case, depository itself takes the responsibility of distribution of corporate benefits.

- f. ***Pledge and Hypothecation***: The securities held with the depository may be used as collateral to secure loans and other credits by the clients. In a manual environment, borrowers are required to deliver pledged securities in physical form to the lender or its custodian. These securities are verified for authenticity and often need to be transferred in the name of lender. This has a time and money cost by way of transfer fees or stamp duty. If the borrower wants to substitute the pledged securities, these steps have to be repeated. Use of depository services for pledging/ hypothecating the securities makes the process very simple and cost effective. The securities pledged/hypothecated are transferred to a segregated or collateral account through book entries in the records of NSDL. In case of CDSL, the securities pledged/hypothecated are not transferred to a segregated or collateral account through book entries in their records.
- g. ***Linkages with Clearing System***: The clearing system performs the functions of ascertaining the pay-in (sell) or pay-out (buy) of brokers who have traded on the stock exchange. Actual delivery of securities to the clearing system from the selling brokers and delivery of securities from the clearing system to the buying broker is done by the depository. To achieve this, depositories and the clearing system should be electronically linked.

Apart from the above listed functions the existing two depositories in India perform a variety of other functions such as providing nomination and transmission facility to the investors, IPO related facility, etc.

## Review Questions

Questions to assess your learning:

1. With the introduction of depository system in India theft, forgery, mutilation of certificates became more prominent.  
(a) True  
(b) False

Ans: (b)

2. During the time when there was no demat of securities, for transfer of securities, \_\_\_\_\_ was evidence of change of ownership.  
(a) Endorsement of physical security  
(b) Proof of Delivery  
(c) Letter of acknowledgement from the transferee

Ans: (a)

3. Can either of the account holders sign in case of a depository account as is the case with a bank account?  
(a) Yes  
(b) No

Ans: (b)

4. DP has to be registered with  
(a) Depository  
(b) Exchanges  
(c) SEBI  
(d) None of the above

Ans: (c)

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## Chapter 3: Depository and its Business Partners

### Learning Objectives:

After studying this chapter, you should know about the following business partners of a depository and their roles and responsibilities:

- Depository Participants
- Clearing Corporation / Clearing House
- Issuers and RTAs

### 3.1 Depository Participants

Under the Depositories Act, 1996, a Depository Participant (DP) is described as an agent of the depository. A DP is an entity who is registered as such with SEBI under the provisions of the SEBI (Depositories & Participants) Regulations, 1996. As per the provisions of these regulations, an entity can offer depository-related services only after obtaining a certificate of registration from SEBI as a depository participant. These regulations also define the eligibility criteria for registration with SEBI as a depository participant.

The relationship between the DPs and the depositories is governed by an agreement made between the two under the Depositories Act. The form of the agreement is specified in the Bye-Laws of the depository.

#### 3.1.1 Eligibility Criteria for becoming Depository Participants

The eligibility criteria to become DPs have been prescribed by the SEBI (Depository & Participants) Regulations, 1996 and the Bye-Laws of depositories. The DPs have to comply with the bye laws of the respective depositories, for which membership is sought.

**Basic Eligibility:** Persons belonging to one of the following categories are eligible to become a DP:

1. A public financial institution as defined in section 4A of the Companies Act.
2. A bank included for the time being in the Second Schedule to the Reserve Bank of India Act, 1934.
3. A foreign bank operating in India with approval of the Reserve Bank of India.
4. A State Financial Corporation established under the provisions of section 3 of the State Financial Corporations Act, 1951.

5. An institution engaged in providing financial services, promoted jointly or severally by any of the institutions mentioned in the four above-mentioned clauses.
6. A custodian of securities who has been granted a certificate of registration by SEBI.
7. A clearing corporation or a clearing house of a stock exchange.
8. A stockbroker who has been granted a certificate of registration by SEBI.
9. A non-banking finance company.
10. An R&T Agent who has been granted a certificate of registration by SEBI.

**Net Worth:** SEBI (Depositories & Participants) Regulations, 1996 prescribe a minimum net worth criteria for different kind of applicants:

- For applicants who are stock brokers or non banking finance companies, the networth should be Rs. 50 lakh, for granting a certificate of registration to act as a DP.
- For R & T Agents a minimum net worth of Rs. 10 crore is prescribed in addition to a grant of certificate of registration by SEBI.
- If a stockbroker seeks to act as a DP in more than one depository, he should comply with the specified net worth criterion separately for each such depository.
- If an NBFC seeks to act as a DP on behalf of any other person, it needs to have a networth of Rs. 50 crore in addition to the networth specified by any other authority.

No minimum net worth criterion has been prescribed for other categories of DPs. Depositories however, can fix a higher net worth criterion for their DPs. As per the Bye-laws of the two depositories, an applicant has to submit a net worth certificate certified by a chartered accountant (which includes the computation of networth). It may happen that different depositories have different methodology for calculation of the net worth. In that case the DP may have different net worth figures for different depositories. The certificate, based on the audited books of account, should be in the format as specified by the depository in its Bye-Laws/Business Rules.

### **3.1.2 Business Restrictions**

As per the SEBI (Depositories & Participants) Regulations, 1996 the aggregate value of the securities of the beneficial owners, held in dematerialised form through a stockbroker DP, cannot be more than 100 times the net worth of the stockbroker. Where the stock broker, however, has a minimum net worth of Rs.10 crore, the limits on the aggregate value of the portfolio of securities of the beneficial owners held in dematerialised form in a depository through him, shall not be applicable. NBFCs, having a net worth of less than Rs. 50 crore, may act as DPs only on their own behalf. Only NBFCs having a minimum net worth of more than Rs. 50 crore, in addition

to the net worth specified by any other authority, may provide depository related services to other persons also.

### **3.1.3 Application for becoming a DP**

An entity desirous of becoming a DP of a depository should make an application to SEBI. The application complete in all respects should be submitted to the depository in which membership is sought for. The depository evaluates the application and if it finds that the applicant has the potential to be admitted as a DP, then it forwards that application to SEBI within 30 days from the date of receipt of the application. Along with the application, the depository also submits its recommendations regarding the applicant.

The applicant at this stage is required to pay SEBI application fees. The depository may reject the application, if it is found to be incomplete or not as per the given instructions. SEBI may require the applicant or the depository to furnish additional information or clarification, appropriate for considering the application. If the application form is found incomplete, SEBI may also reject the application after giving an opportunity to the applicant for addressing the objection(s).

### **3.1.4 Conditions for Grant of Registration**

On being satisfied that the applicant is eligible and has complied with the conditions stipulated in the SEBI (D&P) Regulations, SEBI grants a registration certificate to the applicant. Before granting a certificate of registration to a DP, SEBI considers, inter alia, whether the applicant has adequate infrastructure and systems. It also takes into account whether it has in place the safeguards and trained staff to carry on activity as a DP and the applicant is a fit and proper person. Grant of registration is also subject to the condition that the Participant shall redress the grievance of beneficial owners within thirty days of the date of receipt of the complaint and keep the depository informed about the number and nature of redress. Finally, SEBI also examines whether the grant of certificate of registration to such a person is in the interests of investors in the securities market.

The depositories in its Bye-laws have also prescribed the following additional conditions for admission of DPs to its system.

1. The applicant should furnish information and details of its business history for a minimum period of three years or from the date of its inception, if less than three years.
2. The applicant should not have been convicted in any of the five years immediately preceding the filing of the application in any matter involving misappropriation of funds and securities, theft, embezzlement of funds, fraudulent conversion or forgery.

3. The applicant should not have been expelled, barred or suspended by SEBI, self-regulatory organisation or any recognised stock exchange. However, if three years or more have elapsed since the punishment, the depository may, at its discretion, consider such an application.
4. The applicant should have a minimum net worth of rupees three crore (for NSDL). The net worth is to be calculated as per the method of computation prescribed by the respective depository. The stock broker DP should have a minimum networth of Rs. two crores (for CDSL).
5. The applicant should furnish details of its Board of Directors/ authorised officials, who would be responsible for the conduct of the business of the applicant as a participant.
6. The depository may conduct entrance examinations and/or interviews, to examine the knowledge of the DP (and its staff) related to the operational, functional and technical aspects of the depository. The applicant shall be mandated to appoint a Compliance Officer, who would interact with the depository and on the DP's behalf for compliance with the Bye-Laws and Business Rules and resolving investors/clients' grievances.
7. The applicant should have adequate office space exclusively for depository operations. The applicant should also furnish details of his main office, including address, fax and phone number(s). The depository has the sole discretion to decide whether the applicant has adequate infrastructure facilities at the time of granting admission. For the purpose of satisfying itself regarding the applicants' eligibility, the depository may carry out an inspection of their office and facilities.
8. The applicant should make adequate arrangements for conducting effective and safe depository operations. These should include security measures, risk containment and insurance requirements, as specified by the depository.

### **3.1.5 Validity and Renewal of Registration Certificate**

A certificate of registration is valid for a period of five years from the date of issue. The Securities and Exchange Board of India (Depositories and Participants) Regulations, 1996 were amended as per notification dated July 5, 2011. Accordingly, Participants will have to apply for permanent registration instead of renewal of registration. Such application for permanent registration must be made three months before the expiry of validity of registration certificate, or even before. The application for permanent registration should be made through the depository. The fees specified for issue of certificate of registration should accompany the application. It is dealt with in the same manner as if it were a fresh application for grant of certificate of registration. SEBI may reject the application for permanent registration of certificate after citing the reasons for refusal in writing.

- If the application for renewal is not received at SEBI by the expiry date of the certificate of registration, the intermediary shall:
  1. cease to be an intermediary on the date of such expiry,
  2. stop carrying on the activities of the intermediary from the date of such expiry, and
  3. transfer, wherever relevant, the accounts / business of existing clients to another registered intermediary before the date of such expiry.

If the intermediary fails to comply with all of the above, it will be considered as a violation of section 12 of SEBI Act, 1992 and may attract action under the relevant provisions of SEBI Act, 1992, and/ or the Regulations framed there under. No application for permanent registration can be made after the date of expiry of registration. After the expiry of registration, the erstwhile intermediary can apply for registration, which will be considered as a fresh application for registration made under the relevant Regulations.

- If the application for permanent registration is received at SEBI less than 3 months before the expiry of registration and SEBI has not advised otherwise by the date of expiry of registration, the intermediary shall stop undertaking any fresh business / clients from the date of expiry of the registration. SEBI may initiate any action that may be deemed appropriate for late submission of application under the provisions of the SEBI Act, 1992 and the regulations framed there under. It is clarified that in the above cases, the application for renewal shall mean the application is complete in all respects. Incomplete application will be treated as no application.
- If permanent registration is not granted by SEBI for whatever reason, the intermediary shall:
  - a. cease to be an intermediary on the date of expiry of registration or the date of receipt of communication of refusal to grant renewal,
  - b. stop carrying on the activities of the intermediary from the date as at (a) above, and
  - c. transfer, wherever required, the accounts / business of existing clients to another registered intermediary within such period as may be specified.
  - d. If the intermediary fails to comply with all of the above, it will be considered as violation of section 12 of the SEBI Act, 1992 and shall be liable for action under the relevant provisions of SEBI Act, 1992, and/or the provisions of Rules and Regulations framed there under.
- The DP, to keep the registration in force, shall pay registration fee as specified in Part A of the Second Schedule of the SEBI (Depositories and Participants) Regulations, for every five years from the sixth year of the date of grant of certificate of permanent registration. The specified fee shall be paid three months prior to the expiry of the block for which the fee has been paid.

### **3.1.6 Commencement of Operations**

A DP can commence its operations after complying with the prescribed procedures of the depository for commencing business operations. Depositories have specified following pre-requisites for DPs for commencing operations:

1. Make an application to the depository through prescribed form. Furnish all clarifications and additional documents as may be required by the depository. The depository shall intimate the DP about the application status.
2. On receiving the approval, an application for connectivity with the depository should be made. Primary connectivity can be by way of V-sat or leased line. Full-scale connectivity by way of PSTN line, dial up lines also has to be arranged as a fall back if the primary connectivity fails.
3. At least two officials of the applicant have to successfully complete the in-depth training conducted by depository.
4. Procure the prescribed hardware and communicate to the depository about the details of the hardware installed. The depository then conducts a pilot test to train the staff on the functions of the depository and to check the systems. The DP also has to participate in the pilot test.
5. The applicant has to enter into an agreement (format prescribed by Bye Laws of depositories) with the depository.
6. The application system of the depository has to be activated in the live environment in the office of the DP. A DP - ID is issued to the DP.
7. The DP can start functioning.

### **3.1.7 Rights and Obligations**

The DP must provide a copy of the Rights and Obligations document to the client and keep an acknowledgement of the same on record before acting as a Participant on his behalf. A DP, while conducting any business with a client, acts as an agent of the depository and is liable to the clients for all the acts and deeds performed by it. The Rights and Obligations document has to be made in the form and manner specified by SEBI and the DP Operating Instructions. A copy of the same should be given to the beneficial owner. However no Rights and Obligations document is required in respect of the following:

- a. A Foreign Institutional Investor (FII) registered with SEBI enters into an agreement with the DP either directly or through its power of attorney holders in accordance with the provisions of sub-regulation (1) of regulation 16 of SEBI (Foreign Institutional Investors) Regulations, 1995. Such agreement gives the DP an authority to act on behalf of the foreign institutional investors for availing the services of the depository and such agreement has already been filed with SEBI.

- b. International Multilateral Agency, who has entered into an agreement with the DP under Regulation 17 of the SEBI (Custodian of Securities) Regulations 1996, and such agreement states that the Custodian will also act as a DP and all provisions pertaining to DP shall be applicable.

**Separate Accounts:** The DP should open a separate account in the name of each beneficial owner. The securities of each BO should be segregated from the securities of other beneficial owners or from the DP's own securities. For DP's own securities, he should open a separate account in the depository system.

**Client/Beneficial Owner Instructions:** Securities should be transferred to or from a BO's account only on receipt of instructions from the beneficial owner. No entry in the beneficial owner's account should be made unless it is supported by instructions received from the beneficial owner as per the agreement made with him.

**Transaction Statements** – SEBI has vide its Circular No. CIR/MRD/DP/31/2014 dated November 12, 2014 notified the requirement to issue a Consolidated Account Statement (CAS) to enable a single consolidated view of all the investments of an investor in mutual funds and securities held in demat form with the Depositories. The Depository may directly send statement of account including transaction statement and holdings statement to Clients and in such cases Participants are not required to send such statement of account as per Rule 14.3.1, 14.3.2, 14.3.3 and Rights and Obligations Document. Provided that whenever the Client requests for such a statement, the Participant shall be duty bound to provide the same. However, the statements in respect of Clearing Member (CM) accounts will not be sent by the NSDL and the Participant may continue sending such statements to CMs.

The frequency of sending the CAS is as follows:

1. If there is any transaction in any of the demat accounts of the investor or in any of his mutual fund folios, then CAS shall be sent to that investor on monthly basis.
2. In case there is no transaction in any of the mutual fund folios and demat accounts then CAS with holding details shall be sent to the investor on half yearly basis. However, in case of demat accounts with nil balance and no transactions in securities and in mutual fund folios, the requirement to send physical statement shall be applicable as specified in SEBI circular no. CIR/MRD/DP/21/2014 issued on July 01, 2014.
3. Further, the holding statement dispatched by the DPs to their BOs with respect to the dormant demat accounts with balances shall also be dispatched half-yearly in partial

modification of clauses 5(b) and 6(c) of the circular no. CIR/MRD/DP/22/2012 dated August 27, 2012.

The DP shall furnish a statement of accounts including transaction statement and holdings statement to every Client, who has opened an account with it, giving the details of the security-wise transactions and balances, in the accounts of the Clients. Such a statement shall be furnished to the Clients at monthly intervals and to the Clients opting for Basic Services Demat Account at quarterly intervals unless the Client and the DP have agreed for provision of such statements at shorter intervals. However, if there is no transaction in the account, then the DP shall provide such statement to the Client on a half yearly basis<sup>5</sup>. Provided however that in respect of accounts with no transaction and nil balance, one such statement shall be sent to the Client in physical form on an annual basis. The transaction statement should be dispatched directly to the client's address as mentioned in the Depository system of the DP and not through any franchisee/collection centre. The statement could be provided electronically, provided a written consent has been taken from the client for this purpose and adequate security measures have been taken. SEBI permits the DP's to provide transaction statements and other documents to the BOs under Digital Signature, as governed under Information Technology Act, 2000, subject to entering into legally enforceable arrangement with the BOs for the said purpose. Providing of transaction statements and other documents in the aforesaid manner would be deemed to be in compliance of the provisions of Regulation 43 of SEBI (Depositories & Participants) Regulations, 1996.

**Connectivity:** The DP should maintain continuous electronic means of communication with the depository. In case of failure of primary connectivity the DP should connect to the depository by using fall back medium of connectivity. The primary connectivity can either be V-Sat or leased line while secondary connectivity can be through dial-up line.

**Monitoring, Reviewing and Evaluating Internal Systems and Controls:** The DP should have an adequate mechanism for the purposes of reviewing, monitoring and evaluating its internal systems and accounting controls. As per the Bye-Laws, a DP has to get an internal audit done of the depository operations on a half-yearly basis by a practicing chartered accountant or a company secretary or a cost accountant.

**Reconciliation:** The DP should reconcile its records with its depository on a daily basis. The depository system is designed to do this reconciliation automatically every day at the end of the day (EOD).

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<sup>5</sup> Reference SEBI Circular CIR/MRD/DP/31/2014, dated November 12, 2014

**Returns:** The DP should submit periodic returns to SEBI and to every depository in which it is a Participant in the format specified by SEBI or the Bye-Laws of the depository. The following returns are required to be submitted by its DPs:

<b>Sr. No</b>	<b>Particulars</b>	<b>NSDL Deadline</b>
1	Investor Grievance Report (Monthly)	By 10 <sup>th</sup> of the following month.
2	Compliance Certificate (July - December)	January 31 <sup>st</sup> every year
3	Charge Structure	April 30 <sup>th</sup> every year
4	Internal/ Concurrent Audit Report (October - March)	May 15 <sup>th</sup> every year
5	Compliance Certificate (January - June)	July 31 <sup>st</sup> every year
6	Networth Certificate and Audited Financial Statements	September 30 <sup>th</sup> every year.
7	Internal/ Concurrent Audit Report (April - September)	November 15 <sup>th</sup> every year

<b>Sr. No</b>	<b>Particulars</b>	<b>CDSL Deadline</b>
1	Investor Grievance Report (Monthly)	By 10 <sup>th</sup> of the following month
2	Charge Structure	
3	Internal/ Concurrent Audit Report (October - March)	May 15 every year
4	Networth Certificate and Audited Financial Statements	September 30 <sup>th</sup> every year
5	Internal/ Concurrent Audit Report (April - September)	November 15 <sup>th</sup> every year
6	Compliance report for Internal audit/ Inspection	Within 30 days
7	Change in Compliance officer details	Immediately
8	Change in office address	Immediately
9	Proposed change in constitution / status of DP	Immediately

10	Proposed change in control of DP	Immediately
11	Compliance certificate	Before 31st July for the half year period from January to June & 31st January for the half year period from July to December

**DP to Indemnify Depository:** A DP has to indemnify the depository, its officers and employees for all costs, fees, expenses, liabilities, taxes, actual losses and damages of any nature whatsoever suffered or incurred by any of them for:

1. The failure by the DP to comply with the provision of the Bye-Laws or the DP agreement or to comply with any directions or procedures of the depository.
2. The acts by the depository or its officers and employees placing reliance upon instructions or communications by the DP. These include giving effect to instructions or communications by any of them or the failure of the DP to give instructions to the depository as contemplated in the Bye-Laws.
3. The acceptance by the depository of eligible securities deposited by the DP and effecting transactions by the depository according to the Bye-Laws and withdrawal of eligible securities by the DP.
4. The failure of the DP to deliver eligible securities or to perform other duties or obligations set out in the Bye-Laws.

**Prohibition of Assignment:** No DP can assign or delegate its functions as a depository participant to any other person without prior approval of the depository in which it is a participant. All the DPs are required to provide the details of all places from where they are offering any of the depository services to their Clients whether it is about the depository system set-up, head office, main office, branch, franchisee, service centre, collection centre, drop box centre or by any other name and any further updates (addition/ deletion/modification) in the information to the depository within seven days of the change.

**Insurance:** DPs should take appropriate insurance cover to insure against the losses arising from any possible business risk and system failure. The depository, however takes insurance for itself and on behalf of all DPs. The insurance covers business risk and system failure risk. DPs may additionally take for themselves insurance to cover risks like theft, fire, etc.

**Record of Services:** The DP should maintain and preserve the following records and documents for a minimum period of 5 years as per provisions given under Regulation 49 of the SEBI (Depositories and Participants) Regulation, 1996 and PMLA and the Rules made thereunder. They should also make them available for inspection by the depository whenever required.

1. Forms for Opening, Closing, Freezing and De-freezing of accounts given by the clients.
2. Record of all the dematerialisation and rematerialisation requests received from the clients.
3. Record of all the delivery/ receipt instructions given by the clients and Clearing Members.
4. Copies of correspondence received from clients for updation of client details in system of the depositories.
5. Records of all the actions taken on the exception reports generated by the system.
6. Details of grievances/arbitration proceedings received from the clients, action taken and status of the same.
7. Record of all forms received in respect of Pledge, Securities Lending and Transmission of securities.

If a DP has entered into an agreement with more than one depository, the records specified above should be maintained separately for each such depository.

**DP's to ensure adherence to guidelines on Anti Money Laundering Measures**-The Prevention of Money Laundering Act 2002 (PMLA) has come into effect from 1st July, 2005. As per the provisions of the Act, every banking company, financial institution (which includes chit fund company, a co-operative bank, a housing finance institution and a non-banking financial company) and intermediary (which includes a stock-broker, sub-broker, share transfer agent, banker to an issue, trustee to a trust deed, registrar to an issue, merchant banker, underwriter, portfolio manager, investment adviser and any other intermediary associated with securities market and registered under section 12 of the Securities and Exchange Board of India Act, 1992) shall have to maintain a record of all the transactions; the nature and value of which has been prescribed in the Rules under the PMLA.

Such transactions include-

- All cash transactions of the value of more than Rs 10 lakhs or its equivalent in foreign currency.
- All series of cash transactions integrally connected to each other which have been valued below Rs 10 lakhs or its equivalent in foreign currency where such series of transactions take place within one calendar month.
- All suspicious transactions whether or not made in cash.

Broadly, the guidelines on Anti Money Laundering (AML) measures are as given below-

1. Participants are to evolve their own guidelines (if not already evolved) so as to comply with the provisions of the PMLA and the rules, guidelines thereof issued by Government of India (GOI)/SEBI, from time to time.
2. Participants to put in place proper policy framework on AML measures in compliance with relevant laws, rules and instructions.
3. AML procedures should include inter alia, the following three specific parameters which are related to the overall 'Client Due Diligence Process':
  - a. Policy for acceptance of clients
  - b. Procedure for identifying the clients
  - c. Transaction monitoring and reporting especially Suspicious Transactions Reporting (STR).
4. Each Participant should appoint a senior management executive to be designated as the Principal Officer, if it has not already done so. The Principal Officer shall be located at the head/corporate office of the Participant and shall be responsible for monitoring and reporting of all transactions and sharing of information as required under the law. He will maintain close liaison with the other divisions / departments of the Participant, the other Participant, the enforcement agencies and other institutions which are involved in similar activities. In addition to the existing requirement of designation of a Principal Officer, the registered intermediaries shall also designate a person as a 'Designated Director'. In terms of Rule 2 (ba) of the PML Rules, the definition of a Designated Director reads as under:

“Designated Director means a person designated by the reporting entity to ensure overall compliance with the obligations imposed under chapter IV of the Act and the Rules and includes -

- the Managing Director or a Whole-time Director duly authorized by the Board of Directors if the reporting entity is a company,
- the managing partner if the reporting entity is a partnership firm,
- the proprietor if the reporting entity is a proprietorship concern,
- the managing trustee if the reporting entity is a trust,
- a person or individual, as the case may be, who controls and manages the affairs of the reporting entity if the reporting entity is an unincorporated association or a body of individuals, and
- such other person or class of persons as may be notified by the Government if the reporting entity does not fall in any of the categories above."

In terms of Section 13 (2) of the PML Act (as amended by the Prevention of Money-laundering (Amendment) Act, 2012), the Director, FIU-IND can take appropriate action,

including levying monetary penalty, on the Designated Director for failure of the intermediary to comply with any of its AML/CFT obligations. Registered intermediaries shall communicate the details of the Designated Director, such as, name, designation and address to the Office of the Director, FIU-IND.

5. Monitoring and Reporting to Financial Intelligence Unit-India
6. Participants are required to report information relating to suspicious transactions, in the prescribed format, within seven working days of establishment of suspicion, to the Director, Financial Intelligence Unit-India (FIU-IND) at the following address:  
Director, FIU-IND,  
Financial Intelligence Unit-India,  
6th Floor, Hotel Samrat,  
Chanakyapuri, New Delhi-110021.

Participants are required to report to the depository number of suspicious transaction reports, if any, filed directly with FIU-IND during a given month by 7<sup>th</sup> of the following month.

***Maintenance and Preservation of records***

- a. Participants should take appropriate steps to evolve an internal mechanism for proper maintenance and preservation of relevant records and information in a manner that allows easy and quick retrieval of data as and when requested by the competent authorities. Further, the records have to be maintained and preserved for a period five years from the date of cessation of the transactions between the Client and Participant.
- b. Participants should formulate and implement the client identification program containing the requirements as laid down and such other additional requirements that it considers appropriate. The records of the identity of clients have to be maintained and preserved for a period of five years from the date of cessation of the transactions between the Client and Participant.
- c. Participants should obtain a certification from their internal auditors that the concerned Participant has drawn up a policy on Anti Money Laundering Measures in compliance with the relevant laws, rules and instructions. In addition, in every quarterly report, the internal auditor must check and certify whether the Participant has complied with the Policy so drawn up. Any deficiencies should be specifically pointed out in the report.
- d. The Compliance Officer of the Participant is required to submit a 'Compliance Certificate' in the prescribed format, at half-yearly intervals either separately or through Internal Audit Report as specified by the depository.

- e. Participants should educate the Clients about the objectives of the KYC programme. The front desk staff needs to be specially trained to handle such situations while dealing with Clients.

***DP to Ensure Integrity and Back-up of Data:*** DPs who maintain electronic records should ensure the integrity of the data processing systems. All necessary precautions should be taken to ensure that the records are not lost, destroyed or tampered with. In the event of loss or destruction, sufficient back-up of records should be taken and made available at all times at a different place. In order to ensure this, the depositories have prescribed the following back-up policy for its DPs:

1. Business partners have to take back ups every day without fail.
2. Two copies of back-ups have to be taken; one copy has to be preserved at a remote site away from the operations and another on the site itself.
3. The back-up on external memory devices should be preserved safely, well protected against fire, theft and manipulation.
4. If the DPs have large business volumes, they may install an additional back-up machine which helps them in continuing the business operation even if the main machine fails.

### **3.1.8 Suspension and Cancellation of Certificate**

#### ***Suspension of Certificate***

The certificate of registration granted to a DP may be suspended by SEBI if it is found that the DP has:

- contravened any of the provisions of the Depositories Act, the Bye-Laws, Agreements and SEBI (D&P) Regulations, 1996;
- failed to furnish any information relating to its activity as a DP required under the regulations;
- not furnished the information called for by SEBI under the provisions of the Depositories Act, 1996 or has furnished information which is false or misleading;
- not co-operated in any inspection or investigation or enquiry conducted by SEBI;
- has failed to comply with any direction of SEBI; or
- has failed to pay the annual fee as specified under the SEBI (D&P) Regulations, 1996.

#### ***Cancellation of Certificate***

The certificate of registration granted to a DP may be cancelled by SEBI if it is found that:

- the DP is guilty of fraud, or has been convicted of an offence involving moral turpitude; or
- the DP has been guilty of repeated defaults specified for suspension of the registration.

### **3.1.9 Termination by Depository**

Besides these regulatory provisions, each depository may have its own Bye-Laws for termination or suspension of its DPs.

#### ***Termination by DP***

A DP may also choose to terminate its participation in the depository by giving a notice of not less than 30 days. On receipt of such notice, the depository may cease to provide any service or act for the DP. The depository should notify the DP, other participants, clients of the surrendering DP and SEBI within seven days of this action.

### **3.2 Clearing Corporation (CC)**

Clearing Corporation is an entity responsible for clearing and settlement of trades done by clearing members on a recognised stock exchange. A Clearing Corporation of a stock exchange are admitted to the depository system for clearing and settlement of securities traded on their respective stock exchanges. For electronic settlement of securities in demat form, the concerned CC/CH of the stock exchange needs to have electronic connectivity with the depository.

A Clearing Corporation of a stock exchange may be admitted as a user on the depository after entering into an agreement with the depository as per the Bye-Laws of depository. A different agreement has to be drawn up if a clearing house of a stock exchange is not a legal counterparty to the trades on the exchange and the trade/settlement guarantee fund is held and managed by the exchange. A third type of agreement has to be entered into if the members/dealers of the exchange are not the clearing members of the Clearing House. A stock exchange may be admitted as a user on the depository, if it conducts the activity of clearing and settlement of trades and if it is not a legal counterparty to the trades thereon and holds and manages the trade/settlement guarantee fund. In that case, an agreement as laid down in Bye-Laws of has to be entered into. The provisions of these agreements govern the rights and obligations of the depository, the clearing corporation or the clearing house of a stock exchange and the exchange, in respect of transactions entered into in pursuance of such agreements.

#### **3.2.1 Admission Criteria**

A clearing corporation of stock exchange can be admitted as a user on the depository, only if it fulfills the conditions laid down. These criteria are listed below:

1. The clearing corporation or a clearing house of a stock exchange has adequate hardware and software systems to interact with the depository as specified in the Business Rules;

2. The depository should be satisfied that the clearing corporation or a clearing house of a stock exchange operates in such a manner that it ensures payment against delivery or guarantees settlement;
3. The clearing corporation or a clearing house of a stock exchange undertakes to co-operate at all times to redress the grievances of clients and DPs in respect of its operation in relation to the depository;
4. The depository should be in the opinion that the clearing corporation or a clearing house of a stock exchange has the operational capability to provide the services relating to clearing and settlement of transactions pertaining to the securities admitted to the Depository to be held in dematerialised form.

A Clearing Corporation of a stock exchange shall not be permitted to open beneficiary accounts for clients, except where it has been permitted by RBI to offer Constituent SGL account facility to the investors.

### **3.3 Issuers and Registrar and Transfer Agents**

The Depositories Act, 1996 gives option to investors to hold their securities either in physical form or in book entry form with the depository. Issuer of the security i.e. company may offer a facility to hold the securities issued by it in demat form by entering into an agreement with the depository. The issuers who intend to offer demat facility will have to first establish connectivity with the depository either directly or through a Registrar & Transfer Agent which in turn have connectivity with the depositories.

The following categories of securities are eligible for dematerialisation as per SEBI (Depositories & Participants) Regulations, 1996:

- shares, scrips, stocks, bonds, debentures, debenture stock or other marketable securities of a like nature in or of any incorporated company or other body corporate;
- units of mutual funds (MFs), rights under collective investment schemes (CISs) and venture capital funds (VCFs), commercial paper (CP), certificates of deposit (CD), securitised debt, money market instruments and government securities, unlisted securities shall also be similarly eligible for being held in dematerialised form in a depository.

#### **3.3.1 Eligibility Criteria**

All issuers of the aforementioned securities may make their securities available for dematerialisation upon fulfillment of certain criteria. The Executive Committee /Securities Committee (as it may be called by the depositories) of the depository determines the securities

that are eligible for dematerialisation. Before dematerialisation commences, the Issuer or its R&T Agent, if any, has to comply with the following conditions:

- The Issuer and/or its R&T Agent undertake to co-operate at all times to redress the grievances of the client and the DP.
- The Issuer and/or its R&T Agent shall have adequate hardware and software systems to interact with Depository as specified from time to time in the Business Rules.
- The Issuer and its R&T Agent if any, have signed the tripartite agreement as per the Bye-Laws of the depository.

The above conditions are not applicable to securities issued by Central or State Government. The depositories may even refuse to accept the admission of securities of an issue as an eligible security or may remove the same from the list of eligible securities if –

- in the opinion of the depository, the Issuer or its R&T Agent does not have or has ceased to have the operational capability to provide services in respect of an issue of securities;
- the Issuer or its R&T Agent commits any breach to any terms and/or conditions of the agreement entered into with the depository;
- the Board of Directors of the depository or the Securities Committee (in case of CDSL), in its absolute discretion, is satisfied that circumstances exist which render it necessary in the interest of the investors to do so.

### **3.3.2 Rights and Obligations of Issuers and their R&T Agents**

- a. Each Issuer whose securities are admitted to the depository are required to represent and warrant in favour of the depository that such securities exist at the time of transfer of securities into the depository and thereafter. The Issuer also has to warrant that these securities are validly issued and that it is entitled or has full authority to transfer such securities into the Depository.
- b. Every issuer has to provide timely information to the depository about various corporate actions. These include - book closure, record dates, dates for payment of interest or dividend, dates for the annual general meeting, dates of redemption of securities, dates of conversion, dates of exercising warrants and such other information as may be specified by the Executive Committee of the depository from time to time.
- c. The issuer and its R&T Agents have to reconcile with the records of the depository, the records in respect of balances of eligible securities with clients and confirm to all the Depositories, the total security balances both in physical as well as in electronic holdings in the books.

In case where a State or the Central Government is the issuer, the depository reconciles the records of the dematerialised securities with the statement provided by the RBI on a

daily basis. Every issuer or its R&T Agent shall issue the certificate of securities against receipt of the Rematerialisation Request Form (RRF) from the Client through the DP and on receipt of confirmed instructions from the Depository. The Issuer or its R&T Agent are required to furnish to the depository allotment details of all clients (allottees) who have opted for securities to be credited to their account in the electronic form. The depository electronically provides the details of the Clients (allottees) to the Issuer/R&T Agent as per the requirement of the Issuer. This clause however, does not apply for government securities.

- d. The depository is responsible for the accuracy/correctness of all such information related to eligible securities intimated by it to the Issuer/R&T Agent. The Issuer/R&T Agent is responsible for the accuracy and correctness of all information furnished by it in the prescribed format to the depository.

### **3.3.3 The Main Features of the Tripartite Agreement**

The rights and obligations of the depository, the issuer and R&T Agent are embodied in the Tripartite Agreement between them. This agreement has to be signed before the Issuer/R&T Agent can be admitted in the depository system. Some of the main terms of the Agreement are quoted below:

1. The Issuer/R&T Agent shall furnish a list of authorised officials who shall represent and interact on behalf of the Issuer and/or R&T Agent with the depository within 15 days of the execution of this agreement and any changes including additions/deletions thereof shall be communicated to the depository within 15 days of such change.
2. The depository shall allocate unique identity codes to the securities issued by an issuer. Such code is called ISIN (International Securities Identification Number).
3. The Issuer/R&T Agent shall establish continuous electronic means of communication with the depository and the depository in turn shall provide necessary manuals and procedural guidelines to the Issuer/ R&T Agent as is necessary for effective and prompt conduct of the business of the Depository. The Issuer/R&T Agent shall maintain such systems, procedures, means of communication, adequate infrastructure, hardware, software security devices and backup facilities as may be prescribed by the depository.
4. The Issuer/R&T Agent shall strictly follow the back-up procedure recommended by the depository. A copy of the latest back-up of database and subsequently incremental back-up shall be maintained at a designated remote site.
5. The Issuer/R&T Agent shall comply with all the systems and procedures recommended by the depository and shall allow access to their systems to an Audit Team, designated by the depository for periodic assessment of compliance with systems and procedures.
6. The Issuer/R&T Agent agree that the depository shall not be liable to the Issuer/R&T Agent for any loss arising out of any failure of the Issuer/R&T Agent to keep full and up-to-date

security copies (back-up) of computer programme and data it uses in accordance with the best computing practice.

7. The Issuer shall inform the depository on the next day on which the information is being sent to the stock exchanges in which the eligible securities are listed, about the dates from which new shares arising out of conversions, further issues, final call payments, etc. become pari passu with its existing shares.
8. The Issuer shall furnish information to the depository of any further issues such as rights, bonus, public offerings with details viz., opening and closing dates, issue size, issue price, record date, book closure, proportion, along with a copy of the offer document.
9. The Issuer shall give information to the depository about book closures, record dates, dates for the payment of interest or dividend, dates for annual general meetings and other meetings, dates for redemption of debentures, dates for conversion of debentures and warrants, call money dates, amalgamation, merger, reduction of capital, reconstruction scheme of arrangement, sub-division, consolidation, and conversion of debentures/loans and such other information relating to any corporate action, on the next day it is being communicated to the relevant stock exchanges, where the eligible security is listed.
10. The Issuer and its R&T Agent undertakes that the dematerialisation and rematerialisation requests are processed within 15 and 30 days respectively. However, the period may be relaxed by the depositories in case of bulk dematerialisation requests.
11. The Issuer and its R&T Agent undertakes that no dematerialisation requests shall be accepted when there are any prohibitory order, stop transfer, attachment order, or disputed title, on the day of such request. It is agreed that where a court order has been received by the Issuer and/ or its R&T Agent or where there are court orders against any transfer request if such a request is entertained, the Issuer/R&T Agent shall be entirely responsible. The Issuer/R&T Agent agrees to be fully responsible for destruction, mutilation and cancellation of certificates received and accepted by it for dematerialisation.
12. It is agreed that the Issuer/R&T Agent will continue to be responsible for corporate actions. The depository undertakes to provide the list of beneficial owners with suitable details to the Issuer/ R&T Agent as of the record date. The list shall be provided by the depository within such time as specified by the depository from time to time after such request has been received by them. In the event of any loss caused to the Issuer/R&T Agent, in respect of any incorrect information relating to the Client, furnished by the depository or its Participant, the depository shall indemnify such losses.
13. The Issuer/R&T Agent shall indemnify the depository in respect of any loss or liability incurred, or any claim arising in respect of any incorrect information furnished by the Issuer/R&T Agent in respect of the operations of the Depository.
14. Any claims, disputes or liabilities arising in respect of any securities which have been rematerialised under intimation from the Issuer/R&T Agent to the depository after the

despatch of such securities' certificates in the manner laid down under the Bye-Laws shall be settled between the Issuer/R&T Agent and the owner of such securities.

15. In the case of securities that have been dematerialised and electronically credited to the accounts of the Clients under intimation from the Issuer/R&T Agent in the manner laid down under the Bye-Laws, any claims, disputes or liabilities or cause of action from a third party arising in respect of such securities pertaining to any fake or forged securities shall be settled between the Issuer/R&T Agent and such third party.
16. The depository may authorize persons who shall have the right to enter during the regular business hours, on any working day, the premises of such Issuer/R&T Agent where the records relating to the depository operations are being maintained and inspect, and take copies thereof. It shall also provide reports updating details of BOs on a fortnightly basis to the Issuer/R&T Agent.
17. The depository shall provide the details of the list of BO's as well as the pending requests for Dematerialisation and Rematerialisation that may be required by the Issuer/R&T Agent from time to time on the payment of such charges as may be provided in the Business Rules.
18. Such information shall be provided within a stipulated period from the date of making such request. Where the list of Beneficial Owners is required as on a particular date, the same shall be provided within a stipulated period after such date or as decided by the depository from the date of receipt of such request by the depository whichever is later. NSDL has specified the period as 15 days.
19. The depository shall in its discretion provide any other details that may be required by the Issuer and/ or its R & T Agent from time to time on the payment of such charges as it may deem fit.
20. The Issuer and/or R & T Agent shall inform the depository of any proposed changes in the address of the Registered Offices, Corporate Office or of the location where the equipment for communication with the depository is situated not less than thirty days before the date of such change.
21. The depository shall inform the Issuer and/or its R & T Agent of any proposed changes in the address of its Registered Office or Corporate Office not less than thirty days before the date of such change.
22. The Issuer shall not change, discontinue or substitute its R & T Agent unless the alternative arrangement has been agreed to by the depository.
23. The Issuer and/or its R & T Agent shall not assign to any other person/ entity its functions & obligations, relating to transactions with the Depository, without the approval of the depository.
24. All parties to this agreement shall resolve the grievances of the BOs within a period of 21 days for NSDL and 30 days as per CDSL agreement, from the date of receipt of the complaint, concerning the depository, the Issuer and/ or its R & T Agents.

### **3.3.4 Role of Issuer/ R&T Agent in Dematerialisation of Securities**

The Depository electronically intimates, on a daily basis, all dematerialisation requests to the respective Issuer or its R&T Agent. The Issuer or its R&T Agent have to verify the validity of the security certificates as well as the fact that the demat request has been made by the person recorded as a member in its Register of Members. After such verification, the Issuer or its R&T Agent intimates the depository and authorizes an electronic credit for that security in favour of the Client. On receipt of such intimation, the depository makes the credit entries in the account of the Client concerned. No credit of any securities to the accounts of any client can be made unless the depository has received intimation from the Issuer or its R&T Agent. Where the Issuer or its R&T Agent rejects any dematerialisation request, it has to electronically intimate the depository regarding such rejection within a period of 15 days. After intimating such rejection to the depository, the Issuer or its R&T Agent returns the DRF along with the rejection reason and relevant security certificates, unless the reasons for rejection are any of the following:

- the security certificates are stolen or;
- the security certificates are fake or;
- in the event of an order from a court or a competent statutory authority prohibiting the transfer of such securities or;
- in case duplicate certificates have been issued in respect of the securities with the same distinctive numbers.

The Issuer or its R&T Agent, after giving intimation as set out in the Bye-Laws, represents and warrants to the depository, that such securities exist and are validly issued and it is entitled or has full authority to transfer such securities with the Depository in the name of the Client<sup>6</sup>.

### **3.3.5 Role of Issuer/ R&T Agent in Rematerialisation of Securities**

A Client may withdraw its security balances with the Depository at any point of time by making an application for rematerialisation to the Depository through its DP. When the investor submits the Remat Request Form (RRF), the Issuer and/or its R&T Agent and the depository have to take the following steps:

- The depository intimates electronically about the details of all accepted rematerialisation applications to the Issuer or its R&T Agent on a daily basis.
- The DP forwards the RRF to the Issuer or its R&T Agent within 7 days of accepting such request from the client. The Issuer/R&T Agent, after validating the RRF, confirms to the depository

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<sup>6</sup> CDSL has a provision of opening an account for unclaimed securities by an Issuer, but it is applicable for securities being issued in IPO and is not to be used for dematerialisation process.

electronically that the RRF has been accepted. Thereafter, the Issuer/R&T Agent despatches the security certificates arising out of the rematerialisation request within a period of 30 days from receipt of such RRF directly to the client. On receipt of such acceptance from the Issuer/R&T Agent, depository debits the balances from the respective client's account held with the DP's.

### **3.3.6 Role of Issuer/R&T Agent in Corporate Benefits**

It is the function of the Issuer/R&T Agent to inform the depository about the corporate actions relating to prescribing dates for book closures, record dates, dates for redemption or maturity of security, dates of conversion of debentures, warrants, call money dates and such other action from time to time and submit necessary approval documents for the corporate actions. On receiving such intimation, the depository provides the details of the holdings of the clients electronically to the Issuer/R&T Agent (as of relevant cut-off date) for the purpose of corporate actions and distribution of corporate benefits.

The Issuer/R&T Agent distributes dividend, interest or other monetary benefits directly to the eligible beneficial owners on the basis of the list provided by the depository. The corporate benefits can be distributed through the depository also with its concurrence. The Issuer/R&T Agent may, if the benefits are in the form of securities, distribute such benefits to the clients through the depositories in the following cases:

- The newly created security is an eligible security.
- The concerned client has consented to receive the benefits through the depository.

In such a case, the Issuer/R&T Agent provides allotment details of all clients to the depository. On receipt of these details, the depository makes the necessary credit entries in the account of the client concerned. In certain cases such as split of shares, consolidation of shares, mergers, demergers, bonus shares, etc. corporate action is executed automatically as per the fixed ratio defined by Issuer/R & T Agent, through the depository system. This feature is called "Automatic Corporate Action".

## Review Questions

Questions to assess your learning:

1. For registering as a DP, the application should be submitted \_\_\_\_\_.
- (a) separately to Depository and SEBI
  - (b) to Depository, who will in turn forward it to SEBI after evaluation
  - (c) to Depository who will in evaluate and register the DP
  - (d) directly to SEBI and a copy should be sent to Depository for information only

Ans: (b)

2. After Depository receives an application for registering as a DP, it evaluates and forwards the application to SEBI within \_\_\_\_\_.
- (a) 30 days
  - (b) 15 days
  - (c) 45 days
  - (d) 90 days

Ans: (a)

3. As per PMLA, records of services need to be preserved for \_\_\_\_\_ years.
- (a) 1
  - (b) 5
  - (c) 7
  - (d) 10

Ans: (b)

4. Are Certificates of deposits eligible for dematerialisation as per SEBI (Depositories & Participants) Regulations, 1996?
- (a) Yes
  - (b) No

Ans: (a)

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## Chapter 4: Functions of Depository Participant-Account Opening

### Learning Objectives:

After studying this chapter, you should know about:

- Two types of depository accounts—Beneficiary account and Clearing member account
- Opening and closing procedures of depository accounts
- Freezing of depository accounts
- Procedure for changes in client details of accounts

### 4.1 Introduction

An investor wishing to avail depository services must first open accounts with a DP registered with a depository. The process of opening a demat account is very similar to that of a bank account. An investor has the option of opening an account with several DPs or opening several accounts with a single DP. There are several DPs offering various depository-related services. Each DP is free to frame its own fee structure. Investors have the freedom to choose a DP based on certain criteria such as convenience, comfort, service levels, safety, reputation and charges. The investor while opening an account has to submit an acknowledgement of receipt of the copy of the Rights and Obligations document to the DP. The form and contents of the Rights and Obligations document are specified by SEBI and DP Operating Instructions of the depository in which the DP is registered.

In this chapter we will understand the different types of accounts and the procedure for account opening under the depository system.

### 4.2 Types of Account

There are mainly two types of demat accounts which can be opened with a depository participant viz., (a) Beneficial Owners Account, and (b) Clearing Member Account. The type of depository account depends on the operations to be performed.

**Beneficiary Account:** A beneficial owner's account is an ownership account. The holder/(s) of securities in this type of account owns the securities. For example, Mr. Ram who is a retail investor trades in the securities market. The securities which he buys or sells will be kept in his beneficial owner account which he would have to open with a DP.

**Clearing Member Account:** This account is opened by a broker or by a clearing member for the purpose of settlement of trades executed on a recognised stock exchange.

The clearing member account is a transitory account. The securities in this account are held for a commercial purpose only. The securities in this account will be eligible for any corporate action benefit declared.

### **4.3 Beneficial Owner Account**

This account is opened by investors to hold their securities in dematerialised form with a depository and to carry out the transactions of sale and purchase of such securities in book entry form through the depository system. A beneficiary account holder is legally entitled for all rights and liabilities attached to the securities held in that account. Therefore, the account is called “**beneficial owner account**”. A beneficiary account can be in the name of an individual, corporate, Karta of Hindu Undivided Family (HUF) as used in NSDL and/or HUF entity as in the case of CDSL, minor, bank, financial institution, registered (incorporated) trust, etc. or the broker himself for the purpose of his personal investments in demat form. These accounts are opened with a DP.

A new sub-type viz. "Margin Account" and "Client Beneficiary Account" is also available and added to the Client type viz.; 'Resident' and 'Body Corporate' under the BO Maintenance Module in depository system application software. The main objective behind adding this new sub-type is to enable Clearing Members (CMs) to open beneficial owner accounts to hold securities for client margin purposes or to hold securities for which payment has not been received from the clients. New sub-types are also added to enable promoters to separately hold securities issued as 'Promoter' of the company.

DPs are required to open separate accounts, for their own investments, thereby keeping the 'beneficial owner' accounts separate. This is to ensure that there is no co-mingling of their assets with that of their clients.

#### **General guidelines for Account Opening**

- a) Self-attested copy of PAN card is mandatory for all Clients including Promoters / Partners / Karta / Trustees / Whole Time Directors and persons authorised to deal in securities on behalf of company / firm / others.
- b) Copies of all documents submitted by the applicant should be self-attested and accompanied by originals for verification. In case the original of any documents are not produced for verification, then the copies should be properly attested by the entities authorised for attesting the documents.

- c) If any proof of identity or address is in a foreign language, then translation into English is required.
- d) Name & address of the applicant mentioned on the KYC form, should match with the documentary proof submitted.
- e) In case of PAN, Participants may verify the PAN of their Clients online at the Income Tax website without insisting on the original PAN card, provided that the Client has presented a document for Proof of Identity other than the PAN card.
- f) If correspondence & permanent address are different, then proofs for both have to be submitted.
- g) Sole proprietor must make the application in his individual name & capacity.
- h) For non-residents and foreign nationals, (allowed to trade subject to RBI and FEMA guidelines), copy of passport/PIO Card/OCI Card and overseas address proof is mandatory.
- i) For foreign entities, CIN is optional; and in the absence of DIN no. for the directors, their passport copy should be given.
- j) In case of Merchant Navy NRI's, Mariner's declaration or certified copy of CDC (*Continuous Discharge Certificate*) is to be submitted.
- k) For opening an account with Depository participant or Mutual Fund, for a minor, photocopy of the School Leaving Certificate/Mark sheet issued by Higher Secondary Board/Passport of Minor/Birth Certificate must be provided.
- l) Politically Exposed Persons (PEP) are defined as individuals who are or have been entrusted with prominent public functions in a foreign country, e.g., Heads of States or of Governments, senior politicians, senior Government/judicial/ military officers, senior executives of state owned corporations, important political party officials, etc.

**List of people authorised to attest the documents**

- a) Notary Public, Gazetted Officer, Manager of a Scheduled Commercial/ Co-operative Bank or Multinational Foreign Banks (Name, Designation & Seal should be affixed on the copy).
- b) In case of NRIs, authorised officials of overseas branches of Scheduled Commercial Banks registered in India, Notary Public, Court Magistrate, Judge, Indian Embassy /Consulate General in the country where the client resides are permitted to attest the documents.

With a view to bring about uniformity in securities markets, common KYC form and supporting documents are required to be used by SEBI registered intermediaries. The KYC form shall be filled by an investor at the account opening stage while dealing with any of the above intermediaries. Additional details specific to the area of activity of the intermediary shall be obtained from the investors in Part II of the account opening form.

The additional information (Part II) is prescribed by Depositories for their depository participants and by Association of Mutual Funds in India (AMFI) for all mutual funds. The Portfolio Managers, Venture Capital Funds, and Collective Investment Schemes shall capture the additional information specific to their area of activities, as considered appropriate by them. The intermediaries shall also continue to abide by Circulars issued by SEBI from time to time for prevention of money laundering.

#### **4.3.1 Documents for Verification**

**I. Non-body Corporate / Individuals Investors:** All non-body corporate investors have to submit any one of the following documents as given below prescribed by SEBI, along with the stipulated KYC Application Form (Part I) and Account Opening Form (Part II) as per the format and submit the same to the DP along with acknowledgement of receipt of Rights and Obligation document. The schedule of fees to be charged by the DP to the Client should form a part of the Rights and Obligation document. A beneficiary account can only be opened after obtaining a proof of identity and address of the applicant. An authorised official of the DP should verify the photocopies of any of following documents submitted with their corresponding originals and after putting his/her signature on them with remarks "verified with original" before proceeding to open the account.

It is mandatory for all DPs to carry out 'in-person' verification (IPV) of their Clients. At the time of opening demat accounts, the DP should establish the identity of the applicant(s) (*including guardian in case of minor account*) by verifying the photograph(s) affixed in the KYC Application Form as well as proof of identity document(s), with the person concerned. Further, in case of joint accounts, IPV needs to be carried out for all the holders of the account. DP may use 'web-camera' for carrying out IPV for opening of depository accounts subject to compliance with other SEBI guidelines/circulars relating to opening of depository accounts including verification of documents.

Upon the applicant(s) submitting the KYC Application Form and the account opening form, proof of identity & address documents and PAN details, the DP should follow the procedure as given below:

- I. Verify the identity of the applicant(s) as clarified above.
- II. After due verification, the DP shall ensure that the following details are recorded on the KYC Application Form at the time of IPV:
  1. name of the person doing IPV,
  2. his designation,
  3. organisation

4. his signature and
  5. date
- III. Manner of recording IPV details on KYC Application Form: DP may either affix a stamp or print the IPV details or write the same on the KYC Application Form. If IPV is done through web camera, then mention “IPV through webcam” as well.
  - IV. Place where IPV details are to be recorded on the KYC Application Form: DPs may record the same at any appropriate place on the KYC Application Form as may be deemed fit by the DP without making illegible the other details mentioned in the KYC Application Form. For non-individuals such as HUF, unregistered trust, etc. where the KYC Application Form for non-individuals is filled up and the depository account would be opened in the name of the individual (*such as karta, trustee, etc.*), the IPV details may, if DPs find it appropriate, be recorded at the Annexure to KYC Application Form where the details of the karta, trustee, etc. are mentioned.
  - V. Attachment of separate sheet to the KYC Application Form or affixing stickers on the KYC Application Form for recording of IPV details will not be permitted.

The IPV carried out by one SEBI registered intermediary can be relied upon by another intermediary. In case of stock brokers, their sub-brokers or Authorised Persons (appointed by the stock brokers after getting approval from the concerned Stock Exchanges in terms of SEBI Circular No. MIRSD/DR-1/Cir-16/09 dated November 06, 2009) can perform the IPV. In case of Mutual Funds, their Asset Management Companies (AMCs) and the distributors who comply with the certification process of National Institute of Securities Market (NISM) or Association of Mutual Funds (AMFI) and have undergone the process of ‘Know Your Distributor (KYD)’, can perform the IPV. However, in case of applications received by the mutual funds directly from the clients (*i.e. not through any distributor*), they may also rely upon the IPV performed by the scheduled commercial banks. In the case of NRIs/foreign nationals, considering the infeasibility of carrying out IPV, in such a situation photocopies of the KYC documents should be attested by any of the entities viz., Notary Public, any Court, Magistrate, Judge, Local Banker, Indian Embassy/ Consulate General of the country where NRI/FN is residing [*outside India*] to the effect that it has been verified with the originals. DP must use separate KYC Application Form to collect information for each holder for joint accounts (*i.e. for first holder, second holder and third holder*) as well as for guardian in case the sole holder is a minor.

A demat account can have maximum three holders. Proof of identity is to be obtained for all the holders. For First holder proof of correspondence address as well as permanent address is to be obtained in case the correspondence address is not the same as the permanent address. For joint holders proof of only permanent address is to be obtained. In addition, obtaining PAN Card

details of all the holders is compulsory for all categories of demat account holder(s). In some cases, the PAN is not required to be entered. Such cases have to be handled by entering the appropriate exemption codes. The exemption codes are provided by way of communiqués from time to time.

**(a) Proof of Identity (POI):**

- I. Passport
- II. Voter ID card
- III. Driving license
- IV. PAN card with photograph
- V. Unique Identification Number (UID) (Aadhaar)
- VI. Identity card/document with applicant's photo, issued by
  - a) Central/State Government and its Departments,
  - b) Statutory/Regulatory Authorities,
  - c) Public Sector Undertakings,
  - d) Scheduled Commercial Banks,
  - e) Public Financial Institutions,
  - f) Colleges affiliated to Universities (this can be treated as valid only till the time the applicant is a student),
  - g) Professional Bodies such as ICAI, ICWAI, ICSI, Bar Council etc., to their Members; and
  - h) Credit cards/Debit cards issued by Banks.

**(b) Proof of address (POA) - Following is the list of documents admissible as Proof of Address: (Documents having an expiry date should be valid on the date of submission.)**

- a. Passport/ Voters Identity Card/ Ration Card/ Registered Lease or Sale Agreement of Residence/ Driving License/ Flat Maintenance bill/ Insurance Copy /Aadhaar Letter issued by Unique Identification Authority of India.
- b. Utility bills like – (Not more than 3 months old– as on date of receipt for documents).
  - i. Telephone Bill (only land line)
  - ii. Electricity bill or
  - iii. Gas bill
- c. Bank Account Statement/Passbook – (Not more than 3 months old – as on date of receipt for documents)

Depending on the type of bank statement issued the following checks must be done:

- i. Original bank statement: The original bank statement is printed on the stationery of the bank, carries logo & name of the bank, displays the name and address of the Client.

- ii. Copy of bank statement: In addition, the authorised official of the DP should verify the photocopy of the bank statement submitted with the corresponding original.
- iii. Original Bank statement on plain paper (Computer generated):
  - a. The bank statement clearly mentions the name and address of the Client.
  - b. The bank statement is duly attested (signed and stamped) by the authorised official of the bank mentioning the name and designation of such authorised official.
  - c. Obtain a cancelled cheque leaf in original OR a photocopy of cheque and the authorised official of DP should verify the same with the original cheque.
- d. Bank statement issued in electronic form:
  - a. Print out of the bank statement clearly mentions the name and address of the Client.
  - b. Obtain a cancelled cheque leaf in original OR a photocopy of cheque with the name of the Client pre-printed on it. However, in case of a photocopy of cheque it can be accepted provided the authorised official of DP verifies the same with the original cheque.
- e. Self-declaration by High Court and Supreme Court judges, giving the new address in respect of their own accounts.
- f. Proof of address issued by any of the following: Bank Managers of Scheduled Commercial Banks/Scheduled Co-Operative Bank/Multinational Foreign Banks/Gazetted Officer/Notary public/Elected representatives to the Legislative Assembly/Parliament/Documents issued by any Govt. or Statutory Authority.
- g. Identity card/document with address, issued by any of the following: Central/State Government and its Departments, Statutory/Regulatory Authorities, Public Sector Undertakings, Scheduled Commercial Banks, Public Financial Institutions, Colleges affiliated to Universities and Professional Bodies such as ICAI, ICWAI, ICSI, Bar Council etc., to their Members.
- h. For FII/sub account, Power of Attorney given by FII/sub-account to the Custodians (which are duly notarised and/or apostiled or consularised) that gives the registered address should be taken.
- i. The proof of address in the name of the spouse may be accepted.
- j. Acceptance of third party address as correspondence address in depository account<sup>7</sup>
  - a. Client can also provide third party address as correspondence address in depository account provided Participant ensures that all prescribed 'Know Your Client' norms are fulfilled for the third party also. The DP shall obtain proof of identity and proof of

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<sup>7</sup> SEBI Circular No. CIR/MRD/DP/ 37 /2010 dated December 14, 2010

address for the third party. The DP shall also ensure that customer due diligence norms as specified in Rule 9 of Prevention of Money Laundering Rules, 2005 are complied with in respect of the third party.

- b. DP should further ensure that the statement of transactions and holding are sent to the Client's permanent address at least once in a year.
- c. However, the above provision shall not apply in case of PMS (Portfolio Management Services) clients<sup>8</sup>.

Where the account is to be jointly held, the POI and POA documents must be collected in respect of all the account holders. The aforesaid documents are the minimum requirement for opening a BO Account. Participants are advised to exercise due diligence while establishing the identity of the person to ensure the safety and integrity of the depository system. Participants can apply stricter criteria and accordingly, decide to accept, select documents out of the list of documents prescribed by SEBI, as proof of identity/address.

**II. For Corporate Investors:** All corporate investors have to submit the following documents as prescribed by SEBI along-with the stipulated KYC Application Form (Part I) and Account Opening Form (Part II) as per the format. DPs shall ensure that in case of foreign entities, all transactions in the account are in compliance with FEMA Regulations. Accordingly, DPs are required to obtain from such foreign entities necessary documents evidencing general/specific approvals as may be required under FEMA Regulations. Further, DPs are required to obtain a declaration from the foreign entity that it has complied and will continue to comply with FEMA Regulations. DPs are required to use separate KYC Application Form to collect information for each holder for joint accounts (i.e. for first holder, second holder and third holder).

1. Memorandum & Articles of Association (MOA & AOA) & Certificate of Incorporation.
2. Board resolution authorizing opening of demat account and specifying the names of the persons authorised by Board to operate the said demat account. The Board Resolution must specify the manner of operation of the account and authority given to the authorised signatories to open and operate the account.
3. Names of authorised signatories, designation along-with their specimen signatures and photographs, duly verified by the Managing Director or Company Secretary.
4. Proof of address of the corporate, evidenced by the document registered with Registrar of Companies or acknowledged copy of Income Tax Return or Bank Statement or Leave and License Agreement/Agreement for sale or Landline telephone bill / electricity bill /Pan card of the corporate entity.
5. Copy of the balance sheets for the last 2 financial years (to be submitted every year).

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<sup>8</sup> Reference letter no. IMD/ MT/165502/ 2009 dated June 05, 2009

6. Copy of latest share holding pattern including list of all those holding control, either directly or indirectly, in the company in terms of SEBI takeover Regulations, duly certified by the company secretary/Whole time director/MD (to be submitted every year).
7. Photograph, POI, POA, PAN and DIN numbers of whole time directors/two directors in charge of day to day operations.
8. Photograph, POI, POA, PAN of individual promoters holding control - either directly or indirectly.
9. Copy of the Board Resolution for investment in securities market.

An authorised official of the DP shall verify the copies of the proof of address / identity documents with the original documents and write or put a stamp with the words: “verified with original” and affix his/her signature on the documents submitted by the Client, while exercising such due diligence.

#### **e-KYC service:**

SEBI has already permitted use of e-KYC service launched by UIDAI. The Aadhaar e-KYC service provides an instant, electronic, non-repudiable proof of identity and proof of address along with date of birth and gender (digitally signed and encrypted). In addition, it also provides the resident’s mobile number and email address (if available) to the service provider, which helps to further streamline the process of service delivery. e-KYC may be performed at the service centre of Participant using biometric authentication, as well as remotely using an OTP on a website or mobile connection. Considering the benefits and convenience of e-KYC, Participants may consider using the e-KYC services.

#### **4.3.2 Common Information**

There are some common details which are required for any type of account opening with the DP which is stated below.

- Name of the holder
- Date of birth (for individual accounts)
- Occupation and financial details
- Address & phone/fax number
- Bank details like name of bank, type of account (current/savings), account number, branch address, MICR, IFSC etc.
- PAN number
- Details of nomination (for individual accounts only)
- Specimen signatures
- e-mail address

- Mobile number
- Address for communication

The procedure involved in opening of an account, the nature of such an account, and the various factors to be considered for opening a depository account are explained in the subsequent sections.

#### **4.3.3 Beneficial Owner Account - Procedure for Opening an Account**

Investors wishing to open account with the depository have the following benefits/choices:

- Can select the DP based on the investors convenience, comfort, service levels, safety, reputation, charges etc.
- Have the flexibility to open more than one account with the same DP or any other DPs
- No requirement of minimum balance
- Can close an account anytime with one DP and open another one with any other DP.

The type of the account opening form to be filled by an investor and the list of documents required depend on the type of beneficiary account to be opened - whether it is for NRIs or Corporate or individual. Further, a demat account can be in a single name or joint names. Clearing Members and brokers have to open a beneficiary account if they have to deal with their own holdings.

There are several client types in the depository system and different codes are allotted to them. However, the NSDL and CDSL codes may not be exactly same. Some of the codes are listed below:

1. Resident (Individual in case of CDSL)
  - Ordinary (Resident Individual in CDSL)
  - Hindu Undivided Family (HUF)
2. Financial Institutions (FI)
  - Government-sponsored FI
  - State Financial Corporation
  - Others
3. Foreign Institutional Investors (FIIs)
  - Mauritius-based
  - Others
4. Non-resident Indian (NRI)
  - Repatriable
  - Non-Repatriable
5. Body Corporate
  - Domestic Company

- Government Company
  - Central Government
  - State Government
  - Co-operative Body
  - Non-Banking Finance Companies (NBFC)
  - Non-NBFC
  - Broker
  - Foreign Bodies
  - Group Companies
  - Foreign Venture Capital
  - Limited Liability Partnership
  - Others
6. Clearing Member (CM)
  7. Foreign National
  8. Mutual Fund
  9. Trust
  10. Bank
  11. Intermediary
  12. Foreign Portfolio Investors (FPI) (Category I, II & III)

#### **4.3.4 Rights and Obligations of Beneficial Owner and Depository Participant**

Anyone who wants to avail the depository services should submit the acknowledgement of receipt of the copy of the Rights and Obligation document (of having read) to the DP. The standard format of the Rights and Obligation document is provided by SEBI and forms a part of the depository participant operating instructions. The Rights and Obligation document sets out in contractual form the nature of services to be provided, rights and obligations of the DP as well as the client, and the fees/charges payable for the services. The Rights and Obligation document and the acknowledgement needs to be made on a plain paper and has to be signed by:

- (a) Sole holder in case of single holding; or
- (b) All joint holders in case of joint holding, or
- (c) Constituted attorney (authorised signatories) in the case of corporate/registered trust accounts.

FII clients registered with SEBI and who have entered into an agreement with the DP directly or through their constituted attorney under regulation 16(1) of SEBI (Foreign Institutional Investors) Regulations 1995, are not required to submit acknowledgement of Rights and Obligations

document. The FII-DP agreement authorizes the DP to act on behalf of the FII for availing depository services and it should have been filed with SEBI.

In NSDL, subsequent to opening of a depository account, certain information such as Client Master Report alongwith including charge structure is required to be provided to the Client.

- a) The Client Master Report and the scanned copy of the charge structure is provided to the Client at the e-mail address recorded in the DP system. In case the DP is not able to provide the same to its Clients by e-mail due to any reason (including bounced e-mails), the DP should ensure that the same is provided to the Client in paper form.
- b) Maintain the records of delivery/non-delivery of e-mails to Clients.
- c) When the Client provides e-mail address at the time of account opening, inform the Client that such information will be sent by e-mail to the Client.
- d) In case the Client has opted for DIS booklet along with account opening or in case of BSDA, the DIS booklet must be separately issued to the Client.

In CDSL, subsequent to opening of a depository account:

- The DP shall send the BO a system-generated confirmation letter for having opened the account mentioning the account number along with the formats of necessary forms and instruction slips. This letter shall be given to the BO and the DP shall maintain proof of such despatch. The letter along with other documents mentioned earlier may also be given to the BO if the BO wants to collect the same in person. Proof of such delivery shall be maintained by the DP.
- Alternatively, the client master report may be provided by the DP to the BO at the e-mail address recorded in the CDSL system or through its website, provided the same can be accessed by the BO through secured access, e.g. Login ID-Password / three factor authentication. In case the DP is not able to provide the same by e-mail/ the BO cannot access the same through its website due to any reason (including bounced e-mail), the DP should ensure that the same is provided to the BO in paper form. The DP should maintain record of delivery/ non-delivery of the e-mail to the BO or accessing of the information by the BO through its website.
- The BO should be informed at the time of account opening that such information will be made available through e-mail /website, as the case may be. In case DIS booklet is required to be sent to BO, it must be separately issued to the BO.
- A BO may have an on-line trading account and give /execute a power of attorney (POA) in favour of the CM for executing delivery instructions for settling stock exchange trades effected through such CM or a BO may be a PMS client of a PMS manager and give / execute a power of attorney (POA) in favour of the PMS manager or execute a PMS agreement with an authority to PMS manager to manage the portfolio of securities. In

such a case, the BO may be given option to receive the Delivery Instruction Slip Booklet (DIS) on the DP completing the account opening procedure or at any later date on request by the BO. The BO can exercise such option by submitting an 'Option Form for issue of DIS booklet', as specified in DP Operating Instructions, which shall be given to the intending-BO along with the Account Opening Form. A written consent shall be obtained from BO in case BO agrees to waive off the right to receive DIS at the time of account opening and opts to receive it at a later date.

#### 4.3.5 Types of Application Forms

Different application form needs to be filled for each kind of accounts. A DP must understand clearly the differences in the application forms, to facilitate efficient and error-free service to investors. Separate forms are prescribed for individuals (including karta of the HUF) and corporate clients/clearing member accounts.

The forms prescribed by the Depository's require the applicants to give the following details:

- (a) **Name(s) of account holder(s)**: DP should ensure name & address of the applicant mentioned on the KYC form, should match with the documentary proof submitted. If an application is received from a married lady, along with a PAN card in her maiden name along with her marriage certificate, the BO account can be opened in the married name of the lady. In CDSL, by filling up transposition form, the share certificates with same holders but in different order can be dematerialised. Investors are advised to open their account in their fully expanded name, i.e., to spell to the first name as well as the middle name. This would obviate any doubts about the veracity of the information. Investors can dematerialise all physical securities held in his full name, abridged name, name with initials or any other fashion in this account. By opening the account in the fullest/expanded name, chances of wrong credits/debits and rejection of demat requests are minimised. For example, there may be two investors with the same initials and same last name - A K Khanna may be either Arun Kumar Khanna or Ashok Kishore Khanna. If the name is fully spelt out there is no ambiguity and there is no need then for the DP to take steps to verify the identity. Similarly, investor can dematerialize shares held in any form of name like A.K. Khanna, Arun K. Khanna, A. Kumar Khanna, Arun Kumar K., etc., into one account
- (b) **Mailing and communication address(es)** - Client has the facility to mention two addresses in the KYC application form (Part I) i.e., correspondence and permanent address. For both, permanent and correspondence addresses of a Client, DPs should ensure that they collect and verify the KYC documents. The correspondence address would be the default address that would be forwarded to the Registrar & Transfer Agent (RTA) as well as used for printing Transaction Statement (SOT) from Depository System.

For corporate accounts, a copy of Memorandum of Association, Articles of Association, Certificate of Incorporation Board resolution permitting opening of account, the registered address of the Company as well as addresses of the person(s) authorised to operate the account on behalf of the Company have to be furnished. PAN card of authorised signatories to be “verified with original” and taken on record. In case of CDSL, addresses of the person(s) authorised to operate the account on behalf of the company need not be furnished. Also in case of CDSL, PAN card of authorised signatories need not be verified with the originals or maintained for record purpose.

- (c) **Details of guardian in case account holder is a minor** - The guardian holds and operates the beneficial owner account held on behalf of the minor till he/she becomes a major. The guardian is required to sign the application form and details of his name and address need to be given in addition to the details of the minor.
- (d) **Foreign address and RBI approval details for NRI, FII or OCB accounts** - For foreign based clients like NRIs, FIIs, etc., the DP must obtain original or attested copies of the power of attorney as the case may be and the approval letter from RBI permitting them to invest (this is not required in CDSL). If the account holder is an FII or an OCB, SEBI/RBI registration details along with attested copy of registration certificate issued by SEBI and authorisation letter is required.
- (e) **Clearing member details for a clearing account** - A broker account as a clearing account can be opened only after the depository approves it and allots clearing-member business partner identification number (CM-BP-ID). However, the concept of a separate CM-BP-ID is not followed by CDSL. A broker member can have only one clearing account per stock exchange of which he is a member<sup>9</sup>. The DP should obtain, with the account opening form, the necessary details from the clearing member along with a letter from the Clearing Corporation allotting a CC-CM-ID. In case the clearing member account is being transferred from any other DP, a no-objection certificate from the earlier DP may be obtained. A Clearing Member may open only one CM Account. However, a Clearing Member may open additional CM Account(s) with the Participant for the purpose of Futures & Options (F&O) and / or Securities Lending and Borrowing Mechanism (SLBM) transactions and the Clearing Corporation shall allot additional CC-CM-IDs to the Clearing Member for this purpose. This is not applicable in NSDL, as Clearing Members

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<sup>9</sup> In CDSL system a broker / clearing member of BSE is required to open following accounts with any DP of CDSL viz., CM Principal Account, CM USA (Pool) account, . Clearing Members of NSE and other stock exchanges are required to open, with any DP of CDSL, a CM Clearing account or Pool account. Additionally the CM has to open an Early Pay-in account with CH /CC of the respective stock exchange. All of the above mentioned account type will be referred to as CDSL CM accounts in this workbook.

maintaining CM Accounts with DPs of NSDL can open and maintain only one CM Account per stock exchange.

- (f) **Details of bank account:** Details of bank account of the account holder, including the 9-digit code number of the bank and branch appearing on the MICR cheques issued by the bank have to be filled in the application form. Companies use this information for printing them on dividend/interest warrants, etc. DPs can accept any one or more of the documents given below can be accepted as proof of bank details:
- a) Specimen copy of cheque/cancelled cheque
  - b) Copy of Bank Statement
  - c) Copy of Bank Passbook
  - d) Letter from Bank

The aforesaid documents must contain the following information to be acceptable as proof for bank details:

- a) Bank Name
  - b) Branch Address
  - c) IFSC/MICR code
  - d) Name of account holder
  - e) Account Number
- (g) **Details of Income Tax Permanent Account Number (PAN):** SEBI has made the requirement of PAN as a mandatory requirement for demat account opening. It was decided that the Depositories will issue directions to DPs making Permanent Account Number (PAN) compulsory for all categories of demat account-holders including minor, trust, foreign corporate body, banks, corporates, FIIs and NRIs. This is applicable for existing accounts as well as new accounts to be opened. In cases where the existing demat account holder(s) have failed to submit the PAN details to the DPs by December 31, 2006 or there are discrepancies in the PAN details that have not been resolved by December 31, 2006, such accounts have been 'Suspended for Debit' until PAN details are verified and updated at the depository system application software. It was also decided that the staff of DPs should personally verify the identity and address while opening demat accounts and the record of the person who carried out such verification should be available.
- (h) Further SEBI has issued Circular dated July 29, 2010 which stipulates that with effect from Monday, August 16, 2010, PAN non-compliant demat accounts shall also be "suspended for credit" other than the credits arising out of automatic corporate actions. The circular also clarifies that other credits including credits from IPO / FPO / Rights Issue / Off-market transactions or any secondary market transactions shall not be allowed into such accounts.

**(i) In view of the aforesaid SEBI decision, DPs are required to follow below mentioned procedure for PAN Compliance:**

**a. In respect of accounts that are to be opened:**

- i. DPs should obtain a photocopy of the PAN card of the person(s) seeking to open the account and verify the same with the original PAN card.
- ii. The DP official should personally verify the identity and address of each of the applicant while opening demat accounts and the record of the person who carried out such verification should be maintained.
- iii. Further, the name of demat account holder(s) should be compared to the name appearing on the website of the Income Tax Department (ITD).
- iv. In case the name(s) do not match or the PAN is not present in the Income Tax database, DP should seek necessary clarification from the account holder(s) and activate such accounts in the depository system only after the discrepancy is resolved.
- v. In case of joint accounts, the PAN of each of the joint holder should be captured in the depository system after making verification as explained above.
- vi. After verifying the details of PAN as mentioned above, the DP officials should affix a stamp as 'PAN verified', on the photo copy of the PAN card(s).

**b. In respect of existing accounts that are frozen due to non-compliance of PAN requirement upon the Client submitting the PAN card, DPs should follow the procedure in the below given sequence:**

- i. Verify the PAN details as per the laid down procedure mentioned in points (iii) to (vi) above,
- ii. Update the PAN field and *enable the PAN flag provided in the depository system application software*
- iii. Remove the suspension by initiating unfreeze instruction and ensure that the status of the unfreeze instruction is 'Closed, Settled' prior to executing any other instruction in the system.

***Operating guidelines on SEBI circular providing clarifications on PAN***

Further to the clarifications issued by SEBI (given in italics below), DPs have to follow below mentioned additional operating guidelines /clarifications with respect to capturing of PAN details:

- a. As regards proof of address of FIIs/sub-accounts, a copy of the Power of Attorney (POA) given by the FIIs/FII sub-accounts to the Custodians (which are duly notarised and/or apostilled or consularised) that gives the registered address of the FIIs/sub-accounts can be accepted as proof of address.

- b. The NRIs/PIOs<sup>10</sup> would be required to comply with the mandatory requirement of producing PAN Card at the time of opening a BO account. However, in case of account opened/ to be opened under category NRI/FII in respect of clients not residing in India, the DPs can accept the photocopy of the PAN card of NRI and Foreign national client and follow the procedure laid down for verification of PAN above, provided the copy of the PAN card is duly signed by the account holder and attested by any one of the following entities of the country where NRI and FN is residing:
- The Indian Embassy / Consulate General
  - Notary Public
  - Any Court / Magistrate / Judge
  - Local Banker,

The attestation is to the effect that it has been verified with the originals.

Further, a NRI/foreign national is exempted from obtaining attestation in the photocopy of the PAN card as mentioned above, *provided*, if he/she personally visits the office of the DP to submit the PAN card to comply with the PAN requirements. In such a situation, the DPs will accept the photocopy of the PAN card and verify the PAN details as per the procedure laid down for verification of PAN.

- c. U.N. entities/multilateral agencies which are exempt from paying taxes/filing tax returns in India are exempted from the mandatory requirement of PAN. The exemption, however, would be subject to the DPs associated with NSDL collecting documentary evidence in support of such claim of the investors. After these DPs are satisfied that such entities are exempt from paying taxes/filing tax returns in India, DPs are advised to capture the appropriate PAN exemption codes provided by the depository systems.
- d. In case of HUF, Association of Persons (AoP), Partnership Firm, Unregistered Trust, etc. though the BO account would be in the name of natural persons( In CDSL HUF account can be in the name of HUF entity also), PAN of the respective HUF, AoP, Partnership Firm, Unregistered Trust, etc shall be obtained.
- e. As regards Registered Trust, Corporate Bodies and minors, PAN of the respective entities shall be obtained when accounts are opened in their respective names.
- f. In case where there is difference in the maiden name and current name of the investor (predominantly in the case of married women), DPs can collect the PAN card proof as submitted by the account holder. However, this would be subject to the DPs verifying the veracity of the claim of such investors by collecting sufficient documentary evidence in support of the identity of the investor (reference to prescribed documents by SEBI, to be made as on page 2, under head - Documents for Verification - (a) Proof of Identity).

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<sup>10</sup> In case of CDSL, PIOs falls under the category of Foreign Nationals.

***Operating guidelines for the same are given below:***

- a) This guidance given by SEBI may also be used whenever there is a minor difference in the name mentioned in the PAN Card and the name in which the account is opened / sought to be opened.
- b) Photograph of person appearing on the PAN card can be compared to the account holder and/or the photograph submitted by the account holder along with the application form. Father's name if available on the application form can be compared to the father's name appearing on the PAN card of the account holder.
- c) DPs should call for any additional documents and / or clarification to ascertain and satisfy itself about the identity of the entity, as clarified in the SEBI circular.

**Nomination declaration** - A beneficial owner can make a nomination of his account in favour of any person by filing the nomination form with his DP. Such nomination is considered to be conclusive evidence of the account holder(s) disposition in respect of all the securities in the account for which the nomination is made. The nomination form submitted should be in the format prescribed by the Depository in its Bye-Laws and Business Rules / Operating Instructions.

#### **4.3.6 Forms for Joint Accounts**

A depository account may be opened and maintained in the names of more than one person. All the joint-holders have to sign the application form and acknowledge receipt of copy of the Rights and Obligations document. The supporting documents and photograph should also be provided for all joint holders. The account opening module presently provides only for (up to) three joint names.<sup>11</sup> Though the beneficial ownership of jointly held securities vests in all joint holders,

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<sup>11</sup> Separate set of rule has been prescribed for handling of cases of four or more joint holders:

- (a) A separate account could be opened in the name of the joint holders with four or more names.
- (b) No standing instructions to receive credits, receipt instructions, new issue applications and any other instruction which has the effect of crediting this account should be accepted in respect of such account.
- (c) Appropriate annexure should be attached to the account opening form to include various details, viz., name, address, signatures, etc. of more than three holders.
- (d) An undertaking should be obtained from the client that he will not use this account for the purpose of allotments in the primary market or for purchases from the secondary market. Hence the client will give no instructions (other than for dematerialisation, bonus, rights and preferential offer) to any person which has the effect of crediting this account.
- (e) While opening the account, the DP should capture the names of the four or more joint holders by numbering them in his system and entering the first holder's name in the first holder's field. The rest of the names have to be accommodated in the fields for second and third holder.
- (f) The DP should process the dematerialisation request as per the usual procedure while ensuring that the pattern of holding for each certificate tallies with the pattern of holding of the account.
- (g) After all shares have been dematerialised, the BO shall open a anew demat account in the name of three holders (max) and transfer all securities from the previous account to the new account. After all the balances in such a joint account become nil, the account should be closed.

communications about the joint depository account are provided only to the first holder. The dividend and interest warrants, annual reports and notices for meetings are also issued to the first-named joint holder only.

In the event of the death of a joint holder, the balance lying in the account can be transmitted, on request of the surviving holders, to a new account to be opened by the surviving holders. The earlier account having the deceased holder's name is closed after such transmission. The chapter 5 on Transmission gives the detailed procedure to give effect to this type of request.

#### **4.3.7 Forms for Hindu Undivided Family (HUF)**

As per SEBI's Master Circular No. CIR/MRD/DP/13/2013 dated April 15, 2013, point no. 4.6 it is stated that "it is noted that as per law, in case of HUF, shares can be held in the name of Existing Karta on behalf of HUF. Therefore, HUF demat accounts can be opened in the name of Existing Karta but not in the name of Deceased Karta and HUF entity".

The depository account of an HUF can be opened only in the name of its Karta in case of NSDL and the name of the HUF entity as it appears on the PAN card of the HUF in case of CDSL. DPs should clearly designate the account in the name of the Karta/HUF entity as such. Pan card and bank account proof of HUF should be obtained. The form for Opening a HUF accounts is the same as the individual account. While opening such accounts the DP should select the 'HUF' sub-type in the 'Individual' category of account opening. HUF accounts cannot be opened with joint holders.

#### **4.3.8 Forms for Companies**

A company, being an artificial person, can open a demat account, provided its memorandum authorizes it to make investment in the securities of other companies. A demat account in the name of a company should be operated by the person(s) authorised by a resolution passed by its board of directors. The DP should obtain an attested copy of the memorandum and board resolution, authorizing the opening and mode of operation of the demat account.

#### **4.3.9 Forms for Minors**

A minor may hold shares through his guardian. Accordingly, a minor may open a depository account only through his guardian. Procedure for opening minor account is as follows:

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(h) For holdings of a Trust in the joint names of four or more trustees, this procedure for opening the account can be adopted without any restrictions on receiving credits into that account.

- I. Procedure to be followed by DPs for opening demat account of minors:***
- a. Obtain photocopy of the School Leaving Certificate/Mark sheet issued by Higher Secondary Board/Passport of Minor/Birth Certificate.
  - b. Obtain Proof of Identity, Proof of Address, PAN and the photograph of the Guardian as per the procedure stated in the bye-laws and circulars. Carry out 'in-person' verification of the Guardian.
  - c. Account opened in the name of minor should not have joint holdings.
  - d. Two KYC Application Forms must be filled i.e. one for the guardian and another for the minor (to be signed by guardian).
  - e. In case minor account, PAN details of the minor should be captured by the DP in the Depository System after due verification.
- II. The procedure to be followed by DPs in cases where Minor Clients have attained Majority (i.e. 21 years of age in case of Minor whose Guardian is court-appointed or 18 years where Minor's account is represented by a natural guardian) is as under:***
1. Ascertain the cases where Minors have attained Majority.
  2. Communicate to the Client (Minor attained Majority) immediately advising him/her to submit a fresh account opening form along with necessary KYC documents and PAN card along with photograph of the Client.
  3. In case of NSDL, suspend the account for debit and disable the standing instruction for credit pertaining to the account of Minor. In case of CDSL, such account is automatically suspended for debits.
  4. Verify the account opening form along with necessary KYC documents and PAN as mentioned under point no.2 herein above.
  5. Capture the new demographic details in the depository system after due verification of same
  6. Capture the signature of the Client (Minor turned Major) in the system in place of the signature of the Guardian (captured earlier).
  7. Obtain a fresh acknowledgement copy of the Rights and Obligation document from the BO.
  8. Select "None" or "Nominee" as the case may be in the field 'Nominee/Guardian' in the depository system to disable the entire Guardian details in the said account. If "Nominee" is selected enter the nomination details. This procedure is not applicable in CDSL. If the minor turned major intends to continue with the same account, then the guardian details are to be deleted and Nomination, if given by the client is to be recorded in the system.
  9. Any request or instruction from the guardian, which are to be processed or is having execution date falling on or after the date the Minor has turned Major, shall be

processed/executed only after receipt of confirmation from the Client (Minor turned Major).

10. *Client (Minor turned major) but account is suspended for debit for non-compliance with PAN requirement:* The procedure mentioned in point nos. 1 to 8 above needs to be followed. The PAN details need to be captured in the depository system and the Pan flag should be enabled
11. *In case of accounts already suspended in where Clients have not responded-* The procedure as mentioned under point 2 to point no. 8 is to be followed.

#### **4.3.10 Partnership Firms**

Partnership firm cannot be a member of a company under the provisions of Companies Act. Thus a depository account cannot be opened in the name of a partnership firm. All the partners of the firm, however, can sign as joint holders, and a joint account may be opened in the name of the partners. An exception to this is given for opening a CM Account. The CM account can be opened for broker firms since partnership firms are allowed to become members of a stock exchange.

#### ***Procedure for opening an account in the name(s) of Partners for holding securities that belong to the Partnership firm:***

- a. Copy of the balance sheets for the last 2 financial years (to be submitted every year).
- b. Certificate of registration (for registered partnership firms only).
- c. Copy of partnership deed.
- d. Authorised signatories list with specimen signatures and photograph.
- e. Photograph, POI, POA, PAN of Partners.
- f. The account should be opened only in the names of Partners, operated by the partners and the securities that belong to the Partnership Firm can be held in this account.
- g. Obtain an undertaking in the prescribed format from the Partners to the effect that the Partners would comply with the provisions of the Companies Act and other applicable statutes in respect of securities of the Partnership firm held in the account opened in the names of the Partners.
- h. Where the depository account would be opened in the name of individuals, carry out the 'in-person' verification of such individuals and record the details of IPV as per the current procedure.
- i. As per CDSL operating instructions, partnership deed is to be taken on record.

#### **4.3.11 Signatures/Thumb Impression**

The account opening form should be:

- signed by the sole holder, in case of single holding;
- all joint holders, in case of joint holding;
- authorised signatories, in the case of corporate accounts;
- by guardian, in case of a minor; or
- Both CDSL and NSDL require that the account opening form be signed by the NRI. This account can be operated under signature of account holder(s) or a Power of Attorney Holder. However, according to the CDSL operating instructions, accounts cannot be opened / closed under signature of power of attorney holder.

**Mode of capturing of signature in the depository system for DPs of NSDL:**

- a. The DP should capture the Client's signature(s) as given in the KYC Application Form and/or Account Opening Form in the Depository System. For non-individuals along with signature of authorised signatory(ies), capture the mode of operation in the depository system.
- b. In case the trustee(s)/ partner(s) etc. are individuals, capture the signature(s) of the individuals. In case the trustee(s)/ partner(s) etc. of the unregistered trust/ partnership firm are corporations, companies or entities registered under The Indian Societies Registration Act, 1860, or under the provisions of a state Act such as Bombay Public Trusts Act, 1950 or the relevant State Public Trust Act, capture the signature(s) of the authorised signatories in the depository System. For trust which is an incorporated body, if client informs about the non-applicability of the relevant Public Trusts Act or the Indian Societies Registration Act, in its specific case, then the applicant may be facilitated to hold the beneficial owner account, as proposed, on submission of a certificate obtained by the client as per Section 12AA of income tax, 1961. In addition to the above, Participants are advised as follows:
  - (i) Open the depository account under the category and in the name of trust.
  - (ii) Obtain copy of Registration Certificate issued by the Income Tax Authorities as per Section 12AA of income tax, 1961.
  - (iii) Obtain certified copy of the resolution passed by the Board of Trustees giving the names of trustee(s) authorised by the Board of Trustees to open and operate the depository account,
  - (iv) Obtain certified copy of the latest income tax returns filled by the trust.
- c. Illiterate Person: A remark should be put in the depository System (under the authorised signatory details under "Signatories" screen) at the time of opening the account that the account holder is illiterate or disabled.
- d. Visually Challenged Person: Any visually challenged person can open and operate the demat account including online facility like any other investor, subject to compliance with

requirements as applicable to any investor. The additional steps required to be taken by the Participants in case of visually challenged persons are:

1. If so requested by the client, the Participant should read out and explain to the Client, the contents of the account opening form and rights and obligations document.
2. A remark should be put in the system (under the authorised signatory details in 'signatories' screen) that the Client is "Visually Challenged".
3. Delivery Instruction Slip issued to such Clients should be pre-stamped as "Visually Challenged"

In NSDL, if the signature is in any language other than those specified in the Schedule VIII to the Constitution of India or English, it should be attested by a Magistrate or a Notary Public or a Special Executive Magistrate.

**Process of Opening an account of an Illiterate Person:**

Illiterate person(s), at the time of opening an account with a Participant, must affix the thumb impression (*left hand thumb in case of a male and right hand thumb in case of a female*) on the Rights and Obligations document as well as on the account opening form. All accounts opened by illiterate person(s) with NSDL DPs must be either introduced by an existing account holder or must be attested by applicant's bank. CDSL however does not need an introducer for accounts to be opened by an illiterate person(s). The Client(s) must come in-person to open the account and submit instruction forms and affix his/her thumb impression in the presence of the official of the DP. The DP should identify the Client(s) by verifying the photograph submitted by the Client(s) and read out/explain the contents of the account opening form, Rights and Obligations document and delivery instruction form to the Client(s). In case of CDSL, the DP is not required to read out the delivery instruction form to the client. The official of the DP should then put his signature and remarks "Details explained to the Client(s)", on the account opening form, copy of the Rights and Obligations document and delivery instruction form. In case such Client(s) is/are temporarily or permanently disabled due to which he/she cannot come in person to submit the instruction form as mentioned above, the thumb impression of the Client(s) on the instruction forms must be attested by a Magistrate or a Notary Public or a manager of the account holder's bank. Additionally, for NSDL DPs attestation by Special Executive Magistrate or a similar authority holding a Public Office and authorised to use the Seal of his office is also accepted. The Client should also produce a medical certificate about his/her disability. Further, the instruction forms issued to such Client(s) should be pre-stamped as "Thumb Impression". At the time of opening of account, the aforesaid rules should be explained to the Client(s) in the presence of a witness, who will have to sign the Rights and Obligations document and the account opening form, as a witness.

#### 4.3.12 Client Account Number

On receipt of a valid application form which is complete in all respects and duly signed by the applicant, the DP should verify its contents to his satisfaction. If, after verification, the DP accepts the application and the Rights and Obligations document is signed, the DP has to enter the information on the application form into the depository participant system. The system then generates a client account number which should be referenced by the client for all its transactions in the depository system. The system also generates a report containing the details of client captured from the account opening form. The DP should provide a copy of account opening confirmation report to the client for his reference and verification about the correctness of details. The account number styles are different for different purpose. In case of CDSL, the account number has two parts, i.e., 8-digit DP-ID (identification number of Depository Participant) and 8-digit client account number. In the illustration below, the first 8 digit is the DP –ID and the last 8 digit the Client ID. Together this number is unique across depositories. After opening the demat account, the client master report should be sent to the client at the address given in the account opening form. As per CDSL operating instructions, a system generated confirmation letter for having opened the account should be sent to the BO along with other forms and instruction slips.

1	3	0	1	5	6	0	0	0	0	0	0	0	8	2
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Similarly, an account with the NSDL will have 16 digit number with the first 8 digits indicating the DP-ID starting with IN300100 and the last 8 digits giving the client id i.e. 10005678.

I	N	3	0	0	1	0	0	1	0	0	0	5	6	7	8
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#### 4.3.13 Standing Instructions / Purchase confirmation waiver

A DP may register the transfer of securities to or from a beneficial owner's account only on receipt of instructions from the beneficial owner. No debit or credit can be given to the account of a beneficial owner without a due authorisation from such beneficial owner. However, for ease of operation and elimination of redundancies, a clause has been included in the standard format of Rights and Obligations document. This clause enables clients to give standing instructions to DPs, at the time of opening the account itself, for receiving securities to the credit of their accounts without any further instruction from them. These instructions are given as a part of the account opening form itself. Though not mandatory, it would be better to ask clients to specifically sign in the standing instruction column, to avoid any confusion at a later stage.

**Box 4.1: Operation of demat accounts based on Power of Attorney**

A demat account can also be operated by a **Power of Attorney holder**. In this regard, it may be noted that –

- (i) A Power of Attorney executed prior to the promulgation of The Depositories Act is valid and enforceable.
- (ii) It is the responsibility of the DP to verify whether the Power of Attorney is adequate and sufficiently authorizing the holder of the Power of Attorney i.e., the donee to operate the account of the beneficial owner.

However, it may be mentioned that a DP shall not obtain Power of Attorney (POA) from its client(s) as a requirement for opening a demat account. Further the following needs to be taken care of when executing a POA:

- (i) POA Holder does not have the sole authority to operate the account;
- (ii) Account holders who have executed a POA cannot be denied Delivery Instruction Slip (DIS) books;
- (iii) DPs are not authorised to merge the securities kept under various accounts of the clients;

DPs must inform all the clients who have executed POA about any changes and obtain a written confirmation from the clients that they have taken note of the changes in the POA. It may also be mentioned that where a client has executed a POA, such depository accounts can be operated both by the client(s) as well as by the POA holder. Therefore, DPs should ensure that the signatures of the account holder(s) and the POA holder are captured in the depository participant system and DPs are required to provide DIS books to the clients who have executed a POA and allow the clients to operate their accounts as well. Further, DPs are required to maintain separate accounts of the clients, in conformity with Regulation 42 of Securities and Exchange Board of India (Depositories and Participants) Regulations, 1996. Lien on the securities can be created only as per Regulation 58 of SEBI Regulations and as per the procedure laid down in the Bye Laws and Business Rules of the Depository.

#### **4.4 Clearing Member Account**

The entities which are authorised to do pay-in and receive the pay-out from a Clearing Corporation (CC)/ Clearing House against trades done by them or their clients are known as clearing members (CM). All pay-in and pay-out transactions are carried out through their accounts. There are two types of clearing members:

- All the members of a stock exchange are clearing members; and
- Custodians who have been permitted by the stock exchange to act as a clearing member.

#### **4.4.1 Procedure to Open a Clearing Member Account**

The steps undertaken to open the CM account are same as those of individuals. The difference lies in the type of form and details to be filled in and documents to be submitted. In NSDL, the major difference is that the clearing member has to first register itself with the clearing corporation and obtain a clearing corporation clearing member identification number (CC-CM-ID). The clearing account is identified by the combination of CC-CM-ID given by the clearing corporation, CM-BP-ID given by the depository and the Client-ID given by the DP. Before opening a clearing account, the DP should send to the depository the clearing member's account opening form, letter issued Clearing Corporation providing CC CM ID and copy of SEBI registration certificate. The Depository then allots the CM-BP-ID. Based on the CM-BP-ID so allotted, the account is then activated by the DP and Client-ID is generated. The date of opening of the account in depository participant system to the depository is electronically communicated. However, w.r.t CDSL, the concept of CM-BP-ID is not there and the system generates a 16 digit ID similar to the BO ID. The Clearing member accounts with CDSL can be opened by a DP just like any other demat account after the formalities as mentioned in the CDSL DP Operating instructions are fulfilled.

Details to be filled in the form are:

1. Name of the Clearing Member
2. Company's short name, if any
3. Address of the registered office, telephone number, fax number, e-mail, if any
4. Name and address of the authorised signatories, their designations and telephone numbers, status code, sub-status code
5. Bank account particulars, bank name and its branch, current account number
6. RBI reference number, RBI approval date (Not required in CDSL)
7. PAN/ GIR number
8. Signatures of Authorised signatories)

A separate enclosure has to be attached to the account opening form specifying the following details:

1. Name and address of the clearing member
2. Name and address of the clearing corporation
3. Clearing Corporation Id (CC-ID)
4. Clearing Member Id (CM-ID)
5. Stock Exchange clearing code
6. SEBI Registration number

7. Trade name

8. Copy of Board Resolution for authorised signatories should also be submitted.

Generally, there will be only one CM account per broker for a stock exchange. In CDSL a CM is required to open multiple accounts as given in the footnote in section 4.2.5 'e'. The clearing account should only be used for clearing and settlement purposes and not for any other purpose, e.g., holding of securities. All the securities received in a settlement account should be transferred to respective beneficial accounts as soon as possible, but in no case later than the time prescribed by the depository/ stock exchange/SEBI in this regard. The opening of clearing member account constitutes a "standing instruction" to receive credits from the clearing corporation when there is a pay-out (*not applicable in case of NSDL*).

## **4.5 Closure of Account**

### **4.5.1 Closure on Client's Request**

DP can close a depository account on receipt of an application in the prescribed format. The application should be made by the account holder or by all the joint holders. An account can be closed only when there is no balance in the account. In case, there is any balance in the account which needs to be closed, the following steps are followed:

- (a) Rematerialisation<sup>12</sup> of all securities standing to the credit of the account at the time of making the application for closure; or
- (b) Transferring the balance to the credit of another account opened by the same account holder(s) either with the same participant or with a different participant. This is applicable only if the client wants to avail of free transfer facility. Else to reduce the balance to zero, the client may transfer the securities to any other account or deliver the securities for pay in of his market transactions.

However, where demat request(s) are pending for disposal for a long time in a demat account and the client desires to close such an account, the following procedure maybe adopted by the client:

- Write a letter in the prescribed format to the Issuer (with a copy marked to its Participant and respective RTA), requesting for rejection of the pending dematerialisation request(s) and send fresh physical security certificate(s) to the Client directly.

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<sup>12</sup> Rematerialisation is the process of issuing physical securities in place of the securities held electronically in the book-entry form with the depository. This concept would be dealt in with detail in the later section of this workbook.

- Enclose a copy of the dematerialisation request generated from depository participant system, duly signed & stamped by the Participant, alongwith the aforesaid letter to the Issuer.

On receipt of copy of the letter from the Client, the Participant may also take up the matter with the concerned Issuer and/or its RTA for rejecting the instruction expeditiously. After the pending dematerialisation request(s) is/are rejected by the Issuer and/or its RTA, the Participant can close the account of such Client.

Before closing the account the DP should ensure that all pending transactions have been settled. The request for closure should be processed only after ensuring that there is no balance lying in the account. In case Participant is unable to close the account due to pending demat/ remat requests, ISIN in suspended status or due to open pledges, etc., the Participant should freeze the account i.e. "suspended for debit and credit". In CDSL, account closure can be initiated even if balances are present in the account. CDSL system will change status of such an account to 'TO BE CLOSED' and close the account when all balances are reduced to zero. If a client makes a request for closure of accounts, DPs should provide the Statement of Transaction (SOT) to the Client for the period from the beginning of the quarter in which the account is closed till the date of closure. Further, the SOT should bear the words "Account Closed" and should be prominent. For this purpose, DPs can affix a rubber stamp or create a suitable system that will clearly show on the SOT that the account has been closed.

#### ***Facility for cancellation of long pending demat requests***

In cases, where the clients have pending demat requests, Participants are not in a position to process the requests received from their clients for closure of accounts as certain Issuer companies are not confirming the requests for dematerialisation for a long time a facility for cancellation of pending demat request is introduced. The procedure in this regard is given below:

1. Client must submit a letter in prescribed format requesting to cancel the pending demat request in respect of those demat requests which are pending for more than 60 days.
2. Participant must submit a letter to the depository requesting it to facilitate cancellation of pending demat requests in prescribed format.

After the pending dematerialisation request(s) is/are rejected/ canceled, the Participant can close the account of such Clients.

#### **4.5.2 Consolidation of Accounts**

Some clients could have opened multiple accounts to dematerialize their shares held in multiple combination and sequence of names. However, they may not need so many accounts after they have dematerialised their shares and may want to bring all their share holdings into one or fewer accounts. This can be achieved by using normal off market transfer instruction.

#### **4.5.3 Closure by DP**

The DP may also initiate closure of a client's account if the client has defaulted in performing its obligations laid out in the Rights and Obligations document. The DP should give sufficient notice to the client before initiating closure of his account. In CDSL, a 30 days' notice is required. The notice should clearly state the reasons for closure of account. The process of closing account in such a case is the same as that of client-initiated closure.

#### **4.5.4 Closure/Shifting of Clearing Account**

A clearing member may transfer its clearing account from one DP to another DP. For this, simultaneously applications have to be made for closure of account to the earlier DP and for opening of new clearing member account to the new DP. On receipt of the application, the new DP forwards the application to the depository for approval. Once the application is approved, the new DP opens a new clearing account and intimates the depository about the new Client-ID. On receipt of intimation from the new participant, the depository advises the old DP to close the account. The old DP then closes the account and intimates the clearing member. All pay-out of securities, subsequent to closure of old clearing account takes place in the new account. The above procedure is specific to NSDL DPs. In CDSL, there is no requirement of approval of depository in this category. In CDSL the CM can close his clearing accounts with one DP and open the same with any other DP without any need of approval from CDSL.

#### **4.5.5 Mass Shifting of Accounts**

DPs may set up new centres as their business expands or to provide direct connectivity from different geographical locations. However, there may be several accounts from that location but the account may already have been opened in another DP module machine. For example, a DP may start operation from Delhi and may be servicing clients of Faridabad, Agra, Mathura, etc. When the DP finds enough business at Mathura, he may set up a direct connectivity machine at Mathura also. Depositories have provided a facility to shift in mass, all the Mathura accounts from Delhi in the above example to the machine at Mathura. This facility is called mass shifting facility.

Securities and Exchange Board of India (SEBI) with effect from January 09, 2006 had decided that charges shall not be levied by a depository on DP and consequently, by a DP on a Beneficiary Owner (BO) when a BO transfers all the securities lying in his account to another branch of the same DP or to another DP of the same depository or another depository, provided the BO Account/s at transferee DP and at transferor DP are one and the same, i.e. identical in all respects. In case, the BO Account at transferor DP is a joint account, the BO Account at transferee DP should also be a joint account in the same sequence of ownership.

Further, DPs are required to follow the following procedure in this regard:

The client submits an account closure request in the format as specified by the depository, duly filled & signed by the account holder(s) along with duly certified (signed and stamped) Client Master Report (CMR) obtained from the target DP with whom the client has opened a new account or maintains an account. In case of inter-depository transfers, apart from what has been stated above, the client should submit the CMR in a crystal format duly certified (signed and stamped) by the target DP or if CMR in crystal report format is not available, the target details should be certified (signed and stamped) by the other depository.

1. DPs should verify the documents submitted by the client and if found in order, the DP shall effect the transfer of securities.
2. After transferring the securities, the serial number(s) pertaining to unused DIS should be permanently blocked in the back office system of the Participant and the account of the client should be closed. In case, the DP is unable to close the account due to pending demat/remat requests, ISIN in suspended status, fractional position or due to open pledges etc., the Participant shall freeze the account i.e. 'suspended for debit and credit' in case of NSDL and for CDSL it gets converted 'To be closed' status.
3. DPs should make a request to the depository, seeking credit for the transaction fees pertaining to account closure cases, with supporting documents as detailed above. In case of CDSL if the transfer is effected through the Transfer module, no charges are levied. Application needs to be made for waiver only in case of shifting of accounts through inter depository and transfers to legal heirs and nominees in case of NSDL.

## 4.6 Freezing of Accounts

Account freezing means suspending any further transaction from a depository account till the account is unfrozen. ISIN<sup>13</sup>/specific number of securities in a demat account may be frozen in certain cases.

1. If a written instruction is received from the client by the DP, requesting freezing of account;
2. If an electronic request is made by a client to his DP or to the Depository, in the form and manner as may be prescribed by the Depository. However, this is not necessarily followed by both the depositories.
3. If orders are received by the DP or the depository from the Central or State Government, SEBI, or any order by the court, tribunal, or any statutory authority.
4. If a request is received by the Depository from a DP or client, in case of NSDL.
5. If orders are passed by Disciplinary Action Committee (DAC) or if DP becomes insolvent, bankrupt or if a DP is being wound up, Depository can freeze accounts and /or ISIN and/or specific number of securities held in DP's name.

By freezing an account for debits only (preventing transfer of securities in / out of the account), the client can receive securities in his account. An account can also be frozen for debits as well as credits (preventing any movement of balances out of the account). No transaction can take place in such an account until it is reactivated. A frozen account may be unfrozen or reactivated, by taking the reverse step. This would be done on:

- The valid written request of the account holder where he had requested freezing,
- Directions of depository made in pursuance of the order of the appropriate authority.

The DP should immediately inform the client about change in status of the account from 'active' to 'suspended' and vice versa.

## 4.7 Changes in Client Details

A client may change any of the following particulars in the depository system provided the depository has provision for change in client details. All the changes have to be indicated in writing to the DP.

- Change of name in case of individual BO on submission of prescribed documents like marriage certificate, publication of name change in official gazette etc.
- Father's/Husband's Name (change from father's name to husband's name may be necessary on account of marriage).

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<sup>13</sup> International Securities Identification Number (ISIN) is a unique identification number for each security issued in accordance with the ISIN standard (ISO 6166).

- Standing instruction facility (an investor can activate/deactivate it)
- Address (both local as well as correspondence), telephone number, mobile number (clients may make this change at any time depending on their need). Clients have to provide proof of new address while submitting application for change of address.
- Occupation details
- Nominee details (the DP has to obtain the required form from the client duly filled and effect the changes)
- Bank details (clients may revise the bank details given by him before record date to ensure that the dividend/interest warrants bear the correct bank details)
- PAN Number details
- In case of NRIs, the Reserve Bank of India reference number and approval date for NSDL.
- E-mail addresses

### ***Change of Address***

1. While processing requests for change of address received from Clients, Participants should obtain the following documents:
  - a) a written application for change of address from the Client (In case of joint holdings, all holders must sign the application and in case of non-individual, authorised signatory(ies) must sign);
  - b) Proof of new address alongwith the original document of the new address for verification.
2. The Participant should verify the signature of the Client on the application with the signature of the Client available with the Participant. Further, the document pertaining to new address should be verified and attested and thereafter record the change of address in the System.
3. In case of change (addition/ deletion/ modification) in the landmark details for the address which is already captured in the System, Participants may limit the changes to the landmark details, after obtaining a request from the Clients on a plain paper, which is signed by all the holder(s) (in case of joint holdings). Participants are advised to note that the address of the Client captured in the System, as mentioned in the proof of address, should not change and only limit the change in the landmark details.
4. After effecting the change of address in the System, the Participant should send a communication to the Client, confirming the change of address, to the old and the new addresses.
5. The Participant shall upload the updated information of the Client on the system of KRA.

### ***Change of name in Corporate Accounts***

The facility for change of name in corporate accounts is available for Client type's viz., Body Corporate, Bank, Financial Institution (FI), Foreign Institutional Investors (FII), Mutual Fund (MF) and Trust. The documents required at the time of change of name of Corporate are given below:

(i) In case the entity is registered under the Companies Act, 1956, the following documents should be obtained from the Client:

- Letter requesting for change of name signed by the authorised signatories.
- Certified true copy of fresh certificate of incorporation consequent upon change of name issued by the Registrar of Companies.
- Certified true copy of Board Resolution where the change in name was approved
- List of authorised signatories along with the specimen signature duly verified by MD/Co. Secretary.

(ii) In case of other corporate entities, the following documents should be obtained from the Client:

- Letter requesting for change of name signed by the authorised signatories.
- Certified true copy of Board Resolution for change of name.
- Certificate of registration issued by SEBI / relevant Statutory Authorities, as applicable.

While carrying out the modifications, the name of any existing account holder of an account can neither be deleted nor can any new name can be added. DPs can only make changes to the name(s) of existing account holder(s) of the account on submission of following documents as specified by SEBI.

- i. In case of change in name on account of marriage following documents shall be submitted:
  - a. Marriage Certificate or copy of Passport showing husband's name or publication of name change in official gazette.
- ii. In case of change in name on account of reasons other than marriage
  - a. Publication of name change in official gazette.
- iii. In case of change in father's name
  - a. Publication of name change in official gazette.

***Change of name of Beneficial Account Holder***

For effecting change in name in the depository account of an individual BO, a request letter duly signed by the holder whose name is changing alongwith self-attested copies of the following document(s) are required:

Sr. No.	Reason for name change	Documents required
1	On account of marriage	(i) Marriage Certificate or (ii) Copy of Passport showing husband's name or

		(iii) Publication of name change in official gazette.
2	On account of reasons other than marriage	(i) Publication of name change in official gazette.
3	Change in father's name	(i) Publication of name change in official gazette.

After the name change is carried out, the DP is required to send a communication via letter / e-mail/ Client Master Report / Client Modification Letter generated from the DP System or its back office or any other mode which the DP may deem fit to the Clients informing about changes carried out in their name.

***CDSL allows change in name due to typographical errors at DP end subject to maintenance of prescribed documents***

***Modification in name of the account holder in the system – error by Participant***

In case a Participant commits a typographical error while entering name of the Client in the system (which is noticed after activation of the account) or while processing the request for change in the name, it may be corrected by the Participant as prescribed below:

- a) Participant should examine the Account Opening Form, KYC Form, request for change of name and other documents submitted by the Clients/ authorized signatory (ies) and ascertain that a data entry error was indeed made while entering name of the Client in the system.
- b) Once Participant has satisfied itself about the data entry error, it may modify the name of the Client suitably in the system. The reason should be mentioned as 'Participant error' while making this rectification in the system.
- c) Correction in such cases may be undertaken when error is brought to the notice of Participant by client or by auditor of Participant or is detected by Participant staff. After making required correction, intimation should be sent to the client along-with updated Client Master Report.

***Change of Signature***

1. The Client should make a request in writing specifying reasons for change in signature.
2. New signature should be duly attested by Client's banker, only in case where the beneficiary owner cannot come personally.
3. Client should visit DP's office personally and produce valid proof of identity. Clients opening account with NSDL DPs, needs to bring the latest transaction statement of its account.
4. In the presence of officials of DP, Client should affix his/her new signature.
5. If the client cannot come in person, the request in writing should contain the old and the new signature and the same should be attested by the BO's banker

An authorised official of the DP shall, under his signature, verify the identity proof with the proof and photograph that were furnished at the time of opening of account and thereafter, if found satisfactory, make necessary changes in its records.

## Review Questions

Questions to assess your learning:

1. The Rights and Obligation Document is a standard document approved by
  - (a) SEBI
  - (b) RBI
  - (c) DCA
  - (d) Depositories

Ans: (a)

2. Only a guardian can open a depository account for a minor.
  - (a) True
  - (b) False

Ans: (a)

3. In the event of the death of a joint holder, the balance lying in the account can be transmitted, on request of the surviving holders, to a new account to be opened by the surviving holders
  - (a) True
  - (b) False

Ans: (a)

4. The beneficial owners name in the account can even be changed after the account has been opened. State whether True or False?
  - (a) True
  - (b) False

Ans: (a)

## Chapter 5: Functions of Depository Participant-Transmission and Nomination

### Learning Objectives:

After studying this chapter, you should know about:

- The concept of transmission of securities
- The concept of nomination for securities
- Procedure for transmission of securities

### 5.1 Transmission of Securities

The word 'transmission' means devolution of title to shares, for example, devolution by death, lunacy, bankruptcy, winding-up (in case of corporate) etc. The person on whom the shares devolve has to prove his entitlement by submitting appropriate documents and seek transmission. If the securities are held in the depository system, the documents have to be submitted to the DP.

If the securities are held in physical form, the documents have to be sent to the company for effecting transmission. If the deceased shareholder had holdings in several companies, to effect transmission of securities, the relevant documents must be sent to each of the companies, along with the securities. Survivors have to follow-up with each of the companies in order to get the transmission effected before the book closure, if they wish to avail of the benefits accruing through such shares. In the depository system, such problems are mitigated as the securities are held as account balances in the electronic form.

The process of transmission through a depository is simple as well as quicker because the successor to the title interacts only with one entity i.e., his DP.

### 5.2 Nomination for Securities

The Companies (Amendment) Act, 1999 has introduced provisions for nomination in respect of shares, debentures, fixed deposits, etc. Under the provisions, a shareholder, a debenture-holder, a bondholder or a deposit holder can nominate a person, in whom the shares or debentures or bond or deposits would vest, in the event of original investor's death. The facility can be availed of by any person whether resident Indian or a non-resident Indian investor.

Investors holding securities in dematerialised form have the option of nominating a person who would be entitled to receive securities outstanding in his/her name in the event of their death.

Nomination facility can be availed at the time of opening the depository account itself or subsequently also. There is a separate prescribed form for nomination under depository segment. Nomination can also be changed at will by resubmitting the nomination details in the prescribed form. The DP has to enter and update the nominee details submitted by the account holder. In the event of death of the account holder, the securities lying to the credit of the account holder may be transmitted to the nominee's account after the DP verifies the identity of the nominee. Nomination can be made only by individuals holding beneficiary owner accounts on their own behalf singly or jointly. In a demat account which is held jointly, all the holders should sign the nomination form. Non-individuals including society, trust, body corporate, karta of Hindu Undivided Family (HUF), holder of power of attorney cannot nominate. A minor can nominate through a guardian. A minor can also be appointed as a nominee represented by a guardian. If the account is held jointly all joint holders will be required to sign the nomination form. Nominee can be only individual. Non-individual entities such society, trust, body corporate, HUF cannot be appointed as nominee.

## **5.3 Transmission of Securities**

### **5.3.1 Transmission of Securities held Singly in the Depository with Nomination**

The Client(s) may provide nomination for his/their account in favour of any person by filing with the relevant Participant.

A nomination, substitution shall be valid only if:

- it is submitted to the Participant by the rightful Client(s).The nomination form has to be signed by all holders. A POA holder cannot nominate.
- it is in the prescribed format (format is given by the depository to the participant).
- it is duly signed by Client(s).
- it is properly signed and witnessed.
- signature of the Client(s) tally with the specimen signature records.
- the details of the securities entered in the nomination forms match those in the records of the Participant. CDSL Nomination form does not have provision for mentioning securities. Nomination is applicable to entire holding.
- the photograph of the Nominee is annexed to the nomination form in case of NSDL.
- the Nominee has signed the nomination form and guardian in case of the nominee being a minor in case of NSDL.

As per CDSL Operating instructions, nominee's photograph, signature, or in case of minor, the guardian's signature are not required.

Upon the death of the sole holder or the death of all the joint holders, as the case may be, the nominee shall request the DP in writing along with an original death certificate or a copy of the same(duly notarised/attested) Notary Public or by a Gazetted Officer for transmitting the securities covered by the nomination to the account of the Nominee, held with any Depository, as per the Client Master Report, submitted by the nominee, if the nominee has a demat account in individual capacity with another DP. If the Nominee does not have an account with the Depository, the Nominee shall be required to open an account with any Depository.

### **5.3.2 Transmission of Securities held singly in the Depository without nomination**

The legal heir(s) or legal representative(s) of the deceased account holder have to make a request, in the prescribed form to the DP for transmitting the balances lying in the account of the deceased to their account. The following documents have to be submitted with the request for transmission:

1. Original or a copy of the death certificate, duly notarised/ attested by a Gazetted officer or Notary Public can also be accepted;
2. A copy of the succession certificate, duly notarised, or an order of a competent court, if the deceased has not left a Will; or
3. A copy of the Probate or Letter of Administration duly notarised.

In case the successors express their inability to produce either of the documents mentioned above and if the market value of the securities held in each of the accounts of the deceased BO as on the date of application for transmission is not more than Rs. 5 lakh, or such other amount as may be specified by the depository or SEBI from time to time, DP may admit the request for transmission. The following documents are required for admitting the request of transmission:

- a. Request for transmission in the prescribed format;
- b. Original or copy of the death certificate duly attested by a Notary Public or by a Gazetted Officer;
- c. Any one or more of the following:
  - i) Letter of Indemnity made on appropriate non judicial stamp paper;
  - ii) An Affidavit made on appropriate non judicial stamp paper; and
  - iii) No Objection Certificate(s) from all the legal heir(s) who are not applicants, conveying no objection to such transmission.
  - iv) As an alternate a No Objection Certificate from all legal heir(s) who are not applicants, a copy of Family Settlement Deed duly notarised by a Notary Public or attested by a Gazetted Officer and executed by all the legal heirs of the deceased BO, provided that the Family Settlement Deed clearly vest the securities in favour of the person seeking transmission in his/her name

and vesting of securities in his/her name is not contingent upon any other onerous conditions in such Family Settlement Deed.

Before effecting the transmission of securities, the DP shall ensure the validity of the documents submitted by the legal heir(s) or the legal representatives of the deceased. After effecting the transmission, the DP shall close the account of the deceased<sup>14</sup> BO.

### **5.3.3 Transmission of Securities held jointly in the Depository**

In case of death of one of the Clients in a joint account, the surviving Client(s) shall request the DP to transmit the balances lying in the Client account to the account of the surviving Client(s). The surviving Client(s) shall make an application to the DP in the specified form given by the Depository, along with original or a copy of the death certificate duly notarised / attested by a gazette officer. The surviving joint holder(s) will have to open a new account with the DP in their name(s). If the surviving client(s) wish to open a new account with the same DP, then the DP will open the new account in the name(s) of the surviving member(s), in the same order as in the original account, on the basis of the existing documents already in the possession of the DP, provided that the said documents meet the prevailing requirements for opening an account. In case of securities held jointly:

- The surviving holder(s) to have a separate account with any DP, Client Master Report of such accounts.
- Ensure all surviving holder(s) sign the transmission form.
- Ensure that transmission form is accompanied with an original or copy of notarised / attested death certificate by a Gazetted officer or Notary Public.
- Verify signature of the surviving Client(s).

### **5.3.4 Transmission of Securities held by Karta of Hindu Undivided Family (HUF) in the Depository**

Upon death of the Karta of a Hindu Undivided Family (HUF), the surviving member(s) of the HUF may appoint another person as the new Karta of the HUF.

For transmission of securities to the account of the new Karta from the account of the deceased Karta, the surviving members through the new Karta shall make application to the Depository Participant along with the following documents<sup>15</sup>:

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<sup>14</sup> If the division of shares as per the family Settlement Deed is among more than one person, then the Family Settlement Deed can be considered as an NOC for transmission of shares to each legal heir applying for transmission.

<sup>15</sup> As per CDSL Operating Instructions, HUF does not come to an end in the event of death of the Karta, only new karta will be appointed.

- i) True Copy of the death certificate of the Karta, duly certified by a notary public or by a Gazetted Officer;
- ii) An appropriate order by a competent court,(not a requirement in CDSL)

In NSDL, if the surviving members or the New Karta express their inability to produce the order of a competent Court, and that the market value of securities lying to the credit of such account as on the date of application for transmission of securities does not exceed Rupees Ten Lakh then the Participant shall process the transmission request on the basis of the following documents:

- a) Request for transmission duly signed by the New Karta;
- b) A declaration of the list of surviving members of HUF in an affidavit in the prescribed form duly notarised;
- c) Letter of Indemnity in the prescribed form from the surviving members;
- d) Where there is an objection from any member of the HUF, transmission of securities held in the beneficial owner account should be effected only on the basis of a Decree by a competent Court or the Deed of Partition.

The claimants shall furnish to the Participant the certified copy of the Settlement Deed/Deed of Partition/Succession Certificate/Decree of the relevant Court duly stamped, in case the HUF goes into separation/partition for dealing with the securities lying in the beneficial owner account held by the deceased Karta, and furnish to the Participant the details of the beneficial owner accounts of the individual members in order to have the securities distributed to their respective accounts. The Participant shall ensure that the documents submitted by the claimants are in order and shall then effect a transfer of the balances to the client account of the claimants. After effecting the transmission, the Participant shall close the account held in the name of the deceased Karta. It may be noted that in CDSL the previous account need not be closed and the same account can continue. The new karta shall submit the new list of members and a no objection from the surviving members of the HUF for him to act as a karta of the HUF. The new karta shall record change in signature to operate the account.

In CDSL, in case of a partial partition, the others can still continue the HUF in the existing name. In case of full partition, the entire HUF is dissolved. In both the above cases, the karta can transfer shares to the members who seek partition. If the transfer cannot be amicably settled, the family members can go to a court and transfer of shares can then be based on the court direction.

## Review Questions

Questions to assess your learning:

1. Nomination of shares is a provision under which act?

- (a) Companies (Amendment) Act 1999
- (b) SEBI Act
- (c) Depositories Act 1996
- (d) SCRA 1956

Ans: (a)

2. Can nomination be made by individuals for Beneficiary accounts held jointly or singly?

- (a) Yes
- (b) No

Ans: (a)

3. What kind of account is required by a nominee to give effect to the transmission of shares?

- (a) Savings Account
- (b) Demat Account
- (c) Salary Account
- (d) Current Account

Ans: (b)

4. For transmission of securities to the account of the new Karta from the account of the deceased Karta, the surviving members through the new Karta shall make a joint application to the DP.

- (a) True
- (b) False

Ans: (a)

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## Chapter 6: Functions of Depository Participant-Dematerialisation

### Learning Objectives:

After studying this chapter you should know about:

- The concept of International Securities Identification Number (ISIN) and its importance.
- Dematerialisation process
- Rematerialisation process

### 6.1 Introduction

As already discussed earlier, dematerialisation is the process of holding the securities in a fungible<sup>16</sup> form. They do not bear any distinguishable features like distinctive number, folio number or certificate number. Once the shares are dematerialised, they lose their identification features in terms of share certificate number, distinctive numbers and folio numbers. *Title to the securities owned is in terms of number of securities and not in terms of distinctive numbers, certificate numbers etc. Each security is identified in the depository system by an International Securities Identification Number (ISIN) and a short name.*

### 6.2 International Securities Identification Number (ISIN)

Securities dematerialised bear a distinctive ISIN. This ISIN is a unique identification number for each security issued in any of the International Standards Organisation (ISO) member countries in accordance with the ISIN Standard (ISO 6166). ISO 6166 was developed for use in an international (cross-border) as well as domestic trades.

ISIN is a 12-character long identification code. It has three components – (1) a pre-fix, (2) a basic number and (3) a check digit. The pre-fix is a two-letter country code as stated under ISO 3166 (IN for India). The basic number comprises nine alphanumeric characters (letter and/or digits). The check digit at the end of the ISIN is computed according to the modulus 10 "Double-Add-Double". It establishes that the ISIN is valid. Securities issued by the same company, issued at different times or carrying different rights, terms and conditions are considered different securities for the purpose of allocating ISIN and are allotted distinct ISINs. In India, SEBI has

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<sup>16</sup> Fungible means "movable things that are standardised, so that one unit is essentially the same as another which may be estimated and replaced by weight, number and measure".

delegated the assigning of ISIN of various securities to NSDL. For securities getting admitted on CDSL, the ISIN is allotted to those securities on receiving request from the CDSL. Allotment of ISIN for G-sec is done by Reserve Bank of India.

To illustrate, ISIN INE 475C 01 012 has the following break up:

IN - India

E – Company Type

Last digit - check digit

First four digits 475C - Company serial number;

01 - equity (it can be mutual fund units, debt or Government securities);

01 - issue number;

2 - check digit.

The third digit (E in the above example) may be E, F, A, B or 9. Each one carries the following meaning:

E - Company

F - Mutual fund unit

A - Central Government Security

B - State Government Security

9 - Equity shares with rights which are different from equity shares bearing INE number.

In an ISIN number, it is important to pay special attention to the third digit.

### **6.2.1 Which securities can be dematerialised?**

According to the SEBI (Depositories and Participants) Regulations, 1996, the following securities are eligible for holding in dematerialised form.

1. Shares, scrips, stocks, bonds, debentures, debenture stock or other marketable securities of similar nature of any incorporated company or other 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, government securities and unlisted securities.

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

### **6.3 Dematerialisation Process**

A holder of eligible securities in the depository system may get his physical holdings converted into electronic form by making a request through the DP with whom he holds a beneficiary account.

#### **6.3.1 Prerequisites for Dematerialisation Request**

- a. The registered holder of the securities should make the request.
- b. Securities to be dematerialised must be recognised by the depository, as eligible security. In other words, only those securities whose ISIN has been activated by the depository, can be dematerialised in the depository system.
- c. The company/Issuer should have established connectivity with the depository. Only after such connectivity is established, the securities of that company/Issuer are recognised to be "available for dematerialisation" in the depository system.
- d. The holder of securities should have a beneficiary account in the same name as it appears on the security certificates to be dematerialised.
- e. The request should be made in the prescribed dematerialisation request form.

#### **6.3.2 Procedure for Dematerialisation**

1. DP provides dematerialisation request forms (DRF) to their clients
2. The client completes the DRF in all respects and submits to the DP along with the security certificates to be dematerialised.
3. The DP checks the DRF for validity, completeness and correctness. The following points should be checked particularly:
  - The security certificates sought to be dematerialised are attached to the DRF.
  - The certificates are not mutilated or defaced in a manner affecting any material information
  - The name of the holder(s) on DRF and the certificates is exactly the same as in the BO's account in the DP system. Minor variation however in name, is permitted such as initials in place of first name, middle name, minor spelling mistake in name etc. The permitted variations refer to initials not being spelt out fully or put prior to after the

- surname. In such cases, if the signature on the DRF matches the specimen signature available with the DP, the securities can be considered for demat.
- Details like security type, face value, paid-up value, pari-passu status, certificate numbers, distinctive numbers, number of certificates, total quantity of securities and lock-in status are filled-in correctly.
  - Separate DRFs have to be submitted for:
    - ❖ Free and locked-in securities;
    - ❖ Each ISIN;
    - ❖ Securities locked-in for different reasons;
    - ❖ Securities of different paid-up value; and
    - ❖ For each client account.
  - DRF is signed by:
    - ❖ The sole holder in case of single holding;
    - ❖ All joint holders in case of joint holdings;
    - ❖ Constituted signatories in the case of corporate accounts;
    - ❖ Power of Attorney Holder
    - ❖ The signatures of the client as appearing on DRF should match with the signatures in the records of the DP. If the signatures do not match, the DP should satisfy itself about the identity of the client. If necessary, the DP may insist on attestation of DRF from bankers of the client. DRF should be signed by all the holders and match with specimen signatures. If the client has a signature registered with the company which is different from the specimen signature given to the DP, the client may be advised / allowed to affix both the signatures on the DRF. In CDSL, DRF requires the BO to sign 'as per the signature recorded with the DP' and 'as per the signature recorded with the company'. The DP official is required to verify the signature of the BO as per its records with the signature on DRF under 'signature with DP'.
4. If the DRF and the accompanying security certificates are not found in order, the DP should return the DRF and certificates.
  5. If DRF and accompanying certificates are found in order, the DP should accept the DRF and issue an acknowledgement to the client.
  6. The DP should enter the dematerialisation request in DP system after following maker-checker concept. The DP system generates a request number (DRN), which should be mentioned on DRF.
  7. DP should ensure that the certificates are defaced and mutilated before they are sent to the Issuer / RTA. The security certificates are marked (defaced) with the words "Surrendered for Dematerialisation" with DP name and BO ID. DP must ensure that the security certificates submitted for dematerialisation to the issuer or its RTA, bear the DP name, DP ID and Client

ID. This is a precautionary measure to prevent misuse of share certificates by anyone. The certificates are mutilated by punching two holes at the top of the certificates by using normal office perforator.

8. The DP should forward the DRF and the relevant security certificates to the Issuer or its R&T Agent for dematerialisation. DRF and enclosures have to be sent at the "address to which physical certificates to be sent" communicated by the Depository. The forwarding letter should refer to the allotted DRN and should be sent within seven days of accepting it from the client.
9. The Issuer or its R&T Agent verifies the DRF and the accompanying certificates for validity, completeness and correctness. They also match the details with the intimation received from the depository against the same DRN.
10. The DP informs the client accordingly and requests removal of reasons for objection. The DP removes these or provides additional information to the Issuer or its R&T Agent within 15 days of receiving the objection memo.
11. If the DP fails to remove the objections within 15 days, the Issuer or its R&T Agent may reject the request and return DRF and accompanying certificates to the DP. The DP informs the client accordingly. The DP also returns the security certificates to the client and obtains an acknowledgement.
12. The DP, if the client so requires, may generate a new dematerialisation request and send the securities again to the Issuer or its R&T Agent.
13. If the Issuer or its R&T Agent finds the DRF to be in order, it informs the depository and authorizes it to create the appropriate credit balance in the client's account. The DP system automatically credits the client's accounts when DM is updated. For the purpose of income tax calculations, the date of credit of securities by dematerialisation is taken as the date of acquisition of shares.
14. The DP, on receiving confirmation of credit entry in DP system informs the client through monthly transaction statement.
15. An R&T Agent is required to confirm/ reject a demat request within 15 days from the date of receipt of physical shares.

### ***Checklist for Investors***

While filling up the DRF, investors need to:

1. Obtain the DRF from the DP with whom they have opened an account.
2. Fill- in the DRF in duplicate/triplicate as required by the DP.
3. Fill all the information asked in the DRF since it is mandatory.
4. Fill separate forms;
  - ❖ for separate ISIN numbers of the company.
  - ❖ for lock-in and free securities.

5. All the holders should sign the DRF form. Signatures should match with those of the specimens on the account opening form. However, if the signature with the company/R&T Agent is different from the signature with the DP, the client may affix both signatures.
6. The order of the holders should be same as that in the account opening form. In case of change in order of names, Investor has to fill in transposition request form along with the DRF.
7. After submitting the certificates, an acknowledgement slip duly signed by the DP should be collected.
8. Demat request form for dematerializing government securities is different and is called "DRF - GS".

### ***Checklist for DP***

Before accepting the form and share certificates for dematerialisation the DP should check:

- a. Client has submitted the securities for dematerialisation along with the DRF.
- b. No dematerialisation request, other than one from a registered holder of securities, has been entertained.
- c. The certificates submitted by the client for dematerialisation belong to the eligible list of securities admitted by the Depository.
- d. Verify that the DRF submitted by the client has been filled completely and duly signed.
- e. Verify the signature of the client on the form and compare it with the specimen available in its records. If the signatures are different, the DP has to ensure proper identification of the client.
- f. The DP has to issue to the client an acknowledgement slip duly signed and stamped.
- g. While submitting the shares they should be defaced by mentioning on it "surrendered for dematerialisation".
- h. The depositories from time to time issues circulars cautioning DPs with respect to shares belonging to some companies. Such circulars should be referred to before accepting a demat request. Also the list of such companies is available on websites of depositories
- i. If the form is in order, the request details are entered in its DP system and the DP system generates a Dematerialisation Request Number (DRN).
- j. The DRN so generated is entered in the space provided for the purpose in the DRF. The details given in the DRF should match with the details of reports generated by DP system.
- k. The DRF is forwarded to the Issuer or its R&T Agent only after ascertaining that the number of certificates annexed with the DRF tallies with the number of certificates mentioned on the DRF, within 7 days of its receipt.
- l. The details of the certificates submitted for dematerialisation with the details filled up are in consonance with the DRF.

- m. The client has marked the certificates submitted for dematerialisation with the words "Surrendered for Dematerialisation". As per CDSL Operating instructions, DP should deface and mutilate the certificates and not the client.
- n. DP must ensure that the security certificates submitted for dematerialisation to the Issuer or its R&T Agent bear the DP name, DP Id and Client Id. The safety and security of the certificates submitted for dematerialisation till the certificates were forwarded to the Issuer or its R & T has to be ensured.
- o. Punch two holes on the security certificates before forwarding them to the Issuer or its R&T Agent.
- p. Ensure that the client has filled in a separate DRF for securities having distinct ISINs.
- q. Ensure that the client has filled in a separate DRF for locked in and free securities having the same ISIN.
- r. Ensure that the client has submitted a separate DRF for each of his/their accounts maintained with the DP.
- s. DRF and certificates have to be sent to the correct address of the company where they are accepted. The depositories issues circulars giving information about the addresses where physical documents are accepted. This data is provided by depositories in form of a report which DPs can download and use.

### 6.3.3 Rejection of DRF

A demat request can be rejected in the case of the following objections. The two depositories may have different codes (as per SEBI guidelines, both depositories have adopted common rejection reasons), we here have attempted to cover most of the objections which may lead to rejection of the DRF request. The table below gives the reasons for rejection and the action that DPs need to take in case of each objection.

Sl. No.	Description of Objection	Action to be taken by DP/Client
1	Physical quantity of shares/certificates received by R&T Agent from DP is less than what is mentioned in Demat Request Form	DRN confirmed for partial/physical quantity received from DP or treated under objection for total/partial quantity by R&T Agent. R&T Agent may retain documents received from DP. DP/Client may contact R&T Agent for any further clarification and may submit fresh Demat Request Form to R&T Agent for excess quantity, if any, quoting reference of Objection letter and
2	Physical quantity of shares/certificates received by R&T Agent from DP is more	

	than mentioned in Demat Request Form.	previous DRN to enable R&T Agent to link related entries/documents.
3	All/some certificates received by R&T Agent from DP is/are found to be fake.	DRN confirmed for genuine/valid quantity received from DP or treated under objection for total/partial quantity by R&T Agent. R&T Agent may retain documents received from DP. DP/client may contact R&T Agent for any further clarification, quoting reference of Objection letter to enable R&T Agent to link related entries/documents.
4	All/some certificates received by R&T Agent from DP is/are reported lost or stolen and a stop instruction is recorded in computer master file(s) of R&T Agent.	
5	Duplicate certificates earlier issued by R&T Agent in lieu of all/some certificates received for demat by R&T Agent from DP.	
6	All/some certificates received by R&T Agent are found to bear forged or fake endorsements of Name(s) of Holders	
7	Name(s) of Holder(s) on all/some certificates received by R&T Agent differs in Demat Request Form received by R&T Agent from DP.	DRN confirmed for valid quantity received from DP or treated under objection for total/partial quantity by R&T Agent. R&T Agent may retain documents received from DP. DP/Client may contact R&T Agent for any further clarification, quoting reference of Objection letter to enable R&T Agent to link related entries. DP/Client to submit fresh Demat Request Form to R&T Agent with correct particulars, quoting reference of Objection letter and previous DRN to enable R&T Agent to link related entries/documents.
8	<b>OR</b> Details of all/some certificate(s) differ in Demat Request Form received by R&T Agent from DP	
9	All/some certificate(s) sent to incorrect R&T Agent by DP	R&T will not retain any of the incorrect or incomplete documents but will return all the documents to the DP. DP/Client may contact

		R&T Agent for any further clarification, quoting reference of Objection letter to enable R&T Agent to link related entries. DP/Client may forward documents to pertinent R&T Agent with fresh Demat Request Form.
10	Certificate(s) not received by R&T Agent in time from DP	DRN treated under objection and closed by R&T Agent. DP/Client may forward certificate(s) for dematerialisation with Demat Request Form to R&T Agent under a new/ fresh DRN.
11	Signature(s) of Client on Demat Request Form do not tally with specimen signatures of Holder(s) recorded with R&T Agent.	R&T Agent will return all the document and the DP will set up new DRN with the correct signature and documents. DP/Client may submit to R&T Agent a fresh Demat Request Form duly signed by holder(s) in exact manner as recorded earlier with R&T Agent. In case holder(s) is/are unable to reproduce the signatures as required, specimen of signature(s) of signature(s) on Demat Request Form may be verified by a Bank Manager, under his official stamp/seal, giving full particulars/details of holder(s) bank account number, etc.
12	Stop recorded as per Bank Lien/Statutory Authority/Court Order/etc. in computer master file(s) of R&T Agent against all/some certificates) received for dematerialisation from DP	DRN confirmed for valid quantity received from DP or treated under objection for total/ partial quantity by R&T Agent. R&T Agent may retain documents received from DP. DP/Client may contact R&T Agent for any further clarification, quoting reference of Objection letter to enable R&T Agent to link related entries/documents
13	Demat request initiated under wrong ISIN.	R&T Agent may reject the demat request and forward the documents to the DP. A fresh Demat Request to be generated under the correct ISIN by the DP. The documents to be sent to the concerned R&T Agent.
14	Allotment/call money payment not attached	R&T Agent may reject the demat request and forward the documents to the DP. Client to attach the Allotment/call money payment advice and submit the same to the DP for

		generating a new DRN. In case of any clarification, DP/Client may contact R&T Agent quoting the reference number of the Objection letter.
15	Security certificates not available for demat	R&T Agent may reject the demat request and forward the rejected documents to the DP. DP to contact the client and inform the client accordingly.
16	Rejected under Automatic Corporate Action	R&T Agent may process the demat request of the investor. If the documents are found in order the R&T Agent may credit the account of the client with proportionate number of shares through Credit Corporate Action. Client to check the Transaction Statement and if the shares have not been credited in the demat account, client to contact the Company/R&T Agent.

The DRFs may also be rejected on miscellaneous grounds. These could be any of the reasons as given below (points I to V):

Sl. No.	Description of Objection	Action to be taken by DP/Client
I	Recovery pending from Client for double or excess payment of Dividend/Interest made by R&T Agent.	R&T Agent may retain DRN and documents received from DP for DRN treated under objection. DP/Client may contact R&T Agent for any further clarification, quoting reference of Objection letter to enable R&T Agent to link related entries. Client to refund of amount to R&T Agent, quoting reference of Objection letter and DRN to enable R&T Agent to link related entries/documents.
II	Duplicate Interest warrants issued by R&T Agent as per request of Client and bank reconciliation incomplete to determine status of payment.	R&T Agent may retain DRN and documents received from DP for DRN treated under objection. DP/Client may contact R&T Agent for any further clarification, quoting reference of Objection letter to enable R&T Agent to link related entries. DP/Client to await some time

		for bank reconciliation completion by R&T Agent, before DRN is confirmed or treated under objection as in 13 (i).
III	All/some certificates held under different Holding basis (i.e. Single or Joint) is/are received by R&T Agent under same DRN.	Refer objection codes 7 and 8 above for action taken by R&T Agent and to be taken by DP/Client.
IV	All/some certificates sent by DP to incorrect address or office(s) of R&T Agent.[For e.g.: All operations of Master Growth and Grand Master schemes of Unit Trust of India are handled on completely decentralised basis and computer master file(s) are separately maintained at specific locations. DPs have to therefore, forward documents for demat to R&T Agent's address at Mumbai, Calcutta, Delhi and Chennai mentioned on reverse of every certificate].	DRN confirmed for valid quantity received from DP or treated under objection for total/ partial quantity by R&T Agent. R&T Agent may retain some documents and others returned to DP by R&T Agent. DP/Client may contact R&T Agent for any further clarification, quoting reference of Objection letter to enable R&T Agent to link related entries. DP/Client may forward documents to pertinent address or office(s) of R&T Agent with fresh Demat Request Form.
V	All/some certificates received by R&T Agent from DP do not relate to ISIN (Scheme/ Security code) mentioned in Demat Request Number or Form.	Refer objection codes 7 and 8 above for action taken by R&T Agent and the steps taken by DP/Client.

The DP has to inform his client about the rejection if and when the R&T Agent has rejected the DRF.

### ***Subsequent Disputes***

Any dispute regarding the title of securities (in physical form) after they have been dematerialised and credited to a client's account, has to be settled amongst the DPs, clients and Issuer or its R&T Agent. The procedure for dispute settlement is laid down in SEBI Guidelines for Good and Bad Delivery of documents, as is done in the case of physical securities.

#### **6.3.4 Transposition cum Dematerialisation**

The depositories have amended their Bye-Laws and procedure to enable investors to transpose names of the joint holders along with the process of dematerialisation through their DPs. Prior to this amendment, investors having shares in joint names (Mr. A & Mr. B), but in different sequence (Mr. B & Mr. A) were either required to open multiple accounts for each sequence (Mr. A & Mr. B and Mr. B & Mr. A) or to effect the transposition directly with the Issuer/R&T Agent and then dematerialize their securities through their DPs. In case of transposition-cum-dematerialisation, the Client can get securities dematerialised in the same account if the names appearing on the certificates match with the names in which the account has been opened but are in a different order. The same may be done by submitting the security certificates along with the Transposition Form and DRF.

#### **6.3.5 Transmission cum Dematerialisation of Securities**

In case of death of one or more of the joint holders, the surviving joint holder(s) can get the name(s) of the deceased removed from the security certificate(s) and get them dematerialised by submitting the security certificates along with the Transmission Form and the DRF to the Participant. Original or copy of the death certificate of the deceased holder(s), duly notarised or attested by a Gazetted Officer or by a notary public.

The DP should ensure that the demat account is in the name of the surviving holders only.

#### ***Procedure to be followed if Physical Securities are lost in Transit***

In cases where the Issuer/RTAgent has received information, setup by the DP, about dematerialisation electronically from the depository but physical certificates have not been received, the procedure to be followed is as under: –

- The DP shall provide the Issuer/RT Agent proof of dispatch and also confirm that the certificates are not returned undelivered at their end.
- If the certificates have not been returned undelivered and are not traceable at the Issuer/RT Agent's office, then it will be assumed that the certificates have been lost in transit. In such a case, the DP shall execute an Indemnity Bond in favor of the Issuer/RT Agent.
- If the Issuer/RT Agent has already rejected the original demat request, then a fresh demat request is to be set up by the DP and the Indemnity Bond duly executed shall be submitted to the Issuer/RT Agent, along with a new DRN. The Issuer/RT Agent shall accept the demat request and carry out dematerialisation on the basis of the Indemnity Bond given by the DP.
- In cases where the Issuer/RT Agent has rejected the demat request (for such a reason where the rejection can be rectified by the BO/DP), and dispatched the same to the DP, and such

certificates are lost in transit, then an Indemnity Bond is to be executed and submitted to the Issuer/RTA along with a new DRN. In such cases, the DP is required to obtain prior consent from the Issuer/RTA for execution of Indemnity.

- However, in cases where the Issuer/RT Agent has rejected the demat request (for such a reason where the rejection cannot be rectified by the BO/DP), the Issuer/RT Agent will retain the documents. Such rejections may be on account of Fake / Forged / Duplicates already issued / Court Injunctions, etc. In such cases, the DP should obtain rejection letters from the Issuer/RT Agent & hand over the same to the BO in order to enable the BO to take up the matter with the Issuer/RT Agent concerned.

### ***Procedure for Dematerialisation of Shares which are held in more than three names***

In case the number of joint holders are more than three, the DP has to process the dematerialisation request as per usual procedure ensuring that the main BO name is mentioned as 1<sup>st</sup> Account Holder and the balance joint holders are accommodated in the two joint holders' names but ensuring that the pattern of holding as per the certificate tallies with the pattern of holding as per the account. In case of NSDL, enter the first holder's name in the first holder's field and accommodating the rest of the names in the fields for second and the third holder, eg. : - In case of joint holdings in four joint names of Mr. A, Mr. B, Mr. C & Mr. D, the account can be opened in the system as follows; First Holder's Name : 1. Mr. A; Second Holder's Name 2. Mr. B; Third Holder's Name 3. Mr. C 4. Mr. D. Further, the standing instructions to receive credits, receipt instructions, new issue applications and any other instruction which has the effect of crediting this account should not be accepted. Appropriate annexure should be attached to the account opening form in order to include various details viz., name, address, signatures, etc. of more than three holders. An undertaking should be obtained from the Client on the lines that "the Client shall not use this account for the purpose of allotments in the primary market or purchases from the secondary market and hence no instructions other than for dematerialisation, bonus, rights & preferential offer will be given by the Client to any person which has the effect of crediting this account".

Such an account should be used only for the purpose of dematerialisation and once all certificates have been dematerialised, such account should be closed and shares transferred to a new account opened in the name of maximum three holders

## **6.4 Rematerialisation**

Rematerialisation is the reverse of dematerialisation. It refers to the process of issuing physical securities in place of the securities held electronically in book-entry form with a depository. Under this process, the depository account of a beneficial owner is debited for the securities

sought to be rematerialised and physical certificates for the equivalent number of securities is/are issued.

A beneficial owner holding 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 its R&T Agent through his DP in the prescribed Rematerialisation Request Form (RRF).

On receipt of RRF, the DP checks whether sufficient free /lock-in balance of the securities sought to be rematerialised is available in the account of the client. If sufficient balance is available, the DP accepts the RRF and communicates the request to the depository through the DP system.

When the depository receives such a rematerialisation request, it intimates the Issuer or its R&T agent about such requests. The depository sends this intimation to R&T agents on a daily basis.

DP should forward the RRF to the Issuer or its R&T Agent within seven days of accepting the RRF from the client. The Issuer or its R&T Agent, after validating the RRF, should confirm to the depository that the RRF has been accepted. On receipt of such acceptance from the Issuer or its R&T Agent, the depository removes the balances from the respective client's account by debiting the account. On rematerialisation, R&T Agent issues security certificates as per the specifications given by the client in the RRF. Thereafter, the Issuer or its R&T Agent despatches the security certificates for the rematerialised securities to the client and his name is entered in the Register of Members of the company. The certificate of securities should be sent to the clients within a period of 30 days from receipt of such RRF by the Issuer or its R&T Agent.

The new certificates may not necessarily bear the same folio or distinctive numbers as those that investor had previously, i.e., prior to his getting them in demat form.

When a rematerialisation request is sent, the securities in the client account will not be available for delivery/transfer immediately. The client will have to wait for physical certificates to reach him before they can be sold. Thus the client would encounter temporary illiquidity on the securities requested for in rematerialised form.

#### **6.4.1 Prerequisites for a Rematerialisation Request**

- The beneficial owners of the securities should make the request.
- There should be sufficient free /lock-in balance of securities available in the beneficiary account to honour the Rematerialisation request.

#### 6.4.2 Rematerialisation Process

- a. The DP should provide Rematerialisation request forms (RRF) to clients.
- b. The client should complete RRF in all respects and submit it to the DP.
- c. The DP should check RRF for validity, completeness and correctness. In particular, the following points should be checked:
  - Free / lock-in balance available in the client's account to honour the Rematerialisation request.
  - The name of client on RRF is exactly the same as that in the client account.
  - In case of joint holding, the order of names appearing on RRF is the same as in the client's account.
  - Correctness of the details filled in such as the security type, face value, Issuer's name and lock-in status.
  - The clients option whether to receive the physical certificates either in jumbo lot for the entire quantity requested or in market lot.
  - Separate RRF are submitted for
    - free and locked-in securities;
    - securities locked-in for different reasons;
    - each ISIN; and
    - securities of different paid-up value;
  - RRF is signed by
    - the sole holder in case of single holding;
    - all joint holders in case of joint holding,
    - authorised signatories in the case of corporate accounts,
    - constituted attorney in the case of NRI accounts;
- d. If RRF is not found in order, the DP should return the RRF to the client for rectification.
- e. If RRF is found in order then the DP should accept RRF and issue an acknowledgement to the client.
- f. DP should enter the Rematerialisation request in DP system. The DP system will generate a remat request number (RRN) which should be mentioned on RRF.
- g. An authorised person, other than one who entered the RRF details in DP system, should verify the details of RRN and release the request to the depository. (Not in CDSL)
- h. The DP should complete the authorisation of RRF and forward it to the Issuer or its R&T Agent for rematerialisation. The DP should forward RRF to the Issuer or its R&T Agent within seven days of accepting it from the client.

- i. The Issuer or its R&T Agent should verify the RRF for validity, completeness and correctness. It should also match the details with the intimation received from the depository against the same RRN.
- j. In case the Issuer or its R&T Agent finds RRF in order, it should confirm the remat request. The Issuer or its R&T Agent should then proceed to issue the physical security certificates and despatch them to the beneficial owner.
- k. In case RRF is not found to be in order, the Issuer or its R&T Agent should send an objection memo to the DP, with or without RRF, depending upon the reason for rejection. RRFs are sent back on the following grounds:
  - Incomplete or incorrect RRF
  - RRF details mismatch
  - RRF not received by registrar
  - Rejected due to Auto Corporate Action
- l. The DP, on receiving confirmation of debit entry in the DP system, should inform the client accordingly.
- m. Issuer / R & T Agent should send the certificate to BO within 30 days from the date of confirming the request in the depository system.
- n. No trading is possible on the securities sent for Rematerialisation.

## Review Questions

Questions to assess your learning:

1. Only those securities whose \_\_\_\_\_ has been activated by the depository, can be dematerialised in the depository system
  - (a) ISIN
  - (b) WAP
  - (c) IIP

Ans: (a)

2. Who can make a request for demat of the security?
  - (a) Company
  - (b) Registered holder of the security
  - (c) Depository
  - (d) Depository Participant

Ans: (b)

3. It is possible for investors to transpose names of the joint holders alongwith the process of dematerialisation through their DPs
  - (a) False
  - (b) True

Ans: (b)

4. Within how many days of request for remat of securities should the client receive the physical securities
  - (a) 45 days
  - (b) 30 days
  - (c) 7 days
  - (d) 15 days

Ans: (b)

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## Chapter 7: Functions of Depository Participant-Trading And Settlement

### Learning Objectives:

After studying this chapter, you should know about:

- The role of depository participant in facilitating the transfer of securities from one account to another
- Process flow of settlement of securities in an off-market transaction
- Concepts and procedures related to settlement of securities

### 7.1 Introduction

One of the most important and basic services provided by the depositories in India is to facilitate transfer of securities from one account to another at the instruction of the account holder. In the depository system both transferor and transferee have to give instructions to its DPs for delivering (transferring out) and receiving of securities. Transferee however, can give '*Standing Instructions*' [SI] to its DP for securities to be received<sup>17</sup>. If SI is not given, the transferee has to give separate receipt instructions each time securities have to be received.

Transfer of securities from one demat account to another may be done for any of the following purposes:

- a. For execution of off-market transaction i.e. transactions between two accounts on mutually agreeable terms, i.e. a transaction done on a person-to-person basis, without going through the stock exchange mechanism.
- b. Transfer arising out of a trade executed on a stock exchange.
- c. Transfer arising out of transmission and account closure.

A beneficiary account can be debited only if the beneficial owner has given 'Delivery Instruction' (DI) in the prescribed form i.e. the Delivery Instruction Slip (DIS).

The DI for an off-market trade or for a market trade has to be clearly indicated in the form by marking appropriately. The form should be complete in all respects. All the holder(s) / authorised signatory (ies) / POA holder(s) of the account have to sign the form. If the debit has to be effected on a particular date in future, account holder may mention such date in the space provided for 'execution date' in the form.

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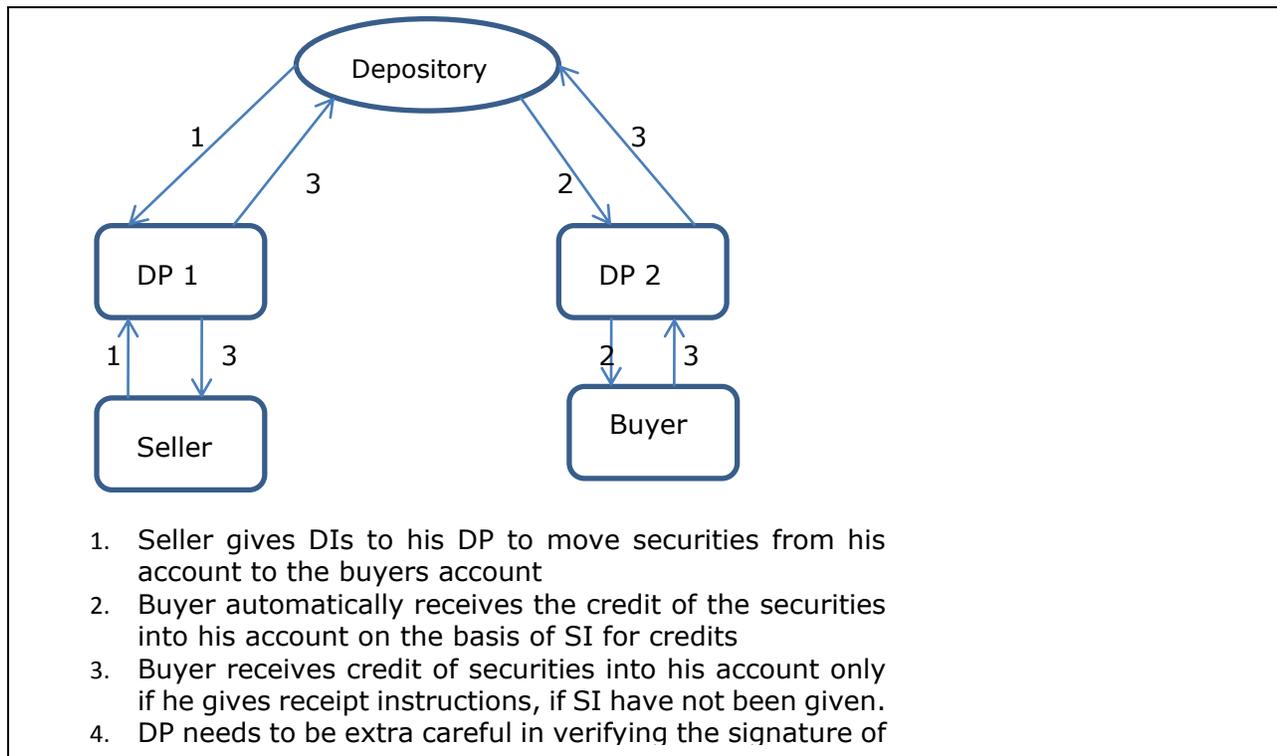
<sup>17</sup> 'SI' is also identified as 'Purchase waiver' or 'Confirmation waiver' in CDSL.

This chapter deals with settlement of off-market trade and market transfer for instructions received in the prescribed form as given above. Transfers arising out of transmission and account closure have already been discussed in the previous chapters on transmission and account opening respectively.

## 7.2 Settlement of Off-Market Transactions

Any trade that is cleared and settled without the participation of a clearing member or clearing corporation is called off-market trade, i.e., transfer from one beneficiary account to another due to a trade between them. Large deals between institution, trades among private parties, transfer of securities between a client and a sub-broker, large trades in debt instruments are normally settled through off-market route. Figure 7.1 shows the flow in an off-market transaction.

**Figure 7.1: Off-Market Transactions**



The transferor will submit a DIS with 'off-market trade' ticked off to initiate an off-market debit. The account holder is required to specify the date on which instruction should be executed by mentioning the execution date on the instruction. The debit will be effected on the execution date. DP will enter the instruction in the DP system if the instruction form is complete in all respects and is found to be in order. DP system will generate an 'instruction ID' for each instruction entered. DP will write the instruction ID on the instruction slip for future reference.

The instruction will be executed on the execution date. If there is adequate balance in the account, such quantity will be debited on the execution date. If adequate balances do not exist in the account, then instruction will wait for adequate balances till the end of the execution day. In NSDL, the account will be debited immediately on receipt of adequate balances in the account. In CDSL, the account will be debited after predefined intervals of time on receipt of adequate balances in the account. In cases where adequate balances are not received till the end of the day of the execution date, the instruction will fail, both for NSDL and CDSL.

Transferee will receive securities into the account automatically if SI were given to the DP at the time of account opening. If SI is not given, transferee has to submit duly filled in 'Receipt-Instruction' (RI) form for every expected receipt. Exchange of money for the off-market transactions are handled outside the depository system.

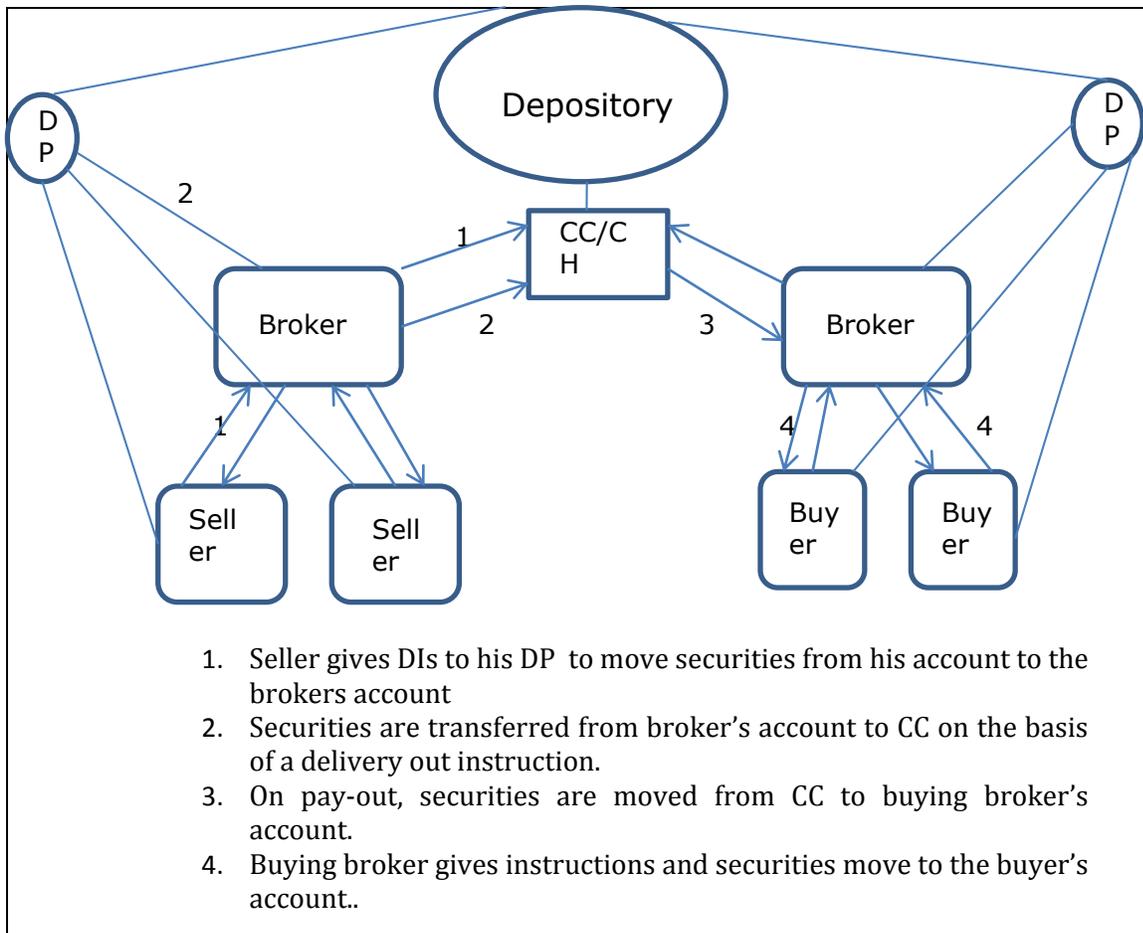
### **7.3 Settlement of Market Transactions**

A market trade is one that is settled through the participation of a Clearing Corporation/ Clearing House (CC/CH). In the depository environment, the securities move through account transfer. Once the trade is executed by the broker on the stock exchange, the seller either gives an on-market delivery instruction to his DP to transfer securities to his broker's account or on behalf of his broker gives normal pay-in or early pay-in delivery instruction to his DP. In case of CDSL, the seller BO can deliver the securities directly to the CC of the exchange ( BO Level pay-in).

The broker has to ensure that the pay-in instruction [normal pay-in or early pay-in] is entered using the CM ID and / or ensure that sufficient balance is there in his CM account / respective settlement number and market type before the pay-in deadline prescribed 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 from its CM account to the buyer's account. If a broker gives pay-out breakup of his clients to CC/CH then pay-out securities are directly credited in the clients account by the CC/CH. The movement of funds takes place outside the depository system. Figure 7.2 shows the settlement in case of market transactions.

#### **Figure 7.2: Market Settlement –Demat Shares**



Transfer of securities towards settlement of transactions done on a stock exchange is called settlement of market transaction. This type of settlement is done by transferring securities from a beneficiary account to a clearing member account.

Brokers of stock exchanges that offer settlement through depository are required to open a 'clearing member account'. The type and number of accounts opened may vary across depositories. In addition to the brokers, custodians registered with SEBI and approved by stock exchanges can open a clearing member account. These accounts are popularly known as 'Broker settlement account' or 'Broker pool account'. A client who has sold shares will deliver securities into the CM account of the broker through whom securities were sold.

### 7.3.1 Important Terms related to transaction on a Stock Exchange

The following are important descriptions of a transaction done on a stock exchange. All these descriptions have to be written on the 'DIS'.

### ***Market Type***

Stock exchanges offer different market segments in which trades can be done. The segmentation is done by the type of settlement or type of trade. Each of the segments is denoted as 'market type' in the depository system. The DIS should contain the name of the stock exchange, market type and settlement number for which securities are being transferred to the clearing member accounts. The contract note/trade confirmation slip given by the broker/ sub-broker will indicate the settlement details.

### ***Settlement Number***

Trading periods of each of the market segments is identified by a settlement number. Every settlement number has a trade beginning day, trade-ending day, settlement pay-in day and settlement pay-out day etc. Stock exchanges divide a period of one year [financial year or calendar year] into several settlement periods and allocate settlement number for each settlement-period. All these days collectively are called 'settlement calendar'. The Depository system will give complete details of settlement calendar for each stock exchange. The DIS should contain the settlement number for which the securities are being transferred to the clearing member account.

### ***Clearing Member***

Every broker in a stock exchange participating in settlement process through depository is required to open clearing member account. These are identified with BO IDs / CM BP IDs and called as 'CM accounts'. If a broker deals in more than one stock exchange, he is required to have a separate set of CM accounts per stock exchange. The DI slip should contain the BO ID / CM BP IDs of a CM account relevant to the stock exchange in which the trade was done.

### ***Delivery Deadline***

Stock exchanges set a deadline time by which clearing member are expected to deliver securities. Clearing member can deliver securities within the deadline time only if they have received securities from their clients. In order to ensure that clients give securities in time to the clearing member, SEBI has prescribed deadline time by which clients have to give securities to clearing members. SEBI has advised DPs to instruct their clients to submit the settlement instructions on T+1 (in physical form upto 4 p.m. and 6 p.m. in case of electronic instructions) for pay-in of securities. For example, pay-in for trades executed on 'Monday' will be on Wednesday. Hence, clients will have to submit instructions to their Participants (upto 4 p.m. in case of physical and upto 6 p.m. in case of electronic instructions) on Tuesday. The client must submit the DIS to its

DP before the DPs acceptance deadline. The steps involved in the Pay-in and Pay-out of securities are discussed in the section below.

### **Steps in Pay-in and Pay-out:**

The process of a broker/trading member submitting securities sold by him on behalf of his client, to CC/CH of a stock exchange is called 'pay-in'. All CM's are expected to complete the pay-in before the deadline time prescribed by the stock exchange. In a depository environment, the following steps have to be completed to execute the 'pay-in' successfully:

- The clients of the brokers who have sold securities will move the securities to the broker settlement account before the deadline time.
- Securities that are made available for pay-in by seller clients [on behalf of CMs] and clearing members through various settlement related instructions before the deadline time given by the stock exchange would be informed to CC/CH in a pay-in file. If the seller client or CM is unable to deliver the securities within a pay-in deadline time, the short deliveries are auctioned and are purchased by the CC/CH in an open auction. This difference in price is borne by the defaulter CM.

The process of a CC/CH transferring the securities to the broker's CM -account for the quantity of securities purchased by them on behalf of their clients is known as 'pay-out'. Payout time is also pre-determined by the settlement calendar. The following steps are taken to distribute securities received in pay-out to buying clients:

- The CC/CH credits the buying CM account immediately on pay-out.
- The CM/broker will transfer securities from its CM Settlement account to the accounts of the buyer.
- If the buying client is a sub-broker, such sub-broker will transfer securities to the final client using the off-market route.

### **Direct Delivery by Clearing Corporation to Client Account**

Direct delivery of securities to the clients can also be effected by the CC/CH, subject to completion of necessary procedures.

### ***Inter-Settlement Transfers***

In a clearing member account, the securities are always kept in a bucket of specific market type and settlement number. The clearing member may have to move securities from one bucket with a different market type-settlement number combination to another bucket from where pay-in is

to be effected. To effect this movement a clearing member can give an instruction to move securities from one settlement to another settlement which is called 'inter-settlement' transfer.

### **Tracking of securities received for pay-in**

A CM is required to track the securities, which it has received for pay-in. A CM can obtain such information from the following sources:

- (1) *Its clients*: CM may contact selling clients to inquire whether they have delivered securities.
- (2) *Its DP*: CM may contact its DP to find out the deliveries received into its CM settlement account.
- (3) *Internet* - using facilities provided by the depositories such as IDeAS of NSDL and *easi*<sup>18</sup> and *easiest*<sup>19</sup> of CDSL

### **Automatic Delivery-out**

- (1) In NSDL, delivery-out instructions for moving securities from CM Pool Account to CM Delivery Account can be generated automatically by the respective Clearing Corporations based on the net delivery obligations of its Clearing Members. The Clearing Corporation can generate auto delivery obligations (Dos) on behalf of those CMs who have authorised it in this regard. The auto DOs will be generated around the time of download of the delivery obligations to the Clearing Members. Such CMs will not be required to give delivery-out instruction forms to the Participants for Pay-in to the CC in respect of the automatically generated DOs. The Clearing Members can know the Auto DOs either by way of downloads from the Clearing Corporation or through the Auto DO Report from the DPs or from facility on Internet provided by the depositories.
- (2) Auto DOs will not be generated in the following cases and the Clearing Members will have to give Delivery-out Instruction forms to their Participants as usual:
  - a. Irreversible Delivery-out (IDO) - Auto DOs will not be generated for IDOs required to be given for the purpose of margin payment / exemption, etc.
    - i. In case IDO is given before generation of Auto DO, Clearing Members will have to ensure that an instruction is given to the Participant subsequently

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<sup>18</sup> CDSL offers Electronic Access to Securities Information (*easi*) which provides real time information to the CMs of their holdings in their demat account. It also provides status of instructions, details of past transactions and enables users to take a print out of their statement of account. It also offers a useful facility of daily valuation of the stocks held in the demat account and aggregate value of the portfolio.

<sup>19</sup> CDSL also offers Electronic Access to Securities Information and Execution of Secured Transaction (*easiest*) which is an internet facility which permits BOs/CMs to submit debit/credit transaction instructions to effect off-market, on-market, inter-depository and early pay-in of transactions.

for cancellation of the corresponding Auto DO alongwith Delivery-out Instruction form for the balance quantity.

- ii. In case IDO is given after generation of Auto DO, Clearing Members will have to ensure that the Auto DO is first cancelled before execution of the IDO. Further, a Delivery-out Instruction form for the balance quantity should also be given to the Participant.
- b. Shifting of CM Settlement Account from one Participant to another Participant Auto DOs will be generated only in respect of one CM Settlement Account i.e., the CM Settlement Account which is designated for receiving pay-out as of the date of generation of Auto DOs. The Clearing Member must carefully monitor the delivery instructions for Pay-in as the securities might be lying during the shifting process in both the CM Settlement Accounts. However, this is applicable only with respect to NSDL.

(3) In case of CDSL, there are options of early pay-in, normal pay-in and auto pay-in.

**Early pay-in** facility is used to avail margin exemptions and other applicable benefits. The CC / CH maintain separate early pay-in accounts for each CM where the securities for early pay-in have to be delivered. For availing margin exemption, the CM / BO can give early pay-in instructions to DP from one day prior to the day of trading upto the pay-in day or any such time as may be specified by the stock exchanges. On receipt of instructions the DP verifies the same and enters the early pay-in instruction in the CDSL system and thereafter the securities get transferred from the concerned BO / CM account to the early pay-in account. The execution of early pay-in will take place only if adequate balance is available with the CM / BO account.

**Normal pay-in** facility can be used by a CM [applicable only in case of BSE CMs, set up of normal pay-in. Instructions from non-BSE CM accounts are not allowed] or the seller BO to deliver securities to the CC / CH of the stock exchange by giving normal pay-in instruction to the DP. These normal pay-in instructions can be given any time from the "T" day to the pay-in day till the pay-in time, even if no balance is available in the account.

- In case of BSE Pay-in, at the time of pay-in, CDSL earmarks the balance in the accounts for which the normal pay-in instructions has been entered by the DP, to the extent of quantity specified (or part) in the normal pay-in instruction. The accounts of the CM / BO are accordingly debited during pay-out time.
- In case of non-BSE pay-in at the time of pay-in, balance in the BO account for which the normal pay-in instructions have been entered by the DPs will be debited, to the extent of quantity entered in normal pay-in instructions (or part) and will be credited to the respective CM accounts.

### ***Auto pay-in***

- A facility is available to BSE-CMs on written request to CC / CH (i.e. BOISL). By using this option the CM will not be required to give any pay-in instructions to his DP and the securities will be automatically considered for pay-in. The details of auto pay-in can be viewed on the CDSL system from T+1 day afternoon, after the auto pay-in instruction are uploaded by CC/ CH. At the designated pay-in time, the securities for which auto pay-in instructions have been generated are earmarked in the designated CM account and considered automatically by the CH for pay-in. Debit of securities are done at the time of pay-out.
- A facility is also available to NSE CMs on written request to CC / CH (i.e. NSCCL). CMs who have availed this option securities for pay-in will be reported using following logic
  - ✓ If early pay-in quantity is more than Auto DO, no quantity will be debited from CM's account
  - ✓ If early pay-in quantity is less than Auto DO, quantity will be debited to the extent difference between Auto DO and early pay-in
  - ✓ In case of no early pay-in but Auto DO is generated, quantity will be debited to the extent Auto DO quantity
  - ✓ In case where no Auto DO is generated entire quantity available in CM's settlement pocket will be debited

The details of auto pay-in can be viewed on the CDSL system from T+1 afternoon, after the auto pay-in instructions are uploaded by CC / CH. At the designated pay-in time, the securities for which auto pay-in instructions have been generated quantity will be debited from the CM account as per the aforesaid logic and will be credited to the CC / CH house account

- For trades done on exchanges, other than BSE, the auto pay-in is the default option, where auto pay-in instructions are not generated by the CC / CH. At the designated pay-in time, the securities that are available in CM's account under the respective settlement pocket are automatically considered for pay-in.
- (4) Clearing Members will be required to give Inter-settlement Instructions to the Participants for securities lying within a same CM account but in different settlement pocket.
- (5) Participants can get a separate report from the DP system for Auto DOs, normal pay-in instructions and early pay-in instructions.

### **CM Settlement to CM Settlement Instructions / CM Pool to CM Pool Account transfer**

The CM may give instructions to its DP to debit its settlement / Pool account and credit the settlement account of another CM in a prescribed format. The CM may give receipt instructions to its DP for crediting its settlement/ Pool account from settlement / Pool account of another CM in the format laid down. Alternatively, a CM may give standing instruction to its participant to credit its settlement/ Pool account. The DP shall ensure that the instruction form is complete and the signature of the CM is valid. The DP shall execute the instructions of the CM to debit/credit the settlement account of the CM.

### **Inter-depository Transfer**

Transfer of securities from an account in one depository to an account in another depository is termed as an inter-depository transfer.

- As per SEBI (Depositories and Participants) Regulations, 1996, both the depositories must be inter-connected to enable inter-depository transfers.
- It can be done only for securities that are available for dematerialisation on both the depositories.
- The account in the depository can be either a clearing member account or a beneficiary account.
- For debiting the clearing member account or the beneficiary account with one depository, the form for "Inter-depository delivery instruction" is required to be submitted by the clearing member/beneficial owner to its DP.
- For crediting the clearing account or the beneficiary account, the standing instruction given for automatically crediting the account is applicable. In case the standing instructions are not given, then the form for "Inter-Depository Receipt Instruction" is required to be submitted by the clearing member/beneficial owner to its DP.
- Inter-Depository Transfer instructions for the day are exchanged online between the two depositories.
- The deadline time for DPs to verify & release Inter Depository Transfer delivery/ receipt instructions is 8 p.m. on weekdays and 2.30 p.m. on Saturdays. W.e.f. September 26, 2011 in an inter depository transfer from NSDL account to CDSL account, where receiving CDSL account is a CM account and securities credited under appropriate settlement id can only be considered against the CM's settlement pay-in obligation.

## Review Questions

Questions to assess your learning:

1. Transfer due to a transaction done on a person to person basis is called \_\_\_\_\_ transaction.
  - (a) Off Market
  - (b) Market
  - (c) Sub-Market
  - (d) Intra-Market

Ans: (a)

2. State whether the given statement is true or false: "If adequate balances do not exist in the account, then delivery instruction will wait for adequate balances till the end of the execution day".
  - (a) True
  - (b) False

Ans: (a)

3. If a broker gives \_\_\_\_\_ of his clients to Clearing Corporation /Clearing House, then pay-out securities are directly credited in the clients account by the Clearing Corporation /Clearing House.
  - (a) Names and PAN
  - (b) Pay-out breakup
  - (c) Identities
  - (d) PAN and DP IDs

Ans: (b)

4. Who is required to give the Inter-settlement Instructions to the Participants for securities lying within a same CM account but in different settlement a pocket?
  - (a) Exchange
  - (b) Clearing House
  - (c) Depository
  - (d) Clearing Member

Ans: (d)

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## Chapter 8: Special Services – Pledge & Hypothecation<sup>20</sup>

### Learning Objectives:

After studying this chapter, you should know about the:

- Concept of pledging and hypothecation of securities
- Procedure for pledging and hypothecation of securities
- Corporate Benefits for pledged/hypothecated securities

### 8.1 Introduction

The creation of pledge and hypothecation against securities which are held in demat mode is permitted under section 12 of the Depositories Act, 1996. Securities (free balances / lock-in balance) held in a depository account can be pledged or hypothecated against a loan, credit, or such other facility availed by the beneficial owner of such securities. For this purpose, both the parties to the agreement, i.e., the pledgor and the pledgee must have a beneficial account with the same depository as inter-depository pledge is presently not permitted. However, both parties need not have their depository account with the same DP. The nature of control on the securities offered as collateral determines whether the transaction is a pledge or hypothecation. If the lender (pledgee) has unilateral right (without reference to borrower) to appropriate the securities to his account and if the borrower (pledgor) defaults or otherwise, the transaction is called a pledge. If the lender needs concurrence of the borrower (pledgor) for appropriating securities to his account, the transaction is called hypothecation.

### 8.2 Procedure for Pledge/Hypothecation

The pledgor initiates the creation of pledge/hypothecation through its DP and the pledgee instructs its DP to confirm the creation of the pledge. The pledge/hypothecation so created can either be closed on repayment of loan or invoked if there is a default. After the pledgor has repaid the loan to the pledgee, the pledgor initiates the closure of pledge/hypothecation through its DP and the pledgee instructs its DP to confirm the closure of the pledge/hypothecation. If the pledgor defaults in discharging his obligation under the agreement, the pledgee may invoke the pledge/ hypothecation. This has to be done after taking the necessary steps under the terms of the agreement with the pledgor and as stated in the Bye-Laws of the depository and rules and regulations framed by SEBI.

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<sup>20</sup> It may be noted, that the term 'hypothecation' is used only in NSDL.

The following steps are involved in the creation of pledge/hypothecation:

### **8.2.1 Creation of Pledge/Hypothecation by Pledgor**

A beneficial owner may contract a loan against the securities owned by him. He may borrow from a bank or any other person. A pledge transaction needs an identification which may be an agreement number. The borrower is called a pledgor and the lender is called a pledgee. There can be any number of pledge/hypothecation transactions between the same set of pledgees and pledgors. Each of these transactions has to be identified separately by a unique system generated number (“pledge sequence number”) in the DP system and a separate set of instructions have to be given against each of these transactions. Multiple pledge instructions can be executed on the basis of a single agreement. In such cases, the same agreement number should be quoted for all the pledge instructions. (Entering the agreement number is optional in CDSL system). The DP of the pledgor initiates a pledge/hypothecation on request received from the pledgor in the prescribed form. The pledgor submits the request form containing all details like the details of securities to be pledged, the agreement number, closure date of the pledge/hypothecation (this date is indicative of the duration of pledge/hypothecation), pledgee's details, etc. The DP verifies the form for completeness and validity and ensures that the securities to be pledged exist in the pledgor's account. If it is not found in order, it is returned to the pledgor for correction. If the form is complete in all respects, the DP accepts it for processing and issues an acknowledgement to the pledgor.

The DP then enters the details of the request in DP system as a pledge/hypothecation. On entering the details, a pledge sequence number for the request is generated. The DP then verifies it and confirms the requests. Securities are then debited from the free or locked-in balances and credited as pledge setup balance in the demat account of the pledgor. The DP intimates to the pledgor, the “pledge sequence number”. Figure 8.1 gives the procedure for pledging of demat shares.

### **8.2.2 Procedure for Confirmation of Creation of Pledge/Hypothecation by Pledgee**

Once a pledge/hypothecation request has been created and verified, the pledgor submits the duly stamped and signed PRF to the pledgee along with the letter generated confirming the pledge set-up. The details of the pledge/hypothecation are also electronically communicated to DP system of pledgee's DP for confirmation. The pledge/ hypothecation request is displayed at DP system of pledgee's DP.

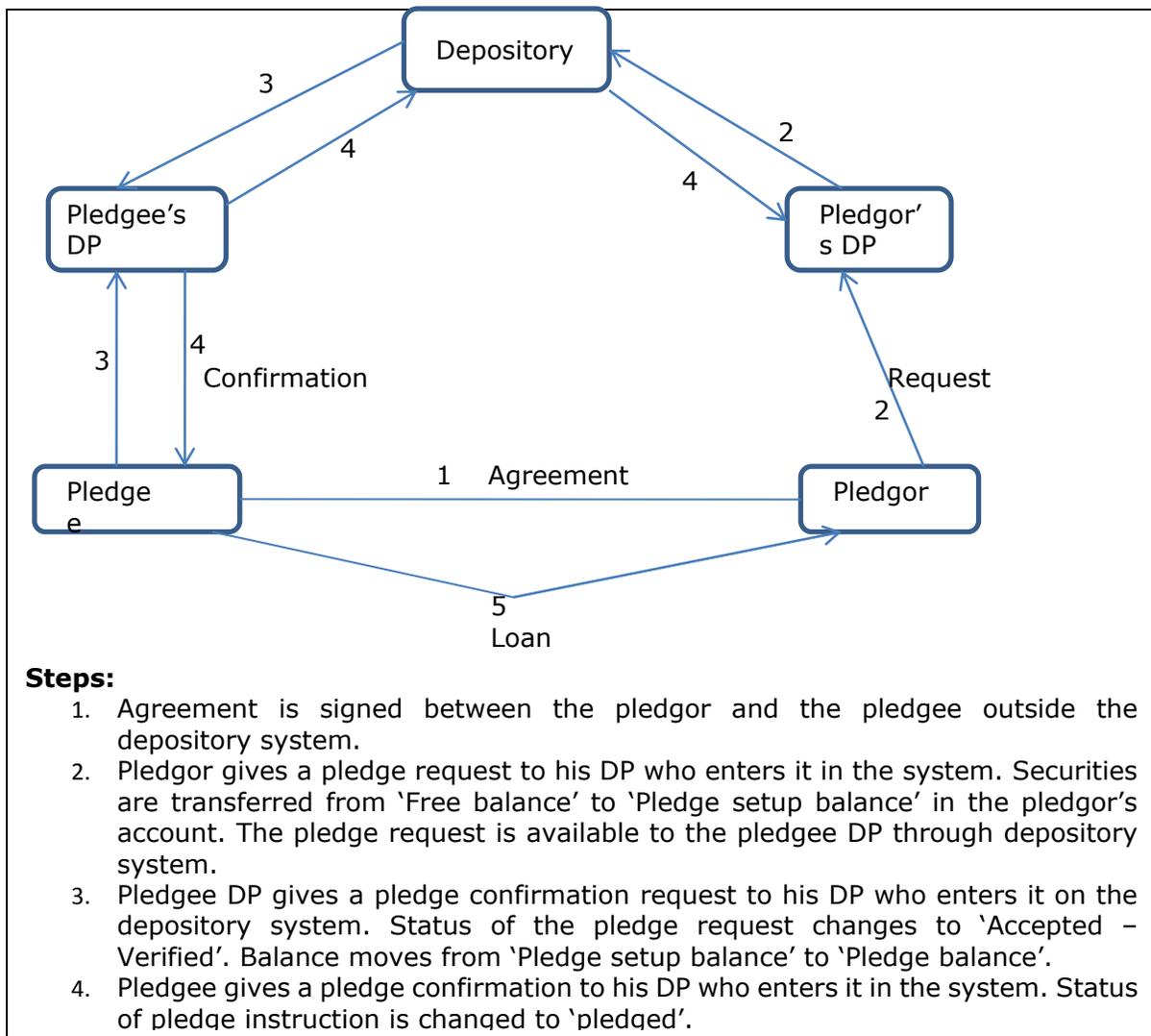
In case of CDSL, if the pledgee DP has not obtained standing instruction from the pledgee BO to confirm the pledge set-up, the pledgee BO shall submit duly signed PRF to its DP with PSN.

The DP also compares the details on the form with the details shown by DP system against the pledge/hypothecation number. On being satisfied, the DP executes the order for accepting/rejecting the pledge/hypothecation request in DP system. In the case of rejection by the pledgee, the DP enters reason for the rejection in DP system as specified in the form. Confirmation of the acceptance/rejection of pledge/hypothecation are electronically communicated to DP system of the pledgor's DP. (Refer figure 8.1).

Acceptance of the creation of pledge/hypothecation appears in DP system of the pledgor's DP and pledgee's DP as a status change. Status of the pledge/hypothecation instruction will change to "Accepted-Verified". DP of the pledgee must confirm the creation of pledge/hypothecation before the date of expiry of pledge/hypothecation mentioned in the request form for creation of pledge submitted by the pledgor (not applicable in case of NSDL). The reason for rejection is displayed in DP system of the pledgor's DP. The pledgor's DP cannot cancel the pledge/hypothecation order after confirmation of creation of the pledge/hypothecation by the pledgee. Once the pledge is confirmed, statement of holding will show the quantity of pledged securities separately as "pledged balance".

A pledgor (borrower) and pledgee (lender) may have their accounts with the same DP or different DPs. The procedure described does not change. It remains the same irrespective of whether or not they have accounts with different DPs. Even if both have their accounts with the same DP, the procedure of receiving the pledge confirmation from the lender has to be followed. The pledge will get credited only after the confirmation advice is entered in the DP system.

### **Figure 8.1: Pledging of Demat Shares**



### 8.2.3 Closure (Unpledge) of a Pledge/Hypothecation by Pledgor

The pledgor can request for un-pledging / closure of pledge/hypothecation after the performance of the underlying agreement. The pledgor submits an instruction in the prescribed form to its DP to initiate the un-pledge / closure of pledge/hypothecation. The DP, upon receiving such request, verifies the form for its completeness and validity and, if not found in order, returns it to the pledgor for rectification. If it is found to be in order, the DP accepts it for processing and issues an acknowledgement to the pledgor. The DP also compares the details given in the form with those displayed at DP system against the pledge/hypothecation instruction number. The DP enters the un-pledge / closure request details in DP system against the pledge/hypothecation instruction number as per the instructions given in the form.

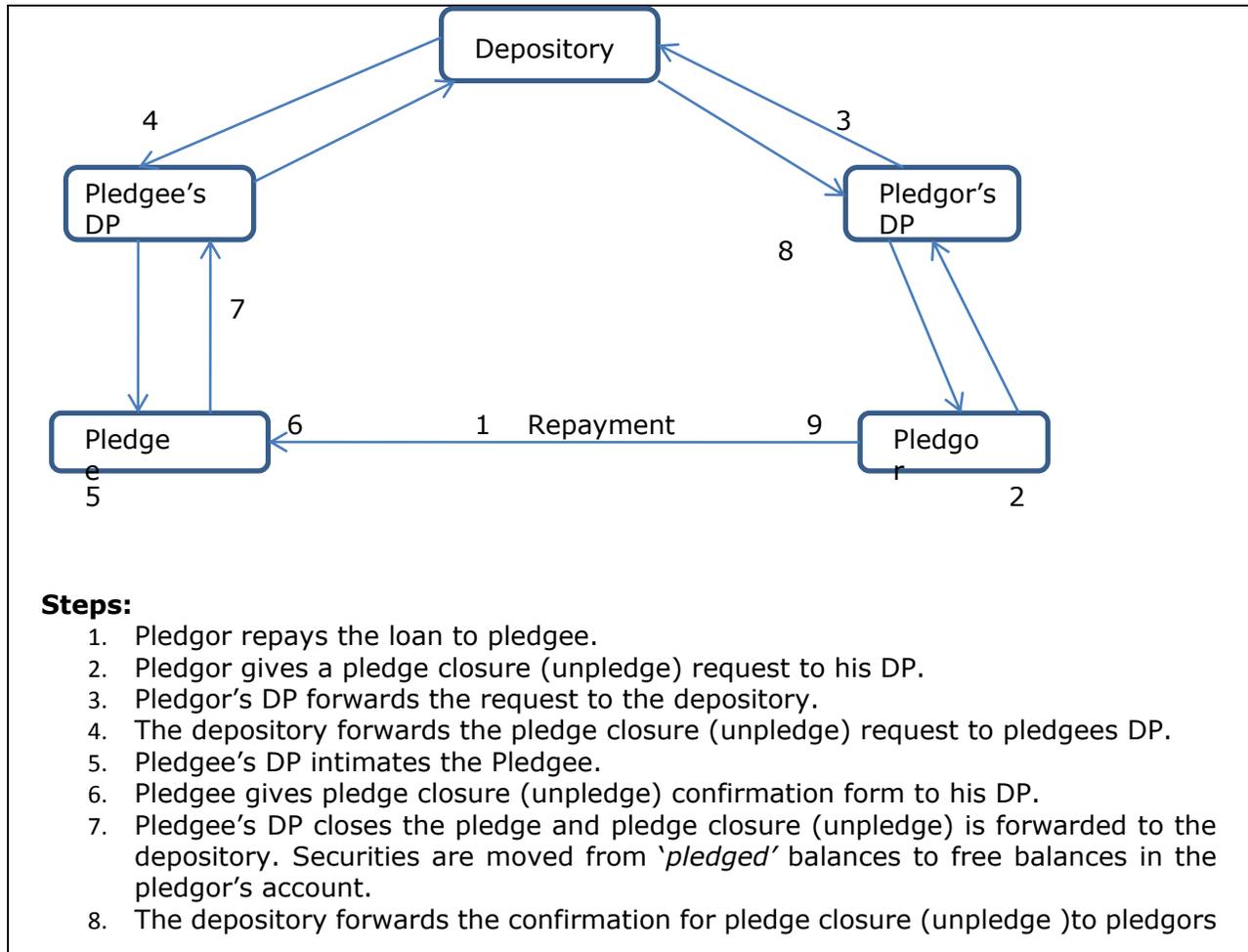
The details of the pledge/hypothecation un-pledge / closure request are communicated electronically through depository system to the DP system of pledgee's DP for confirmation. On receiving such intimation, the pledgee's DP is required to furnish the details of the un-pledge/hypothecation closure requests received for confirmation to the pledgor. The pledgor then submits his acceptance/rejection of the un-pledge / closure request in the prescribed form. The DP verifies the form for its completeness and validity and, if not found to be in order, returns it to the pledgor for rectification. If it is in order, the DP accepts it for processing and issues an acknowledgement to the pledgor. The DP also compares the details on the form with those displayed at DP system against the pledge/hypothecation instruction number. Figure 8.2 shows the un-pledge / closure procedure.

The DP executes the order accepting/rejecting the un-pledge/hypothecation closure request in DP system as per the instructions given in the form. In case of rejection by the pledgor, the DP enters the reason for rejection in DP system as specified in the form. The acceptance/rejection of un-pledge/hypothecation closure confirmation is electronically communicated to DP system of the pledgor's DP. The securities accepted for un-pledge/closure gets debited from the pledged balances of the pledgor and credited to its free/locked-in balances. In case of rejection by the pledgor, the securities continue to remain as pledged balances in the pledgor's account. The reasons for rejection are displayed in DP system of the pledgor's DP. Some of the reasons for rejection are as follows:

- Un-pledge / Closure date not accepted
- Pledged quantity not accepted
- ISIN not accepted
- Security details not accepted
- Market value of pledged ISINs insufficient
- ISIN delisted from trading
- POA not received from all holders
- Holders not acceptable to the pledgor
- Agreement number differs from that on the agreement
- Others

The rejection reasons are not present in CDSL system. If the pledgor DP is rejecting the unpledge request, he can enter the reason for same in a remark field provided for this purpose.

**Figure 8.2: Pledge closure procedure**



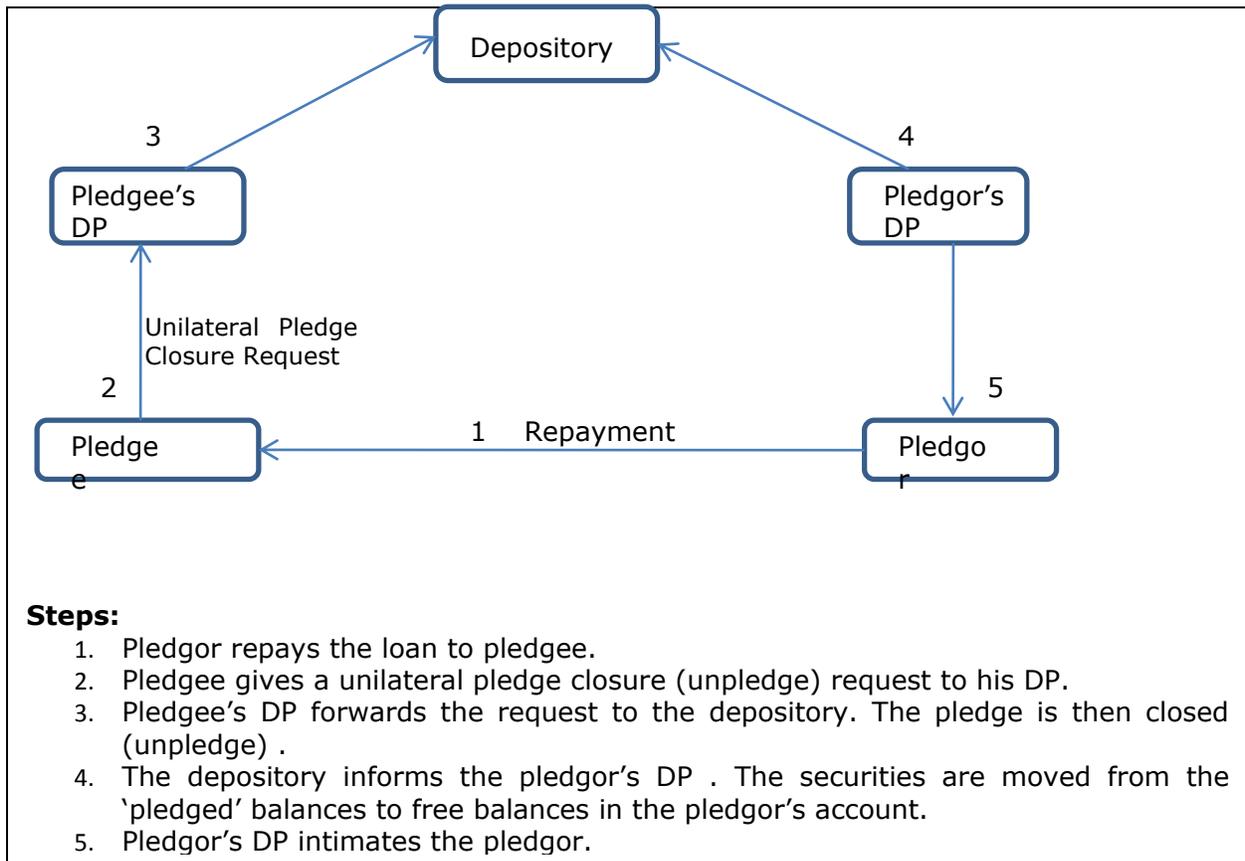
In CDSL system, Pledge closure is referred as unpledge.

#### 8.2.4 Unilateral Closure (Unpledge) of Pledge

The facility for unilateral closure (Unpledge) of Pledge by the Pledgee is also provided by the depositories. In this case, the pledgee submits an instruction in the prescribed form to its DP to initiate unilateral closure of pledge/hypothecation.

The process remains the same as mentioned under head (section 8.2.3), Un-pledge/Closure of a Pledge/Hypothecation by Pledgor. However, no action (confirmation / rejection) is required to be taken by the pledgor and/or pledgor's DP. Figure 8.3 shows the process flow for universal (unpledged) closure.

**Figure 8.3: Unilateral Pledge Closure Procedure**



### 8.2.5 Invocation of Pledge by Pledgee

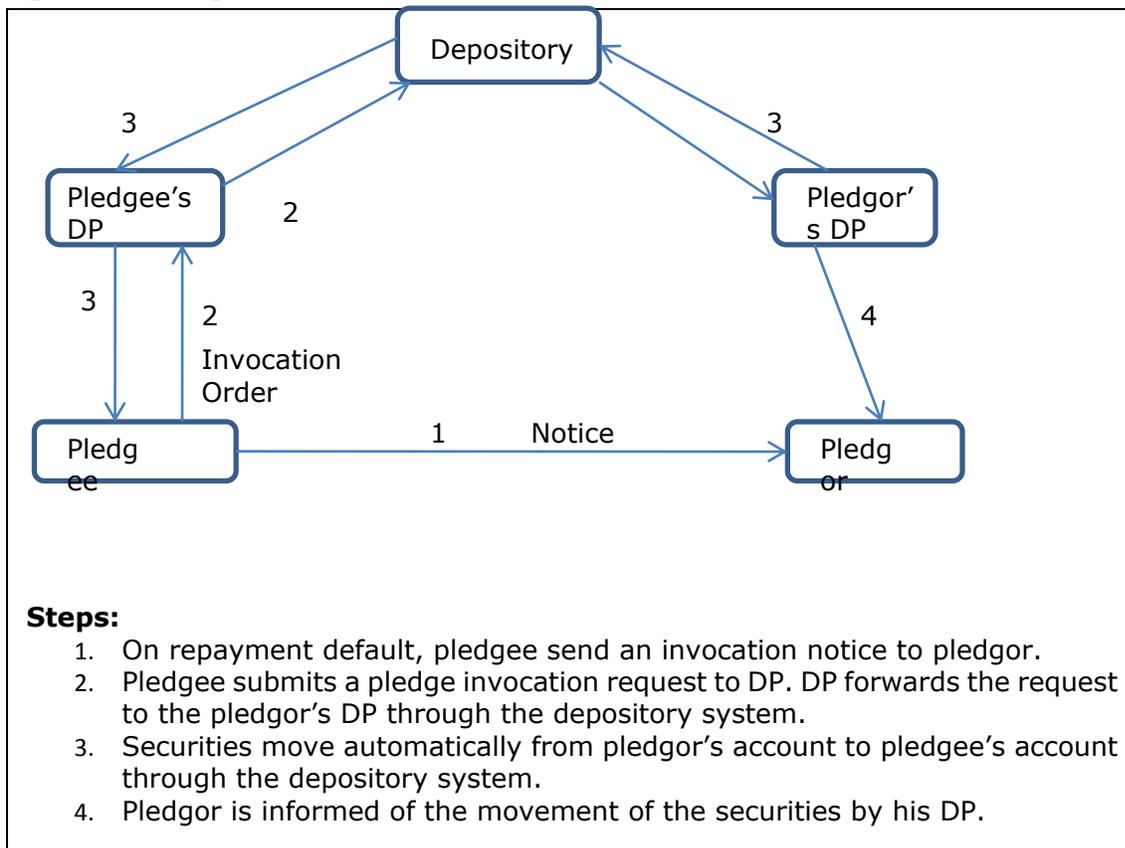
If the pledgor fails to discharge his obligations under the agreement of pledge or for any other reason, the pledgee may invoke the pledge. He can then claim the beneficial ownership of the concerned securities after taking the necessary steps in terms of the pledge agreement, Bye-Laws of the depository and SEBI regulations. In such a case, the pledgee fills up the Invocation Request Form (IRF) to his DP for invoking the pledge. The DP verifies the form for its completeness and validity and if not found in order returns the same to the pledgee for rectification. If it is in order, the DP accepts it for processing and issues an acknowledgement to the pledgee. The DP also compares the details on the form with those on the DP system displayed against the pledge number.

Figure 8.4 shows the process flow for pledge invocation. The DP enters (maker) the invocation request details in DP system against the pledge instruction number as per the instructions given in the form and verifies (checker) the details. On verification by pledgee, the securities are

transferred from the 'pledged balance' of the pledgor's beneficial owner account to the 'free balance' of pledgee's beneficial owner account. It may be noted that in case of pledge, no confirmation is required in DP system of the pledgor's DP for transferring securities from pledgor's (borrower's) account to pledgee's (lender's) account. Further if the pledge is for lock-in securities, then invocation request cannot be setup till the lock-in period is over.

It is important to note that locked-in securities cannot be invoked before the lock-in release date. In case of hypothecation, the pledgor instructs its DP to confirm the invocation of the hypothecation in DP system.

**Figure 8.4: Pledge Invocation**



### 8.2.6 Invocation of Hypothecation (Not applicable in CDSL)

If the borrower fails to discharge his obligations under the agreement of hypothecation or for any other reason, the lender may invoke the hypothecation. He can then claim the beneficial ownership of the concerned securities after taking the necessary steps in terms of the hypothecation agreement, Bye-Laws of the depository and SEBI regulations. In such a case, the lender submits a request in the prescribed form to his DP for invoking the hypothecation. The DP

verifies the form for its completeness and validity and, if not found in order, returns it for rectification. If it is in order, the DP accepts it for processing and issues an acknowledgement to the lender. The DP also compares the details on the form with those on the DP system displayed against the hypothecation instruction number.

On receiving the instructions from the borrower, the DP executes the order for accepting/rejecting the invocation request in the DP system as per the instructions given in the form. In case of rejection by the borrower, the DP enters the reason for rejection in DP system as specified in the form. The acceptance/rejection of invocation confirmation is communicated to DP system of the lender's DP. In case of rejection by the borrower, the securities will continue to remain as pledged balances in the borrower's account and the reasons for rejection are displayed in DP system of the lender's DP.

### **8.2.7 Corporate Benefits for Pledged/Hypothecated Securities**

Ownership of the pledged/hypothecated securities remains with the pledgor (borrower) until the pledge is invoked. Hence, all corporate benefits - cash and non-cash - like dividends, bonus, rights etc., will accrue to the borrower. Dividends will be given to the borrower in the usual manner and bonus shares will be credited to his account as pledged balances. The securities arising out of corporate actions like share splits or consolidation or exchange under a merger/acquisition scheme are credited to the account of the pledgor with pledge marked. The checklist for processing a pledging and hypothecation request by a depository participant is shown in Box 8.1.

#### **Box 8.1: Checklist for pledge/hypothecation**

While processing a pledge/hypothecation request, the DP should take care with regard to the following steps/points:

1. Ensure that the instruction form is submitted in duplicate.
3. Pledgor DP and Pledgee DP each shall create at least two users to implement the Maker-checker feature. Ensure that all compulsory fields in the instruction form are entered.
4. Ensure that request for confirmation of pledge is given before the closure date mentioned in the instruction form (not applicable in case of NSDL).
5. The DP shall maintain copies of all Pledge Request Forms (PRF), Unpledge Request Forms (URF) & Invocation Request Forms (IRF) for a minimum period of 5 years or any such period informed by SEBI / NSDL/ CDSL from time to time.

## Review Questions

Questions to assess your learning:

1. If the lender needs concurrence of the borrower for appropriating securities to his account, the transaction is called \_\_\_\_\_?
  - (a) Pledge
  - (b) Hypothecation
  - (c) Either of the above
  - (d) None of the above

Ans: (b)

2. State whether the given statement is true or false: "For pledging and hypothecation of securities, the pledgee and the pledgor can have their account with DPs under the different depository".
  - (a) True
  - (b) False

Ans: (b)

3. When do we call that a Pledge transaction is completed?
  - (a) When SEBI approves the proposal
  - (b) When the depository gives its nod
  - (c) When the confirmation advice is entered in the DP system
  - (d) None of the above

Ans: (c)

4. From who does the DP receives the pledge closure request?
  - (a) Pledgor
  - (b) Depository
  - (c) Pledgee
  - (d) None of the above

Ans: (a)

## Chapter 9: Special Services – Corporate Actions

### Learning Objectives:

After studying this chapter, you should know about:

- The concept of corporate actions
- Terminology related to corporate actions.
- Procedure for corporate actions with respect to the monetary and non-monetary benefits

### 9.1 Concept of Corporate Actions

Corporate actions are events, which affect the rights, obligations and/or interests of the beneficial owners of the securities held in a depository. The most common examples are payment of interest, dividend, bonus shares, rights, splits, merger, redemption, payment of call money, liquidation etc. For securities held in a demat mode, the depository facilitates the execution of corporate actions. The depository Bye-Laws define corporate benefits to mean and include any action taken by the issuer relating to prescribing the dates for book closures, record dates, dates for redemption or maturity of security, dates of conversion of debentures, warrants, call-money dates and such other action from time to time.

Corporate actions can be categorised into two types:

- *Cash corporate actions* involve distribution of monetary benefits, e.g., dividend and interest etc. In case of cash corporate actions, depository merely provides information to the Issuer about the persons entitled to receive corporate benefits.
- *Non-cash corporate actions* involve distribution of benefits other than cash such as bonus issues, offer of shares on right basis, conversion of securities, etc. In case of non-cash corporate actions, depository may facilitate the distribution of corporate benefits. Presently the depositories in India facilitate the distribution of non-cash corporate benefits.

## 9.2 Important Terms

Since corporate actions affect the beneficial owners of the securities, it is important to determine the actual beneficial owner of the securities on the cut-off date announced by the issuer for a specific corporate action. Such cut-off date is called record date/ book closure.

**Record Date:** Corporate actions affect the holder of the securities. Thus, whenever any corporate action takes place it is necessary to determine the eligible BOs as of a particular date who are entitled to the corporate benefits. The issuer thus announces a cut-off date to determine the BOs of the securities as of that date. This date is referred to as the 'Record Date' and depository system provides holding report i.e. list of BOs having holdings in the ISIN of the issuer as of end of the day of record date.

**Book Closure Start Date / End Date:** In certain cases, issuer may setup a corporate action specifying book closure start date and book closure end date. In such cases, the depository system generates holding report i.e. list of BOs having holdings in the ISIN of the issuer as of end of the day of one day prior to book closure start date.

## 9.3 Procedure for Corporate Actions

Whenever a corporate action is announced, the Issuer / its R&T Agent, informs the depository about the proposed corporate action. The information of the corporate actions is made available to the DPs through the depository system.

On receiving such information, DPs take the following steps to ensure that:

- the changes in tax status, bank details, change of address etc. in the beneficial owners' accounts are updated well in advance of the book closure/record date;
- all positions in the transit accounts<sup>21</sup>, e.g., settlement accounts and intermediary accounts, are cleared and the balances lying therein are transferred to the relevant beneficiary accounts well in advance of the book closure/record date as per the instructions received from account holders.

On the relevant cut-off date announced for the corporate action, the depository provides the details of the holdings of the beneficial owners to the issuer or its R&T Agent. The details provided by the depository include the particulars of tax-status, if any of the beneficial owner and his bank account details. Securities balances lying in the accounts of the Clearing Members / Clearing Corporations / Intermediaries will be eligible to receive corporate benefits. In such cases, the

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<sup>21</sup> CDSL does not have the concept of transit account.

Issuer or its RTAs will distribute the corporate benefits to the Clearing Members / Clearing Corporations / Intermediaries for onward distribution to the beneficial owners. The corporate benefits availed by Clearing Members / Clearing Corporations and intermediaries shall be held in trust on behalf of the beneficial owners.

### **9.2.1 Monetary Benefits**

On the basis of the particulars of the holdings of beneficial owners received from the depositories on the cut-off date, the Issuer / its R&T Agent distribute dividend, interest and other monetary benefits directly to the beneficial owners.

Advancements in the field of electronic payment systems in the last decade have made available various other modes of electronic funds transfer viz. National Electronic Funds Transfer (NEFT), Real Time Gross Settlement (RTGS), etc. In view of such advancements, SEBI has vide its circular no. CIR/MRD/DP/10/2013 dated March 21, 2013 modified the framework as under:

- (i) For making cash payments to the investors, companies whose securities are listed on the stock exchanges shall use, either directly or through their RTI & STA, any RBI (Reserve Bank of India) approved electronic mode of payment such as ECS [ LECS (Local ECS) / RECS (Regional ECS) / NECS (National ECS) ], NEFT, etc.
- (ii) Further in order to enable usage of electronic payment instruments, companies whose securities are listed on the stock exchanges (or their RTI & STA) shall maintain requisite bank details of their investors.
  - a) For investors that hold securities in demat mode, companies or their RTI & STA shall seek relevant bank details from the depositories. To this end, depositories have been advised to ensure that correct account particulars of investors are available in the database of depositories.<sup>22</sup>
  - b) For investors that hold physical share / debenture certificates, companies or their RTI & STA shall take necessary steps to maintain updated bank details of the investors at its end.
  - c) In cases where either the bank details such as MICR (Magnetic Ink Character Recognition), IFSC (Indian Financial System Code), etc. that are required for making electronic payment are not available or the electronic payment instructions have failed or have been rejected by the bank, companies or their RTI & STA may use physical payment instruments for making cash payments to the investors. Companies

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<sup>22</sup> vide circular SEBI/MRD/DEP/Cir-3/06 dated February 21, 2006 and letter MRD/DEP/PP/123624/2008 dated April 23, 2008,

shall mandatorily print the bank account details of the investors on such payment instruments.

### **9.2.2 Non-monetary Benefits**

On the basis of the particulars of the holdings of beneficial owners received from the depository as of the cut-off date, the Issuer/its R&T Agent informs the eligible beneficial owners about the corporate action/benefit. In case, the benefits are in form of securities, the Issuer / its R&T Agent gives an option to all shareholders (including shareholders holding shares in physical form), to get securities allotted in electronic form or physical form. A person holding securities in physical form may opt for receiving securities in dematerialised form and vice-versa. If holders do not indicate any choice, the Issuer / its R&T Agent issues the securities in the same form in which the shareholder held the securities as on the record date. Thus, if a shareholder is holding shares in electronic form, the newly allotted shares will be credited to his account electronically.

If shareholders holding shares in physical form, opt for credit of newly allotted shares in electronic form, the Issuer/its RTA executes a corporate action to credit the newly allotted shares to the demat accounts of such shareholders on a particular date (i.e. the execution date). The Issuer/ its R&T Agent allot the securities and inform the depositories about allotment details of all beneficial owners. On receipt of these details, the depository makes the credit entries in the accounts of the beneficial owners on a date requested by the Issuer / its R&T Agent (the execution date).

In cases where the details of accounts to which the Issuer / its R&T Agent has made allotment, do not match with those maintained with the depository, such records will be rejected. The depository then requires the Issuer / its R&T Agent to rectify the records. In case the Issuer / its R&T Agent is unable to rectify the records within the stipulated period, the allotment of the rejected records will have to be made in physical form outside the depository system. The statement of transactions sent by the Depositories to the beneficial owners, will indicate the updated holdings after execution of the corporate action.

### **9.2.3 Rights Issue**

The Issuer / its R&T Agent, on the basis of details of holdings received from the depository, dispatch the application form for rights issue to the beneficial owners. The form requires the applicant to state his option about whether he would like to receive the new securities in physical form or dematerialised form. In case, the applicant does not exercise his option, new securities are allotted in the form in which the shareholder held the security as on the record date. The

allotment procedure for rights securities is the same as in case of initial public offer (refer chap 10 of this workbook).

#### **9.2.4 Merger/Amalgamation/Capital Reduction/Sub division etc**

In case of events such as merger, amalgamation, capital reduction, sub-division etc., shares held in demat accounts under old ISIN will be automatically debited and proportionate number of new shares will be credited in the new ISIN.

#### **9.2.5 Rights of Pledgor/hypothecator**

Ownership of the pledged/hypothecated securities remains with the pledgor (borrower) until the pledge is invoked. Hence, all corporate benefits - cash and non-cash - like dividends, bonus, rights etc., will accrue to the borrower. Dividends will be given to the borrower in the usual manner. The securities arising out of corporate actions like bonus, share splits or consolidation or exchange under a merger/acquisition scheme are credited to the account of the pledgor, with pledge marked in favour of the pledgee, provided that on the execution date of the corporate action, pledge exists for atleast one share.

#### **9.2.6 Payment of Interest on Debt Securities**

Eligible investors in debt securities will receive interest from the Issuers / its R&T Agents. In respect of government securities, however, the depository distributes the interest to eligible clients, after RBI has credited interest amount to the depositories account.

## Review Questions

Questions to assess your learning:

1. Which of the following is a "Cash Corporate Actions"?
  - (a) Corporate Benefits
  - (b) Dividend
  - (c) Rights
  - (d) Bonus

Ans: (b)

2. "Non-cash corporate actions" involves which of the following?
  - (a) All benefits other than monetary benefits
  - (b) Monetary Benefits
  - (c) Both monetary as well as non-monetary benefits

Ans: (a)

3. Record Date for a Corporate Action is announced by:
  - (a) Exchanges
  - (b) Issuers
  - (c) Depository
  - (d) Shareholders

Ans: (b)

4. During distribution of dividends, companies should mandatorily print the bank account details furnished by the Depositories on the payment instruments.
  - (a) True
  - (b) False

Ans: (a)

## CHAPTER 10: SPECIAL SERVICES – PUBLIC ISSUES

### LEARNING OBJECTIVES:

After studying this chapter, you should know about:

- Process followed by Depositories in allotment of securities to investors in case of a public offer such as an IPO.

### 10.1 Introduction

The primary market provides the channel for raising funds from investors through sale of new securities; the issuers of securities issue (create and sell) new securities in the primary market to raise funds for investment and/or to discharge some obligation. The issue of securities in the primary market can be made by a new company, a new company promoted by an existing company, an existing public listed company, or an existing public unlisted company. They do so either through public issues (initial public offer or follow on public offer) or private placement. According to the Companies Act, 2013 every listed public company, making an initial offer of any security of Rs. 10 crore and above has to issue it only in dematerialised form in accordance with Depositories Act, 1996.

To encourage issue of securities in demat form, the SEBI has issued the following guidelines for public issues in electronic mode:

- Issuer shall be required to enter into an agreement with all the depositories.
- Issuer shall give an option to subscriber/investor to receive the physical certificates or hold the securities in electronic mode with the depository.
- In order to eliminate the risks to investors on account of fake/forged certificates, bad deliveries, delays in transfer, etc., trading in securities of company making an IPO shall be in demat form only.

### 10.2 Public Issue Procedure

The present procedure followed for getting demat allotment in public issue is by giving option in application form, to subscribe to the issue either in physical form or electronic form. Investors can apply in public offerings to get allotments directly in dematerialised form. To receive the securities in electronic form, investor must open a demat account through any DP with any depository before making an application. For this purpose, the application form should have

provision for investors to furnish their demat account number along with the following information:

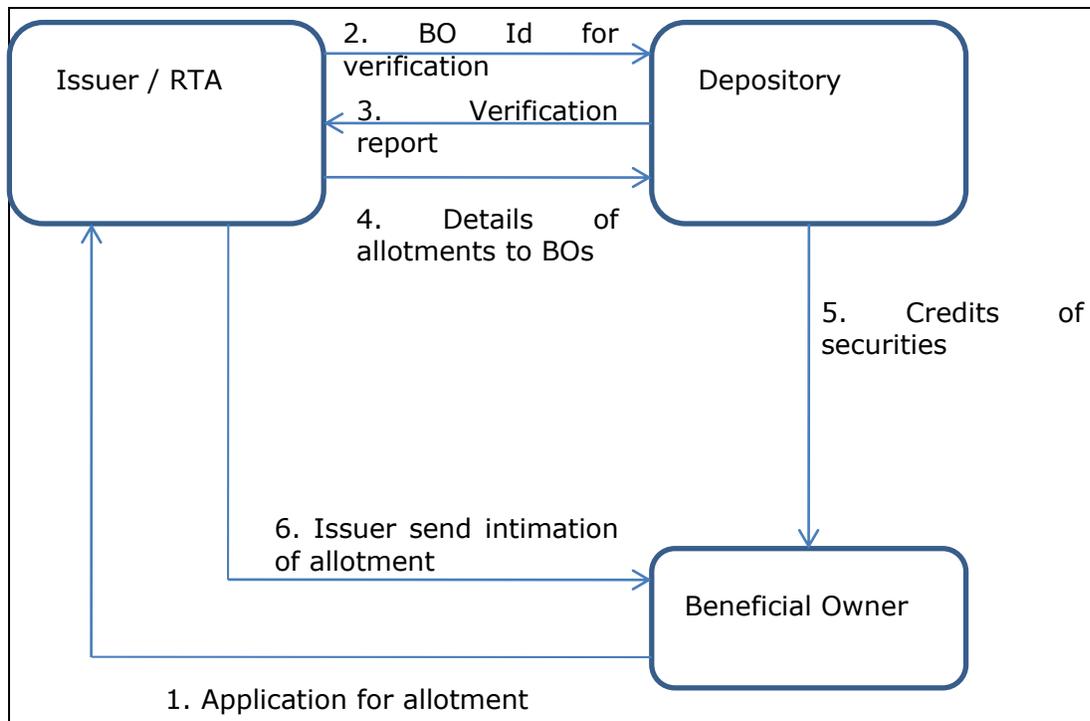
- Depository Name
- DP's Name
- DP-ID
- Beneficiary Account Number (BO ID)

The SEBI guidelines require that all public issues of the size of Rupees ten crores and above be compulsorily made in demat form.

The disclosures and the instructions for exercising such an option is generally given in the application form as well as in the offer document. Allotment in electronic form is given only when the client name and the beneficiary account are matched with details filled in the application form. In case, the applicant does not exercise the option of holding securities in demat form, the Issuer will allot securities in physical form. There are no charges for the allotment process. All the applications, whether with demat option or not, are treated alike for allotment purposes.

On allotment, the Issuer / its R&T agent provides the details of successful allottees who have opted for receiving securities in demat form, to the depository and the execution date when the securities should be credited to the beneficial owners accounts. The depository will credit the securities to the allottee accounts on the execution date and the Issuer / its R&T agent inform the investors of the credit of securities in the electronic form by sending the allotment advice. The statement of accounts provided by the Depository will indicate balances created in the respective beneficiary owner's account. Figure 10.1 gives the process flow chart on an IPO through the depository.

**Figure 10.1: Process Flow of IPO through the depository**



Investors who have not opened a depository account with a DP at the time of applying for the public offer and intend to take credit in their demat account have to follow a slightly different procedure.

1. The investor is required to fill up the application form (except the Client-ID) and approach the DP along with the payment instrument. The DP will open an account of the investor after obtaining a duly filled-up account opening form and duly executed DP-Client Rights and Obligation Document as approved by SEBI.
2. The DP ensures that the client-ID is mentioned on the application form before depositing it with the collecting bank.

## Review Questions

Questions to assess your learning:

1. Public limited companies are required to make the public offer only in dematerialised form in case the offer is more than \_\_\_\_ crore.
  - (a) Rs. 10 crore
  - (b) Rs. 25 crore
  - (c) Rs. 15 crore
  - (d) Rs. 50 crore

Ans: (a)

2. Issuer shall be required to enter into agreement with all the \_\_\_\_\_ before coming out with a public offer.
  - (a) Depositories
  - (b) Depository Participants
  - (c) Investors
  - (d) SEBI

Ans: (a)

3. Can SEBI issue guidelines pertaining to public issues?
  - (a) Yes
  - (b) No

Ans: (a)

4. The securities offered in the public offer can only be traded in the stock exchange in demat form?
  - (a) True
  - (b) False

Ans: (a)

## CHAPTER 11: SPECIAL SERVICES – DEBT INSTRUMENTS & GOVERNMENT SECURITIES

### LEARNING OBJECTIVES:

After studying this chapter, you should know about dematerialisation, settlement and redemption process for:

- Certificate of Deposits
- Commercial Papers
- Government Securities

### 11.1 Introduction

A Debt Security is a written agreement to repay a loan, usually with interest, within a given time frame. A Debt Security is also referred to as a Debt Instrument. Depending on features like Issuer, tenure, interest rate, etc., debt instruments can be classified into different categories like bonds, debentures, commercial paper, government securities, treasury bills, etc. These are further classified broadly into subordinate bonds, floating rate bond/debenture, deep discount bond, secured/unsecured debentures, zero coupon bonds, variable coupon rate bond, etc. *While financial institutions or corporate bodies issue bonds, debentures and commercial paper, government securities and treasury bills are issued by governments - State or Central.*

The features associated with a debt instrument differentiate it from other instruments. These include coupon/interest rate, redemption/maturity date secured or unsecured put/call option (if any). An Issuer may issue multiple debt instruments by varying the features of the instruments. Any type of debt instrument can be admitted in the depository system. Instruments like bonds, debentures, commercial paper, certificates of deposit, etc., irrespective whether they are listed/unlisted/privately placed or even issued to a single holder, can be dematerialised.

#### **Identification**

Each debt security is given a unique identification in the depository system, which is linked to the special features of the security, through an ISIN and a descriptor. Each instrument is identified separately in the system through a unique code called ISIN. The description of each instrument is communicated / available to all the DPs and Issuers / RTAs through circulars / reports.

#### **Instrument Descriptor**

The instrument descriptor in the depository system indicates:

- Name of the Issuer
- Coupon/Interest Rate
- Security name
- Redemption date
- Face Value

For example, the descriptor 'ICICI BANK LIMITED SR-B98 14.25 UMD 14FB05 FVRS1LAC' indicates:

Issuer Name: ICICI Bank Limited

Coupon Rate: 14.25percent

Instrument Name: Series B98 UMD

Redemption date: 14/02/2005

Face Value: Rs. 1,00,000

In addition to this the depository forwards the complete details of the instrument to all Depository Participants vide circulars.

### ***Admission of Debt Instrument to the Depository System***

An Issuer may offer demat facility for its debt instruments by sending a request to the depositories detailing the type of instrument, along with a Letter of Intent. On receipt of the request, a tripartite agreement is signed between the depository, the Issuer and Registrar & Transfer Agent. Once admitted, these securities are made available for dematerialisation by the depository.

### ***Mode of Operation***

The manner of operation of debt instrument in the depository is identical to that which is followed for the equity segment. *The only difference is that a debt instrument has a limited life.*

### ***Key features***

- *Identification of right ISIN while processing demat/remat requests:* Debt instruments can have exactly the same features. But they are differentiated either by a different coupon rate or redemption date or put/call exercise date or interest payment schedule or by being secured / unsecured.
- *Differentiating between the Letter of Allotment (LOA) and Debenture Certificates:* On issue of secured debentures, the Issuer initially allots LOA till the charges are created. On creation of the charge, debenture certificates are issued in lieu of the LOA. The depository allots the ISIN to a LOA. On creation of charge, the nomenclature of ISIN of LOA is changed to that of a debenture.

For e.g. Descriptor for LOA ISIN - KMPL 9.5 LOA 29DC05 FVRS1LAC is changed to KMPL 9.5 NCD 29DC05 FVRS1LAC LOA UPTO 23MR05.

- *Time value of money*: Debt instruments bear interest. Receiving the credit of a debt instrument into demat account a day earlier, will result in earning one day interest. Therefore, the execution date is crucial while executing any transfer instruction for debt instrument.
- *Redemption date*: On redemption, the ISIN associated with the instrument is de-activated in the depository system.

### ***Allotment in Demat Form***

Any new instrument can be issued directly in dematerialised form. Securities will be directly credited into the accounts of the investor by the depository on receipt of allotment details from Issuer/ Registrar & Transfer Agent.

### ***Corporate Action***

Interest payment for debt instruments is handled in the same way as corporate benefits are handled for equity. Issuer will send interest warrant directly to the investor.

### ***Instruments with Call/Put Option in Demat Form***

Call option, in simple terms, means the Issuer has an option of repaying the debt raised through the instrument at a time earlier than the final redemption date. Put option, in simple terms, means investor has an option of demanding repayment on the debt instrument at a time earlier than the final redemption date. Exercising of call/put option only prepones the redemption date of an instrument. If a company exercises a call option, the procedure followed is the same as one followed in normal redemption. On fulfilling the procedure prescribed, Issuer will send the redemption proceeds to the investor directly.

### ***Investors in Demat Debt Instruments***

The depositories have no restriction on existing accounts being used for demat of debt instruments. It depends upon the convenience of investors whether they want to open a separate account for debt instruments. The procedure for dematerialisation of debt instrument is same as that for equity shares. In order to dematerialize the certificates; an investor has to open an account with a DP. He then requests for the dematerialisation of certificates by filling up a dematerialisation request form (DRF), which is available with DP and submits it along with the physical certificates. The investor has to ensure that before the certificates are handed over to the DP for demat, they are marked as "submitted for dematerialisation". A DP does not provide

a separate Transaction Statement for debt instruments. A single transaction statement reflects all the holdings and transactions in a particular account, irrespective of the type of instrument.

## **11.2 Certificate of Deposit (CD)**

The investor has the choice of holding Certificate of Deposit (CD) in a separate account or all its holdings in one account. The minimum size to be subscribed/ transacted by investor through the depository system is Rs. 1 lakh.

### ***Dematerialisation***

The procedure for dematerialisation of CD is same as that carried out for equity shares. The client will submit a request to the DP, in the DRF, along with the original CD certificate/s to be dematerialised. Before submission, the client/holder has to write on the reverse of the 'CD' (certificate/s) in the space provided for endorsement followed by signature of authorised official of holder;

"SURRENDERED FOR DEMATERIALISATION and credit to my/our demat ACCOUNT. (Account number) with (DP) name /----- number.

The DP would give an acknowledgement (DRF acknowledgement portion) to its client confirming the acceptance of the CD for dematerialisation. Only those CD, which have been made available for dematerialisation by its issuer, can be dematerialised. Direct allotment of Certificates of Deposit can be made in dematerialised form. The procedure followed is identical to that followed for direct credit of equity shares during IPO/ Bonus/ Rights. Investors will have to provide demat account number alongwith DP ID to the Issuer.

### ***Settlement***

The seller authorizes its DP through Delivery Instructions to debit his account and transfer the security into the account of Buyer who may have opened account with the same or any other DP. Buyer receives the said securities in its account immediately if the buyer has given one-time standing instruction to its DP. Settlement of funds between the parties is settled outside the depository.

### ***Redemption***

The Issuer has to open a redemption account with Depository Participant. The Investors holding CDs in demat form will give the delivery instruction slip (DIS) to their respective DPs to transfer the CDs to the Issuers Redemption Account so that the transfer takes place by 3.00 p.m. atleast

two working days prior to the maturity date. On sighting the securities in the redemption account, the Issuer will initiate the steps to pay the investors the redemption proceeds.

The redemption account opened by the Issuer will be the same for all the CDs issued by the Issuer. As per the FIMMDA guidelines, the Issuer will provide the details of the redemption account in the form of a certificate to the first investor of the CD. As per the RBI Monetary and Credit Policy of 2002-03, effective June 30, 2002, banks and FIs require to issue CDs only in the dematerialised form.

### **11.3 Commercial Paper (CP)**

An investor can subscribe to minimum of Rs. 5,00,000 or multiples thereof, as the face value of a Commercial Paper in the depository system is taken as Rs. 5,00,000. The securities (CP) will be credited in the investor's account in terms of units. For eg. If the investor invests 5 crore issue in a CP issue, then 100 units will be credited to his account. The investor has the choice of holding Commercial Paper in a separate account or all its holdings in one account.

#### ***Dematerialisation***

For dematerialisation of CP, the client has to submit the CP alongwith demat request form (which is available with DP) to the DP. Only those commercial papers, which have been made available for dematerialisation by its Issuer, can be dematerialised. After dematerialisation, the transaction statement, received periodically by the client, will reflect all credits in a particular account irrespective of type of instrument. Allotment of Commercial Paper can be made directly in dematerialised form. Investors will have to provide demat account number along-with DP ID to the Issuer. Issuer will provide these details to the Issuing & Paying Agent (IPA). The Issuer will provide the details of the IPA certificate and other documents required by the depository to credit the IPAs CP allotment account one day prior to the value day. On the allotment date, the IPA can transfer the securities from its allotment account to the subscribers account.

#### ***Settlement***

Buyer and seller decide upon price and quantity of securities to be transacted. The seller authorizes its DP through delivery instructions to debit his account and transfer the securities into the account of Buyer who may have opened account with the same or any other DP. Buyer receives the securities in its account immediately if the buyer has provided standing instruction to its DP. Settlement of funds is between the parties and is as per their mutual convenience.

#### ***Redemption***

IPA will open redemption account with the DP at the time of issue of Commercial paper in demat mode. A copy of the IPAs certificate, provided to the beneficial owner by the IPA, contain details of the redemption account. The beneficiary holder should transfer the securities before 3.00 p.m on one working day before the maturity date so as to give sufficient time for the IPA to process the papers and arrange to effect the payment on the due date of the CP. On receipt of confirmation from IPAs to the depository after payment to beneficiary holders, the balance in the redemption account is extinguished by carrying out debit-type corporate action.

On receiving the confirmation from the IPA, the process is initiated by Share Registrar in coordination with the depository. For all secondary market transaction the seller will forward the copy of IPA certificate to the buyer.

As per the RBI Monetary and Credit Policy 2001-02, effective June 30, 2001, banks, financial institutions (FIs), primary dealers (PDs) and satellite dealers (SDs) are permitted to make fresh investments and hold CP only in dematerialised form and outstanding investments in scrip form should also be converted into demat by October, 2001.

For any buying or selling of demat debt instruments, the procedures involved for delivery or receipt of debt instrument is the same as that involved for equity shares.

#### **11.4 Government Securities**

Government security means a security created and issued by the Central Government or a State Government for the purpose of raising a public loan. *There are two types of Government Securities, Dated Securities and Treasury Bills.* Dated Securities have a maturity period of more than one year. Treasury Bills have a maturity period of up to one year. All the activities relating to issue of government securities (G-Secs) - issue management, settlement of trade, distribution of interest and redemption - are handled by the Reserve Bank of India through its Public Debt Office (PDO).

Although only corporate and institutional investors subscribe to government securities, individual investors have also been permitted to subscribe to these securities. An investor in government securities has the option to have securities issued either in physical form or in book-entry form (commonly known as SGL form). There are two types of SGL facilities, viz., SGL-1 and SGL-2.

In the SGL-1 facility, the account is opened with the RBI directly. Only entities, which fulfill all the eligibility criteria prescribed by RBI, are permitted to open SGL-1 account. SGL-1 facility can be used only for own investments of the account holder. Any entity, which is permitted to open SGL-1 account, may avail of SGL-2 facility as well. However, SGL-2 facility is to be used to keep accounts of the constituent investors. In other words, SGL-2 is used to route investments of clients who are not eligible to directly open SGL-1 accounts. The entity which offers SGL-2 facility, has to keep sub-accounts for each investor separately in its books; SGL-2 account with RBI will show the consolidated balances of all account holders.

#### **11.4.1 Specific Features of Dealings in Government Securities**

##### ***Account Opening***

The depositories in India have been given permission to maintain SGL accounts, of investors through its DPs. Any client account opened with a DP may be used for dealing in government securities. Thus, equity shares, mutual fund units and G-Secs can be dealt with through a single account.

##### ***Dematerialisation of Government Securities***

Government securities, like other securities, may be held either in physical form or as electronic entries in an SGL account. They are held in the depository system,

- i. on account of dematerialisation of physical securities; or
- ii. on account of transfer from SGL accounts maintained by other eligible entities; or
- iii. on fresh issue of securities in dematerialised form.

##### ***Dematerialisation of Physical Certificates***

The physical certificates are registered in the name of the holder with any one of the PDOs of RBI. The DP will accept request for dematerialisation from registered holders only. Requests for partial dematerialisation of a certificate are not entertained. The client has to submit a request to the DP in the DRF for G-Secs (DRF-GS) along with following documents<sup>23</sup>:

1. Physical certificates of securities to be dematerialised.
2. Form of Transfer<sup>24</sup>. The DP ensures that the client has filled the following on the DRF-GS:
  - a) Option exercised as 'Submitting Physical G-Sec to ..... (depository name)'

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<sup>23</sup> However, the specification on the form need not be same for all the depositories, such as in case of CDSL, the DRF is the same for G-Sec as used for other securities.

<sup>24</sup> RBI prescribed form to effect transfer of securities held in physical form. The DP ensures that the Form of Transfer is printed on a single sheet of semi security paper. The form can be obtained from the concerned depository through e-mail. Requests for partial dematerialisation of a certificate are not entertained.

- b) Account No.
- c) Account Holder Name
- d) Name of the Security
- e) Face Value of Securities to be Dematerialised (in words and Figures)
- f) Certificate Number

Some of the details as mentioned above may not be required by both the depositories.

ISIN number for a G-sec can be determined by relating the security description available on the physical certificate with ISIN description given by the depository. The following information is available on physical certificates:

- Nomenclature (Description) of the stock, e.g., 13.85percent Government Stock 2001
- Book Debt Certificate No., e.g., BY34 (BY stands for issuing office Bombay)
- Face Value
- Date of redemption
- Date of Issue
- Name of Holder

The DP scrutinizes the form of transfer, the DRF-GS and the certificates which involves the following:

- Compare the order of holders' names on DRF-GS and certificates with the client account.
- Whether the certificate details mentioned on the DRF and the physical certificates enclosed tally.
- Verification of client's signature on the DRF with the specimen signature recorded by the DP during the account opening.
- In case of Trusts and Corporate Bodies, DP shall ensure the registration number of the signatories in the form of transfer is mentioned. Any signature difference may result in rejection of the transfer by RBI.
- ISIN
- Security descriptor
- Whether Face value as mentioned in DRF-GS tallies with what is mentioned on the Certificates

#### **Box 11.1: ISIN**

The DP captures the demat request for the G-sec if the ISIN already exists in the depository system. If the ISIN for that specific G-Sec has not been activated, the DP informs the G-Sec cell of the depository by faxing a standard letter along with a photocopy of the certificate or the SGL credit advice. Based on this communication, ISIN is generated and activated in the depository system. The DP ensures that in case of different Loan Codes the Clients submit separate DRF-GS

and Form of Transfer. If the certificate numbers of the stock are in consecutive order for a single Loan Code, a single Form of Transfer may be used.

On receipt of the certificates, the DP ascertains whether PDO Mumbai or any other PDO has issued the certificates submitted for dematerialisation. In case of certificates issued by a PDO outside Mumbai, the DP will accept them provided the Form of Transfer has been attested by the respective PDOs. On finding the forms and security count in order, the DP issues an acknowledgement slip duly signed and stamped to the client. In case the certificates are mutilated, or they are defaced in such a way that the material information is not readable, the DP does not accept the certificates for dematerialisation.

The DP fills details on the DRF-GS pertaining to ISIN and Loan Code. The DP has to ensure that the ISIN and Loan code are verified at two levels. After verification, the dematerialisation request is entered in the DP system. The DP must ensure that number of the security is entered in the quantity field in the DP system. A dematerialisation request number (DRN) will be generated by the system which has to be entered in the space provided for the purpose in the DRF-GS. A person other than the person who entered the data should verify details entered in the system for the DRN. The DP then releases the request to depository module.

The DP has to endorse on the reverse of the certificate by writing 'Tendered for Cancellation and credit to SGL A/c No. \_\_\_\_\_, Mumbai'. The DP is instructed not to punch holes on the face of G-Secs. This is unlike the procedure for forwarding other securities to the respective R&T. The DP has to despatch the certificates along with the request form after duly authenticating the DRF-GS to the depository, within seven working days of accepting them from the client. The depository fills-in and signs the relevant portion of the Form of Transfer and submit the documents to RBI for credit in the SGL-2 account of the depository. On receiving the necessary confirmation from RBI, the depository confirms acceptance of the request for dematerialisation. The DP informs the client, of the changes in the client's account following the confirmation of the request. During the 'shut period' applicable to Government securities, RBI will not register transfer of securities during this period. Therefore, dematerialisation requests entertained during shut period may take long time to get confirmed.

### ***Objections for demat of Government Securities***

The depository acts as a R&T Agent and discharges RTA functions for G-Secs. On receipt of physical certificates with the DRF-GS and the form of transfer, the G-Sec cell of the depository matches the details provided in the DRF-GS with the electronic message received by the depository's system. In case of a mismatch, the depositories G-Sec cell sends a letter/fax to the

DP intimating them of the mismatch, seeking necessary clarification/documentation from the DP. The DRN is kept pending till such rectification is obtained. The DP does not generate a fresh request in the system until it receives electronic intimation of rejection.

The depository's G-Sec cell also rejects the dematerialisation requests in case RBI rejects the transfer on account of signature mismatch or in case the signatories are not registered with RBI. In such cases, the DP intimates the client of rejection by letter/fax along with the rejection memo sent by the depository's G-Sec cell.

### ***Procedure for Transferring Government Securities in SGL Form to Depository account***

An investor may be holding balances with any other entity in a book entry form (SGL I or II) which the investor may like to transfer into the depository's account. Even this process is handled through dematerialisation module of the depository. The client has to submit a request (DRF-GS) along with a SGL credit advice and a request letter for 'Value free transfer'.

The DP must ensure that the client has filled the following details in the DRF-GS including:

- Entered the option exercised as "Transfer of SGL securities to .....(depository name)" (Not applicable to CDSL)
- Account No.
- Account Holder Name
- Name of the Security
- Face Value of Securities to be Transferred (in words and Figures)

It may be noted here, that each depository may have its own specific requirement details apart from the ones, which have been mentioned above.

The DP should ensure that the SGL account from where the BO wishes to transfer securities to depository's SGL account is registered with PDO at RBI, Mumbai. This is ascertained by examining the prefix to the SGL account number that shall begin with the prefix "BY". The DP has to fill in details of ISIN and Loan Code on the DRF-GS. If the documents are in order, the DP issues an acknowledgement slip duly signed and stamped to the client.

The DP scrutinizes the document / letter of authority (as may be specified by the depositories) and the DRF-GS which involves the following:

- Verification of Clients signature or of the authorised signatory in case of corporates on the DRF-GS with the specimen signature recorded with the DP. If the signature differs, the DP should satisfy himself of the identity of the client.
- Compare the order of holders' names on DRF-GS with the Client account.

- Loan code and Face Value mentioned in the DRF-GS.
- The DP shall scrutinise that in case of different ISIN/Loan Codes separate DRF-GS is submitted by the Clients.
- The DP shall also ensure that the ISIN and Loan code are verified at two levels. After verification, the DRF-GS is entered in the depository system.
- DP must ensure that number of securities is entered in the quantity field in the depository system.
- A DRN will be generated by the system. The DRN so generated is entered in the space provided for the purpose in the DRF-GS.
- A person other than the person who entered the data should verify details entered in the system for the DRN. The request is then released to Depository software system by the DP.
- The DP will fill the relevant portion viz., the authorisation portion of the request form.
- The DP will despatch the DRF-GS along with the other documents within seven working days of accepting the same from client to the Depository G- Sec Cell.
- On receiving the credit confirmation from RBI, the depository's system confirms the request for dematerialisation.
- The depository's system shall credit the client's account automatically.
- The DP may inform the client of the changes in the client's account following the confirmation of the request.
- RBI will not register transfer of securities during the 'Shut Period'. Therefore, dematerialisation requests entertained during shut period may take long time to get confirmed.

### ***Settlement of Depository Trades***

Procedure for transfer of government securities within the depository is exactly similar to that of transfer of equity shares.

### ***Settlement of RBI Trades<sup>25</sup>***

Procedure for purchase or sale of government securities when the counter party has government security balances in book entry form with any other SGL entity may involve the following steps as listed below.

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<sup>25</sup> This facility is not enabled at CDSL as on October 2011.

### Purchase by Depository Client

In case of purchase of government securities by a depository client from a seller holding securities in an SGL account with other eligible entity, the buying client should submit *inter-SGL trade purchase instructions* in the prescribed format to the DP. The client should also make necessary funds available to the depository for the purchase of these securities. The DP, on the basis of the purchase instruction form, executes a dematerialisation instruction for the quantity of security purchased, at least one day prior to the day of trade settlement at RBI. The DP should also forward the purchase instruction form to the depository. On the basis of the documents received from the DP, the depository executes the designated form and submits it to RBI for settlement. On settlement day, the RBI credits the SGL-2 account of the depository and debit its current account for funds. On receiving information about crediting of securities from RBI the depository confirms the receipt of securities to the client.

### Sale by Depository Client

In case of sale of government securities by a depository client to a buyer who maintains an SGL account with other eligible entity, the selling client should submit Inter-SGL Trade Sale Instruction in the prescribed format to the DP. The DP, on the basis of the sale instruction form, executes a rematerialisation instruction for the quantity of security sold, at least one day prior to the day of trade settlement at RBI. The DP also forwards the sale instruction form to the Depository. On the basis of the documents received from the DP, the depository executes the designated form and submits it to RBI for settlement. On settlement day, the RBI debits the SGL-2 account of the depository and credits its current account for purchase consideration. The depository credits the current account of the DP with the sale consideration and intimates the DP accordingly. The DP, on receiving the intimation, credits the amount to the account of the client.

### Corporate Benefits with respect to Government Securities

DP must ensure that changes in the beneficial owner's accounts, such as change in bank details, change of address, etc., are updated well in advance of the due date of interest payment and/or redemption payment due date. The depository should distribute the interest to clients who have balances in government securities, on which interest payment is due, before the EOD of the interest payment due date, after RBI has been made it available to the depository. The depository pays the redemption amount to clients who have balances in government securities, due for redemption, before the EOD of the redemption due date, after the redemption amount has been made available to depository by RBI. The depository makes the payment directly to the clients or to the bank account of the clients as per the instructions received from the clients.

## ***Rematerialisation of Government Securities***

### ***Conversion of securities in Depositories SGL II to Physical Securities***

An investor in government securities holding electronic balances in the depositories SGL-2 account can convert them into physical certificates or to book entry form by the process of rematerialisation. For this, an application has to be made to the depository, through the DP, in the Rematerialisation Request Form (RRF-GS). On receipt of the RRF-GS, the DP checks the form for completeness, correctness and validity. The DP should also ensure that sufficient free security balance is available in the account of the client. If the form is found to be in order and there is sufficient balance, the DP accepts the RRF-GS and blocks the balance of the client to the extent of the requested quantity and intimates the request to the depository. On receipt of such request, the depository blocks the balance of the client in depository system to the extent of quantity sought to be rematerialised. The DP should forward the RRF-GS to the depository within seven days of accepting such request from the client. The depository should forward the rematerialisation request to RBI in the prescribed form in case physical certificate is required by the client.

On receipt of the debit confirmation from RBI, the depositories confirm the acceptance of RRF-GS and forward the physical certificates along with the form of transfer to the client directly. In case the request was for transfer to an SGL account with other eligible entity, the depository should confirm the acceptance of RRF to the DP, after obtaining approval from RBI. On receipt of such confirmation from RBI, the depository removes the balance from the client's account. The DP then informs the client accordingly.

### ***Objections by Depositories Shareholders System for G-SECs***

The depositories G-Sec cell, on receipt of the RRF-GS, matches the Rematerialisation Request Number given on the RRF-GS with the electronic message received by the depository's system linked to its shareholders system. In case of a mismatch, the depositories G-Sec's cell will send a letter/fax to the DP intimating them of the mismatch. The DP has to resolve the mismatch.

## Review Questions

Questions to assess your learning:

1. Who resolves the mismatch during rematerialisation of government securities?

- (a) Depository Participant
- (b) Depositories G-Sec cell
- (c) SEBI
- (d) RBI

Ans: (a)

2. State whether the statement is true or false: An investor in government securities holding electronic balances in the depositories SGL-1 account can convert them into physical certificates by the process of rematerialisation.

- (a) False
- (b) True

Ans: (a)

3. RBI does not register transfer of securities during \_\_\_\_\_.

- (a) Closure Period
- (b) Shut Period
- (c) Lock Period
- (d) Enclose Period

Ans: (b)

4. What is the maturity period of Treasury Bills?

- (a) Upto One year
- (b) Upto 3 months
- (c) Upto 6 months
- (d) More than 10 years

Ans: (a)

## CHAPTER 12: FOREIGN PORTFOLIO INVESTORS (FPI)

### LEARNING OBJECTIVES:

After studying this chapter, you should know about:

- The concept of Foreign Portfolio Investors
- Eligibility criteria for a Foreign Portfolio Investor applying for a Depository Participant.

### 12.1 Introduction

SEBI had issued the notification viz. FPI Regulations, 2014 on January 7, 2014 to put in place a framework for registration and procedures with regard to foreign investors who propose to make portfolio investment in India and vide its Circular No. CIR/IMD/FIIC/02/2014 dated January 8, 2014 issued the operational guidelines for Designated Depository Participants (DDPs) in respect of FPI regime. Subsequently, FPI regime commenced in India from June 1, 2014.

FPI regime offer a single route to various class of foreign investors viz., FIIs, Sub Accounts & QFIs under portfolio investment scheme to converge into one class of foreign investor viz., Foreign Portfolio Investor (FPI). DDPs will do the registration of FPI and will carry out the necessary due diligence process and issue registration certificate to the FPI. All existing FIIs, Sub Accounts & QFIs are deemed to be FPIs from June 1, 2014.

No person shall buy, sell or otherwise deal in securities as a foreign portfolio investor unless it has obtained a certificate granted by the designated depository participant on behalf of the Board. An application for the grant of certificate as foreign portfolio investor shall be made to the designated depository participant in prescribed forms and shall be accompanied by the fee as specified in the regulations.

### 12.2 Eligibility criteria of foreign portfolio investor applying for a Depository Participant:

The designated depository participant shall not consider an application for grant of certificate of registration as a foreign portfolio investor unless the applicant satisfies the following conditions namely, -

- a. the applicant is a person not resident in India;

- b. the applicant is resident of a country whose securities market regulator is a signatory to International Organisation of Securities Commission's Multilateral Memorandum of Understanding or a signatory to bilateral Memorandum of Understanding with SEBI;
- c. the applicant being a bank, is a resident of a country whose central bank is a member of Bank for International Settlements (BIS);
- d. the applicant is not resident in a country identified in the public statement of Financial Action Task Force (FATF) as:
  - 1. a jurisdiction having a strategic Anti-Money Laundering or Combating the Financing of Terrorism deficiencies to which counter measures apply; or
  - 2. a jurisdiction that has not made sufficient progress in addressing the deficiencies or has not committed to an action plan developed with the Financial Action Task Force to address the deficiencies;
- e. the applicant is not a non-resident Indian;
- f. the applicant is legally permitted to invest in securities outside the country of its incorporation or establishment or place of business;
- g. the applicant is authorised by its Memorandum of Association and Articles of Association or equivalent document(s) or the agreement to invest on its own behalf or on behalf of its clients;
- h. the applicant has sufficient experience, good track record, is professionally competent, financially sound and has a generally good reputation of fairness and integrity;
- i. the grant of certificate to the applicant is in the interest of the development of the securities market;
- j. the applicant is a fit and proper person based on the criteria specified in Schedule II of the Securities and Exchange Board of India (Intermediaries) Regulations, 2008; and
- k. any other criteria specified by the Board from time to time.

**Categories of foreign portfolio investor:**

An applicant shall seek registration as a foreign portfolio investor in one of the categories mentioned below or any other category as may be specified by SEBI from time to time:

- (a) 'Category I foreign portfolio investor' which shall include Government and Government related investors such as Central Banks, Governmental agencies, Sovereign Wealth Funds and international or multilateral organisations or agencies;
- (b) "Category II foreign portfolio investor" which shall include:
  - (i) appropriately regulated broad based funds such as mutual funds, investment trusts, insurance/reinsurance companies;
  - (ii) appropriately regulated persons such as banks, asset management companies, investment managers/ advisors, portfolio managers;

(iii) broad based funds that are not appropriately regulated but whose investment manager is appropriately regulated. However, the investment manager of such a broad based fund should itself be registered as Category II foreign portfolio investor. Also, the investment manager should undertake that it shall be responsible and liable for all acts of commission and omission of all its underlying broad based funds and other deeds and things done by such broad based funds under these regulations.

(iv) university funds and pension funds; and

(v) university related endowments already registered with the SEBI as foreign institutional investors or sub-accounts. The applicant seeking registration as an FPI shall be considered to be 'appropriately regulated' if it is regulated or supervised by the securities market regulator or the banking regulator of the concerned foreign jurisdiction, in the same capacity in which it proposes to make investments in India. Further, the 'broad based fund' shall mean a fund, established or incorporated outside India, which has at least twenty investors, with no investor holding more than 49 percent of the shares or units of the fund. If the broad based fund has an institutional investor who holds more than 49 percent of the shares or units in the fund, then such institutional investor must itself be a broad based fund. For ascertaining the number of investors in a fund, direct investors as well as underlying investors shall be considered. In this respect, it should be noted that only investors of entities which have been set up for the sole purpose of pooling funds and making investments, shall be considered for the purpose of determining underlying investors.

(c) "Category III foreign portfolio investor" which shall include all others not eligible under Category I and II foreign portfolio investors such as endowments, charitable societies, charitable trusts, foundations, corporate bodies, trusts, individuals and family offices.

#### **Eligibility criteria of Designated Depository Participant.**

(1) SEBI shall not consider an application for the grant of approval as designated depository participant unless the applicant satisfies the following conditions, namely:

- (a) the applicant is a participant registered with SEBI;
- (b) the applicant is a custodian of securities registered with SEBI;
- (c) the applicant is an Authorised Dealer Category-1 bank authorised by the Reserve Bank of India;
- (d) the applicant has multinational presence either through its branches or through agency relationships with intermediaries regulated in their respective home jurisdictions;
- (e) the applicant has systems and procedures to comply with the requirements of Financial Action Task Force Standards, Prevention of Money Laundering Act, 2002, Rules prescribed thereunder and the circulars issued from time to time by the Board;

- (f) the applicant is a fit and proper person based on the criteria specified in Schedule II of the Securities and Exchange Board of India (Intermediaries) Regulations, 2008; and
- (g) any other criteria specified by SEBI from time to time.

Other than the above stated criteria, SEBI may also consider an application from a global bank, regulated in its home jurisdiction, for grant of approval to act as designated depository participant, if it is satisfied that it has sufficient experience in providing custodial services and the grant of such approval is in the interest of the development of the securities market. However, that global bank should be registered with the SEBI as a participant, custodian of securities, and shall have tie up with Authorised Dealer Category-1 bank.

**Engagement of Designated Depository Participant (DPP)**

Each FPI shall engage a DDP before making investment in Indian securities market. At all times the DDP and the Custodian of Securities (Custodian) of the FPI shall be the same entity.

## Review Questions

1. The Designated Depository Participant and the \_\_\_\_\_ of the Foreign Portfolio Investor (FPI) shall be the same entity.
- (a) Stock Broker
  - (b) Custodian of the Securities
  - (c) Banker
  - (d) R&T Agents

Ans: (b)

2. Which of the following conditions are required to be met for becoming Designated Depository Participant?
- (a) The applicant shall have multinational presence either through its branches or through agency relationships with intermediaries regulated in their respective home jurisdictions.
  - (b) The applicant should be an Authorised Dealer Category-1 bank authorised by RBI.
  - (c) The applicant should be a custodian of securities registered with the Board
  - (d) All of the above

Ans: (d)

3. A resident Indian can also be a Foreign Portfolio Investor. State True or False?
- (a) True
  - (b) False

Ans: (b)

4. Which of the following is considered a Foreign Portfolio Investor?
- (a) Foreign Institutional Investors
  - (b) Sub-Accounts
  - (c) Qualified Financial Institutions
  - (d) All of the above

Ans: (d)

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## Chapter 13: Additional Services - Rajiv Gandhi Equity Savings Scheme, 2012 (RGESS)

### Learning Objectives:

After studying this chapter, you should know about:

- The Rajiv Gandhi Equity Savings Scheme (RGESS)
- How investors can open an account to invest in RGESS through a Depository Participant

### 13.1 About Rajiv Gandhi Equity Savings Scheme, 2012

With an objective to encourage flow of savings of the small investors in domestic capital market, the Government of India (GOI) announced a scheme named Rajiv Gandhi Equity Savings Scheme, 2012 (RGESS) vide its notification dated November 23, 2012 to offer tax benefits to 'New Retail Investors'. Subsequent to the Union Budget 2013-14, Section 80CCG was amended vide Finance Act, 2013, to expand the scope of the Scheme. The notification dated 23 November, 2012 was accordingly amended vide Notification dated 18 December 2013 (Section No. 3693 (E); Notification No.94).

Under RGESS, 'New Retail Investors' will be eligible for additional tax benefit (i.e. deduction) upto Rs.25,000 under Section 80CCG upto a maximum investment Rs.50,000 made in eligible securities.

'New retail investor' must be a resident individual, who has a gross income less than or equal to Rs.12 lakh. Further, such an investor does not have a demat account or in case has a demat account then should not have done any transactions in equity or derivatives as on RGESS account opening / designation date. In case, the demat account is opened as first holder and there are no transactions in the equity or derivative segment then such a demat account is eligible. In case of joint accounts, the second/third holder/nominees are eligible as new retail investors irrespective of transactions done in such demat accounts.

In the Union budget 2013, the RGESS was further liberalised to enable first time retail investors to invest in mutual funds and listed shares not in one year alone, but for three successive years.

## 13.2 Investing in RGESS

Eligible investor will be required to submit specified form to the Depository Participant at the time of account opening or designating his/her existing demat account for taking the benefits under RGESS. Investor will be required to invest in eligible securities considered for RGESS investment, which are follows:

- a. Equity shares of selected companies which includes:
  - 1) Companies falling in the list of 'CNX-100' of NSE or 'BSE-100'
  - 2) Public sector enterprises categorised by the Central Government as Maharatna, Navratna or Miniratna.
- b. Units of Mutual Fund (MF) schemes which are RGESS compliant.
- c. Units of Exchange Traded Funds (ETFs) which are RGESS compliant
- d. Follow-on public offers (FPOs) IPOs and New Fund Offers (NFOs) of above mentioned companies/funds.

Investors can invest in eligible securities through Secondary Market (i.e., by approaching any SEBI registered Stock Broker of your choice), Mutual Funds (i.e., by approaching any Mutual Fund distributor or a SEBI registered Stock Broker) or IPO / NFO of RGESS compliant companies/funds). Investors will be required to ensure to provide demat account details i.e., Demat Account Number and DP ID on the concerned applicable form.

The mode of holding eligible securities will be in a demat account. Other securities (viz., equity shares, debentures, bonds, mutual fund units, etc.) can also be held in the demat account designated for RGESS. Further, if investors do not wish certain securities credited to their demat accounts to be considered for the RGESS, then they will be required to submit declaration in a prescribed format within one month from the date of transaction.

Investment holding period under RGESS is for three years which includes 'Fixed Lock-in' of one year and 'Flexible lock-in' of two years. Declared eligible securities are not allowed to sell, pledge or hypothecate eligible securities during 'Fixed Lock-in' period. During flexible Lock-in, eligible securities can be sold subject to certain conditions. The designated RGESS demat account will be converted into a regular or ordinary demat account at the end of the flexible lock-in period.

The Depository will furnish an Annual Statement of the eligible securities invested in or traded through the RGESS demat account to the investor i.e., demat account holder.

## Review Questions

Questions to assess your learning:

1. Under RGESS, 'New Retail Investors' will be eligible for additional tax benefit upto Rs.25,000 under Section 80CCG upto a maximum investment Rs.50,000 made in eligible securities. State whether True or False?  
(a) True  
(b) False

Ans: (a)

2. Eligible investor will be required to submit specified form to the Depository Participant at the time of account opening or designating his/her existing demat account for taking the benefits under RGESS. State whether True or False?  
(a) False  
(b) True

Ans:(b)

3. Investors do not wish certain securities credited to their demat accounts to be considered for the RGESS, then they will be required to submit declaration in a prescribed format within \_\_\_\_\_ month from the date of transaction?  
(a) 5  
(b) 2  
(c) 1  
(d) 3

Ans:(c)

4. The Depository will furnish a quarterly statement of the eligible securities invested in or traded through the RGESS demat account to the investor. State whether True or False?  
(a) True  
(b) False

Ans:(b)

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## Chapter 14: Additional Services - Basic Services Demat Account (BSDA)

### Learning Objectives:

After studying this chapter, you should know about various aspects of the Basic Services Demat Account:

- Eligibility conditions for opening BSDA
- Annual Maintenance Charges
- Services offered to BSDA Holders

### 14.1 Introduction

With a view to achieve wider financial inclusion, encourage holding of demat accounts and to reduce the cost of maintaining securities in demat accounts for retail individual investors, depository participants (DPs) are required to make available a "Basic Services Demat Account" (BSDA) with limited services as per terms specified herein. In order to facilitate the eligible individuals to avail the benefits of BSDA, DPs are advised to convert all such eligible demat accounts into BSDA unless such Beneficial Owners (BOs) specifically opt to continue to avail the facility of a regular demat account.<sup>26</sup>

### 14.2 Eligibility Conditions for Opening BSDA

Individuals shall be eligible to opt for BSDA subject to the following conditions:

- a. All the individuals who have or propose to have only one demat account where they are the sole or first holder.
- b. Individuals having any other demat account/s where they are not the first holder shall be eligible for BSDA in respect of the single demat account where they are sole or first holder.
- c. The individual shall have only one BSDA in his/her name across all depositories.
- d. Value of securities held in the demat account shall not exceed Rupees Two Lakhs at any point of time.

**Option to open BSDA:** The DP shall give option:

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<sup>26</sup> SEBI Circular Ref No. CIR/MRD/DP/ 20 /2015 Dated December 11, 2015.

- a. To open BSDA to all eligible individuals who open a demat account after the date of applicability of SEBI circular CIR/MRD/DP/22/2012 dated August 27, 2012;
- b. To all the eligible individuals to avail the benefits of BSDA, and convert all such eligible demat accounts into BSDA unless such Beneficial Owners (BOs) specifically opt to continue to avail the facility of a regular demat account.

### **14.3 Annual Maintenance Charges:**

- a. The charge structure may be on a slab basis as indicated below:
  1. No Annual Maintenance Charges (AMC) shall be levied, if the value of holding is upto Rs. 50,000.
  2. For the value of holding from Rs 50,001 to Rs 200,000, AMC not exceeding Rs 100 may be charged.
- b. The value of holding shall be determined by the DPs on the basis of the daily closing price or NAV of the securities or units of mutual funds, as the case may be. Where such price is not available the last traded price may be taken into account and for unlisted securities other than units of mutual funds, face value may be taken in to account. For the purpose of valuation of holdings in an account, it is clarified that the value of suspended securities may not be considered for the purpose of determining eligibility of demat account as BSDA.
- c. If the value of holding in such BSDA exceeds the prescribed criteria at any date, the DPs may levy charges as applicable to regular accounts (non- BSDA) from that date onwards.
- d. The DPs shall reassess the eligibility of the BOs at the end of every billing cycle and give option to the BOs who are eligible to opt for BSDA.

### **14.4 Services offered to Basic Services Demat Account Holders:**

- a. **Transaction statements:**
  1. Transaction statements shall be sent to the BO at the end of each quarter. If there are no transactions in any quarter, no transaction statement may be sent for that quarter.
  2. If there are no transactions and no security balance in an account, then no further transaction statement needs to be provided.
  3. Transaction statement shall be required to be provided for the quarter in which the account became a zero balance account.
- b. **Holding Statement:**

1. One annual physical statement of holding shall be sent to the stated address of the BO in respect of accounts with no transaction and nil balance even after the account has remained in such a state for one year. The DP shall inform the BO that the despatch of physical statement may be discontinued if the account balance remains zero balance even after one year.
  2. One annual statement of holding shall be sent in respect of remaining accounts in physical or electronic form as opted for by the BO.
- c. **Charges for statements:** Electronic statements shall be provided free of cost. In case of physical statements, the DP shall provide at least two statements free of cost during the billing cycle. Additional physical statement may be charged at a fee not exceeding Rs.25/- per statement.
  - d. **SMS Alert facility:** All BOs opting for the facility of BSDA, shall register their mobile number for availing the SMS alert facility for debit transactions.
  - e. **Delivery Instruction slip:** At least Two Delivery Instruction Slips (DIS) shall be issued at the time of account opening.
  - f. All other conditions as applicable to regular demat accounts, other than the ones mentioned above shall continue to apply to basic services demat account.

## Review Questions

Questions to assess your learning:

1. What is the eligibility criterion for opening a Basic Services Demat Account (BSDA)?
  - (a) The individual shall have only one BSDA in his/her name across all depositories.
  - (b) Value of securities held in the demat account shall not exceed Rupees Two Lakhs at any point of time
  - (c) Both of the Above
  - (d) None of the above

Ans:(c)

2. Electronic statements of the BSDA sent to Beneficial Owners are charged at the rate of Rs. 25 per statement. State whether True or False?
  - (a) True
  - (b) False

Ans:(b)

3. How many Delivery Instruction Slips (DIS) are issued to the BO's at the time of opening the BSDA?
  - (a) 1
  - (b) 2
  - (c) 3
  - (d) 4

Ans:(b)

4. All BOs opting for the facility of BSDA, shall register their mobile number for availing the SMS alert facility for debit transactions. State whether True or False?
  - (a) True
  - (b) False

Ans:(a)

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