

# **CRITICAL ANALYSIS AND EVALUATION OF THE CENTRAL DEPOSITORY COMPANY OF PAKISTAN AND ITS SYSTEM**



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Requirements for the degree of MASTER OF LAWS (CORPORATE LAW)  
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*In the International Islamic University, Islamabad*

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*In the name of Allah, the Most Merciful, the Most Kind.*

## ***FINAL APPROVAL***

It is certified that we have evaluated the dissertation submitted by, registration No 231-FSL/LLMCL/F09 on "Critical analysis and evaluation of the central depository company and its system" in Faculty of Shari'ah & Law. It is our Judgment that this dissertation is of sufficient standard and scope to warrant its acceptance by the International Islamic University for the award of LL.M. Corporate Law degree.

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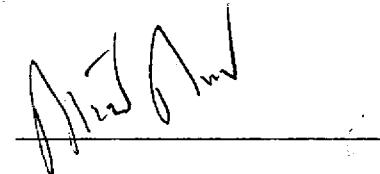


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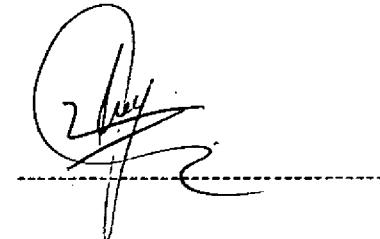
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2012*

***DECLARATION***

I, Hafiz Shahid Javed, hereby declare that the work in this dissertation was carried out in accordance with the Regulations of the International Islamic University. The work is original except where indicated by special reference in the text and no part of the dissertation has been submitted for any other degree. The dissertation has not been presented to any other University.

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(March, 2012)

## ***PREFACE***

The successful completion of this Dissertation was a unique experience for me because by visiting many place and interacting various person, I achieved a better knowledge about this system. The experience which I gained by doing this dissertation was essential at this turning point of my carrier this project is being submitted which contains detailed analysis of the research undertaken by me. The research provides an opportunity to the student to devote his/her skills knowledge and competencies required during the technical session. The research is on the topic "Critical analysis and evaluation of the Central Depository Company of Pakistan and its System".

## ***DEDICATION***

*This thesis is dedicated to Allah Almighty,  
my Parents and rest of my family for their love, endless support  
and encouragement.*

## ACKNOWLEDGMENT

Saying of Prophet Muhammad (PBUH):

“A person who is not thankful to his benefactor is not thankful to ALLAH”

First and foremost, all and every kind of praises is upon Allah Almighty. I humbly thank to Allah almighty for bestowing me with powers to complete this task. Allah has made my life more bountiful. All and every kind of respect to His Holy Prophet Muhammad (Peace Be Upon Him) for unique comprehensive and everlasting source of guidance and knowledge for humanity.

I would like to express my sincere gratitude to my Supervisor Mr. Attaullah Khan Mahmood for the trust deposited in my work and for his patience, motivation, enthusiasm, and immense knowledge. His guidance helped me in all the time of research and writing of this thesis. I could not have imagined having a better advisor and mentor for my LLM study.

Last but not least, my deepest gratitude goes to my family for their unflagging love and support throughout my life. This dissertation is simply impossible without them.

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## ACRONYMS

BB	Bank of Baroda
BI	Bank of India
BO	Beneficial Owner
CCASS	Central Clearing and Settlements System
CCS	Central Certificate Service
CDC	Central Depository Company
CDS	Central Depository System
CDSL	Central Depository Services Ltd
CSD	Central Securities Depository
CSDL	Central Securities Depository Limited
CMO	Central Money markets Office
DPs	Depository Participants
DRF	Dematerialization request form
DTC	Depository Trust Company
DTCC	Depository Trust & Clearing Corporation
DVP	Delivery vs. Payment
ETC	Electronic Trade Confirmation System
EU	European Union
FSA	Financial Services Authority
FSMA	Financial Services and Markets Act
IAS	Investor Account Services
IBM	International Business Machines
IDBI	Industrial development Bank of India
IFM	India's financial markets
ISM	Indian Securities Markets
ISE	Islamabad Stock Exchange
KSE	Karachi Stock Exchange
LSE	Lahore Stock Exchange
MCB	Muslim Commercial Bank
MMIs	Money Market Instruments
MIP	Master Implementation Plan

NCC	National Clearing Company
NCDS	National Clearance and Depository Systems'
NSCC	National Securities Clearing Corporation
NSDL	National Securities Depository Ltd
NSE	National Stock Exchange
NRIs	Non Resident Indians
R&TA	Registrar and Transfer Agents
SBI	State Bank of India
SCHCIL	Stock Holding Corporation of India Limited
SEBI	Securities and Exchange Board of India
SECP	Securities and Exchange Commission of Pakistan
SMAC	Salinas Monterey Agility Center
SRS	Share Registrar Services
T&C	Trustee & Custodial Services
UK	United Kingdom
USA	United States of America
USAID	United States Agency for International Development
USRs	Uncertificated Securities Regulations
UTI	Unit trust of India

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## **ABSTRACT**

# **CRITICAL ANALYSIS AND EVALUATION OF THE CENTRAL DEPOSITORY COMPANY OF PAKISTAN AND ITS SYSTEM**

Supervisor: Attaullah Khan Mahmood

Submitted By: Hafiz Shahid Javed

In the old system, shareholders had to worry when they sent shares for registration to the company. It was immaterial whether the shares were sent by registered post or through courier; one had to keep fingers crossed till the duly transferred shares certificates were properly received by the concerned shareholder. The depository system and dematerialized securities offer paperless trading and transfer of shares through the use of technology. It enables processing of share trading and transfers electronically without involving share certificates and transfer deeds, thus eliminating the paper work involved in scrip-based trading and share transfer system. More specifically, it can refer to a company, bank or an institution that holds and facilitates the exchange of securities. Or a depository can refer to a depository institution that is allowed to accept monetary deposits from customers. Since the shares are in demate mode, it is much easier

for the investor to keep records. On the other hand, the share certificates which are in dematerialization form are cancelled and the same will not be sent back to the investor. The shares, represented by dematerialized share certificates are fungible and, therefore, certificate numbers and distinctive numbers are cancelled and become non-operative. The Brokers on their account do their best but still they make some legal faults and the investors have to face many problems due to these mistakes.

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 benefited the issuer companies, in terms of reduced costs and the effort expended in managing their shareholder populace.

My whole thesis is divided into four chapters which are as follows:

Chapter 1 gives the precise description about the term Depository and historical background of the dematerialization. The intermediaries of depository system and its models are also discussed here. There are some similarities and differences between Bank and Depository which will be discuss here and further more discuss about the Central Depository system and its origin in Pakistan.

Chapter 2 will focus on the global approach of Central Depository system. There will be discussion about four countries like U.K, U.S.A, Canada and. In these countries depository have its roots. Acts and Regulations in these countries on depository system will also be discussed here.

# **CRITICAL ANALYSIS AND EVALUATION OF THE CENTRAL DEPOSITORY COMPANY OF PAKISTAN AND ITS SYSTEM**

## **INTRODUCTION:**

Central Depository System plays a fundamental role in providing electronic custody of financial instruments and enabling efficiency, reliability and security of the transactions on the instruments. They can manage transactions such as the book entry transfers of financial instruments from the seller to the buyer against the transfers of funds from the buyer to seller. CDS provides the services including dematerialization of existing scrips, dematerialization of new issues, reliable and efficient settlements, rematerialization and safe keeping of scrips, account information to investors and companies.

A depository holds securities in electronic forms and provides all services related to transactions of shares/ debt instruments. A depository interacts with clients through a depository participant with whom the client has to maintain a D-mat account. The main objectives of depository systems are to accelerate scrip less trading, to make trust in individual investor's participation in depository system and to create a competitive environment so as to be responsive to the user's interest and concern.

The aim of Central Depository system is immobilization of physical certificates. This is done by means of book entries with central depository who keeps custody of all physical certificates as a first step. As a next step, new issues will be made as book entries only and not as physical certificates. Book entries transfers lead to quicker transfers and at lower costs. It meets the increasing work load of investment activity and dealings to the increasing volume of transfer work.

Whenever securities are bought and sold, transfer of name has to take place. Earlier, when the securities were in the physical form, it used to take a lot of time as it was a cumbersome process. Investors faced many problems because the whole process was time consuming and sometimes the securities never reached its destination. These problems were solved as all securities were changed into demat form which helped in quick transfer of securities and also eliminate the fear of theft, mutilation etc.

A centralized Depository System offers economies of scale in the clearing and settlement of transactions. In many cases, the depository and book-entry system for government securities has been centralized in the central bank; however, private sector institutions also perform this function in some countries. Examples of countries with a centralized depository in the central Bank include Ireland, Italy, Japan, Mexico, Newzealand, Pakistan, the United Kingdom, and the United States. Countries with a private sector owned depository institution include Canada (Canada Depository for securities) and Sweden (Swedish Securities Register Center, VPC AB); in Argentina, the government has an agreement with a private institution (Caja de Vafores SA) to register public securities. In France, the central bank (Saturne System) is the depository institution for treasury bills and notes while for treasury bonds, a private company (Pairs Bourse SICOVAM Clearinghouse) is the depository system operating Book-entry system. Euroclear (in Brussels, Belgium) and Clear stream (in Luxembourg) are the second and third largest central securities depositories in the world.

Because the central banks of the countries are interested and they want to make the system of transactions of securities efficient, many private sectors are interested in making the depositories and where private sectors have these depositories; these are coordinated with the central banks. This coordination is sought to ensure the security in the transactions.

As opposed to most misconceptions, trading activities and other practices like “badla”, borrowing or lending of shares, short selling and blank selling are independent of the workings of the CDS. This system is simply an electronic vehicle to facilitate the delivery, settlement and transfer of securities. Trading practices in securities will remain as they were before. Investors can still instruct their brokers to buy or sell, settlement and clearing will continue as per the existing system. Electronic book entry deliveries can still be made by the participants and not by the CDC staff. There are group accounts which replace the current “benami” accounts. The CDC will not check short selling or blank selling. It is not the CDC's job to interfere in transactions, only to ensure that deliveries are made on time, and that payments are made.

In our country securities such as equity shares, preference shares, bonds and treasury bills are being issued at present in the form of paper certificates. They are called scrip securities. In a depository system an organization which holds such securities electronically in a computer based system without a paper certificate which is called scrip less securities. Prior to dematerialization there was almost a gap of three months between application date and listing of shares. Dematerialization has reduced this gap to a great extent. But quick money brings with itself a host of problems. Depositories have with them reliable and accurate records of ownership of shares. There is a registry which tells that by whom these shares are owned. The depository has the record of share holdings of all market players i.e participants. If there happens a transaction then the depository records the share transfer from seller to buyer in its register. This system reduces human intervention and the need for physical verification of securities thus resulting in the enhancement of efficiency. The lengthy and tedious activities undertaken by issuers at the time of book closure, is eliminated. Issuers need no longer be concerned with the dispatch and

dispatch and printing of certificates at the time of new allotments or at the time of distribution of bonus and right issues.

The Karachi Stock Exchange (KSE) , the Lahore Stock Exchange (LSE), the Islamabad Stock Exchange (ISE) are all mutualized, i.e. owned by their members, most of whom are brokers, creating a conflict of interest in their role as self-regulatory organizations. The SECP is the apex regulator. Custody services are provided by the Central Depository Company (CDC), and clearing and settlement services by the National Clearing Company. These three stock exchanges are still using the physical system of deliveries and settlement. This age-old system may have had its advantages at one time but now, with the increased trading volumes, the risk of malpractice like forgeries, theft of shares as well as the fear of loss had made this system redundant.

## CHAPTER 1

### INTRODUCTION AND HISTORICAL BACKGROUND

Dematerialization<sup>1</sup> helps to overcome many problems as well as reduces the transaction time as compared to physical segment.<sup>2</sup> Now a days the word "Demat" becomes a very common word. The institutional and individual investors spread all over Pakistan are found to be making an extensive use of the depository participant services for holding their securities in electronic form. This chapter is about the introduction of depository system and its historical background. And will also discuss about its models and briefly discuss about the central depository company and its evolution in Pakistan. There are many similarities among the performance of a bank and a depository system although some difference between them this chapter gives detailed information about these similarities and differences. This chapter simply emphasizes on the book entry system and its objectives and intermediaries of depository system.

#### 1.1 Depository:

A depository is an organization where the securities of an investor are held in electronic form and carries out the securities transaction by book entry and facilitates the transfer of ownership of securities on the settlement dates. In other words, a depository is a file or set of files in which data is stored for the purpose of safe keeping or identity authentication. Depository in very simple terms means a place where something is deposited for safe keeping.<sup>3</sup> Holders of demat

<sup>1</sup> Dematerialization is the process by which physical share certificates of an investor are converted to an equivalent number of securities in electronic form and credited into the investor's account maintained with his/her depository participant (DP). It is like having a bank account where instead of money, you hold securities in your account.

<sup>2</sup> G. Vasudha, "Dematerialization: An introduction" Available at <[http://www.indianmba.com/Faculty\\_Column/FC435/fc435.html](http://www.indianmba.com/Faculty_Column/FC435/fc435.html)> (Last accessed March 1, 2012).

<sup>3</sup> V S Rama Rao, "Depository System" (December 10, 2008), Available at <<http://www.citeman.com/4579-the-move-on-depository-system-in-india.html>> (Last accessed January 25, 2012).

shares enjoy rights i.e. dividend, voting rights etc. like any other shareholder holding shares in physical form. A depository has also been defined as:

“A bank or company which holds funds or securities deposited by others, and where exchanges of these securities take place”<sup>4</sup>

“The party of the institution (e.g bank or trust company) receiving a deposit. One with whom anything is lodged in trust, as ‘depository’ is the place where it is put. The obligation upon the depository is that he keeps the thing with reasonable care and upon request restores it to the depositor.”<sup>5</sup>

“Depository is an entity that holds securities. It holds no physical certificates but communicates with companies, or their agents, by electronic means. Depository participants are usually banks and brokerage houses who have a direct link with the depository”<sup>6</sup>

Depository is defined as:

1. Person or firm entrusted with safekeeping of funds, securities, or other valuable assets.
2. Storage in which something is placed to be taken out later. In comparison, a repository is meant for indefinite or permanent placement.<sup>7</sup>

Depository system is secure, in the sense that only authorized persons or institutions can gain access to the data it contains. However, experience has shown that many depositories, no matter how secure they claim to be, can be compromised by a determined hacker or thief.<sup>8</sup>

The concept behind depository system is paperless or scrip less trading because shares in a depository are held in the form of electronic accounts that is, in dematerialized form. This system

<sup>4</sup> “Definition of Depository” Available at <<http://www.investorwords.com/1413/depository.html>> (Last accessed November 4, 2011).

<sup>5</sup> Definition from Black’s Law Dictionary.

<sup>6</sup> “Services Provided by a Depository” (January 31, 2009), Available at <<http://www.managementheaven.com/depository1/>> (Last accessed January 25, 2012).

<sup>7</sup> “Definition of Depository” Available at <<http://www.businessdictionary.com/definition/depository.html>> (Last accessed November 4, 2011).

<sup>8</sup> A project report on “Working of Depository System” Available at <[http://www.slideshare.net/ps342\\_mpast/working-ofdepositorysystem](http://www.slideshare.net/ps342_mpast/working-ofdepositorysystem)> (Last accessed January 27, 2012).

is to some extent is just same like to open an account in a bank. Bank holds money on behalf of the investor and the investor has to open an account with bank to utilize its services.<sup>9</sup>

## 1.2 Historical Background of Dematerialization:

The earlier settlement system in Pakistan stock exchanges was very inefficient because they were unable to take care of the transfer of securities in a speedy manner. To wipeout these problems, the Depositories Act was passed. The basic purpose behind the formation of this Act was to ensure free transferability of securities with speed, accuracy & security.<sup>10</sup>

During the late eighties, the common man used to stay away from the Stock market because of the sheer complexity of the paperwork involved in trading at the market. This resulted in a very low mobilization of funds in the market. Besides this, the paper based system also gave rise to a number of problems duplication of shares, fake signatures, signature mismatches and transfer problem. Stock certificates became the major reason for rising arbitration cases and investor disputes.

The congress government initiated financial reforms in the early nineties, stock exchanges and financial institutions realized that the paper based system were not be able to keep up with the rapid growth which the economy would witness in times to come. There was a need to bring in more investors in the market for greater mobilization of funds, which would feed the economy growth of the country.

<sup>9</sup> V S Rama Rao, "Depository System" (December 10, 2008), Available at <<http://www.citeimap.com/4579-the-move-on-depository-system-in-india.html>> (Last accessed January 25, 2012).

<sup>10</sup> Operations of Depository Participant "CBSE - Introduction to Financial Markets - II" Available at <[http://cbse.nic.in/fmm-12/FMM%2011\\_Chapter%208.pdf](http://cbse.nic.in/fmm-12/FMM%2011_Chapter%208.pdf)> (Last accessed March 1, 2012).

### **1.3 Intermediaries of Depository System:**

The major intermediaries of Depository System are as follows:

#### **1.3.1 Depository:**

Depository is the apex entity which maintains records of shares in electronic form of all companies. A depository is a firm where the securities of an investor are held in electronic form in the same way a bank holds money.

#### **1.3.2 Depository Participant (DP):**

Depository Participant is the link between the Depository and the Shareholder. Depository Participant maintains the accounts of shareholders in electronic form and a unique registration number called the Depository Participant ID provided to depository participant.

#### **1.3.3 Beneficial Owner (BO):**

Beneficial Owner is the owner of shares in demat form. Upon opening of a demat account with Depository Participant, the Beneficial Owner is given an account number called the Client ID. The combination of Depository Participant Id and Client Id is a unique identification Id of each holder of demat account.

### **1.4 Depository Models:**

Basically there are two types of Depository models which are as follows:

#### **1.4.1 Dematerialization:**

Dematerialization is the process of converting shares or securities from physical form into electronic form. All dealings and holdings are recorded electronically in an account.<sup>11</sup> There is

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<sup>11</sup> L.C.B. Gower et al., *Gower's Principles of Modern Company Law*, 5<sup>th</sup> Edition (London: Sweet & Maxwell Ltd., 1992), 391.

no any physical scrip exist in this model. "Neither the individual nor the depositor keeps scrip". Normally the securities held in dematerialized form are fungible, that is to say they do not bear any distinguishing features.<sup>12</sup> The process of dematerialization "involves allotting securities (in stock market trading) directly to an electronic record format rather than on physical paper".<sup>13</sup>

There are some advantages of dematerialization like it is least costly in implementation, simple and efficient, quick in implementation and generally in keeping with the world wide Industry trends. On the other hand, there are also some disadvantages of this system like it presents a total departure from existing practices prevailing in the country at present and thus difficult to gain individual acceptance overnight.<sup>14</sup>

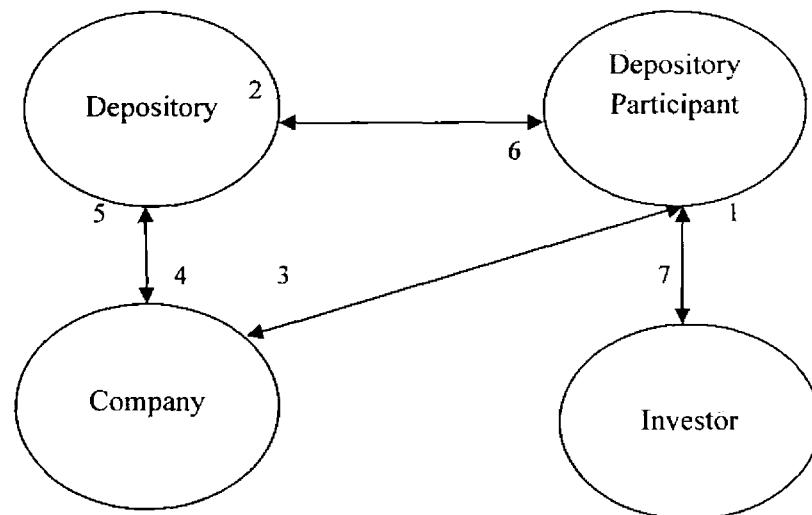


Figure 1: The Dematerialization Process

In brief, the following steps are involved for joining the system:

1. Investor has to approach a depository participant of his choice and open an account by surrendering the certificates.

<sup>12</sup> Irene Martinez-Calcerrada, "Note on Statutory Dematerialization across the European Union" (August 2005) Available at <[http://ec.europa.eu/internal\\_market/financial-markets/docs/certainty/background/30\\_8\\_5\\_martinez-calcerrada\\_en.pdf](http://ec.europa.eu/internal_market/financial-markets/docs/certainty/background/30_8_5_martinez-calcerrada_en.pdf)> (Last accessed January 18, 2012).

<sup>13</sup> Preetam Kaushik, "Dematerialization of Shares" Available at <<http://preetam-kaushik.suite101.com/dematerialization-of-shares-a86548>> (Last accessed February 1, 2012).

<sup>14</sup> K. Sekhar, *Guide to SEBI Capital Issues, Debentures & Listing*, 2<sup>nd</sup> Edition (India: Law Publishers, 1996), Vol. 2, 2576.

2. Depository Participant sends electronic message to the Depository of the request of the investor for dematerialization.
3. He also intimates to the company and the certificates are sent to the company for confirmation and cancellation.
4. Company confirms the request from the Depository.
5. Company cancels the physical certificates and records the name of the depository as the "registered owner"
6. Depository completes the dematerialization process and credits the accounts of the investor and informs the participant.
7. Depository participant, in turn, updates the account and informs the investor.

#### 1.4.2 Immobilization:

In immobilization the physical certificates of share holders are deposited in the depository custody which supports the book entry record on computer. Immobilization entails securities in paper form and the use of depositaries, which are linked to a settlement system. Securities constituted by paper instruments or represented by paper certificates are immobilized in the sense that they do not move and are held by the depository at all times.<sup>15</sup> The main advantage of this model is that "it represents the least variation from the current practices and, therefore, least susceptible to resistance to change from the public". But on the other hand this system also gives disadvantages like high cost (in terms of capital and operational requirements) higher level of systematic risk and long gestation period.<sup>16</sup>

<sup>15</sup> Irene Martínez-Calcerrada, "Note on Statutory Dematerialization across the European Union" (August 2005) Available at [http://ec.europa.eu/internal\\_market/financial-markets/does/certainty/background/30\\_8\\_5\\_martinez-calcerrada\\_en.pdf](http://ec.europa.eu/internal_market/financial-markets/does/certainty/background/30_8_5_martinez-calcerrada_en.pdf) (Last accessed January 18, 2012).

<sup>16</sup> K. Sekhar, *Guide to SEBI Capital Issues, Debentures & Listing*, 2<sup>nd</sup> Edition (India: Law Publishers, 1996), Vol: 2, 2576.

### 1.4.3 Rematerialization of shares:

Re-materialization is the process of converting shares from electronic form into physical form. After re-materialization, the shareholder is given the share certificate covering the shares, hitherto held by him in electronic form.<sup>17</sup>

### 1.5 Objectives of the Book Entry System:

In this system there is no requirement of certificates for investors to hold their securities or in other words there is no any existence of certificates in this system. In this system there is no need to keep physical certificates.

“Securities that are recorded in electronic records called book entries rather than as paper certificates”<sup>18</sup>

“A system used to record who owns shares, bonds, etc. when each owner is not given a certificate”<sup>19</sup>

In other words book-entry system is an electronic register and processing system for shares and other securities and comprises book-entry securities accounts and lists of owners. Book-entry securities accounts include data on the owners of book-entry securities, and their types and quantities.<sup>20</sup>

Objectives behind the book entry system are given as below:

1. It Provides participants in the market for Government securities with a format for securities without physically holding certificates that is, dematerializing the securities.
2. Participants in the system are entitled to statements of their holdings after every

<sup>17</sup> L.C.B. Gower et al., *Gower's Principles of Modern Company Law*, 5<sup>th</sup> Edition (London: Sweet & Maxwell Ltd. 1992), 391.

<sup>18</sup> “*Investopedia definition*” Available at <<http://www.investopedia.com/terms/b/bookentrysecurities.asp#axzz1o23gIMOR>> (Last accessed March 2, 2012).

<sup>19</sup> “*Cambridge Business English Dictionary*” Available at <<http://dictionary.cambridge.org/dictionary/business-english/book-entry>> (Last accessed March 2, 2012).

<sup>20</sup> “*Proventia's shares in the book-entry system*” Available at <[http://www.proventia.com/sivu/en/about\\_us/book-entry\\_system/](http://www.proventia.com/sivu/en/about_us/book-entry_system/)> (Last accessed March 2, 2012).

transaction, on a monthly basis and upon demand.

3. It Eliminates the need to print and manually handle securities and the risk of papers being lost or miss placed is therefore eliminated.
4. It Reduces the amount of time needed to deliver securities and if it is linked to the Settlement System it reduces the amount of time needed to settle and altogether minimize settlement risk.
5. Exemption from stamp duty
6. Its efficiency is expected to stimulate secondary market activities and facilitate open market operations.
7. It makes it easy for commercial banks to pledge bills to the central Bank.
8. This system creates a competitive environment in secondary market.<sup>21</sup>

## 1.6 Similarities and differences between a bank and a Depository:

There are some similarities among bank and depository which are as follows:

1. Both are promoted by persons and institutions of repute and good standing.
2. Both renders services like safe keeping of the money (funds) and securities (shares, bonds, debentures etc.) of customers in book entry form.
3. The requirement of both systems is to verify the identity and address of the customer before opening a bank account.
4. Both charge some fees for their services like account maintenance, remittances, safe custody, dematerialization, pledging, transaction charges etc.

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<sup>21</sup> "Book Entry system" Available at  
<<https://www.bon.com.na/content/toplevelitems/BankOperations/Financial%20Markets/FMbookentry.aspx>> (Last accessed January 2, 2012).

5. Both facilitate transfer of funds between two banking institutions (through clearing) and transfer of ownership of securities within the depository (transfer) and also between two depositories (Inter Depository transfer).
6. Both needs express written consent of the customer (like a cheque) for debiting his account and from the account holder for debiting his account.
7. Both accounts hold by Power of attorney.
8. In banks, customer is entitled to get a statement of account from the branch periodically. An account holder is entitled to get a statement of demat account periodically from the DP.
9. Both provide nomination facility.

These are some differences among Bank and a Depository.

Banks	Depository
Allocation of Account number	Allocation of Client ID number
It holds funds in accounts	It holds Securities in accounts
In the bank account, there is no requirement of execution of an agreement between the bank and account holder at the time of opening the account	In demat account, the beneficial owners is required to sign a DP-BO agreement before opening the demat account.
A bank is entitled to use funds lying in the savings or current deposit accounts of the customers in the normal course of business and pays interest to them for the use.	A depository is not entitled to use the securities lying in the demat accounts of the customers and hence does not pay any interest to them.
A customer having an account with a bank is called as an Account Holder.	An account holder of the depository is called as Beneficial Owner (of the securities).

A bank account can be operated upon "jointly", or, by "either or survivor" of the account holders or by "any one/two/three of", the joint account holders.	A demat account can be opened, operated upon only by all the account holders Jointly, at present.
In the bank account, addition or deletion of name(s) of one or more of the account holders is permitted.	In the demat account, addition or deletion of name(s) of one or more of the account holders (beneficial owners) is not permitted.
For opening a bank account, such as a savings bank account, a minimum balance has to be deposited along with the account opening form.	A demat account is opened by an investor without any securities, i.e. with zero balance.
Functions through Branches	Functions through depository participants
Issues account statement & pass book.	Issues account statement i.e. statement of holding and statement of transactions
Provides interest to the account holders	In future, through stock lending, it will be possible to earn income on Depository Account.

Figure 2: Difference between Banks and Depository

### 1.7 Central Depository Company:

CDC is the sole entity which handles electronic settlement of transactions. These transactions are carried out in all three exchanges of the country.<sup>22</sup> The basic purpose of establishment of this company was to run the Central Depository System (CDS) for financial instruments that are transacted in our Capital Market. With the passage of time and development of Pakistan's Capital Market, Central Depository Company now also provides services that are beyond the traditional depository services.<sup>23</sup> Chapter 13 of Central Depository Company of Pakistan Limited Regulations (CDC Regulations) provides that Central Depository Company conducts a periodic

<sup>22</sup> "CDC" Available at <<http://www.cdpakistan.com/>> (Last accessed November 20, 2011).

<sup>23</sup> Available at <<http://www.scribd.com/doc/24886796/Central-Depository-company-of-Pakistan>> (Last accessed December 12, 2011).

conducts a periodic audit of back office records of the broker in order to monitor compliance with the CDA 1997 and the CDC Regulations.<sup>24</sup>

### 1.7.1 Evolution of central Depository Company in Pakistan:

In 1993, The Central Depository Company of Pakistan Limited was established to operate the Central Depository System on behalf of the financial services industry.<sup>25</sup> In September 1997, the Company started its operations to provide efficient delivery, settlement, and transfer of securities transactions through a computerized book entry system.<sup>26</sup>

In 1993 experts from “Price Waterhouse Coopers” conducted a study to develop a conceptual framework for the depository. The mentioned study was supported and aided by United States Agency for International Development (USAID) whose report became basis for the establishment of our depository.<sup>27</sup>

In September 3, 1997, for getting an experience of scripless trading the Central Depository started on line work with MCB. Their aim was that the company will gradually add more scrips but if all goes according to schedule than all listed companies will have been shifted to the depository by June 1998. Than this system will be run and maintained by the Central Depository Company of Pakistan Limited (CDC). The main services performed by the CDC are efficient

<sup>24</sup> International Monetary Fund, “*Staff Country Reports*” Available at <http://books.google.com.pk/books?id=ih0DF71OGz8C&pg=PT50&dq=central+depository+company+in+pakistan&hl=en&sa=X&ei=w-EKT6ndlozPrQfRw6XxDw&ved=0CEwQ6AEwBQ#v=onepage&q=central%20depository%20company%20in%20pakistan&f=false> (Last accessed January 9, 2012).

<sup>25</sup> Chwee Huat Tan, “*Dictionary of Asia Pacific business terms*” Available at <http://books.google.com.pk/books?id=KjCgmXhNPsmC&pg=PA51&dq=central+depository+company+in+pakistan&hl=en&sa=X&ei=w-EKT6ndlozPrQfRw6XxDw&ved=0CDYQ6AEwAQ#v=onepage&q=central%20depository%20company%20in%20pakistan&f=false> (Last accessed January 9, 2012).

<sup>26</sup> Alison Harwood, “*Building local bond markets: an Asian perspective*” Available at <http://books.google.com.pk/books?id=YF8-GKo-NgsC&pg=PA186&dq=central+depository+company+in+pakistan&hl=en&sa=X&ei=w-EKT6ndlozPrQfRw6XxDw&ved=0CDwQ6AEwAg#v=onepage&q=central%20depository%20company%20in%20pakistan&f=false> (Last accessed January 9, 2012).

<sup>27</sup> *Ibid.*

delivery, settlement and transfer of securities transactions through computerized book entry system. "Securities will not physically change hands but the transfer of securities from one counterpart to another is completed electronically".<sup>28</sup>

### 1.8 Central depository system:

The central depository system is an electronic book entry system which records and transfers securities and also records their transfer's registration. Without any transfer deed or physical movement this system changes the ownership of securities. This system is operated and maintained by the Central Depository Company of Pakistan.<sup>29</sup> Central Depository Company is recognised and supported by specific legislation.<sup>30</sup> In other words Central Depository Company may be called as a Shares Bank.<sup>31</sup> This system maintains the account of each and every single holder of securities.<sup>32</sup>

The reason behind the move on of paper less securities trading is to enhance efficiency in the existing secondary market by removing threats connected with scrip based securities. On line trading is convenient for all market participants i.e. primary dealers, banks and investors. This is very secure system for all the holders of securities. The payment for securities or settlement of funds in paperless securities is transacted immediately on real time.<sup>33</sup>

<sup>28</sup> Khurram Baig, "The Central Depository goes online" (1997), Available at <<http://www.pakistaneconomist.com/database2/cover/c97-24.asp>> (Last accessed January 9, 2012).

<sup>29</sup> A Presentation on "Key impacts of participant insolvency on the Central Depository System of the Central Depository Company of Pakistan Limited" Presented by: Rasool Hooda, Manager Legal & Compliance. 11th ACG Cross Training Seminar, 2-5 July 2009 Dhaka, Bangladesh.

<sup>30</sup> The legislation on Central depository system is the Central Depositories Act, 1997 (CD Act).

<sup>31</sup> "Islamabad Stock Exchange" Available at <<http://www.isc.com.pk/InvestorGuideCDS.asp>> (Last accessed December 12, 2011).

<sup>32</sup> "Lanka Secure" Available at <[http://www.chsl.gov.lk/pics\\_n\\_docs/10\\_pub/\\_docs/pa/booklet/bl\\_4.pdf](http://www.chsl.gov.lk/pics_n_docs/10_pub/_docs/pa/booklet/bl_4.pdf)> (Last accessed January 11, 2012).

<sup>33</sup> Gobinda Sharma Gairhe, "Central Depository System" (January 1, 2010) Available at <<http://gobindasharma.blogspot.com/2010/01/central-depository-system.html>> (Last accessed January 12, 2012).

## **1.9 Account Structure in Central Depository System:**

In Central depository system all participants trade for their clients. These participants are limited to the institutions of securities such as stock brokers, financial institutions and some qualified private investors. The participants of Company or the account holders of CDC settle their transactions within the Central Depository System through five types of accounts, namely:

### **1.9.1 Main Account:**

A main account allocated to each account holder. This account used as a transit account for movement of securities. Any security which is coming in or moving out of an account holder's family of accounts passes through this account in other words this account is used as a transit account for movement of securities.

### **1.9.2 House Account:**

This system is used for securities owned beneficially by Account Holders and by participants. It is optional to hold a house account and any number of such accounts may be created by a participant.

### **1.9.3 Sub-account (Client Account):**

This account is used for holding securities owned individually by each of the clients of an Account Holder. On behalf of their clients an account holder when he requires may open and maintain any number of subaccounts.

#### **1.9.4 Group Client Account:**

This account is used for holding securities which are owned beneficially by the client of the Account Holder. This account is used for Clients who do not want to avail the facility of opening separate sub-accounts. The Account Holder maintains all such clients in his Group account. The detailed division of the securities kept by each client of such a group will be kept by the depository participant and CDC will hold no such type of record.

#### **1.9.5 Cash Account:**

Every person holding an account in the system, who chooses to avail himself the facility of Delivery vs. Payment (DVP), will be required to deposit, in advance, a rolling settlement fund to be used for the settlement of his DVP obligations.<sup>34</sup> The remaining balance of the participant's rolling settlement amount will be kept stored in this account.

### **1.10 Elements of CDS:**

These elements of Central depository system have a defined role as the system is run or operated by them without direct involvement of CDC on daily basis.<sup>35</sup> These elements are given as below:

#### **1.10.1 Account Holder / Participant:**

Account Holders are beneficial owner and divided into two categories which are account holders and participants. They can directly approach to the CDS. Participants provide custody services to their clients. On the other hand account holders keep only their beneficially owned securities in this system. Different accounts are maintained by the participants for every account,

<sup>34</sup> Ejaz Ali Shah, "A walk through the Central Depository System." Available at <<http://www.pakistaneconomist.com/database2/cover/e97-8.asp>> (Last accessed January 17, 2012).

<sup>35</sup> Available at <<http://www.scribd.com/doc/18682143/What-is-Central-Depository-System>> (January 3, 2012)

holder and securities are kept separate and not mixed up with the securities of the other account holders. "Securities will be transferred from one account to another in the CDS on a request made by a customer through the relevant CDS participant in a specified manner prescribed by law".<sup>36</sup>

### 1.10.2 Issuer (Security):

Securities are held in the CDS in electronic form in either Accounts or Sub Accounts.

"Securities that are recorded in electronic records called book entries rather than as paper certificates".<sup>37</sup>

The issuers of securities declared as eligible to be held in dematerialized form should enter into an agreement with a depository. After a security is declared eligible for the purpose of Central Depository System, necessary software and CDS connection is provided to that particular issuer upon signing an agreement with CDPs. After proper verification by the issuers the shares are entered into CDS.

Security process in CDS is divided into three major parts:

1. Declaration of Securities as CDS Eligible Securities
2. Set up of Securities in CDS
3. Deposit or Credit of Securities into CDS

The securities of company can easily be interchanged with any other security of the same company, as the distinctive number of the security does not matter for example Rs. 100 note can

<sup>36</sup> Gobinda Sharma Gairhe, "Central Depository System" (January 1, 2010) Available at <<http://gobindasharma.blogspot.com/2010/01/central-depository-system.html>> (Last accessed January 12, 2012).

<sup>37</sup> "Definitions" Available at <<http://www.investopedia.com/terms/b/bookentrysecurities.asp#axzz1iLBJu02G>> (Last accessed January 2, 2012).

be interchangeable with any other note of Rs.100.<sup>38</sup>

### 1.10.3 Eligible Pledgee:

From any financial institution any holder of securities can pledge his securities as collateral for loans obtained by the holder. Like in the case of sales and transfers. A Beneficial owner who wants to create pledge on his securities should firstly apply to the CDC via the depository participant who will make a written note in its records of the acknowledgment of pledge and send the application to the CDC within the time authorized or prescribed by law. The statements issued by the Central Depository System may be used as evidence of holding of securities.<sup>39</sup>

The control over the pledged securities moves to eligible pledgee until the securities are released. If there are any benefits, they will still be given to the Pledgor. Eligible pledgees can demand the call of the pledged securities in another account if they so wish.<sup>40</sup>

### 1.11 Corporate actions handled by the CDC:

Corporate actions handled by the CDC in the following manner:

#### 1.11.1 Notice of meetings:

Notice of meeting should be given to its shareholders at least 21 days before the meeting. The depository prepares a list of beneficial owners in which all the relevant details are mentioned.

<sup>38</sup> Khurram Baig, "The Central Depository goes online" (1997), Available at <<http://www.pakistaneconomist.com/database2/cover/c97-24.asp>> (Last accessed January 9, 2012).

<sup>39</sup> Gobinda Sharma Gairhe, "Central Depository System" (January 1, 2010) Available at <<http://gobindasharma.blogspot.com/2010/01/central-depository-system.html>> (Last accessed January 12, 2012).

<sup>40</sup> *Ibid.*

### **1.11.2 Dividends:**

The report which is prepared by Central Depository Company prepared on the last day before the start of the book closure period announced by the concerned company. These lists will be sent to the relevant issuer or his nominated R/ TA, and dividends will be given or divided accordingly.

### **1.11.3 Bonus Shares:**

In case of bonus shares, on the receipt of information from the company issuer, the CDC will increase the standing position held by each participant by the amount of bonus shares which are issued.

### **1.11.4 Rights Issues:**

Rights of issuers are being dealt in the same manner similar to bonus shares. Beneficial owners are credited automatically with their entitlements. This ensures that trading in “unpaid rights” can start immediately.

### **1.11.5 Share Sub-division & Consolidation:**

In the case of share sub-division & consolidation, the Central Depository Company calculates the new share balances which the shareholders in the Depository System will be entitled to, based on their existing share holdings. When the sub-division or consolidation is granted or approved by the issuer, a program is run which replaces the old balances with the new share balances.<sup>41</sup>

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<sup>41</sup> Khurram Baig, “The Central Depository goes online” (1997), Available at <<http://www.pakistaneconomist.com/database2/cover/c97-24.asp>> (Last accessed January 9, 2012).

## CHAPTER 2

### GLOBLA APPROACH TO CENTRAL DEPOSITORY SYSTEM

Dematerialization took place in different countries with different processes. In this Chapter I am going to focus on different countries like United Kingdom, Unites States, Canada and India in which depository system plays an important role in their capital markets and I will also discuss their relevant laws regarding depository system.

#### 2.1 United Kingdom:

There is an increasing trend in the UK towards the removal of scrip based share handling and settlement i.e the “the process of dematerialization” of shares. Because entry on the register of the company governs title the certificate is superfluous.<sup>42</sup> From a very long time the main objective of government was to promote a more competent market in financial services and so far as the European Union is concerned they support London as the leading financial centre. In reality with the “implementation of the CREST settlement system in 1996 some 80% of UK transactions were effectively dematerialized and shareholders able to benefit from the efficiency of electronic settlement and custody of their shareholdings”. Ireland and United Kingdom both use the CREST system. The financial markets of UK do not have fully dematerialized its share trading system. On the other hand Ireland enacted the relevant legislation on the

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<sup>42</sup> David Warne, Nicholas Elliott, “Banking litigation” Available at <http://books.google.com.pk/books?id=hAsncxE70dEC&pg=PA218&dq=dematerialisation+of+shares+in+Uk&hl=en&sa=X&ei=Az8pT5PQFIGj-gbgpdmjBQ&ved=0CC0Q6AEwAA#v=onepage&q=dematerialisation%20of%20shares%20in%20Uk&f=false> (Last accessed February 1, 2012).

securities but waiting for the UK because there is a significant overlap with the same registrars operating in both countries.<sup>43</sup>

### 2.1.1 Evolution:

In the UK, the question was first addressed on dematerialization of securities in the late 1980s. There was a proposal by a Jack Committee<sup>44</sup> on the immobilization of securities. The report of the committee said that "the requirement was for legislation which reproduced, in relation to screen based trading, the effects that the Bills of Exchange Act 1882 produced for scrip based trading".<sup>45</sup>

Committee recommended new legislation which would:

".....contain provisions giving to transactions taking place in a screen based or book entry depository (or dematerialized) system...the same status as equivalent transactions in negotiable instruments generally"<sup>46</sup>

The recommendations of the committee were not adopted instantaneously. But the changes which had been predicted on this system are implemented to some extent. In the year 1990, the Bank of England started to provide a service called as immobilized trading service for MMIs by Means of its Central Money markets office (CMO). This depended on the presence of physical instruments kept by a central depository, and these instruments were traded handled and settled between members of the CMO in book entry form. These arrangements were regulated by the

<sup>43</sup> Robert M Blank, "Dematerialisation of Shares in the UK and Ireland" Available at <<http://www.icsa.org.uk/assets/files/pdfs/Policy/Demat3.pdf>> (Last accessed February 1, 2012).

<sup>44</sup> The Review committee on banking services Law and Practice (usually called "The Jack Committee") was asked to consider proposal for an immobilized system in which negotiable instruments would be held by a central depository and thereafter traded electronically.

<sup>45</sup> Colin Bamford, "Principles of International Financial Law" Available at <<http://books.google.com.pk/books?id=c7IFjSvTvEQC&pg=PA171&dq=central+depository+system+in+UK&hl=en&sa=X&ei=N-QoT9Uajo37BpypnJkF&ved=0CFwQ6AEwCQ#v=onepage&q=central%20depository%20system%20in%20UK&f=false>> (Last accessed February 2, 2012).

<sup>46</sup> *Ibid.*

regulations of the system, which were agreed by the members through their mutual consent through a contract.<sup>47</sup>

Finally in 2003, the “move to full dematerialization” took place. The experience of United Kingdom regarding MMIs proves that a “move to full dematerialization” have no need to involve the legal complexities that have long been assumed. The dematerialization of the international bond market is perhaps, a much easier process than has long been thought.<sup>48</sup>

### **2.1.2 Legislations:**

The dematerialization of equities and other corporate securities was made possible by regulations made under Section 207 of the Companies Act 1989, the Uncertificated Securities Regulations (USRs) 1995. Those regulations were amended in June 2000 to permit the integration of UK government stock (gilts) into CREST. The USRs were re-enacted with modifications in November 2001 to allow the introduction of electronic transfer of title. CREST is subject to regulation by the FSA, both as an RCH under the FSMA 2000 and as the Operator of a relevant system under the 2001 USRs. The merger with Euroclear has not affected the regulatory status.

#### **2.1.2.1 Companies Act 1989:**

The legal basis for dematerialization in United Kingdom is the Companies Act 1989. According to section 207 which empowers the Treasury to make regulations “to enable title to securities to be evidenced and transferred without a written instrument”, and the Uncertificated

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<sup>47</sup> *Ibid.*

<sup>48</sup> *Ibid.*

Securities Regulations 2001 made under that section.<sup>49</sup>

### 2.1.2.2 Uncertificated Securities Legislation 2001:

Euroclear UK and Ireland Limited is, according to the uncertificated Securities Regulations 2001, obliged to enter on the register of uncertificated shares the names and addresses of members holding uncertificated shares in the CREST system. If anyone infringed the obligations which are mentioned in these regulations than that matter will be dealt according to section 113 of the Companies Act.<sup>50</sup>

### 2.1.2.3 Uncertificated securities (Amendment) Regulations 2003:

The provisions of the Companies Act 1989 section 207, which had permitted the trading of equity shares in dematerialized form, were used to authorize the making of the uncertificated securities (Amendment) Regulations 2003. Under these regulations, obligations including the obligations of HM Treasury in respect of treasury bills may be created in dematerialized form, and entered into the CREST trading system, the same system that is used for the holding of, and settlement of trades in, UK equity securities. No legislation was thought to be needed, in order to replicate the advantages given to negotiable instruments, because the statutory protection conferred on transfers within CREST was sufficient in practice.<sup>51</sup>

<sup>49</sup> David Warne, Nicholas Elliott, “*Banking litigation*” Available at <<http://books.google.com.pk/books?id=hAsncxE70dEC&pg=PA218&dq=dematerialisation+of+shares+in+UK&hl=en&sa=X&ei=Az8pT5PQFIGl-gbgpdmjBQ&ved=0CC0Q6AEwAA#v=onepage&q=dematerialisation%20of%20shares%20in%20UK&f=false>> (Last accessed February 1, 2012).

<sup>50</sup> Organisation for Economic Co-operation and Development, “*Global forum on transparency and exchange of information for Tax purpose*” Available at <<http://books.google.com.pk/books?id=7DQ-SF6Ak2MC&pg=PA42&dq=euroclear+UK+and+Ireland+Limited&hl=en&sa=X&ei=qe0oT9HsOYOf-QbhzfyqBQ&ved=0CEkQ6AEwBQ#v=onepage&q=euroclear%20UK%20and%20Ireland%20Limited&f=false>> (Last accessed February 1, 2012).

<sup>51</sup> Colin Barnford, “*Principles of International Financial Law*” Available at <<http://books.google.com.pk/books?id=cZlFiSyTyEQC&pg=PA171&dq=central+depository+system+in+UK&hl=en&sa=X&ei=N-QoT9Uajo37BpvpnJkF&ved=0CFwQ6AEwCQ#v=onepage&q=central%20depository%20system%20in%20UK&f=false>> (Last accessed February 2, 2012).

### 2.1.3 Euroclear UK & Ireland Limited:

In the UK and Ireland the Central Securities Depository is Euroclear UK & Ireland Limited.<sup>52</sup> Euroclear UK & Ireland Ltd was previously known as CRESTCo, which was capitalized in October 2004. It is the United Kingdom's only central securities depository (CSD). It is part of the Euroclear group, based in Brussels, which also includes the CSDs of Belgium, Finland, France, Sweden and the Netherlands. Euroclear is completely user owned and user governed.<sup>53</sup> In September 2002, CRESTCo Ltd was acquired by Euroclear. As of 1 July 2007, CRESTCo Ltd has changed its legal and operating name to Euroclear UK & Ireland Ltd. Securities held by Euroclear UK & Ireland Ltd are dematerialized and thus recorded in electronic form.<sup>54</sup> Euroclear UK & Ireland Limited provides real-time securities settlement services to corporate and individuals in the United Kingdom and Ireland.<sup>55</sup>

#### 2.1.3.1 CREST:

The project on CREST was launched in 1993. In 1994, the CREST was created and began its settlements in august 1996.<sup>56</sup> The inauguration of CREST was held in 15 July 1996.CREST

<sup>52</sup> Francis Groves, "Corporate Actions" Available at <<http://books.google.com.pk/books?id=ZLVEVQTWFwoC&pg=PA50&dq=dematerialisation+of+shares+in+Uk&hl=en&sa=X&ei=Az8pT5PQFIGI-egbpdmjBQ&ved=0CFMQ6AEwBg#v=onepage&q=dematerialisation%20of%20shares%20in%20Uk&f=false>> (Last accessed February 2, 2012).

<sup>53</sup> Alexander Davidson, "How the global financial markets really work" Available at <[http://books.google.com.pk/books?id=ShY3\\_mtpO5kC&pg=PA197&dq=euroclear+UK+and+Ireland+Limited&hl=en&sa=X&ei=qe0oT9HsOYOF-QbhzfvqBQ&ved=0CDkQ6AEwAg#v=onepage&q=euroclear%20UK%20and%20Ireland%20Limited&f=false](http://books.google.com.pk/books?id=ShY3_mtpO5kC&pg=PA197&dq=euroclear+UK+and+Ireland+Limited&hl=en&sa=X&ei=qe0oT9HsOYOF-QbhzfvqBQ&ved=0CDkQ6AEwAg#v=onepage&q=euroclear%20UK%20and%20Ireland%20Limited&f=false)> (Last accessed February 1, 2012).

<sup>54</sup> Erica Johansson, "Property Rights in Investment Securities and the Doctrine of Specificity" Available at <[http://books.google.com.pk/books?id=9\\_8UW\\_H72NsC&pg=PA49&dq=euroclear+UK+and+Ireland+Limited&hl=en&sa=X&ei=qe0oT9HsOYOF-QbhzfvqBQ&ved=0CC0Q6AEwAA#v=onepage&q=euroclear%20UK%20and%20Ireland%20Limited&f=false](http://books.google.com.pk/books?id=9_8UW_H72NsC&pg=PA49&dq=euroclear+UK+and+Ireland+Limited&hl=en&sa=X&ei=qe0oT9HsOYOF-QbhzfvqBQ&ved=0CC0Q6AEwAA#v=onepage&q=euroclear%20UK%20and%20Ireland%20Limited&f=false)> (Last accessed February 1, 2012).

<sup>55</sup> "Capital Markets" Available at <<http://investing.businessweek.com/research/stocks/private/snapshot.asp?privcapId=5646544>> (Last accessed February 1, 2012).

<sup>56</sup> Francis Groves, "Corporate Actions" Available at <<http://books.google.com.pk/books?id=ZLVEVQTWFwoC&pg=PA50&dq=dematerialisation+of+shares+in+Uk&hl=en&sa=X&ei=Az8pT5PQFIGI-egbpdmjBQ&ved=0CFMQ6AEwBg#v=onepage&q=dematerialisation%20of%20shares%20in%20Uk&f=false>> (Last accessed February 2, 2012).

system is operated by Euroclear UK & Ireland. CREST is the settlement system for a wide range of UK, Irish and international securities (including Equities, Gilts and Funds). Through personal membership the investors have opportunity to hold their securities in electronic form in their own name.<sup>57</sup> CREST is a system which in other words can say as “dematerialized electronic share settlement system” which is developed by London Stock Exchange. Since July 1996, this system had been operated in UK and Ireland by Crest Co Ltd “which itself was owned by a range of CREST users”.<sup>58</sup> There are two different countries (the UK and Ireland) in which CREST contributed its experience with two different currencies, on one platform.<sup>59</sup>

CREST allows its shareholders and bondholders to hold their assets in a dematerialized, i.e. electronic form, rather than holding physical share certificates.<sup>60</sup> Now a days only listed companies need to have uncertified shares. In all other companies, shares are certificated.<sup>61</sup>

“By holding securities as well as maintaining an electronic clearing system, Crest can provide for same-day clearing of securities transactions if needed. Its overall ability to provide a fast transfer of title for the securities it handles is its most important advantage to investors”<sup>62</sup>

<sup>57</sup> “Euroclear UK & Ireland Limited” Available at <[http://www.apcims.co.uk/findafirm/profile.php?member\\_id=676](http://www.apcims.co.uk/findafirm/profile.php?member_id=676)> (Last accessed February 1, 2012).

<sup>58</sup> David Warne, Nicholas Elliott, “Banking litigation” Available at <<http://books.google.com.pk/books?id=hAsncxE70dEC&pg=PA218&dq=dematerialisation+of+shares+in+Uk&hl=en&sa=X&ei=Az8pT5PQFIGI-gbgpdmjBQ&ved=0CC0Q6AEwAA#v=onepage&q=dematerialisation%20of%20shares%20in%20Uk&f=false>> (Last accessed February 1, 2012).

<sup>59</sup> Peter Norman, “*Plunbers and visionaries: securities settlement and Europe's financial market*” Available at <<http://books.google.com.pk/books?id=UD3on0PC0PQ&pg=PA234&dq=euroclear+UK+and+Ireland+Limited&hl=en&sa=X&ei=ge0oT9HsOYOf-QbhzfqBQ&ved=0CD4Q6AEwAw#v=onepage&q=euroclear%20UK%20and%20Ireland%20Limited&f=false>> (Last accessed February 2, 2012).

<sup>60</sup> “Euroclear UK & Ireland Limited (CREST)” Available at <<https://www.uk.computershare.com/investor/faqs2.asp?hj=1&fla=0&category=%7B1FC96636-C0EF-4D77-A811-F0B0AE700F85%7D>> (Last accessed February 1, 2012).

<sup>61</sup> L. Sealy, Sarah Worthington, “*Cases and Materials in Company Law*” Available at <<http://books.google.com.pk/books?id=VK3JtxpWAXQC&pg=PA441&dq=dematerialisation+of+shares+in+Uk&hl=en&sa=X&ei=Az8pT5PQFIGI-gbgpdmjBQ&ved=0CEEQ6AEwAw#v=onepage&q=dematerialisation%20of%20shares%20in%20Uk&f=false>> (Last accessed February 2, 2012).

<sup>62</sup> “CREST” Available at <<http://www.investopedia.com/terms/c/crest.asp#ixzz1kRX41QH5>> (Last accessed January 24, 2012).

Companies still have a choice to hold its securities in uncertified form, and there is also an option for any individual holder of the securities to hold his or her securities in one form or the other.<sup>63</sup>

There are three ways for investors to hold shares in CREST:

- a. In the congenital way, investors can continue to hold share certificates in their own name. CREST, though, provides facilities for investors holding certificates to sell their shares or for buyers to receive certificates if they wish to.
- b. Through a nominee account operated by a bank, custodian or stock broker which is a member of CREST.
- c. "Sponsored membership" meaning that shares are held electronically in the name of the individual investor, but the operation of the electronic interface with CREST is carried out by a bank or stockbroker appointed by the investor.<sup>64</sup>

Until 2001, CREST did not itself maintain any register of holders, but merely provided a settlement system and an instruction to the company to amend its share register accordingly. An entry in the company's register remained evidence of title in the same way as if the entry related to certificated securities. Since 2001, CRESTCo has maintained an operator register (separate from the company's own register), and registers the transfers immediately they occur. The

<sup>63</sup> L. Scaly, Sarah Worthington, "Cases and Materials in Company Law" Available at <<http://books.google.com.pk/books?id=VK3JtxpWAXQC&pg=PA441&dq=dematerialisation+of+shares+in+UK&hl=en&sa=X&ei=Az8pT5PQFIGI-ghgpdmjBQ&ved=0CEEQ6AEwAw#v=onepage&q=dematerialisation%20of%20shares%20in%20UK&f=false>> (Last accessed February 2, 2012).

<sup>64</sup> David Warne, Nicholas Elliott, "Banking Litigation" Available at <<http://books.google.com.pk/books?id=hAsnxE70dEC&pg=PA218&dq=dematerialisation+of+shares+in+UK&hl=en&sa=X&ei=Az8pT5PQFIGI-ghgpdmjBQ&ved=0CC0Q6AEwAA#v=onepage&q=dematerialisation%20of%20shares%20in%20UK&f=false>> (Last accessed February 1, 2012).

operator register is *prima facie* evidence of the title to uncertificated shares (just as the company's register is for certificated shares).<sup>65</sup>

CREST also serves a number of other important functions, such as assisting in the payments of dividends to shareholders. It provides advanced, low-cost settlement facilities for a wide range of corporate and government securities, including those traded on the London and Irish Stock Exchanges.<sup>66</sup> CREST provides a settlement system for simultaneous transfer of title and payment. Legal title to the shares is recorded electronically by CREST and transactions between members of CREST are governed by the CREST rules.<sup>67</sup>

### 2.1.3.2 CMO:

This system is used for money markets which include T-bills, bank Bills and CDs. In October 1990, CMO was firstly opened by the Bank of England. The Bank of England acts as a depository for immobilize securities for CMO system.<sup>68</sup> CMO provides a central depository and electronic book entry transfer system for real non-fungible<sup>69</sup> money market instruments. This system eliminates the handling of paper between members and also provides a quick, efficient

<sup>65</sup> L. Scaly, Sarah Worthington, "Cases and Materials in Company Law" Available at <<http://books.google.com.pk/books?id=VK3JtxpWAXQC&pg=PA441&dq=dematerialisation+of+shares+in+UK&hl=en&sa=X&ei=Az8pTSPQFIGI-gbgpdmjBQ&ved=0CEEQ6AEwAw#v=onepage&q=dematerialisation%20of%20shares%20in%20UK&f=false>> (Last accessed February 2, 2012).

<sup>66</sup> "Euroclear UK & Ireland" Available at <[https://www.euroclear.com/site/public/EUI/!ut/p/c5/dY7BcoIwFEW\\_xQ9w3iMjCysEvgigK2g6YTQfQZilhaYvjKE-vHdeeuzx3eUDAc6a-KIflDW1heqE-V7xX5NE4I84x6SjbiNkYUujiwikIKS2zfnZsra7MRt!FrHdMC5QJwIJt0uuonRvgyhL9LQ39J4vOmwl9vAt682118v6qMS801bjkxinVabY-cxxWITlUxjmK-5xwMd6cfFDx8Huef7wIz1ffPMujGU\\_8XvCzP68viGAGGT2P4EP12D51kweQAtVrFo/dl3/d3/l.2dIQSEvUUt3QS9ZQnZ3l.zZfNjVRU0w3SDIwOFZMODAvVEFQOVRPRDAwSjM!/">https://www.euroclear.com/site/public/EUI/!ut/p/c5/dY7BcoIwFEW\\_xQ9w3iMjCysEvgigK2g6YTQfQZilhaYvjKE-vHdeeuzx3eUDAc6a-KIflDW1heqE-V7xX5NE4I84x6SjbiNkYUujiwikIKS2zfnZsra7MRt!FrHdMC5QJwIJt0uuonRvgyhL9LQ39J4vOmwl9vAt682118v6qMS801bjkxinVabY-cxxWITlUxjmK-5xwMd6cfFDx8Huef7wIz1ffPMujGU\\_8XvCzP68viGAGGT2P4EP12D51kweQAtVrFo/dl3/d3/l.2dIQSEvUUt3QS9ZQnZ3l.zZfNjVRU0w3SDIwOFZMODAvVEFQOVRPRDAwSjM!>](https://www.euroclear.com/site/public/EUI/!ut/p/c5/dY7BcoIwFEW_xQ9w3iMjCysEvgigK2g6YTQfQZilhaYvjKE-vHdeeuzx3eUDAc6a-KIflDW1heqE-V7xX5NE4I84x6SjbiNkYUujiwikIKS2zfnZsra7MRt!FrHdMC5QJwIJt0uuonRvgyhL9LQ39J4vOmwl9vAt682118v6qMS801bjkxinVabY-cxxWITlUxjmK-5xwMd6cfFDx8Huef7wIz1ffPMujGU_8XvCzP68viGAGGT2P4EP12D51kweQAtVrFo/dl3/d3/l.2dIQSEvUUt3QS9ZQnZ3l.zZfNjVRU0w3SDIwOFZMODAvVEFQOVRPRDAwSjM!/) (Last accessed February 1, 2012).

<sup>67</sup> David Warne, Nicholas Elliott, "Banking Litigation" Available at <<http://books.google.com.pk/books?id=hAsncxE70dEC&pg=PA218&dq=dematerialisation+of+shares+in+UK&hl=en&sa=X&ei=Az8pTSPQFIGI-gbgpdmjBQ&ved=0CC0Q6AEwAA#v=onepage&q=dematerialisation%20of%20shares%20in%20UK&f=false>> (Last accessed February 1, 2012).

<sup>68</sup> International Monetary Fund, "United Kingdom: Financial System Stability Assessment" Available at <<http://books.google.com.pk/books?id=25pECKC-kHUC&pg=PT130&dq=central+depository+system+in+UK&hl=en&sa=X&ei=ZOUoT7foBsuh-Qa7-pDNBQ&ved=0CEQO6AEwBDgK#v=onepage&q=central%20depository%20system%20in%20UK&f=false>> (Last accessed February 2, 2012).

<sup>69</sup> Non-Fungible means that each instrument retains its separate identity.

and secure way of transferring money market instruments and for producing the associated payment instructions.<sup>70</sup>

#### 2.1.4 Dematerialization of MMIs:

During the time period of 2001 to 2002, the money markets of United Kingdom change their system from paper work to electronic system.<sup>71</sup> Before the introduction of this system, most treasury bills and a large quantity of bank bills, commercial bills, CDs and CP were held in immobilized form within a central depository which is called as the (CMO).<sup>72</sup> Before this project the money markets in United Kingdom have been:

- In paper form
- Bearer instruments, and tradable (negotiable) in a secondary market
- Not fungible
- Not settled in an assured payments system

#### 2.2 USA:

The problems regarding American depository system are now clearly apparent.<sup>73</sup> There are only two major clearing and settlement entities which are the Federal Reserve System and the

<sup>70</sup> Robert Hudson, Alan Colley, Mark Lagan, "The capital markets & financial management in banking" Available at <<http://books.google.com.pk/books?id=bu2rYqHQZ0oC&pg=PA103&dq=central+depository+system+in+UK&hl=en&sa=X&ei=ZOUoT7foBsuh-Qa7-pDNBQ&ved=0CF4Q6AEwBjgK#v=onepage&q=central%20depository%20system%20in%20UK&f=false>> (Last accessed February 1, 2012).

<sup>71</sup> Brian Coyle, "Money Markets" Available at <<http://books.google.com.pk/books?id=NzvPAqsH8r0C&pg=PA106&dq=central+depository+system+in+UK&hl=en&sa=X&ei=N-QoT9Uajo37BpvpnIkF&ved=0CD8Q6AEwBA#v=onepage&q=central%20depository%20system%20in%20UK&f=false>> (Last accessed February 2, 2012).

<sup>72</sup> *Ibid.*

<sup>73</sup> Jaime. Agudelo, *Journal of Applied Business research*. "A Market Value Reporting System for Depository Institutions". Vol. 8:3 (1992), 38.

Depository Trust and Clearing Corporation (DTCC), a user owned entity.<sup>74</sup> Before the establishment of these two entities,<sup>75</sup> brokers physically exchanged certificates. All the process was depended on “pen and paper”.

The paperwork burden became vast in the late 1960s. Stock certificates were left for weeks piled haphazardly on any level surface, including filing cabinets and tables. Stocks were mailed to wrong addresses, or not mailed at all. It was mandatory to do Overtime and night work. Because of this problems the stock exchanges were forced to close every week (they chose every Wednesday), and trading hours were shortened on other days of the week.

Two methods were used to solve the crisis:

1. The first solution was to hold all paper stock certificates in one centralized location, and automate the process by keeping electronic records of all certificates and securities clearing and settlement (changes of ownership and other securities transactions). In 1872, this method was first used in Austria by the Vienna Giro and Depository Association.
2. The other problem was state laws which required brokers to deliver certificates to investors. Finally for getting solution, all the states were convinced that this concept is outdated and changed their laws. Investors can still request their certificates, but this has several inconveniences, and most people do not, except for novelty value. This led the New York Stock Exchange to establish the Central Certificate Service (CCS) in 1968. The Central Certificate Service transferred securities electronically, eliminating their physical handling for settlement purposes, and kept track of the total number of shares

<sup>74</sup> Alexander Davidson, “How the global financial markets really work” Available at <[http://books.google.com.pk/books?id=ShY3\\_mtpO5kC&pg=PA197&dq=euroclear+UK+and+Ireland+Limited&hl=en&sa=X&ei=qe0oT9HsQYOf-QbhZsyqBQ&ved=0CDkQ6AEwAg#v=onepage&q=euroclear%20UK%20and%20Ireland%20Limited&f=false](http://books.google.com.pk/books?id=ShY3_mtpO5kC&pg=PA197&dq=euroclear+UK+and+Ireland+Limited&hl=en&sa=X&ei=qe0oT9HsQYOf-QbhZsyqBQ&ved=0CDkQ6AEwAg#v=onepage&q=euroclear%20UK%20and%20Ireland%20Limited&f=false)> (Last accessed February 8, 2012).

<sup>75</sup> Federal Reserve System and the Depository Trust and Clearing Corporation (DTCC).

held by NYSE members. The aim of this system is to eliminate up to 75% of the physical handling of stock certificates traded between brokers.

### **2.2.1 Depository Trust & Clearing Corporation (DTCC):**

In 1999 Depository Trust & Clearing Corporation was created as a holding company to combine the Depository Trust Company (DTC) and National Securities Clearing Corporation (NSCC). The aim behind its establishment was to provide an efficient and safe way for buyers and sellers of securities to make their exchange, and thus "clear and settle" transactions. It also provides "central custody of securities". In 2007, DTCC settled the vast majority of securities transactions in the United States, more than \$1.86 quadrillion in value. DTCC has operating facilities in New York City and at multiple locations in and outside the U.S.

#### **2.2.1.1 Subsidiaries:**

Depository Trust & Clearing Corporation provides clearance, settlement, and information services for equities, corporate and municipal bonds, unit investment trusts, government and mortgage-backed securities, money market instruments, and over-the-counter derivatives through these subsidiaries. The Depository Trust & Clearing Corporation has several subsidiaries which are as follows:

##### **2.2.1.1.1 The Depository Trust Company (DTC):**

It is an original securities depository. This depository was established in 1973. The basic purpose behind its creation was to reduce costs and provide efficiencies by immobilizing securities and making "book-entry" changes to show ownership of the securities. The Depository Trust Company (DTC) was created to alleviate the rising volumes of paperwork and the lack of

security that developed after rapid growth in the volume of transactions in the U.S. securities industry in the late 1960s.

“One of the world's largest securities depositories, it holds in excess of US\$10 trillion worth of securities in custody. The DTC acts like a clearinghouse to settle trades in corporate and municipal securities”.<sup>76</sup>

“DTC is owned by many companies in the financial industry, with the NYSE being one of its largest shareholders”.<sup>77</sup>

The Depository Trust Company is a member of the U.S. Federal Reserve System, and a registered clearing agency with the Securities and Exchange Commission. This depository provides movements of securities for NSCC's net settlements, and settlement for institutional trades (which typically involve money and transfer of securities between custodian banks and broker-dealers), as well as money market instruments. In 2007, DTC settled transactions worth \$513 trillion, and processed “325 million book-entry deliveries”. In addition to settlement services, DTC retains custody of 3.5 million issues of securities , worth about \$40 trillion, including securities issued in the US and more than 110 other countries.

#### **2.2.1.1.2 National Securities Clearing Corporation (NSCC):**

This is an original clearing corporation which provides clearing and serves as the central counterparty for trades in the US securities markets. This is a jointly owned firm of the New York Stock Exchange, the American Stock Exchange, and the National Association of Securities Dealers. This depository settles accounts among brokerage firms.<sup>78</sup> In 1976, National Securities Clearing Corporation (NSCC) was established to provide settlement, risk management, central counterparty services and a guarantee of completion for certain transactions for virtually all

<sup>76</sup> Definition Available at <<http://www.investopedia.com/terms/d/dtc.asp#axzz1lpDx2ZrA>> (Last accessed February 8, 2012).

<sup>77</sup> “Investopedia definitions” available at <<http://www.investopedia.com/terms/d/dtc.asp#axzz1lpDx2ZrA>> (Last accessed February 8, 2012).

<sup>78</sup> David L. Scott, “*An A to Z Guide to Investment Terms for Today's Investor*” Published by Houghton Mifflin Harcourt Publishing Company, Available at <<http://invest.yourdictionary.com/national-securities-clearing-corporation-nscc>> (Last accessed February 8, 2012).

broker-to-broker trades involving equities, corporate and municipal debt, American depository receipts, exchange-traded funds, and unit investment trusts. NSCC is regulated by the U.S. Securities and Exchange Commission (SEC).<sup>79</sup>

"A jointly owned firm of the New York Stock Exchange, the American Stock Exchange, and the National Association of Securities Dealers that settles accounts among brokerage firms. NSCC nets trades among the firms and directs payments and security transfers appropriate to each participant".<sup>80</sup>

"A clearing corporation that facilitates the settlement of accounts among brokerage firms, exchanges, and other clearing corporations".<sup>81</sup>

"A subsidiary of the DTCC that provides centralized clearing, information, and settlement services to the financial industry."<sup>82</sup>

## 2.3 CANADA:

### 2.3.1 Canadian Depository for Securities Limited:

The Canadian Depository for Securities Limited (CDS) is a valued partner to securities market participants which provides reliable, cost-effective depository, clearing, settlement, regulatory and information services. It delivers innovative, value-added solutions that help our stakeholders and maintain a competitive capital market in Canada and build a strategic global advantage.

In June 9, 1970, the Canadian Depository for Securities Limited (CDS Ltd.) was established in response to rising "back office costs" and increased volumes in the capital markets resulting from a vibrant Canadian economy. This depository was formed to control new technologies and automation to create a centralized depository service and an electronic clearing and settlement

<sup>79</sup> "National Securities Clearing Corporation" Available at <<http://www.dtcc.com/about/subs/nscc.php>> (Last accessed February 8, 2012).

<sup>80</sup> "National Securities Clearing Corporation" Available at <<http://financial-dictionary.thefreedictionary.com/National+Securities+Clearing+Corporation>> (Last accessed February 8, 2012).

<sup>81</sup> *Ibid.*

<sup>82</sup> "Definitions" Available at <<http://www.investopedia.com/terms/n/nscc.asp#axzz1IpDx27rA>> (Last accessed February 8, 2012).

system that could not only handle higher volumes, but can meet future needs. In 1976, CDS was began clearing trades executed on the Montreal Exchange. CDS's reputation for reliability and innovation grew over the decade, as did the number of participants.

Canadian Depository for Securities Limited is owned by major Canadian Chartered banks, the members of the Investment Dealers Association of Canada, and the Toronto Stock Exchange.<sup>83</sup> CDS also settles almost 40 million cross-border transactions with the U.S. annually and has custodial relationships with the Depository Trust Company (DTC), Euroclear France, JASDEC and Skandinaviska Enskilda Banken AB (SEB).<sup>84</sup>

In 1998, the Depository Trust Company became a direct CDS participant for making cross-border clearing and settlement a reality. In 1981, the first equity securities were deposited in the book-based system. Government of Canada bonds were added to the system in the late 1980s, followed by the implementation of the Debt Clearing System for bonds and money market instruments in the early 1990s. The opening of the Vancouver office in 1985, followed closely by Calgary in 1987 and finally Halifax in 1997 created a truly national trade clearing and settlement service.

In 1998, CDS launched its "Sweep the Street" initiative, a program that ran until 2002 and resulted in the reconstitution of \$150 billion in strip bonds, further centralized Canadian holdings and reduced risk. With the launch of CDSX in 2003, one of the most advanced clearing and settlement systems in the world securities processing at CDS became simpler, faster and more effective. The completion of the securities settlement risk model in 2004 added highly effective

<sup>83</sup> "Other clearing and settlement systems" Available at <<http://www.bankofcanada.ca/financial-system/payments/other-clearing-and-settlement-systems/#securities>> (Last accessed February 8, 2012).

<sup>84</sup> "About CDS clearing" Available at <<http://www.cds.ca/cdsClearingHome.nsf/Pages/-EN-Profile?Open>> (Last accessed February 8, 2012).

mechanisms for managing operational, liquidity and counterparty risk exposures to CDS's operating environment.

In 2006, CDS restructured its business units to segregate operations based on varied business models and further reduced cross-over risks. This entailed forming CDS Clearing and Depository Services Inc. to provide core clearing and settlement services previously delivered to participants and the financial industry by CDS Ltd.

Annually CDS supports Canada's equity, fixed income and money markets, holding over \$3.5 trillion on deposit and handling over 360 million domestic and cross-border securities trades.<sup>85</sup> Canadian Depository for Securities Limited is accountable for the safe custody and movement of securities, accurate record keeping, the processing of post-trade transactions, and the collection and distribution of entitlements relating to the securities that have been deposited by participants. This depository manages the safekeeping of securities in both physical certificate and electronic form for its participants. The depository is regulated by the Ontario and Quebec securities commissions and the Bank of Canada, with working and reporting relationships with the Canadian Securities Administrators (CSA), other provincial securities commissions and the Office of the Superintendent of Financial Institutions.

Most CDS eligible securities are in physical certificate form and are held by CDS or transfer agents and registered in CDS's nominee name. When physical securities are deposited with the depository than CDS enters them in a ledger and they are traded electronically. More than 88,000

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<sup>85</sup> "History and milestones" Available at <<http://www.cds.ca/cdsClearingHome.nsf/Pages/-EN-HistoryandMilestones?Open>> (Last accessed February 8, 2012).

equity and debt security issues are eligible for deposit at CDS. Of these, 60 per cent are Canadian issues and 40 per cent are foreign (mostly U.S.).<sup>86</sup>

### 2.3.2 Authoritative source of Canadian entitlement data:

Because CDS is the nominee security holder of record for most Canadian securities, transfer agents must provide CDS with primary-source entitlement information from issuers. Being first to receive most entitlement data establishes CDS as an authoritative source of Canadian entitlement information to the securities industry. CDS's electronic bulletin service provides information on corporate events that participants and subscribers can pass on to their clients.<sup>87</sup>

## 2.4 INDIA:

Many problems faced by Indian Stock markets because of the "lack of depository services on modern lines". Before the introduction of depositories system in India, all the shares were transferred physically.<sup>88</sup> With the introduction of electronic depositories which enable the dematerialization of shareholding was another essential reform of the 1990s that has contributed to the strength of India's financial markets.<sup>89</sup> To overcome the problem of a large number of transfer deeds and share certificates, the concept of "jumbo transfer deed"<sup>90</sup> and "jumbo

<sup>86</sup> "Depository System" Available at <<http://www.cds.ca/cdsClearingHome.nsf/Pages/-EN-Depositorysystem?Open>> (Last accessed February 8, 2012).

<sup>87</sup> *Ibid.*

<sup>88</sup> Trinath Tadakamalla, "Dematerialized Securities" Available at

<[http://www.legalserviceindia.com/articles/dematerialized\\_securities.htm](http://www.legalserviceindia.com/articles/dematerialized_securities.htm)> (Last accessed January 25, 2012).

<sup>89</sup> Alan R. Kanu, "Capital Markets of India: An Investor's Guide" Available at <[http://books.google.com.pk/books?id=z0bVjK2jivkC&pg=PT127&dq=SECURITIES+AND+EXCHANGE+BOARD+OF+INDIA+\(DEPOSITORIES+AND+PARTICIPANTS\)+\(AMENDMENT\)+REGULATIONS.+2011&hl=en&sa=X&ei=RVIIr82oNNDsOe2ota4I&ved=0CC8Q6AEwAA#v=onepage&q=&f=false](http://books.google.com.pk/books?id=z0bVjK2jivkC&pg=PT127&dq=SECURITIES+AND+EXCHANGE+BOARD+OF+INDIA+(DEPOSITORIES+AND+PARTICIPANTS)+(AMENDMENT)+REGULATIONS.+2011&hl=en&sa=X&ei=RVIIr82oNNDsOe2ota4I&ved=0CC8Q6AEwAA#v=onepage&q=&f=false)> (Last accessed January 30, 2012).

<sup>90</sup> Only one transfer deed is to be executed for a large number of transfers.

certificate”<sup>91</sup> had been introduced. Because of its introduction physical dealings were completely diminished to bring the Indian Stock markets at par with the International markets.<sup>92</sup>

Technology has changed the face of the Indian stock markets in the post liberalization era. Competition amongst the stock exchanges, increase in the volume of activity. The traditional settlement and clearing system proved to be inadequate due to operational inefficiencies. Hence, there emerged a need to replace this traditional system with a new system called the “Depository System”.

#### 2.4.1 Evolution of Depository System in India:

India's financial markets were not famous in past because of their long, inefficient, and unreliable paper based settlement system which causes bad deliveries. Because of this many foreign investors were not interested in Indian financial markets.

In the mid 1990s, SEBI mandated the dematerialization of securities holdings in a phased approach.<sup>93</sup> In 1996, depository system was first introduced in India to enhance the investor security and the transparency of the Indian capital markets.<sup>94</sup>

National Securities Depository Ltd (NSDL) was company sponsored by the NSE, IDBI and UTI and on June 7, 1996, this company got a certificate of registration. The second depository is Central Depository Services (India) Ltd (CDSL) which was promoted by BSE along with

<sup>91</sup> It reflects a large number of certificates.

<sup>92</sup> Khan, “*Indian Financial System*” 5<sup>th</sup> Edition, Available at <<http://books.google.com.pk/books?id=HUX-y4oXl04C&pg=SA8-PA21&dq=The+Depositories+Act.+1996&cd=10#v=onepage&q=The%20Depositories%20Act%2C%201996&f=false>> (Last accessed January 31, 2012).

<sup>93</sup> Alan R. Kanu, “*Capital Markets of India: An Investor's Guide*” Available at <[http://books.google.com.pk/books?id=z0bVjK2jivkC&pg=PT127&dq=SECURITIES+AND+EXCHANGE+BOARD+OF+INDIA+\(DEPOSITORIES+AND+PARTICIPANTS\)+\(AMENDMENT\)+REGULATIONS.+2011.&hl=en&sa=X&ei=RVIIrT82oNNDsOc2ota4I&ved=0CC8Q6AEwAA#v=onepage&q=&f=false](http://books.google.com.pk/books?id=z0bVjK2jivkC&pg=PT127&dq=SECURITIES+AND+EXCHANGE+BOARD+OF+INDIA+(DEPOSITORIES+AND+PARTICIPANTS)+(AMENDMENT)+REGULATIONS.+2011.&hl=en&sa=X&ei=RVIIrT82oNNDsOc2ota4I&ved=0CC8Q6AEwAA#v=onepage&q=&f=false)> (Last accessed January 30, 2012).

<sup>94</sup> Linda S. Spedding, “*Due diligence and corporate governance*” Available at <[http://books.google.com.pk/books?id=cEbVaWwPVSkC&pg=PA330&dq=SEBI+\(Depositories+and+Participant\)+Regulations+1996&hl=en&sa=X&ei=jCIIT8hFyp464YL8vgg&ved=0CDkQ6AEwAg#v=onepage&q=SEBI%20\(Depositories%20and%20Participant\)%20Regulations%201996&f=false](http://books.google.com.pk/books?id=cEbVaWwPVSkC&pg=PA330&dq=SEBI+(Depositories+and+Participant)+Regulations+1996&hl=en&sa=X&ei=jCIIT8hFyp464YL8vgg&ved=0CDkQ6AEwAg#v=onepage&q=SEBI%20(Depositories%20and%20Participant)%20Regulations%201996&f=false)> (Last accessed January 31, 2012).

financial institutions and banks and on August 19, 1998 this company was granted certificate of registration. In 1999 inter depository transfer through on line connectivity was established between CSDL and NSDL.

In July 1992 the move on depository was initiated by the Stock Holding Corporation of India Limited (SCHCIL) when it prepared a concept paper on 'National Clearance and Depository Systems' in collaboration with Price waterhouse under a program sponsored by the US Agency for international Development. After that, the Government of India constituted a technical group which submitted its report in 1993.

Subsequently, the Securities and Exchange Board of India (SEBI) constituted a group of seven members for the discussion on various structural and operational parameters of the depository system. Finally, in 1995, the Government of India promulgated the Depositories Ordinance to establish depositories in the country.<sup>95</sup> Now more than 99 percent of the settlement of securities occurs in dematerialized form.

#### **2.4.2 Demat account opening process:**

The accounts which are opened in dematerialization form with CSDL are known as "Beneficial Owner Accounts" or "BO account". When securities are held in physical form name of the investor is recorded in the books of the company as "Registered owner". After it when the same securities are converted into electronic form and held in a demat account, the depository becomes registered owner of the securities. Since depository is acting as a "custodian of the securities", original investor is legally entitled for all rights as well as liabilities attached with

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<sup>95</sup>V S Rama Rao, "The move on Depository System in India" (December 10, 2008), Available at <<http://www.citeman.com/4579-the-move-on-depository-system-in-india.html>> (Last accessed January 25, 2012).

securities and that is why he is called “Beneficial Owner”. All accounts opened in CDSL system are beneficiary accounts irrespective of the type of account.

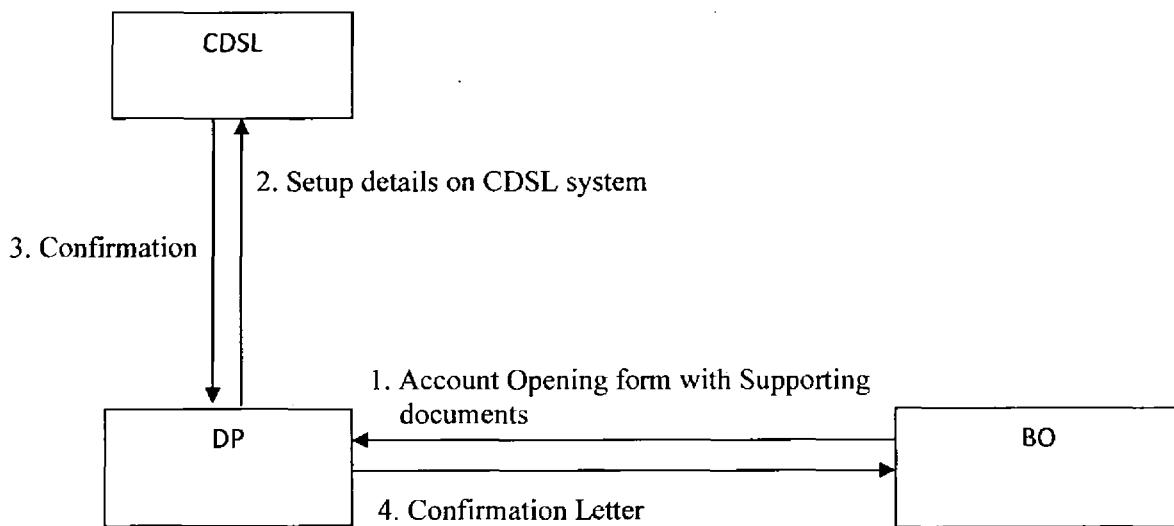


Figure 3: Graphical representation of the account opening process

#### 2.4.3 Number of Depositories in India:

There are two depositories in India, the National Securities Depository Ltd (NSDL) and the Central Depository Services Ltd.<sup>96</sup> These depositories provides depository services in the electronic form for securities traded in equity and debt markets and also provide instantaneous electronic transfer of securities. These depositories are governed by the Depositories Act, 1996, Securities and Exchange Board of India (Depositories & Participants) Regulations, 1996, Bye-Laws approved by SEBI, and Business Rules framed in accordance with the Regulations and Bye-Laws. There is a competition in the service and there is more than one depository in operation.

<sup>96</sup> Alan R. Kanu, “*Capital Markets of India: An Investor’s Guide*” Available at <[http://books.google.com.pk/books?id=z0hVjK2jivkC&pg=PT127&dq=SECURITIES+AND+EXCHANGE+BOARD+OF+INDIA+\(DEPOSITORIES+AND+PARTICIPANTS\)+\(AMENDMENT\)+REGULATIONS,+2011:&hl=en&sa=X&ei=RVIIIT82oNNDsOe2ota4I&ved=0CC8Q6AEwAA#v=onepage&q=&f=false](http://books.google.com.pk/books?id=z0hVjK2jivkC&pg=PT127&dq=SECURITIES+AND+EXCHANGE+BOARD+OF+INDIA+(DEPOSITORIES+AND+PARTICIPANTS)+(AMENDMENT)+REGULATIONS,+2011:&hl=en&sa=X&ei=RVIIIT82oNNDsOe2ota4I&ved=0CC8Q6AEwAA#v=onepage&q=&f=false)> (Last accessed January 30, 2012).

### 2.4.3.1 National securities depository Ltd. (NSDL):

When the National securities Depository Ltd (NSDL) was set up as the first depository in India, the Indian capital market took a major step in its rapid modernization. The NSDL, promoted by the Industrial development Bank of India<sup>97</sup>, the Unit trust of India (UTI)<sup>98</sup>, the National Stock Exchange of India Limited (NSE)<sup>99</sup>, and the State Bank of India (SBI) was registered on 7 June 1996, with the SEBI<sup>100</sup> and commenced operations in 8 November 1996.<sup>101</sup> Some of the prominent banks in the country also have a stake in NSDL.<sup>102</sup> In January 1999, all market participants were required to have depository accounts for the recognition of the future for dematerialization. The NSDL is the only existing depository in existence at the launch of dematerialization, had the first entrant advantage of signing up virtually all of the eligible parties.<sup>103</sup>

The progress of NSDL is “a tribute to India's and Indian people's ability to adapt to change”. From a mere 8,000 investor accounts opened with NSDL the country's first depository in the month of March 1998, these investor accounts have crossed the 50,000 mark by August 1998. From more than 563 cities in the country and 35 cities from overseas, investors have joined a

<sup>97</sup> The largest development bank in India.

<sup>98</sup> The largest mutual fund in India.

<sup>99</sup> The largest stock exchange in India.

<sup>100</sup> Pathak, “*The Indian Financial System: Markets, Institutions and Services*” 2<sup>nd</sup> Edition, Available at <[http://books.google.com.pk/books?id=2cZ1nuzYCwwC&pg=PA234&lpg=PA234&dq=Depositories+Act+\(Amendment\)+Bill+1998&source=bl&ots=mN1nHTNUmk&sig=vobPA2-ce2RrEXeZMm28xxjMpsg&hl=en&sa=X&ei=dm8mT-GjJ4-f0srMvMAI&ved=0CC8Q6AEwAw#v=onepage&q=Depositories%20Act%20\(Amendment\)%20Bill%201998&f=false](http://books.google.com.pk/books?id=2cZ1nuzYCwwC&pg=PA234&lpg=PA234&dq=Depositories+Act+(Amendment)+Bill+1998&source=bl&ots=mN1nHTNUmk&sig=vobPA2-ce2RrEXeZMm28xxjMpsg&hl=en&sa=X&ei=dm8mT-GjJ4-f0srMvMAI&ved=0CC8Q6AEwAw#v=onepage&q=Depositories%20Act%20(Amendment)%20Bill%201998&f=false)> (Last accessed January 30, 2012).

<sup>101</sup> Kailash N. Gupta, Kamalesh N. Agarwala, Prateek Amar Agarwala, “*Digital Signature: Network Security Practices*” Available at <[http://books.google.com.pk/books?id=H2Q748wM10cC&pg=PA135&dq=SEBI+\(Depositories+and+Participant\)+Regulations+1996&hl=en&sa=X&ei=vvIIT-fa1YvdOpLkrVE&ved=0CFYQ6AEwCDgK#v=onepage&q=SEBI%20\(Depositories%20and%20Participant\)%20Regulations%201996&f=false](http://books.google.com.pk/books?id=H2Q748wM10cC&pg=PA135&dq=SEBI+(Depositories+and+Participant)+Regulations+1996&hl=en&sa=X&ei=vvIIT-fa1YvdOpLkrVE&ved=0CFYQ6AEwCDgK#v=onepage&q=SEBI%20(Depositories%20and%20Participant)%20Regulations%201996&f=false)> (Last accessed January 30, 2012).

<sup>102</sup> Saloni Sharma, “*Working of Depository System*” Available at <[http://www.slideshare.net/ps342\\_impasr/working-ofdepositorysystem](http://www.slideshare.net/ps342_impasr/working-ofdepositorysystem)> (Last accessed January 27, 2012).

<sup>103</sup> Alan R. Kanu, “*Capital Markets of India: An Investor's Guide*” Available at <[http://books.google.com.pk/books?id=z0hVjK2jjvkC&pg=PT127&dq=SECURITIES+AND+EXCHANGE+BOARD+OF+INDIA+\(DEPOSITORIES+AND+PARTICIPANTS\)+\(AMENDMENT\)+REGULATIONS.+2011&hl=en&sa=X&ei=RVII82oNNDsOe2oIa4I&ved=0CC8Q6AEwAA#v=onepage&q=&f=false](http://books.google.com.pk/books?id=z0hVjK2jjvkC&pg=PT127&dq=SECURITIES+AND+EXCHANGE+BOARD+OF+INDIA+(DEPOSITORIES+AND+PARTICIPANTS)+(AMENDMENT)+REGULATIONS.+2011&hl=en&sa=X&ei=RVII82oNNDsOe2oIa4I&ved=0CC8Q6AEwAA#v=onepage&q=&f=false)> (Last accessed January 30, 2012).

silent revolution to rid the Indian Capital Markets of fake, forged or stolen shares and to help it to move to a paperless form of trading. Since the year 1996, NSDL has dematerialized more than 256 crores shares worth Rs.40, 900 crores. The figures of shares delivered in “demat” form as compared to the percentage of the total delivery coming in are very encouraging. The next best competitor of NSDL is the BSE's Central Depositories Services Ltd.<sup>104</sup>

#### 2.4.3.2 Central depository services (India) Ltd. (CDSL):

Central Depository services limited (CDSL) was sponsored by the Bombay stock exchange<sup>105</sup> and co-sponsored by the State Bank of India, Bank of India, Bank of Baroda, and HDFC Bank<sup>106</sup> and commenced its operations during February 1999. This is the second depository which provides depository services to the investors.<sup>107</sup>

#### 2.4.4 Legal framework governing the depository functions in India:

The Depositories Act gives an infrastructure to eliminate various risks associated with capital market transactions and increasing the efficiency of clearance and settlement system.<sup>108</sup> Following are the acts and regulations under which a depository functions:

<sup>104</sup> Sudhir Shah, “*Securities transactions of India*” Available at <<http://www.sudhirlaw.com/chapter7.htm>> (Last accessed at January 29, 2012).

<sup>105</sup> L. C. Gupta and Naveen Jain, “*Indian Securities Depository System: What Has Gone Wrong?*” 38: 20, (2003), 1969. Available at <<http://www.jstor.org/pss/4413573>> (Last accessed January 30, 2012).

<sup>106</sup> Pathak, “*The Indian Financial System: Markets, Institutions and Services*” 2<sup>nd</sup> Edition, Available at <[http://books.google.com.pk/books?id=2eZ1nuzYCwxC&pg=PA234&lpg=PA234&dq=Depositories+Act+\(Amendment\)+Bill,+1998&source=bl&ots\\_mN1nHTNUmk&sig=vobPA2-ce2RrEXeZMm28xxjMpsg&hl=en&sa=X&ei=dm8mT-GjJ4-fOsrmMyMAI&ved=0CC8Q6AEwAw#v=onepage&q=Depositories%20Act%20\(Amendment\)%20Bill%2C%201998&f=false](http://books.google.com.pk/books?id=2eZ1nuzYCwxC&pg=PA234&lpg=PA234&dq=Depositories+Act+(Amendment)+Bill,+1998&source=bl&ots_mN1nHTNUmk&sig=vobPA2-ce2RrEXeZMm28xxjMpsg&hl=en&sa=X&ei=dm8mT-GjJ4-fOsrmMyMAI&ved=0CC8Q6AEwAw#v=onepage&q=Depositories%20Act%20(Amendment)%20Bill%2C%201998&f=false)> (Last accessed January 30, 2012).

<sup>107</sup> Kailash N. Gupta, Kamlesh N. Agarwala, Prateek Amar Agarwala, “*Digital Signature: Network Security Practices*” Available at <[http://books.google.com.pk/books?id=H2Q748wMl0cC&pg=PA135&dq=SEBI+\(Depositories+and+Participant\)+Regulations+1996&hl=en&sa=X&ei=vyIIT-faJYydOpLkrVE&ved=0CFYQ6AEwCDgK#v=onepage&q=SEBI%20\(Depositories%20and%20Participant\)%20Regulations%201996&f=false](http://books.google.com.pk/books?id=H2Q748wMl0cC&pg=PA135&dq=SEBI+(Depositories+and+Participant)+Regulations+1996&hl=en&sa=X&ei=vyIIT-faJYydOpLkrVE&ved=0CFYQ6AEwCDgK#v=onepage&q=SEBI%20(Depositories%20and%20Participant)%20Regulations%201996&f=false)> (Last accessed January 30, 2012).

<sup>108</sup> Gopalsamy, “*Information Technology And E-Governance*” Available at <[http://books.google.com.pk/books?id=\\_DXjS0FyEiwC&pg=PA66&dq=SEBI+\(Depositories+and+Participant\)+Regulations+1996&hl=en&sa=X&ei=vyIIT-faJYydOpLkrVE&ved=0CDgQ6AEwAjgK#v=onepage&q=SEBI%20\(Depositories%20and%20Participant\)%20Regulations%201996&f=false](http://books.google.com.pk/books?id=_DXjS0FyEiwC&pg=PA66&dq=SEBI+(Depositories+and+Participant)+Regulations+1996&hl=en&sa=X&ei=vyIIT-faJYydOpLkrVE&ved=0CDgQ6AEwAjgK#v=onepage&q=SEBI%20(Depositories%20and%20Participant)%20Regulations%201996&f=false)> (Last accessed January 31, 2012).

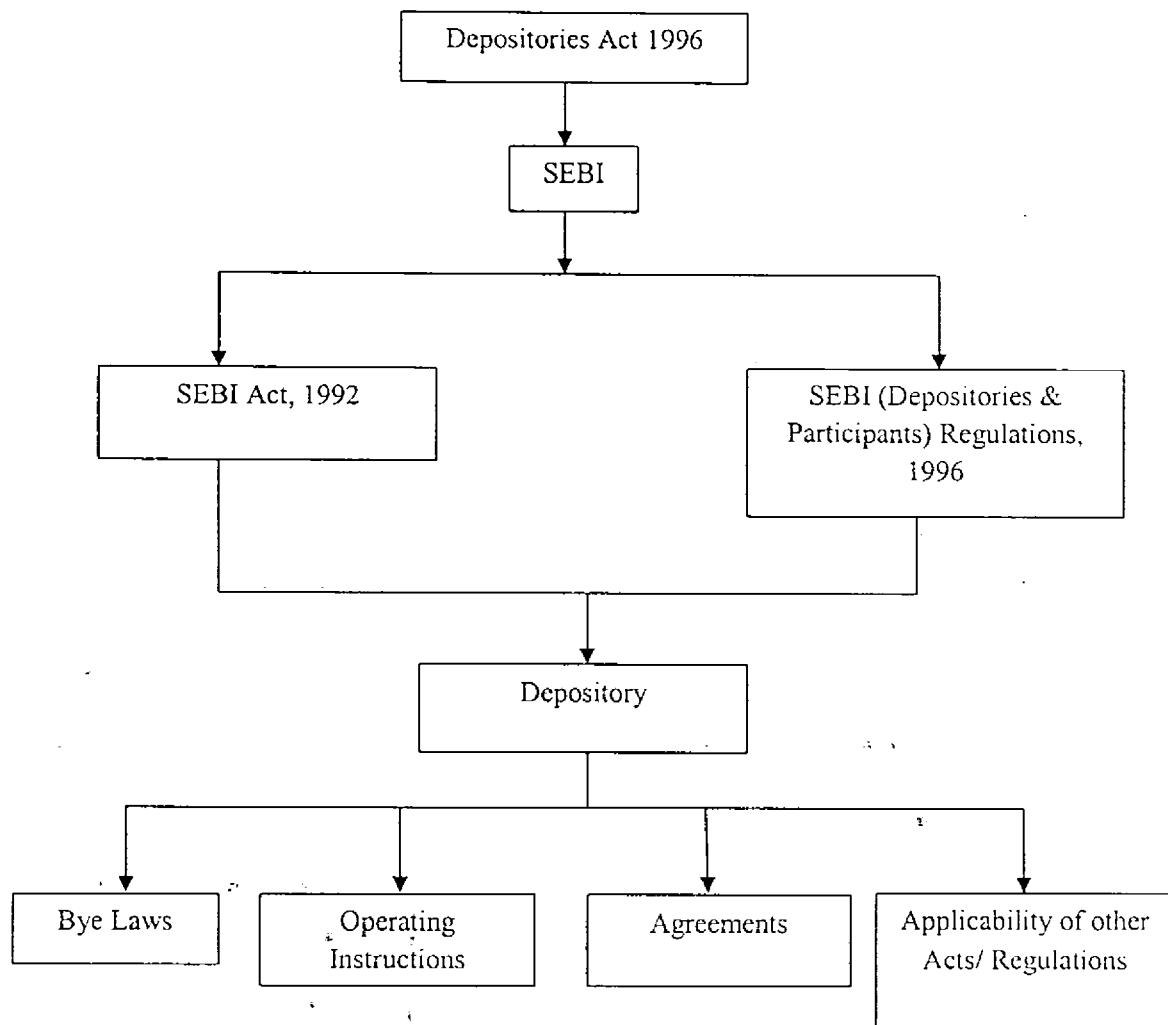


Figure 4: legal framework of regulations of depositories

#### 2.4.4.1 The Depositories Act, 1996:

The depository system was introduced in India under the 1995 Depository Ordinance. On 20<sup>th</sup> September, 1995, the depository Act came into force. After that parliament passed it and it became the Depositories Act in August 1996.<sup>109</sup> This Act was landmark in the development of

<sup>109</sup>Thumimuluri Siddaiah, "Financial Service" Available at <<http://books.google.com.pk/books?id=1ktCzl8emgC&pg=PA210&dq=The+Depositories+Act.+1996&cd=3#v=onepage&q=The%20Depositories%20Act%201996&f=false>> (Last accessed January 30, 2012).

the Indian Capital Markets.<sup>110</sup> This Act diminished the paper based system and support electronic system to ensure faster settlement of trade<sup>111</sup> and to improve the efficiency of the system<sup>112</sup> in which investors made their transaction through demat account<sup>113</sup> and also provides the regulation of depositories in the securities market.<sup>114</sup> Though, investors have option to hold securities in physical or dematerialized form or to rematerialize securities previously held in dematerialized form.<sup>115</sup>

The Act primarily provides for:

- i. A multi depository system<sup>116</sup>
- ii. Dematerialization of Securities
- iii. Appointment of depository participants

The transfer deed and other procedural requirements under the companies Act, 1956, are also given under this Act and the stamp duty on transfer of dematerialization (demat) securities is also waived.<sup>117</sup> This Act provides regulations which deals with regulating Depository companies, and

<sup>110</sup> R. K. Dash, Jagannath Panda, "Contemporary Issues in Financial Markets" Available at <<http://books.google.com.pk/books?id=BKdH5OKajp8C&pg=PA191&dq=The+Depositories+Act.+1996&cd=7#v=onepage&q=The%20Depositories%20Act%2C%201996&f=false>> (Last accessed January 31, 2012).

<sup>111</sup> Lal, "Direct Taxes" Available at <<http://books.google.com.pk/books?id=K5lI7ut7gdcC&pg=SA9-PA31&dq=The+Depositories+Act.+1996&lr=&cd=13#v=onepage&q=The%20Depositories%20Act%2C%201996&f=false>> (Last accessed January 30, 2012).

<sup>112</sup> S. Kevin, "Security Analysis and Portfolio Management" Available at <<http://books.google.com.pk/books?id=vnhYlcuYB8cC&pg=PA39&dq=The+Depositories+Act.+1996&lr=&cd=20#v=onepage&q=The%20Depositories%20Act%2C%201996&f=false>> (Last accessed January 30, 2012).

<sup>113</sup> "Demat Account: Benefits and process of Dematerialization" Available at <<http://www.charteredclub.com/demat-account-%E2%80%93-benefits-and-process-of-dematerialisation/>> (Last accessed February 1, 2012).

<sup>114</sup> G. Ramesh Babu, "Financial Services in India" Available at <[http://books.google.com.pk/books?id=Qfm1TzPABmcMC&pg=PA470&dq=SEBI+\(Depositories+and+Participant\)+Regulations+1996&hl=en&sa=X&ei=vv1T-](http://books.google.com.pk/books?id=Qfm1TzPABmcMC&pg=PA470&dq=SEBI+(Depositories+and+Participant)+Regulations+1996&hl=en&sa=X&ei=vv1T-)> (Last accessed January 31, 2012).

<sup>115</sup> V S Rama Rao, "The move on Depository System in India" (December 10, 2008), Available at <<http://www.citeman.com/4579-the-move-on-depository-system-in-india.html>> (Last accessed January 25, 2012).

<sup>116</sup> The Depositories Act, 1996, enables the setting up of multiple depositories in the country and all the operations of the depositories are governed by regulations as framed from time to time with reference to the provisions of the Depositories Act.

<sup>117</sup> Thumminuluri Siddaiah, "Financial Service" Available at <<http://books.google.com.pk/books?id=1ktCZti8emgC&pg=PA210&dq=The+Depositories+Act.+1996&cd=3#v=onepage&q=The%20Depositories%20Act%2C%201996&f=false>> (Last accessed January 30, 2012).

makes sure that they function in a fair and transparent manner and to stop malpractice in the securities market.<sup>118</sup>

According to section 2(e):

This section provides the meaning of depository as “a company formed and registered under the Companies Act 1956 and which has been granted a certificate of registration under section 12 (1A) of the Securities and Exchange Board of India Act, 1992”.

In *Probir Kumar Misra v. Ramani Ramaswamy* case<sup>119</sup> it was held that:

“After the Depositories Act, 1996, such depositors who are holding equity share capital of the company and whose name is entered as beneficial owner are also deemed to be members of the company, thus making them members under the Act”.<sup>120</sup>

The Madras High Court, held that:

The definition of ‘member’ includes beneficial owner, whose name is entered in the records of the depository. It cannot now be contended that the register of members to be maintained under Section 150 of the Companies Act, 1956, will not cover the beneficial owner, whose name is entered in the records of the depository. Once the members of the depository are deemed to be members of the Company, register of the Company, which is being maintained as per Section 151 and 152 of the Companies Act, 1956, must contain the names of the beneficial owners maintained by the Depository.<sup>121</sup>

Hence the order passed by the Company Law Board directing the respondents to furnish the list of members extract of register of its members, excluding the list of beneficial owners of the shares of the bank is unsustainable as the same is contrary to Section 41(3) of the Company Act, 1956, and also in violation of Section 152A of the Act.<sup>122</sup>

According to Section 8:

<sup>118</sup> Prashaanth B. “What is the mandate of the depositories act?” Available at <<http://www.vakilsearch.com/law/securities-and-shares/depositories/mandate-of-depositories-act>> (Last accessed January 29, 2012).

<sup>119</sup> The second respondent, who has acted as a promoter of the Company, who has not been made as a subscriber of the Memorandum of Association but its representative was only made as a first and permanent Director, has become a member by virtue of Section 41(3) of the Act as an investor after the Investment Agreement dated 26.5.2006 has come into existence.

<sup>120</sup> Atin Kumar Das, “*Law relating to Depositories with Special Reference to India: An Analytical Study*” (April 9, 2011) Available at <<http://jurisonline.in/2011/04/law-relating-to-depositories-with-special-reference-to-india-an-analytical-study-2/>> (Last accessed January 29, 2012).

<sup>121</sup> *Dinesh Kumar Jhunjhunwala v. The Karur Vysya Bank Ltd.*

<sup>122</sup> Atin Kumar Das, “*Law relating to Depositories with Special Reference to India: An Analytical Study*” (April 9, 2011) Available at <<http://jurisonline.in/2011/04/law-relating-to-depositories-with-special-reference-to-india-an-analytical-study-2/>> (Last accessed January 29, 2012).

This section provides option for the investor that he can receive the security certificated or hold these securities with depository.

According to section 9 (1):

This section describes as “all securities held by a depository shall be dematerialized and shall be in a fungible form”.

According to section 19D:

This section provides penalty for delay in dematerialization or issue of certificate of securities.<sup>123</sup>

The penalty is one lakh rupees for each day during which such failure continues or one crore rupees, whichever is less.

#### 2.4.4.2 SEBI (Depositories and Participant) Regulations 1996:

The Securities and Exchange Board of India (Depositories and Participant) Regulations 1996 provides for the establishment of depositories but these depositories should register with Securities and Exchange Board of India.<sup>124</sup> The Securities and Exchange Board of India has the authority to make regulations and control the affairs of the depository<sup>125</sup> and it also introduced an accurate regulatory regime to ensure fairness, transparency and good practice.<sup>126</sup> Before

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<sup>123</sup> If any issuer or its agent or any person, who is registered as an intermediary under the provisions of section 12 of the Securities and Exchange Board of India Act, 1992 (15 of 1992), fails to dematerialize or issue the certificate of securities on opting out of a depository by the investors, within the time specified under this Act or regulations or bye-laws made there under or abets in delaying the process of dematerialization or issue the certificate of securities on opting out of a depository of securities.

<sup>124</sup> Linda S. Spedding, “*Due diligence and corporate governance*” Available at <[http://books.google.com.pk/books?id=EbVaWwPVSkC&pg=PA330&dq=SEBI+\(Depositories+and+Participant\)+Regulations+1996&hl=en&sa=X&ei=jCIIT8hFyp464YL8vgg&ved=0CDkQ6AEwAg#v=onepage&q=SEBI%20\(Depositories%20and%20Participant\)%20Regulations%201996&f=false](http://books.google.com.pk/books?id=EbVaWwPVSkC&pg=PA330&dq=SEBI+(Depositories+and+Participant)+Regulations+1996&hl=en&sa=X&ei=jCIIT8hFyp464YL8vgg&ved=0CDkQ6AEwAg#v=onepage&q=SEBI%20(Depositories%20and%20Participant)%20Regulations%201996&f=false)> (Last accessed January 29, 2012).

<sup>125</sup> G. Ramesh Babu, “*Financial Services in India*” Available at <[http://books.google.com.pk/books?id=QfmTzPABmcMC&pg=PA470&dq=SEBI+\(Depositories+and+Participant\)+Regulations+1996&hl=en&sa=X&ei=vyIT-faJYydOpLkrVE&ved=0CF0Q6AEwCTgK#v=onepage&q=SEBI%20\(Depositories%20and%20Participant\)%20Regulations%201996&f=false](http://books.google.com.pk/books?id=QfmTzPABmcMC&pg=PA470&dq=SEBI+(Depositories+and+Participant)+Regulations+1996&hl=en&sa=X&ei=vyIT-faJYydOpLkrVE&ved=0CF0Q6AEwCTgK#v=onepage&q=SEBI%20(Depositories%20and%20Participant)%20Regulations%201996&f=false)> (Last accessed January 29, 2012).

<sup>126</sup> Franklin Allen, Rajesh Chakrabart, Sankar D, “*India's Financial System*” (October 27, 200) Available at <<http://fic.wharton.upenn.edu/fic/papers/07/0736.pdf>> (Last accessed January 25, 2012).

commencing operations, depositories should obtain a certificate of registration and a certificate of commencement of business from Securities and Exchanges Board of India.<sup>127</sup>

Regulation 28 of the SEBI Regulations, 1996 provides the securities which can be dematerialized. Regulation 26 of the SEBI (Depositories and Participants) Regulations, 1996 states as:

“Depositories, participants, issuers, and issuer’s agent, in addition to the rights and obligations laid down in the Depositories Act and the bye laws shall have the rights and obligations arising from the agreements entered into by them”.

#### 2.4.4.3 Depositories Act (Amendment) Bill, 1998:

The Dhanuka panel in its draft Depositories Act (Amendment) Bill, 1998 recommended empowering the SEBI to make trading in demat shares mandatory.<sup>128</sup> SEBI laid down an elaborate time schedule envisaging that beginning January 4, 1999 till March 26, 2001 listed scrips or 40 per cent of the total listed securities would be traded compulsorily in the demat form, besides equity new debt issues will also be in demat form.<sup>129</sup> This Bill amends the Depositories Act, 1996. There were many proposed amendments of Depositories Act 1996 before the committee. The committee is determinedly of the opinion that the relationship between the depository and the participant does not amount to relationship of principal and agent. The relationship between depository and participant is a special relationship governed by the statute and it does not fit in the traditional mould of principal-agent relationship.<sup>130</sup>

<sup>127</sup> A project report on “Working of Depository System” Available at <[http://www.slideshare.net/ps342\\_impsr/working-of-depository-system](http://www.slideshare.net/ps342_impsr/working-of-depository-system)> (Last accessed January 27, 2012).

<sup>128</sup> Pathak, “The Indian Financial System: Markets, Institutions and Services” 2<sup>nd</sup> Edition, Available at <[http://books.google.com.pk/books?id=2e71nuzYCwwC&pg=PA234&lpg=PA234&dq=Depositories+Act+\(Amendment\)+Bill,+1998&source=bl&ots=mN1nHTNUmk&sig=vobPA2-ce2RfExe7Mm28xxjMjse&hl=en&sa=X&ei=dm8mT-GjJ4-f0srMvMAI&ved=0CC8Q6AEwAw#v=onepage&q=Depositories%20Act%20\(Amendment\)%20Bill%2C%201998&f=false](http://books.google.com.pk/books?id=2e71nuzYCwwC&pg=PA234&lpg=PA234&dq=Depositories+Act+(Amendment)+Bill,+1998&source=bl&ots=mN1nHTNUmk&sig=vobPA2-ce2RfExe7Mm28xxjMjse&hl=en&sa=X&ei=dm8mT-GjJ4-f0srMvMAI&ved=0CC8Q6AEwAw#v=onepage&q=Depositories%20Act%20(Amendment)%20Bill%2C%201998&f=false)> (Last accessed January 30, 2012).

<sup>129</sup> V S Rama Rao, “The move on Depository System in India” (December 10, 2008), Available at <<http://www.citeman.com/4579-the-move-on-depository-system-in-india.html>> (Last accessed January 25, 2012).

<sup>130</sup> “Amendment of Depositories Act 1996” Available at <<http://www.sebi.gov.in/commreport/Dhanuka9.html>> (Last accessed January 30, 2012).

The committee was agree on the point that there should be compulsory dematerialization in certain cases so the committee inserted two sub clauses of section 8 which are 8 (1) and 8 (2) of the amended Bill.<sup>131</sup>

According to amended section 8 which states as the conditions in which there should be compulsory Dematerialization these cases are as follows:

1. Every listed company or to be listed public company making public offer of any securities for a sum of Rs.10 Crores or more should be in dematerialised form.
2. Every foreign institutional investor who is registered with the Board or a public financial institution which is defined under the Companies Act or a mutual fund including Unit Trust of India shall buy or sell the securities through the stock exchange should be only in dematerialized form.

According to section 8B of the amended Bill which states as:

“In case the Board has granted certificate of registration to more than one depository, the issuers as well as the participants shall have the option to enter into the statutory agreement with any one or the other depository as contemplated hereinabove. Subject to this option, the issuers and the participants shall comply with all other provisions of the Act”.<sup>132</sup>

#### **2.4.4.4 Securities and Exchange Board of India (Depositories and Participants)**

##### **(Amendment) Regulations, 2011:**

In exercise of the powers conferred by section 30 of the Securities and Exchange Board of India Act, 1992 (15 of 1992), the Board have made the following Regulations to amend the Securities and Exchange Board of India (Underwriters) Regulations, 1993. These Regulations

<sup>131</sup> Raj Kapila & Uma Kapila, “Economic Developments in India” Vol 9, Available at <[http://books.google.com.pk/books?id=TJH5gcPc6k8C&pg=PA121&dq=Depositories+Act+\(Amendment\)+Bill.+1998&hl=en&sa=X&ei=qm8m17SYBNCXOuTCkKgI&ved=0CC0Q6AFwAA#v=onepage&q=Depositories%20Act%20\(Amendment\)%20Bill%201998&f=false](http://books.google.com.pk/books?id=TJH5gcPc6k8C&pg=PA121&dq=Depositories+Act+(Amendment)+Bill.+1998&hl=en&sa=X&ei=qm8m17SYBNCXOuTCkKgI&ved=0CC0Q6AFwAA#v=onepage&q=Depositories%20Act%20(Amendment)%20Bill%201998&f=false)> (Last accessed January 30, 2012).

<sup>132</sup> Available at <<http://www.schi.gov.in/comimreport/Dhanuka26.html>> (Last accessed January 30, 2012).

may be called the Securities and Exchange Board of India (Underwriters) (Amendment) Regulations, 2011.<sup>133</sup>

#### **2.4.5 Eligibility Criteria for a Depository:**

Any of the following may promote a depository:

1. A public financial Institution which is 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 recognized stock exchange;
5. An institution engaged in providing financial services where not less than 75% of the equity is held jointly or severally by these institutions;
6. A custodian of securities approved by Government of India,
7. A foreign financial services institution approved by Government of India.

#### **2.4.6 The Relevance of the Depository System in India to Non Resident Indians:**

The cost relating to the dealing with "Non resident Indians" investors in physical form is too much high. The depository system allows the investors to hold securities in an account and to transfer theses securities by means of account transfers provides an efficient solution to these problems and also removes the inconveniences due to geographical distances.<sup>134</sup> To facilitate all the clients including Non Resident Indians (NRIs) and investors in general, Corporation Bank

<sup>133</sup> U.K. Sinha, "SEBI (Underwriters) (Amendment) Regulations, 2011" (July 5, 2011) Available at <<http://caesnews.blogspot.com/2011/07/sebi-underwriters-amendment-regulations.html>> (Last accessed January 29, 2012).

<sup>134</sup> "The Relevance Of the Depository System in India to Non Resident Indians" (January 31, 2009), Available at <<http://www.managementheaven.com/depository3/>> (Last accessed January 25, 2012).

has started depository services by opening a specialized branch in association with National Securities Depositors Ltd.<sup>135</sup>

#### 2.4.7 Role of Depository system in Indian Capital Markets:

One of the biggest problems faced by the Indian capital market has been the manual and paper based settlement system. There are many problems relating to the system of physical delivery of scrips for the purchaser as well as the seller in the form of delayed settlements, long settlement periods, high level of failed trade, high cost of transaction, bad deliveries etc. In many cases transfer process takes much longer time then two month as stipulated in section 113 of companies Act, 1956 or section 22 A of the securities Contracts (Regulations) Act, 1956.<sup>136</sup> Majority of security related transactions in the Indian Capital market has been shifted to the Dematerialized form. Therefore, it has become all the more necessary for Investors to maintain Depository accounts. The process of dematerialization has eliminated physical paper and related problems from the Indian Capital Market in a smooth and efficient manner.<sup>137</sup>

With the implementation of depository system, the Indian capital market has shown rapid growth in the recent past with foreign investors, more Stock exchanges and increased market intermediaries. The government of India enacted the Depositories Act in 1996 for the systematic growth and development of the Indian capital market. It is a system whereby the transfer and settlement of scrips take place not through the traditional method of transfer, deeds and physical delivery of scrips but through the modern system of effecting transfer of ownership of securities

<sup>135</sup> "Depository Services" Available at <<http://www.corphank.com/asp/0100/text.asp?presentID=130&headID=66>> (Last accessed January 29, 2012).

<sup>136</sup> A project report on "Working of Depository System" Available at <[http://www.slideshare.net/ps342\\_mpasri/working-ofdepositorysystem](http://www.slideshare.net/ps342_mpasri/working-ofdepositorysystem)> (Last accessed January 27, 2012).

<sup>137</sup> Sona Kapila, "Academic Foundation's Bulletin On Banking And Finance" Vol: 33, Available at <<http://books.google.com.ng/books?id=LW162oW1GYgC&pg=PA203&dq=The+Depositories+Act+1996&cd=9#v=onepage&q=The%20Depositories%20Act%201996&l=false>> (Last accessed January 29, 2012).

by means of book entry on the ledgers or the depository without the physical movement of scrips.<sup>138</sup>

Indian capital market has been linked to the International Financial Market, and the standard has been increased in terms of efficiency and transparency through Dematerialization of the Indian Capital Market. In this context dematerialization is one of the right steps taken by the Government to make the share transfer process easier and on other hand the earlier demerits of the paper transfer process can be rectified.<sup>139</sup> At Present the Indian stock exchanges are following screen based trading and electronic settlement system. But the investors are scattered at various distant places from trading and settlement place. So there are some problems arising in the settlement and transfer system. Thus, there is a need to evaluate the effectiveness of Indian Depository system.<sup>140</sup>

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<sup>138</sup> A project report on “Working of Depository System” Available at <[http://www.slideshare.net/ps342\\_mpasi/working-ofdepositorysystem](http://www.slideshare.net/ps342_mpasi/working-ofdepositorysystem)> (Last accessed January 27, 2012).

<sup>139</sup> Ms. Kiran Chaudhary, and Mr. Ramesh Kumar Malik “Depository System in India” *International Journal of Research in Social Science*, Vol. 1:1 (2011), 209. Available at <[http://www.ijmra.us/project%20doc/IJRSS\\_AUGUST/IJMRA-SS375.pdf](http://www.ijmra.us/project%20doc/IJRSS_AUGUST/IJMRA-SS375.pdf)> (Last accessed February 25, 2012).

<sup>140</sup> *Ibid.*

## CHAPTER 3

### **AN INSIGHT INTO THE PERFORMANCE OF CENTRAL DEPOSITORY COMPANY OF PAKISTAN AND ITS DEPOSITORY SYSTEM**

The Central Depository Company acts as a trustee for investors and all securities within the Central Depository Company are registered in its name. Central Depository Company has no beneficial rights to these securities. The company holds them as a nominee on the investor's behalf. Therefore all rights and benefits, such as dividends, bonus, rights entitlements and voting rights are remained with the actual owner of those securities. No doubt, there are lot of benefits of dematerialized system but at the same time there are many flaws in this system particularly with reference to Pakistan which can easily curtail the confidence of the investors to invest in our capital markets and securities, the existence of these flaws is a matter of serious concern for our government, stock market regulators and the depository itself because this can impair the growth of our capital markets and ruin the trust of the investors who consider it a safe haven for their investment.

In this chapter I am going to discuss about the performance of Central Depository Company of Pakistan. Here I will discuss its benefits, features and certain misconceptions about this system and also criticize its performance through mentioning its flaws, specially, how the CDC itself commits unlawful acts and flouts the provisions of law and how brokers, financial agents or experts and other members of our stock exchanges which are authorized agents of the Central

Depository Company of Pakistan and which are technically called as depository participants, manipulate the market, with the help of relevant case laws.

### **3.1 Features of the central depository system:**

There are some unique features to the Central Depository System in Pakistan which have been implemented in Pakistan. Some features of Depositories system of Pakistan are as follows:

1. One unique feature is that participants are able to interact independently with the Central Depository System with no involvement whatsoever of the Central Depository Company employees. Their job is simply to keep the system up and running. Apart from that all buying, selling pledging of shares are done by the participants as per the instructions of their clients.
2. Another unique feature is that the shares that are to be deposited will not be sent to the Central Depository Company but to the registrars who will check to see that all is in order, intimate the CDC and the shares will be registered. The participant has a record of the shares and the owner is issued a slip of paper which shows his ownership. This reduces the work load on the Central Depository Company and also allows them to concentrate more on the task at hand, maintaining the depository.<sup>141</sup>
3. The depository is a registered owner of the share. The shareholders are the beneficial owner retaining all the economic and voting rights arising out of share ownership.
4. Shares in the depository are fungible.
5. Transfers pertaining to sale and purchase are effected automatically
6. Any loss or damage caused to the participant will be indemnified by the depository

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<sup>141</sup>Khurram Baig, "The Central Depository goes online" (1997), Available at <<http://www.pakistaneconomist.com/database2/cover/c97-24.asp>> (Last accessed January 9, 2012).

7. If trades are routed through depository, there is no need to pay stamp duty<sup>142</sup>
8. Immobilization and dematerialization of certificates
9. Electronic book entry delivery and settlement
10. Ability to handle corporate actions
11. Strict confidentiality and maximum security for users of the system
12. Safeguards for account holders through legislation
13. Automated system which provides investors an efficient central clearing of securities
14. Real time information is available to issuer or registrants and share transfer agents
15. Companies can monitor critical holdings
16. Legal matters can be solved easily
17. There is no additional security or storage cost of data as there is no critical database residing at the front-end terminals with the issuers or registrants
18. Investors are more confident as securities are held under their names
19. Easier to manage and minimize errors
20. Direct transfer facility
21. Easier to monitor the trading as first hand information on trading personnel<sup>143</sup>
22. In the matter of security, records are maintained electronically with a hot backup, it will be difficult to steal or lose information. The records are updated concurrently as and when the transactions are carried out. Therefore, the probability of omissions will be very remote. <sup>144</sup> Strict confidentiality is one of the key features of CDS. No unauthorized person has access to information, including CDC employees. Legal safeguards also ensure that strict confidentiality is maintained. Security measures have been

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<sup>142</sup> Central depository Act 1997.

<sup>143</sup> Ibid.

<sup>144</sup> Ibid.

ensure that strict confidentiality is maintained. Security measures have been implemented at various levels. The Local Area Network (LAN) as well as the Wide Area Network (WAN) has been equipped with sophisticated protective mechanisms to secure the entire system against piracy or breach of confidentiality. A series of checks have been installed in the network so as to restrict unauthorized access and minimize security risk.

23. In addition, backups of the data made daily to reduce data loss risk. The system is connected to a UPS with further backup by two standby generators. The database also maintains audit trails and log reports daily. There is a disaster recovery program in the event of disruption of service to the users.<sup>145</sup>

### **3.2 Operation of Central Depository System:**

The main operations performed in the CDS are as follows:

- Deposit of existing and new securities into the depository
- Withdrawal of securities in the form of certificates from the depository to provide for investors who prefer to have physical possession of certificates.
- Free transfer or book entry transfer of securities without any associated cash movement.
- Pledge/release/call like placing a lien on securities in favor of a lender which can only be released by the lender.
- Stock borrowing or lending through the mechanism of transfer with or without associated money movement through the depository system.

<sup>145</sup> Khurram Baig, "The Central Depository goes online" (1997), Available at <<http://www.pakistaneconomist.com/database2/cover/c97-24.asp>> (Last accessed January 9, 2012).

- • A corporate action like bonus issues, rights entitlements, sub-division, consolidation and any other action that changes the number of securities held in a participant's account or involves the determination of entitlement to beneficial owners.
- Delivery versus payment, book entry transfer of ownership of a security in exchange for payment to settle a transaction.
- Cash only movement, movement of cash from one account to another without any associated securities movement.<sup>146</sup>

### 3.3 Process of conversion of securities into the demat form:

Securities can be converted or issued in a dematerialized form. The process of conversion of securities into a dematerialized form or the issuance of the same in a dematerialized form can be explained as follows:

1. First of all the issuer company, whose securities are eligible for dematerialization, has to enter into an agreement with a depository for dematerialization of securities already issued, or proposed to be issued to the public or existing shareholders.
2. The investor is given an option to hold the securities in a dematerialized form and it is his prerogative to exercise the option to hold the securities in that manner.
3. The depository enters into an agreement with the participants who are the agents of the depository and co-functionaries in the process of dematerialization of securities.
4. Any person can then enter into an agreement, through the participant, with the depository for availing the services provided by the depository.
5. On the entrance into such contract with the CDC, the person has to give up and deliver his certificates concerning the securities required to be converted into dematerialized form

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<sup>146</sup> Ibid.

to the company who is issuer. This give up or surrender is completed in the following manner:

- (i) The person (beneficial owner) who has entered into an agreement with the participant for dematerialization of the securities has to inform the participant about the details of the certificate of such securities.
- (ii) The beneficial owner has to then deliver the said certificates to the participant.
- (iii) The depository participant tells the depository about the particulars of the securities to be dematerialized and the agreement entered into between him and the beneficial owner.
- (iv) The participant then transfers the certificate concerning the said securities to the issuer along with the details and particulars of the securities.
- (v) These share certificates are destroyed on the receipt by the company and replaced in the records held by it against the name of the CDC, who is the registered owner entitled of the mentioned securities. For this purpose a certificate is sent to the CDC and all capital markets where the said security is listed.
- (vi) Subsequent to this, the depository enters the name of the person who has given up or delivered the certificate of security as the beneficial owner of the dematerialized securities.
- (vii) The depository also enters the name of the participant through whom the process has been carried out and sends an intimation of the same to the said participant.

6. Once the abovementioned process of dematerialization is carried out, the depository has the responsibility to maintain all the records pertaining to the securities that have been dematerialized.<sup>147</sup>

### 3.4 Transactions in investor account services:

Investor Account Services offered by Central Depository Company allows retail investors to directly open and maintain accounts in Central Depository System for electronic settlement of securities. Earlier, to settle the securities through Central Depository System, investors had to open client accounts (subaccounts) with the CDS Participants (brokers & financial institutions). With Investor Account Services, investors can now have direct access to their accounts. Investors now have direct access to their securities, which are maintained by Central Depository Company in accounts operated directly and only on the instructions of investors.

#### 3.4.1 Deposit:

In order to deposit securities into Central Depository System, an investor needs to fill out the Securities Deposit Form; affix transfer stamps as per the prevailing rate on the R/TA copy of the form and submit it at the front desk of Investor Account Services department. Deposit request along with relevant documents is sent to respective issuer on the same day. An investor can check account balance to ensure that securities have been transferred by the respective Issuer.<sup>148</sup>

<sup>147</sup> Trinath Tadakamalla, "Dematerialized Securities" Available at <[http://www.legalserviceindia.com/articles/dematerialized\\_securities.htm](http://www.legalserviceindia.com/articles/dematerialized_securities.htm)> (Last accessed January 25, 2012).

<sup>148</sup> "Investor Account Services (IAS)" Available at <<http://www.cdepakistan.com/userpanel/AboutUs/ViewContent.aspx?m=ch&ttype=0038>> (Last accessed January 16, 2012).

**3.4.2 Delivery in:**

An investor needs to provide his investor account number to the Participant in order to transfer securities in his Investor Account.

**3.4.3 Delivery out:**

At the time of opening of Investor Account, an investor<sup>149</sup> is given a transaction order book (which is similar to a bank cheque book) for delivery out transactions. The investor fills out details in the transaction order leaf and submits the same at the front desk of Investor Account Services department along with the payment. Before making the payment, the investor makes sure that his account has sufficient available balance of the security to be transacted. Delivery to another CDC Investor Account Holder can only be made by way of a gift.<sup>150</sup>

**3.4.4 Pledge:**

In order to pledge his securities, an investor needs to fill out the securities pledge form and submit it at the front desk of Investor Account Services department. The investor can only pledge securities in favor of Pledgees having accounts in Central Depository System as Eligible Pledgees. On the day of submission the pledge instructions are executed at anytime.

**3.4.5 Withdrawal:**

In order to withdraw securities from Central Depository System, an investor needs to fill out the Securities Withdrawal Form; affix transfer stamps as per the prevailing rate on the second or

<sup>149</sup> Investors having accounts with Investor Account Services can give instructions of a maximum of three securities per transaction order. While transacting in more than one security, the investor makes sure that sufficient available balance of each security is present in his account. If there is no sufficiently available balance of any security in his account, the transaction order cannot be executed, as partial transaction cannot be carried out. A new transaction order is required in such cases.

<sup>150</sup> In such cases, the gift deed has to be submitted with the transaction order, if both the account holders transferor and transferee are blood relatives. If both transferor and transferee are not blood relatives then in addition to gift deed transaction account holder is required to underline the transactions from the stock broker. In other words, CDC only makes deliveries to the CDC Participants and Account Holders and not to Investor Account Holders.

third copy of the form and submit it at the front desk of Investor Account Services department. Withdrawal request along with relevant documents is sent to respective issuer at any time on the same day. An investor receives physical certificates from the issuer directly on the basis of first copy of Securities Withdrawal Form.

### 3.4.6 Free Delivery:

It applies to all book entry delivery of securities, which takes place without any equivalent movement of cash in the system. Once the securities are deposited in Central Depository System, they become available for delivery from one Central Depository System account to another. If the transfer of securities is within the account family of a Participant, it is called Intra-Participant Free Delivery. Similarly, if securities are transferred from one Participant to another, the transaction is called Inter-Participant free delivery.<sup>151</sup>

## 3.5 Legislations on Depository system:

### 3.5.1 Central Depositories Act, 1997:

Central Depository Company of Pakistan Limited was formed under Central Depositories Act 1997 which was passed on June 10, 1997. Subsequently, Central Depository Company of Pakistan Limited Regulations were developed and approved by the Securities and Exchange Commission of Pakistan. The establishment of a Central Depository System required changes in the legal framework. Registered owners of securities were recognized as beneficial owner by law before the Central Depositories Act 1997. Therefore, all the rights of the security holder (benefits & voting rights etc.) were vested with the registered owner which was not suitable to the depository structure. The Central Depositories Act 1997 recognized the beneficial owner of

<sup>151</sup> "What is Central depository System" <<http://www.scribd.com/doc/18682143/What-is-Central-Depository-System>> (Last accessed January 9, 2012).

securities on the basis of share holdings in CDC accounts. In the existing depository system, all certificates and securities are registered in the name of Central Depository Company of Pakistan in the capacity of a trustee, the persons having accounts are deemed to be the beneficial owners of securities on the basis of their share holdings in CDC accounts. This Act provides provisions for the establishment and operation of book entry systems for the transfer of securities by central depository companies. Where it is necessary to make provisions for the set up and running of book entry systems for the handling and settlement of securities by central depository companies.

Section 4 provides definition of central depository system. This system shall establish a central depository system in accordance with the regulations. The accounts may be opened and maintained with the central depository by the account holders so as to record the title of the account holders to book entry securities which were entered in such accounts.<sup>152</sup>

Section 12 provides pledging of book entry securities:

“Where any securities are issued to or registered in the name of a central depository or transferred by endorsement to or deposited with a central depository, such securities shall, in accordance with the regulations, be entered in the relevant accounts or sub-accounts, as the case may be, as book entry securities”.<sup>153</sup>

According to section 6 which provides transfers under book entry system:

“A transfer of book entry securities from accounts or sub accounts to other accounts or sub accounts shall be made in such manner as may be prescribed and shall be effected by making of an appropriate entry in the central depository register in accordance with such regulations”.<sup>154</sup>

<sup>152</sup> Where the account-holders are participants, sub-accounts may be opened and maintained, as part of the accounts of the participants, with the central depository by the participants on behalf of the sub-account holders so as to record the title of the sub-account holders to book entry securities entered in such sub-accounts. Transfers of such book-entry securities shall be effected electronically or by any similar means.

<sup>153</sup> Section 12 of Central Depositories Act, 1997.

<sup>154</sup> Section 6 of Central Depositories Act, 1997.

Exchange Ordinance, 1969 (XVII of 1969. It is desirable that the affairs of the central depository system be established and regulated in accordance with the Central Depositories Act, 1997 (XIX of 1997). It is also desirable that the contract between each user of the central depository system and the Central Depository Company of Pakistan Limited be made in accordance with the Regulations. The Central Depository Company of Pakistan Limited, in use of the powers given to it by sub-section 1 of Section 35 of the Central Depositories Act, 1997 , drafts rules and regulations with the anticipated approval of the Commission.

### **3.6 Reasons behind the depository system:**

There are mainly three reasons behind the establishment of central depository system which are as follows:

1. In the last few years, with the entry of foreign investors in the local markets the Stock Markets in Pakistan have registered exceptional growth. With the passage of time trading volumes have increased multiple problems relating to physical handling of certificates. This system became more cumbersome and time consuming. Without automation and immobilization of certificates, the delivery and settlement of securities would become unmanageable, not to mention highly risky.
2. Secondly, the current delivery, settlement and transfer procedures have traditionally been infected by lengthy delays, risks of damage, loss, forgeries, duplication and considerable investment in time and capital. Implementation of the Central Depository System will not only minimize these problems, but also assist in the development of the capital market.
3. Thirdly, the implementation of Central Depository System in Pakistan will fulfill the recommendations made by the Group of Thirty, a private international body whose charter is to raise awareness and understanding of major international and financial

investment in time and capital. Implementation of the Central Depository System will not only minimize these problems, but also assist in the development of the capital market.

3. Thirdly, the implementation of Central Depository System in Pakistan will fulfill the recommendations made by the Group of Thirty, a private international body whose charter is to raise awareness and understanding of major international and financial issues. The main objective behind this is to standardize the settlement procedures and reduce associated inherent risks on a global basis. The most important recommendation made by the Group of Thirty was to setup securities depositories by major stock exchanges worldwide so as to facilitate delivery and settlement of transactions. The Group of Thirty's recommendations have been adopted by the International Federation of Stock Exchanges and are supported throughout the international securities community.<sup>155</sup>

### **3.6.1 Misconceptions regarding depository system:**

The process of handling securities is just same like old process the only difference is that the securities are converted into electronic form rather than in physical forms. The only change occurred at the time of settlement. As opposed to most misconceptions, trading activities and other practices like badla, borrowing or lending of shares, short selling and blank selling are independent of the workings of the Central Depository System. This system is simply an electronic vehicle to facilitate the delivery, settlement and transfer of securities. Trading practices in securities remained as they were before. Investors are still instructing their brokers to buy or sell, settlement and clearing process is continue as per the existing system. Electronic book entry deliveries are still be made by the participants and not by the Central Depository Company staff. There are group accounts which will replace the current "benami" accounts. The

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<sup>155</sup> Khurram Baig, "The Central Depository goes online" (1997), Available at <<http://www.pakistaneconomist.com/database2/cover/c97-24.asp>> (Last accessed January 9, 2012).

### 3.7 Advantages of Depository system:

When the securities are transferred in dematerialized form the beneficial ownership will be transferred as soon as the shares are transferred from one account to another. This process helps for saving time and eliminates the process of posting of certificates. Many problems are solved due to the implementation of central depositories system which was faced by investors. These problems were:

- Delay in the receipt/non-receipt of securities after allotment,
- Delay in refund orders to non-allottees,
- Delay in getting duplicate copy of shares/debentures certificates,
- Difficulties in handling a large volume of application and storage of share certificate.<sup>156</sup>

The system provides various direct and indirect benefits which are as follows:

#### 3.7.1 Elimination of bad deliveries:

The question of bad delivery is totally removed when the investor is holding his securities in demat form. The problems are reduced like bad delivery, fake certificates, shares under litigation, signature difference of transferor and the like in the physical environment, buyer of shares was required to take the risk of transfer and face uncertainty of the quality of assets purchased. In a depository environment good money certainly produces good quality of assets. Statistically, in the physical environment, about 20% of delivered stock comprises bad deliveries. Of these, about 1% is ultimately absorbed by the system as bad delivery cost. The investor is not entitled to trade the securities until the securities are registered. This means that in the scrip based environment, every fifth person receiving or accepting of the handing over of securities

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<sup>156</sup> Gobinda Sharma Gairhe, "Central Depository System" (January 1, 2010) Available at <<http://gobindasharma.blogspot.com/2010/01/central-depository-system.htm>> (Last accessed January 12, 2012).

the physical environment, about 20% of delivered stock comprises bad deliveries. Of these, about 1% is ultimately absorbed by the system as bad delivery cost. The investor is not entitled to trade the securities until the securities are registered. This means that in the scrip based environment, every fifth person receiving or accepting of the handing over of securities receives or accepts securities, the authenticity to which there is a ambiguity whereas he give away genuine money.

### **3.7.2 Elimination of all risks associated with physical certificates:**

There are security risks like theft of stocks, mutilation of certificates, and loss of certificates during movements through and from the registrars, thus exposing the investor to the cost of obtaining duplicate certificates and advertisements, etc. are eliminated which were associated with physical securities. This also reduced workload and manpower requirements due to paperless settlement.

### **3.7.3 Vault charges and custodian charges:**

Without the depository system, a lot of physical space was required to store the certificates of securities. But when all the securities are in electronic form, there is no need to store large numbers of certificates. With the passage of time with the increasing volume of shares additional space was needed and caused great additional cost. This results in savings on vault charges and custodian charges. In Pakistan with the introduction of depository system, the need for a vault has been eliminated because when the shares registered with the Central Depository Company after the approval of the registrars these will be destroyed. Later on, if some shareholders decide to withdraw their shares from the Central Depository Company they will be issued a jumbo certificate for all the shares that he owns. In other words, even if a shareholder owns a million

shares, he will have just one certificate indicating his ownership with all the relevant details. Among other things this has contributed substantially to reducing expenses for the Central Depository Company.

#### **3.7.4 Faster settlement cycle:**

The sole scripless section follow rolling settlement cycle of T+2 i.e. the handling and settlement of business deals will be on the second working day from the transaction day. This allows faster turnover of securities and more liquidity with the investor. Pay in & pay out of securities & funds is on the same day for scripless trades. In the exclusive demat segments the settlement of trades (both securities and funds) is on the 2nd working day from the trade day. This means that a buyer, who parts with funds on the 2nd working day, gets the securities on the same day evening and a seller who parts with securities on the 2nd working day gets funds on the same day evening. This reduces the funding cost for a broker (in case of institutional trades) that they have to bear in the physical segment. In the physical segment, the settlement period is spread over a period of 3-4 days. All stock exchanges currently follow the T+2 rolling settlement cycle i.e. settlement of trades is done on the 2nd working day from the trade day. This has become possible because of demat, which enables faster transfer of securities and enhances liquidity.

#### **3.7.5 Enhances the marketability of securities:**

The depository system facilitates faster settlement and greater liquidity in the market, which enhances the marketability of securities. In fact, the current rolling settlement cycle being followed in the stock exchanges is made possible only by the depository system.

**3.7.6 Waiver of stamp duty:**

No stamp duty for transfer of equity instruments & units of mutual funds in the Central depository system.<sup>157</sup> And also there is no any requirement of stamp duty by transferee on purchase of shares. There is no need to fill a transfer form for transfer of shares and affix share transfer stamps. The investor is able to save a lot on account of stamp duty because the government has exempted stamp duty on transfer of securities.

**3.7.7 Pledge or hypothecate the securities:**

If an investor wants to pledge or hypothecate the securities, it is easy to do in the demat mode. Money lending institutions also extend easy and more credit against securities that are dematerialized. The interest rate may also be low on such bank credit. Because the demat securities that are pledged or hypothecated can be transferred easily and quickly in the name of the credit institution in case the borrower fails to repay the loan amount as per the terms and conditions of the loan.

**3.7.8 Improves the efficiency of the Company's secretarial department:**

The system reduces the cost incurred by the company in issuing and distributing shares due to elimination of all paperwork. It also improves the efficiency of the company's secretarial department.

**3.7.9 Freezing or locking of an investor's demat account:**

The facility for freezing or locking of an investor's demat account is made available by the depository system. This enables certain authorities and even the investors to make the accounts non operational, providing complete safety to the investor.

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<sup>157</sup> In case of physical shares, stamp duty of 0.5% is payable on transfer of shares.

valuable time on the physical handling of certificates and paperwork. The Central Depository System today cause a sharp decline in back office work by providing a convenient, efficient and reliable means to settle securities transactions.

### **3.7.11 Less margin payments:**

Trading in dematerialized securities involve less margin payments by the investors. Now they may be able to deliver securities well before the pay in day.

### **3.7.12 Insurance Cover:**

The depository system offers an insurance cover to the investors in the event of a loss suffered by the investor due to negligence at the depository level.

### **3.7.13 immediate transfer and registration of securities:**

In the depository system, there is easy trading and instantaneous settlement of trades. The investors can enter and exit from the trade easily and quickly. This enables the investors, particularly institutional investors to trade more frequently. So it benefits investors to make more profit with their increased business. On the sale of securities the investors received funds more quickly and then immediately registered securities on purchase. Thus, they do not miss out corporate benefits such as dividends and rights. On the other hand when securities are transferred physically, that process take around three to four months and is rarely completed within the statutory framework of two months which results the delay and risk of loss in transit.<sup>158</sup>

### **3.7.14 Faster disbursement of non cash corporate benefits like rights, bonus, etc.:**

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<sup>158</sup> "Citibank NRI Demat Account" Available at <<http://www.online.citibank.co.in/citi-nri/products-services/demat.htm>> (Last accessed Februry 1, 2012).

physically, that process take around three to four months and is rarely completed within the statutory framework of two months which results the delay and risk of loss in transit.<sup>158</sup>

### **3.7.14 Faster disbursement of non cash corporate benefits like rights, bonus, etc.:**

Depository system provides for direct credit of non cash corporate entitlements to an investors account, so ensuring faster disbursement and avoiding risk of loss of certificates in transit. The system makes it easier and faster to provide corporate entitlements like dividends, rights and bonus to the investors when their securities are dematerialized. The non cash corporate benefits if any, are directly credited to investors demat account.

### **3.7.15 Reduction in brokerage by many brokers for trading in dematerialized Securities:**

Brokers provide this benefit to investors as dealing in dematerialized securities reduces their back office cost of handling paper and also eliminates the risk of being the introducing broker. Reduction in handling of huge volumes of paper and periodic status reports to investors on their holdings and transactions, leading to better controls.

### **3.7.16 Elimination of problems related to change of address of investor, transmission, etc.:**

In case of change of address or transmission of demat shares, investors are saved from undergoing the entire change procedure with each company or registrar. Investors have to only inform their Depository Participant with all relevant documents and the required changes are effected in the database of all the companies, where the investor is a registered holder of securities. For all investments held in the Beneficial Owner's account, instead of informing each

<sup>158</sup> "Citibank NRI Demat Account" Available at <<http://www.online.citibank.co.in/citi-nri/products-services/demat.htm>> (Last accessed February 1, 2012).

company separately about the change in address, bank account details, nomination, one single instruction to the Depository Participant takes care of all such changes.

### **3.7.17 Elimination of problems related to selling securities on behalf of a minor:**

A natural guardian is not required to take approval of the court for selling demat securities on behalf of a minor.

### **3.7.18 Lower interest cost and margins:**

Banks charge lower rate of interest on credit against pledge of dematerialized securities because dematerialized securities eliminates all risks. enhancement in maximum extent of advances from Rs. ten lakh to Rs. twenty lakh per borrower and diminution in minimum perimeter from fifty percent to twenty five percent by banks for advances against scrip less securities as per the Monetary and Credit Policy for the first half of 1998 to 1999 announced by the Reserve Bank of India. Lessening in brokerage of 0.25 percent to 0.5 percent by most of the brokers for dealing in scrip less security.

### **3.7.19 Lower brokerage cost:**

Brokers charge lower brokerage to investors as dealing in dematerialized securities reduces their back office cost of handling paper and also eliminates the risk of being the introducing broker. Reduction in handling of huge volumes of paper periodic status reports to investors on their holdings and transactions, leading to better controls.

### **3.7.21 E-mail Facility:**

In central depository company the facility of E-mail provides the capability to send encrypted emails with digital signatures to its Elements in Karachi, Lahore and Islamabad. With this facility Central Depository Company can correspond with its clients in an effective and cost efficient manner.

### **3.7.22 Government securities:**

The scripless securities improve efficiency in the government debt securities market. All the settlement of transactions of securities is recorded in the computer system of Central Depository System. Because of the electronic book entry system, the bulk of transactions in government securities are anticipated to enhance by many times. Intromission of electronic book entry system aids in generalizing government securities among the investors. The ownership of the government securities will be broad based and the profoundness of the market will enhance. The liquidity of government securities is increased because of the efficiency in trading and settlement.

## **3.8 Flaws in Central Depository Company and Central depository system of Pakistan:**

No doubt, majority of the earlier flaws tormenting the capital markets in the country were removed or erased, some new ones happen to come into being with the changed system. While the depository system itself airs many built in risks of fraud, the more everyday problem confronted by the investors was that of huge expenditures imposed by the depository participants on the persons who are account holders. In consequence, many small investors give precedence to keep their shareholding in scrip form as they found the charges to be excessively high.

Central depository company of Pakistan is the only depository operating in our country and thus being sole depository it is entrusted with the huge responsibility to be honest and impartial in all its dealings .Because a fraud on its part may cause irreparable loss to our financial markets thereby damaging the progress and development of Pakistan by breaking the trust of the investors which play the role of backbone in the development ,growth and progress of a country. central depository company in the underneath mentioned case is declared to have exercised prejudice and partiality and acted unlawfully in favor of Lahore stock exchange and committed fraud in collusion with Lahore stock exchange which is highly objectionable on its part and a matter of serious concern for Pakistan who wants to make its secondary markets efficient and secure heavens for the incoming investors.

There are some flaws in the central depository system in Pakistan which describes the clear picture of our depository system. Though the Central Depository Company plays an important role but in some cases the CDC has done wrong on its side. Here I am going to discuss the flaws with the reference of case laws which are as follows:

### **3.8.1 Unlawful sale of pledged shares:**

Central Depository Company at one place unlawfully sold the pledged shares of an investor which is the wrongful act by the company. A case<sup>159</sup> law which clearly criticizes the role of

Central Depository Company on holding the pledged shares of investors. The plaintiff<sup>160</sup> Mian Nisar Elahi files a suit under section 8(5) and section 11 of the Central Depository Act 1997.

<sup>159</sup> *Mian Nisar Elahi vs. Lahore Stock Exchange (G) Limited. 2007 CLD 376.*

<sup>160</sup> The plaintiff who is an investor in securities, has prayed for a decree against defendant No. 1 which is the Lahore Stock Exchange and defendant No.2 the Central Depository Company of Pakistan Limited jointly and severally for a minimum sum of

Central Depository Company on holding the pledged shares of investors. The plaintiff<sup>160</sup> Mian Nisar Elahi files a suit under section 8(5) and section 11 of the Central Depository Act 1997. Plaintiff was a sub-account holder. Plaintiff claimed that his shares were illegally sold. He had direct contractual relationship with the Stock Exchange created through the agency of the Member of the Stock Exchange. Right of sub-account holder to sue the central Depository for compensation was vested in himself and he was not dependent on the participant (member) for enforcing his right.

Iftekhar Shafi who is another defendant of the suit, he is an investor and was also a member of the Lahore Stock Exchange. He has been impeded for the reason, *inter alia*, that LSE and SECP have treated him and the plaintiff as part of one group which, according to LSE and SECP, had indulged in illegal activates including manipulation of prices of securities listed on the LSE. As a consequence, LSE has sold the securities of the plaintiff to adjust the liabilities owed to it by Iftekhar Shafi.

The LSE has resisted the suit; *inter alia*, on the ground that the sale of shares was in accordance with law and was also justified by the circumstances which prevailed between end May, 2000, when the stock markets in Pakistan crashed and April, 2001, when the pledged shares were sold by LSE. It has also been averred by LSE that sale of the pledged shares was sanctioned by the order dated April 9, 2001 passed by a Commissioner of the SECP. In addition, LSE has alleged that the plaintiff had agreed to the sale. The CDC in its defense, has pleaded that it was obliged by law and its own regulations to honor all instructions of LSE as pldgee and,

<sup>160</sup> The plaintiff who is an investor in securities, has prayed for a decree against defendant No. 1 which is the Lahore Stock Exchange and defendant No.2 the Central Depository Company of Pakistan Limited jointly and severally for a minimum sum of Rs. 318,588.624 together with interest on the said amount from the date of institution of the suit till the date of decree and thereafter from the date of decree till the satisfaction of the same. Costs of the Suit and such other relief which the court deems fit are also prayed for.

therefore, it had no involvement other than recording the call on the pledged shares and to transfer the same from the account of the plaintiff in accordance with LSE's call.

The pledged shares are not in the form of paper scrips. These shares are entered in and the transactions relating thereto are effected through electronic book-entry in a central depository system maintained and operated by the CDC. The liability of a Central Depository for its wrongful acts and negligence is governed under section 8 of the Central Depository Act. Subsections (1) and (5), being relevant for our purposes, are reproduced as under:

According to Section 8:

(1) A central Depository, if acting in good faith and without negligence, shall not be liable for any loss, damages, compensation, costs and expenses in tort or under any law or contract for any breach of trusts or duty and in the cases where the Central depository has, in the accounts or sub accounts maintained by it, made or allowed to be made entries or handled or allowed handling of any book-entry securities, according to the instructions of an account holder or a participant. Notwithstanding that the account holder or a participant, as the case may be, had no right to dispose of or take any other action in respect of such book entry securities.

(5) Without prejudice to the provisions of any other law for the time being in force, if any loss is caused to an account holder or a sub account holder due to any negligent or wrongful act or omission of a central depository or any of its employees, the central depository shall compensate such account holder or sub account holder for such loss.<sup>161</sup>

The plaintiff's claim against CDC is based on above subsection (5).

Pledges of book-entry securities are dealt with by section 12 of the CD Act, which provides as under:

(1) Book entry securities shall be pledged only in favor of an eligible pledgee to secure the payment of a debt or liability or performance of any obligation by any account holder directly or by any sub account holder through instruction given to a participant when the book entry securities are blocked in the manner set out in sub section (2).

<sup>161</sup> Section 8 of CDC Act, 1997.

(2) The book-entry securities to be pledged shall be blocked when an account holder or a participant gives instructions to the central depository system in a manner that the pledgor or the relevant participant when the pledgor is a sub account holder ceases to handle the pledged book-entry securities and notice of the blocking is available through the central depository system to the eligible pledgee.

(3) A pledgee of the pledged book entry securities shall in addition to the powers available to him under the Contract Act, 1872 have the following powers:-

- a. A power, upon the default of the pledgor, to transfer the pledged book-entry securities or any part thereof
- b. Any other power which may be granted to him in writing by the pledgor in relation to the pledged book entry securities provided that the central depository shall not be concerned with or affected by the exercise of any such power.

(4) The Central depository system shall only allow the pledgee to remove the block from the pledged book entry securities in such manner that they are available to the pledgor for the purpose of handling them.

(5) The Central depository system shall not allow the pledgor to handle the pledged book-entry securities save upon the removal by the pledgee of the block from such pledged book-entry securities.

(6) A participant shall not create a pledge over any book-entry securities entered in any sub-accounts maintained under his account with the central depository without the authorization of the sub account holder concerned.

(7) No pledge of any book-entry securities may be made except as provided in this section.

(8) Except as otherwise provided in this section the provisions of the Contract Act, 1872 shall be applicable to pledging of book-entry securities.

The provisions of section 12 above are in particular relevant for resolving the controversy between the contesting parties as will become evident when the issues are considered in the light of the evidence produced on record.

The Commission noted that Lahore Stock Exchange had acted unlawfully in selling the shares and CDC had also acted illegally and negligently. The Lahore Stock Exchange and Central Depository Company are entities which enjoy privileged positions by virtue of the respective licenses granted to them by SECP under SE Ordinance and CD Act. The two companies also enjoy protection from competition. At present, the Central Depository Company is the only Central Depository in Pakistan and, therefore enjoys a monopoly in its area of business. The Lahore Stock Exchange is also just one out of three Stock Exchanges in Pakistan. Both companies, as has been discussed above, are important for the efficient functioning of capital markets. The CDC, as its name suggests, is a Depository and also acts as a custodian of the interests of the various stake holders connected with the Stock market including sub account holders such as the plaintiff. In this capacity CDC has a fiduciary responsibility and a special duty of care, to ensure that the interests of account holders are properly and diligently safeguarded. A special onus, therefore, lies on CDC to perform its duties in a fair and transparent manner. The only way in which CDC can protect itself from legal action is by acting in good faith, within the law and without negligence. In the present case, for reasons noted earlier in this judgment, the commission not left in any doubt that CDC did not act lawfully and in good faith when it accepted the pledge call made by LSE and permitted the transfer of the pledged shares from the plaintiffs account to the account of LSE. Likewise LSE, as noted above, acted against

the law and in breach of the duty of care owed by it to the plaintiff. The High Court calculated the loss and passed decree in favor of the plaintiff and against Stock Exchange and central Depository Company jointly and severally.

### **3.8.2 Supervision on the role of Brokers:**

It is incumbent upon the capital market regulator to keep a close watch on the trading in dematerialized securities and see to it that trading does not act as a detriment to investors. The role of key market players in case of dematerialized securities, such as stock-brokers, needs to be supervised as they have the capability of manipulating the market.

### **3.8.3 Trading become uncontrolled:**

In case of dematerialized securities trading in securities become uncontrolled.

### **3.8.4 Different levels of dematerialization:**

In the process of dematerialization agreements are entered at various levels. These may cause anxiety to the investors who are wishing for simplicity.<sup>162</sup>

### **3.8.5 Book entry securities of different customers, keeping in a single sub-account:**

By keeping the book entry securities of different clients in a single Central Depository Company sub account opened in the name of another client is the violation by the Central Depository Company. The company place all its customers account in a single account which is infringement under section 2(27) of CDC Act, 1997. There is a case<sup>163</sup> on the issue where a

<sup>162</sup> Trinath Tadakamalla, "Dematerialized Securities" Available at <[http://www.legalserviceindia.com/articles/dematerialized\\_securities.htm](http://www.legalserviceindia.com/articles/dematerialized_securities.htm)> (Last accessed January 25, 2012).

<sup>163</sup> Ghory's Securities (Private) Limited vs Securities and Exchange Commission of Pakistan, 2008 CLD 161.

show cause notice issued to Ghory's Securities (Pvt) Ltd<sup>164</sup> by the Securities and Exchange Commission of Pakistan under section 28 of the CDC Act.<sup>165</sup>

In terms of section 2 (27) of CDC Act where "sub account" has been defined as:

"Sub-account maintained as part of the account of a participant in accordance with the regulations by a central depository in the name of a sub-account holder so as to record the title of the sub-account holder to any book-entry securities entered in such sub-account"<sup>166</sup>

In this case book entry securities which were beneficially owned by different customers were kept in a single C.D.C. sub-account opened in the name of a certain customer in violation of S.2 (27) of central depositories Act, 1997.

On the other hand the respondent made the following submission on this issue as:

The respondent contended that these book entry securities were previously held in a group account maintained by the respondent. Upon discontinuation of the group account the same had to be transferred to the individual CDC sub-accounts opened in the name of respective clients. However, these clients were not easily traceable and until the relevant information for opening of CDC sub-account could be obtained. These shares were temporarily held in a separate CDC sub-account.

The Commission considered the contentions of the respondent and the issues raised therein and the same are addressed by the commission as below:

"C.D.C. accounts are opened to establish the title and beneficial ownership of the shares and keeping the shares of clients in a C.D.C. sub-account opened in the name of another customer is a serious violation of central depositories Act, 1997, as it results in the change in the beneficial ownership of the shares"

<sup>164</sup> The respondent whose name was Ashfaq Zakaria Ghori.

<sup>165</sup> Brief facts of the case are that respondent is a member of the Karachi Stock Exchange (Guarantee) Limited and is registered with the commission under the Brokers Rules. An enquiry was initiated by the Commission in exercise of its powers under section 21 of the Securities and exchange Ordinance, 1969. The findings of the enquiry officer revealed several instances of potential non-compliances with applicable laws and regulations. A copy of the enquiry officer's report was sent to the respondent under cover letter dated May 7, 2007 which required the respondent to provide explanations on the observations of the enquiry officer together with supporting documents.

<sup>166</sup> Section 2 (27) of CDC Act 1997.

“Further, upon discontinuation of Group accounts, sufficient time period was provided to the brokerage houses to enable them to open CDC sub accounts and transfer the shares held in the Group account”

The commission<sup>167</sup> imposed penalty of Rs.25000 on the respondent because the respondent has violated the section 2(27) of CDC Act, 1997 because the respondent had kept the book entry securities of different clients in a single CDC sub-account opened in the name of another client. Since by keeping, the respondent has violated section 2(27) of CDC Act, 1997.

Another case<sup>168</sup> on the same issue where a show cause notice issued to Al Asar Securities (Pvt) Ltd by the Securities and Exchange Commission of Pakistan under section 28 of the CDC Act. The commission also imposed fine of Rs.25,000 on the respondent for the violation of section 2(27) of CDC Act, 1997. The same issue was revised in another case<sup>169</sup> and the commission imposed Penalty of Rs.75,000 on the company.<sup>170</sup>

The Enquiry Officer had disclosed that in another case<sup>171</sup> where in case of certain customers sub-accounts were not opened and in the absence of said sub-accounts, the related movements of book entry securities against the transactions undertaken by such customers were affected through a separate C.D.C. account opened in the name of another customer. The commission imposed penalty of Rs.25,000 on the company.

<sup>167</sup> In terms of section 28 read with section 3 of the CDC Act, it is provided that the Commission can impose a penalty for contravention or an attempt to contravene any provision of the CDC Act or CDC Regulations.

<sup>168</sup> *Al Asar Securities (Pvt.) Ltd. vs. Securities and Exchange Commission of Pakistan, 2008 CLD 318.*

<sup>169</sup> *Muhammad Munir Muhammad Ahmad Khanani Securities (Pvt) Ltd vs. Securities and Exchange Commission of Pakistan, 2008 CLD 259.*

<sup>170</sup> The Enquiry Officer had revealed that book entries beneficially owned by different customers were kept in a single sub-account opened in the name of a certain customer in violation of S.2(27) of central depositories act , 1997. It had established that the company had violated S.2(27) of central Depository act , 1997 in terms of Ss.3 & 28 of said act.

<sup>171</sup> *Y.H. Securities(Pvt)Ltd vs. Securities and Exchange Commission of Pakistan, 2008 CLD 509.*

### 3.8.6 Blank Sales:

In another place the company made another fault on its side to make blank sales. In terms of Regulation 4 of the 2002 Regulation, blank sales are not permissible. There is a case law<sup>172</sup> in which company had made blank sales and violated central depositories company Regulations, 2002. In this case the enquiry officer revealed that 83 instances of blank sales during the review period. But the respondent claimed that majority of these instances were in fact not blank sales and proper evidences were submitted to the enquiry office in support of the contention. The respondent submitted evidences in support of its contention, perusal of which established that 19 out of 83 instances were indeed not blank sales and pre existing interest existed at the time of the sale. But satisfactory evidences were not provided in respect of remaining 64 instances. These facts established that on 64 occasions blank sales have been made in violation of Regulation 4 of the 2002. Penalty of Rs. 25,000 are imposed on the respondent under Rule 8 (b) of the Brokers Rules. There were 785 instances where the enquiry officer reveled 785 instances of blank sales and the commission imposed 75,000 penalties on the company.<sup>173</sup>

The enquiry officer revealed in one case<sup>174</sup> that there were 6,829 instances of blank sales and the commission imposed penalty of 100,000 on the company. The same penalty was also imposed on the company<sup>175</sup> where the company made 2,444 instances of blank sales. At one place the commission did not take any penetrative action against the company<sup>176</sup> where the company made 41 instances of blank sales.

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<sup>172</sup> *Amz Securities (Pvt) Ltd vs. Securities and Exchange Commission of Pakistan*, 2008 CLD 344.

<sup>173</sup> *A.H.K.D. Securities (PVT) Ltd vs. Securities and Exchange Commission of Pakistan* 2008 CLD 280.

<sup>174</sup> *Bawa Securities (Pvt) Ltd vs. Securities and Exchange Commission of Pakistan* 2008 CLD 631.

<sup>175</sup> *Motiwala Securities (private) Ltd vs. Securities and Exchange Commission of Pakistan* 2008 CLD 639.

<sup>176</sup> *Eastern Capital Ltd vs. Securities and Exchange Commission of Pakistan* 2008 CLD 553.

### 3.8.7 Failure to send C.D.C. balance statement to customers:

It is a requirement under CDC Regulations to send balance statement to all of its customers by the 10<sup>th</sup> of each month. But the company on many cases did not send the balance statement to their customer which is the violation under regulation 6.2 A.1 of the CDC Regulations. But in all these cases the commission did not take any punitive action. But the commission gave its strict direction to the company to take measures to obtain acknowledgments of its clients to demonstrate the compliance with the CDC Regulations. Broker should take measures to obtain acknowledgment of its clients with the Regulations, 2002.

A Case<sup>177</sup> where a show cause notice issued to A.H.K.D. Securities (Pvt) Ltd by the Securities and Exchange Commission of Pakistan under section 28 of the CDC Act.<sup>178</sup>

In terms of Regulation 6.2 A.1 of the CDC Regulations, it is provided that:

Every Participant shall send by the 10<sup>th</sup> day of every month to all sub-account holders maintaining sub accounts under the control of such participant holding Balance statements showing the number of every Book-entry security entered in every such sub account as of the end of the preceding month. Such holding balance statements shall be generated from the CDS and shall be sent to the sub account holders in the manner set out in Regulation 2.6.4.<sup>179</sup>

The Enquiry officer revealed that the respondent did not have a practice to send the CDC balance statements to all of its customers by the 10<sup>th</sup> of each month which is required under the CDC Regulations and where the CDC Balance statements were sent, the same were not generated from the CDS, instead the statement was sent on the respondent's own format. The respondent contented that its clientage is mainly comprised of retail clients who obtain their CDC balance statements and other details by hand on a daily basis and record of provision of

<sup>177</sup> A.H.K.D. Securities (PVT) Ltd vs. Securities and Exchange Commission of Pakistan 2008 CLD 280.

<sup>178</sup> Brief facts of the case are that respondent is a member of the Karachi Stock Exchange (Guarantee) Limited and is registered with the commission under the Brokers Rules. An enquiry was initiated by the Commission in exercise of its powers under section 21 of the Securities and exchange Ordinance, 1969.

<sup>179</sup> Regulation 6.2 A.1 of the CDC Regulations.

CDC balance statements to the clients is not maintained due to the large number of clients. In this case Broker was directed to take measures to obtain acknowledgment of its clients to demonstrate the compliance with the Regulations, 2002 and the commission decided that they will not take any punitive action under section 28 of the CDC Act.

Another Case<sup>180</sup> on the same issue where a show cause notice issued to Al Asar Securities (Pvt) Ltd by the Securities and Exchange Commission of Pakistan under section 28 of the CDC Act. Brief facts of the case are that respondent is a member of the Karachi Stock Exchange (Guarantee) Limited and is registered with the commission under the Brokers Rules. An enquiry was initiated by the Commission in exercise of its powers under section 21 of the Securities and Exchange Ordinance, 1969. The commission imposed penalty of Rs.25,000 was imposed on the company. Because the company did not send the balance statement to its clients by the 10th of each month and the company has violated RegIn.6.2A-1 of central Depository Company of Pakistan Regulations, 2002.

Another place the respondent file a suit<sup>181</sup> where a show cause notice issued to First Pakistan Securities Ltd by the Securities and Exchange Commission of Pakistan under section 28 of the CDC Act.<sup>182</sup> The enquiry Officer had revealed that the company did not have a practice to send C.D.C. balance statements to all of its customers by the 10th of each month.

The respondent contended that the CDC report appears at the end of its ledger statement and is thus accessible to its customers. Further, the respondent contended that the customers are regularly informed of their CDC positions. The Commission considered that the CDC position as

<sup>180</sup> *Al Asar Securities (PVT.) Ltd vs. Securities and Exchange Commission of Pakistan 2008 CLD 318.*

<sup>181</sup> *First Pakistan Securities Limited vs. State. 2008 CLD 168.*

<sup>182</sup> Respondent is a member of the Lahore Stock Exchange (Guarantee) Limited and is registered with the commission under the Brokers Rules. An enquiry was initiated by the Commission in exercise of its powers under section 21 of the Securities and Exchange Ordinance, 1969.

appearing in the back office record of the respondent cannot be a substitute for the CDC balance statement s generated from the CDS. Further, the CDC balance statements must be sent to all customers strictly by the 10<sup>th</sup> of each month and the respondent must have measures in place to established compliance with this requirement. However, considering the practical difficulties in sending the C.D.C. balance statements to all the clients of the company, including the dormant accounts. The commission takes a lenient view in the matter and did not take any punitive action under section 28 of the CDC Act. The commission directs the respondent to ensure that full compliance should be made in future.

In another suit <sup>183</sup> on the same issue, a show cause notice issued to Motiwala Securities (Pvt) Ltd by the Securities and Exchange Commission of Pakistan under section 28 of the CDC Act. The respondent submitted that it regularly sends CDC holding statements to its clients through courier service. The respondent submitted supporting documents for this claim. The Commission considering the above mentioned facts and decided to take no punitive action which is required under section 28 of central depositories Act, 1997.

There is also another case<sup>184</sup> where a show cause notice issued to Bava Securities (Pvt) Ltd by the Securities and Exchange Commission of Pakistan under section 28 of the CDC Act. The respondent contended that the CDC Balance statements are regularly sent to its clients through courier service. However, evidence of dispatch of statements was impractical to maintain. The commission decided not to take any action under section 28 of the CDC Act. The commission further directs the respondent to take measures to maintain evidence of dispatch of CDC Balance statements to its clients in order to demonstrate compliance with the CDC Regulations.

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<sup>183</sup> Motiwala Securities (private) Ltd vs. Securities and Exchange Commission of Pakistan 2008 CLD 639.

<sup>184</sup> Bawa Securities (Pvt) Ltd vs. Securities and Exchange Commission of Pakistan 2008 CLD 631.

On the other hand show cause notice<sup>185</sup> issued to Amz Securities (Pvt) Ltd by the Securities and Exchange Commission of Pakistan under section 28 of the CDC Act. The enquiry Officer had revealed that the company did not have a practice to send said C.D.C. balance statements to all of its customers by the 10th of each month as required under the CDC Regulations and where the CDC Balance statements were sent, the same were not generated from the CDS. Instead the statement was sent on the respondent's own format. The respondent admitted that the CDC Balance statements were provided only to its active clients and whenever requested by any client, as sending the same to all of its clients raised its operating costs and placed unnecessary burden on the respondent. The respondent also claimed that it provides CDC Balance statements to its inactive clients if requested by them. The respondent further stated that it has made arrangements to comply with the requirements of above mentioned regulation in future.

The Commission is cognizant of the practical difficulties associated with sending C.D.C. balance statements to all customers, especially in cases of brokerage houses with a large clientage comprising a significant number of dormant accounts and acknowledging the fact that the company is following the requirement of the Regulations in spirit by providing the CDC balance statements to its active clients. The commission did not take any punitive action under S.25 of central depositories act, 1997.

Another Case<sup>186</sup> where a show cause notice issued to Ismail Iqbal Securities (Pvt) Ltd by the Securities and Exchange Commission of Pakistan under section 28 of the CDC Act.<sup>187</sup> The respondent contented that it has a practice of balance reports to its clients on daily basis through

<sup>185</sup> *Amz Securities (Pvt) Ltd vs. Securities and Exchange Commission of Pakistan 2008 CLD 344.*

<sup>186</sup> *Ismail Iqbal Scurties (Private) Ltd vs. Securities and Exchange Commission of Pakistan 2008 CLD 526.*

<sup>187</sup> Enquiry Officer had revealed that the company did not have a practice to send said C.D.C. balance statements to all of its customers by the 10th of each month as required under the CDC Regulations and where the CDC Balance statements were sent, the same were not generated from the CDS. Instead the statement was sent on the respondent's own format.

e-mail and has also started the practice of sending the CDC Balance statement through courier. The commission decided that to avoid future problems the company should avoid these actions and the commission takes no any action against the company.

Another Case<sup>188</sup> which is about the same issue where a show cause notice issued to Inter-market Securities (Pvt) Ltd by the Securities and Exchange Commission of Pakistan under section 28 of the CDC Act. Contention of the company was that it was regularly sending C.D.C. holding statements to its clients through courier service. The respondent submitted supporting documents for this claim. The commission again did not take any punitive action.

Another Case<sup>189</sup> where a show causes notice issued to Eastern Capital Ltd by the Securities and Exchange Commission of Pakistan under section 28 of the CDC Act.

The respondent contended that "the CDC Balance statements to its clients on regular basis and any failure in this regard would be of isolated nature and due to bona fide error". However, evidences of dispatch of CDC Balance statements were impractical to maintain. No punitive action was required under S.28 of central depositories act, 1997. The commission directed the respondent to take measures to obtain acknowledgements of its clients to demonstrate compliance with the CDC Regulations.

### 3.8.8 Failure to open sub-account:

In some circumstances company fail to open sub account. The reason behind to open C.D.C. sub-accounts is to establish the title and beneficial ownership of the shares and keeping the shares of clients in a C.D.C. sub-account opened in the name of other customer, is a serious

<sup>188</sup> *Inter market Securities (Private) Ltd vs. Securities and Exchange Commission of Pakistan 2008 CLD 539.*

<sup>189</sup> *Eastern Capital Ltd vs. Securities and Exchange Commission of Pakistan 2008 CLD 553.*

violation of the central depositories Act, 1997 because it would result in the change in the beneficial ownership of the shares.

A Case<sup>190</sup> where the findings of the Enquiry Officer had revealed that in case of certain customers, sub-accounts were not opened and in the absence of those sub-accounts, the shares beneficially owned by those customers were affected. Submission of the company was that all the customers whose shares were held in the sub-account, had given authority letters for that practice and those customers were not interested in opening individual C.D.C. Sub accounts. Penalty of Rs.25, 000 was imposed on the company in terms of Section 28 read with Section 3 of central depositories act, 1997.

Another case<sup>191</sup> in which shows cause notice issued to Eastern Capital Ltd by the Securities and Exchange Commission of Pakistan under section 28 of the CDC Act. The officer revealed certain cases of customers of the company where no sub-accounts were opened and in the absence of said accounts, the related movements of securities against the transactions undertaken by such customers were effected through either the house accounts or a C.D.C. sub-account opened in the name of another customer. On the other hand, the company contended that under central depositories Act, 1997, it was not mandatory to open the C.D.C. account of customer and that it had corrected its practice and had opened C.D.C. account of all of its customers. By keeping the book entry securities of different clients in a single C.D.C sub-account opened in the name of another client, the company had violated S.2(27) central depositories act 1997 and Regulation. 2.11.1 of central Depository Company of Pakistan Regulations. 2002, a penalty of Rs.25,000 was imposed on the company.

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<sup>190</sup> *Siddiq Moti vs. Securities and Exchange Commission of Pakistan* 2008 CLD 665.

<sup>191</sup> *Eastern Capital Ltd vs. Securities and Exchange Commission of Pakistan* 2008 CLD 553.

Another case<sup>192</sup> where a show cause notice issued to Standard Capital Securities (Pvt) Ltd by the Securities and Exchange Commission of Pakistan under section 28 of the CDC Act. Findings of the Enquiry Officer had revealed that in certain client to client transactions, delivery was moved to the Director's account instead of opening a sub-account of a client. It was established that the company had, violated S.2(27) of central depositories act , 1997. However, considering the magnitude and frequency of the instances in question, lenient view in the matter was taken and punitive action under R.8 of Brokers and Agents Registration Rules, 2001 would not be taken. A "caution" to the company would suffice with direction to the company to ensure that full compliance would be made of all the regulations in future for avoiding any punitive action under the law.

### **3.8.9 Customers Securities held in house account for pledge purpose:**

In some cases book entry securities of certain customers are kept in the C.D.C. house account of the company. But the practice has now been stopped. Placing of customers shares in the C.D.C. house account of the company for pledge with financial institutions was not an acceptable practice in order to provide financing to the customers. CDC accounts are opened to establish the title and beneficial ownership of the shares and keeping the shares of clients in the house account is a serious violation of the CDC Regulations, as it results in a change in the beneficial ownership of the shares. In terms of Sections 3 & 28 of the central depositories Act, 1997, it is provided that Securities and Exchange Commission can impose a penalty for contravention or an attempt to contravene the provision of central depositories Act, 1997 or Regulations, 2002. There are few cases on this matter which are as follows:

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<sup>192</sup> Standard Capital Securities (Pvt) Ltd vs. Securities and Exchange Commission of Pakistan 2008 C.I.D 221.

A case<sup>193</sup> law on this issue where a show cause notice issued to Ismail Abdul Shakoor Securities (Pvt) Ltd by the Securities and Exchange Commission of Pakistan under section 28 of the CDC Act. Brief facts of the case are that respondent is a member of the Exchange and is registered with the commission under the Brokers Rules. An enquiry was initiated by the Commission in exercise of its powers under section 21 of the Securities and exchange Ordinance, 1969.

In terms of CDC Regulations 2.11.1, the term "House Account" is defined as:

"An account maintained on the CDS by an account holder for recording book entry securities beneficially owned by the account holder."

Findings of the enquiry Officer had revealed that the book entry securities of certain customers were kept in the C.D.C. house account of the company. But the submission of the company was that it had a practice of holding customers' shares in the C.D.C. house account of the company so as to pledge the shares and obtain financing for customers from financial institutions. The respondent submitted that the practice has now been stopped. The commission considered that, placing of customers shares in the C.D.C. house account of the company for pledge with financial institutions was not an acceptable practice in order to provide financing to the customers. CFS and margin financing could be utilized. CDC accounts are opened to establish the title and beneficial ownership of the shares and keeping the shares of clients in the house account is a serious violation of the CDC Regulations, as it results in a change in the beneficial ownership of the shares.

Company had been established that the respondent has violated Regn.2.11 of central Depository Company of Pakistan Regulations, 2002. In terms of Sections 3 & 28 of the central

<sup>193</sup> *Ismail Abdul Shakoor Securities (Pvt) Ltd vs. Securities and Exchange Commission of Pakistan 2008 CLD 456.*

depositaries Act, 1997, it is provided that Securities and Exchange Commission can impose a penalty for contravention or an attempt to contravene the provision of central depositories Act, 1997 or Regulations, 2002. Penalty of Rs.25, 000 was imposed on the company.

In another case<sup>194</sup> the findings of Enquiry Officer revealed that the book entry securities of certain customers were kept in the C.D.C. House Account of the company. Contention of the company was that it had a practice of holding customers' shares in the C.D.C. House Account of the company so as to pledge the shares and obtain financing for customers from financial institutions. Company had further contended that the practice had been adopted in order to safeguard itself in case of default of a client. Placing of customers' shares in the C.D.C. House Account of the company for pledge with financial institutions was not an acceptable practice. Interest of the company in the case of default could be safeguarded by developing appropriate risk management system which was in no way in contravention of the applicable legal framework. Company violated Regulation 2.11.1 of central Depository Company of Pakistan Regulations, 2002, and penalty of Rs.25, 000 was imposed on the company.

Findings of the Enquiry Officer had revealed in another case<sup>195</sup> that in case of certain customers no C.D.C. sub-accounts were opened and in the absence of those accounts, the related movements of securities against the transactions undertaken by such customers were effected through the house account. C.D.C. accounts were opened to establish the title and beneficial ownership of the shares and keeping the shares of clients in the house account was a serious violation of central Depository Company of Pakistan Regulations, 2002 as it resulted in a change in the beneficial ownership of the shares. Placing of customers' shares in the C.D.C. house account of the company was not an acceptable practice. Company violated Regn.2.11.1 of

<sup>194</sup> Inter market Securities (Private) Ltd vs. Securities and Exchange Commission of Pakistan 2008 CLD 539.

<sup>195</sup> Ismail Iqbal Securities (Private) Ltd vs. Securities and Exchange Commission of Pakistan 2008 CLD 526.

central Depository Company of Pakistan Regulations, 2002 in terms of S.28 read with 3 of the central depositories Act, 1997. Penalty of Rs.25,000 was imposed on the company.

## CHAPTER 4

### ROLE OF CDS IN THE DEVELOPMENT OF CAPITAL MARKETS OF PAKISTAN

Electronic revolution has brought about a number of changes in the functioning of capital markets of Pakistan. The most revolutionary change that was brought in the entire history of the Pakistan market is the introduction of depository and that was a step forward in making the market place safe and secure. The old system is paper based and caused many problems like bad delivery, delayed transfers etc., until the enhancement of Depository Act in 1997.

In this chapter I will focus on the role of Central depository system in the development of capital markets and I will also discuss the major developments of the capital markets in Pakistan and what are the future development programs for Capital markets. There were many problems which have been faced by the Capital and financial markets; in this chapter I will discuss all these problems. At the end I will conclude my whole thesis and I will also give some suggestions for the better depository system in Pakistan.

#### 4.1 Role of the IBM in the implementation of CDS project in Pakistan:

There is no doubt that the implementation of the Central Depository System in Pakistan has direct in a new era of a fast, modern and efficient delivery and settlement system. Now the investors are freed from physical handling of certificates and paperwork, while eliminating the chances of manual errors of omission and commission, reducing costs and risks, by providing for instantaneous transfer. The Central Depository System is a convenient, efficient and reliable means to settle our securities transactions.

The Central Depository System is being executed by an IBM led association along with the management of Central Depository Company. The group comprises international depository experts, information technology experts, management and financial consultants, legal advisors and international and local software companies.

In 1993, a study conducted by the experts of the renowned international firm Price Waterhouse to develop a conceptual framework for the depository. The study was sponsored by the "United States Agency for International Development" (USAID) and their report laid the foundation of depository design. In November 1994, the Board of Central Depository Company awarded a turnkey contract to the IBM group for the implementation of the system in Pakistan. The IBM group proposed a comprehensive Master Implementation Plan (MIP) to the Central Depository Company after a detailed analysis of the following matters which are as follows:

- i. National requirements
- ii. Company and Banking Laws
- iii. Regulations & Procedures
- iv. Financial and Organizational aspects of the project

In April 1995, Master Implementation Plan (MIP) was approved by the CDC Board. Subsequently, user groups performed, training sessions were conducted to introduce the system to the clients and the necessary infrastructure was developed.<sup>196</sup>

"Prior to the IBM Tivoli solution, the IT team spent approximately 21 hours per week dealing with customer complaints"<sup>197</sup>

<sup>196</sup> "Master vision to Stock Markets" Available at <<http://www.stockmaster.com.pk/stockmarket.htm>> (Last accessed December 10, 2011).

<sup>197</sup> Available at <[http://www01.ibm.com/software/success/essdb.nsf/CS/1.WIS8GDNUV?OpenDocument&Site=default&ctv=en\\_us](http://www01.ibm.com/software/success/essdb.nsf/CS/1.WIS8GDNUV?OpenDocument&Site=default&ctv=en_us)> (Last accessed December 10, 2011).

"Now that time has been cut to 4.5 hours per week a 79 percent decrease."<sup>198</sup>

The infrastructural development included development and testing of software, hiring and training of personnel and establishment of Central Depository Company offices. The CDC offices at Lahore and Islamabad were connected to the head office through VSA Tlink leading to the development of a geographically neutral depository.<sup>199</sup>

#### **4.2 Problems faced by the capital and financial markets before the central Depository system:**

The Depository system in Securities dealing is the result of a long felt need in the securities markets in Pakistan for a reliable and efficient way of handling security dealings. The Securities market in the developed countries have been on the dematerialized mode for quite some time now while the lack of it in Pakistan markets were apparent as a major infrastructure bottleneck for the future development of the markets. For several decades, the Pakistan markets were dependent on holding of securities and dealing in them through the physical form in which certificates were printed and issued to investors and these were the evidence for their title to such securities. Whenever these were traded, they were sent to the issuing company for transfer in the name of the transferee along with a share transfer deed signed by the transferor. This system was only depended on physical handling and transportation of securities through postal department and other means. This resulted in several bottlenecks such as delay in transit, bad deliveries due to non matching of signatures or other technical errors, loss in transit and issue of duplicate certificates, additional paper work in verification of signatures and other details and more importantly, the danger of duplicate share certificates floating in the market leading to loss of

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<sup>198</sup> *Ibid.*

<sup>199</sup> "Central Depository company" Available at <<http://www.scribd.com/doc/24886796/Central-Depository-company-of-Pakistan>> (Last accessed December 12, 2011).

investors' confidence in the system. The duplicate share problem "that rocked the stock market in the mid-nineties is a fall out of the physical handling system".<sup>200</sup>

Since the last decade, the capital markets of Pakistan have witnessed a "substantial growth leading to a manifold increase in the trading volume". The custody and safe keeping of physical certificates required maintenance of huge vaults by the individuals and institutions and the physical settlement of certificates was no longer possible.

These are major problems which had been faced by the Members of the Stock Exchange, Investors, Issuers of Securities and others. This list is as follows:

- a. Increased volume of book keeping and paper work.
- b. Problems in settlement due to increased volume.
- c. Maintenance of huge vaults for safe keeping of certificates.
- d. Long and cumbersome share transfer procedure taking up to 45 days.
- e. Payment of stamp duty on share transfers which ranged from 0.1% to 1.5% of the face value.
- f. In case of new issues the issuers would take more than two months for the dispatch of certificates to the successful applicants and for the subsequent preparation and verification of transfer deeds.
- g. Risks of damaged, lost, forged and duplicate certificates.
- h. Lengthy and tedious procedure involved in pledging of physical securities.

Capital and time investment required for issue and dispatch of share certificates, cash

<sup>200</sup> Pratap G Subramanyam, "Investment Banking: Concepts, Analysis and cases" Available at <[http://books.google.com.pk/books?id=c\\_VrZrO6VeIC&pg=SA1-PA21&lpg=SA1-PA21&dq=indian+depository+system&source=bl&ots=3yqSEbx3eo&sig=GFvvbhZv\\_217H3rrJwZDsovgML0&hl=en&sa=X&ei=NsMfT4aY1JKk4gTKzqCYDw&ved=0CFEQ6AEwCDgU#v=onepage&q=indian%20depository%20system&f=false](http://books.google.com.pk/books?id=c_VrZrO6VeIC&pg=SA1-PA21&lpg=SA1-PA21&dq=indian+depository+system&source=bl&ots=3yqSEbx3eo&sig=GFvvbhZv_217H3rrJwZDsovgML0&hl=en&sa=X&ei=NsMfT4aY1JKk4gTKzqCYDw&ved=0CFEQ6AEwCDgU#v=onepage&q=indian%20depository%20system&f=false)> (Last accessed January 26, 2012).

dividend, bonus and right issues.

- i. Issuance of duplicate certificates.
- j. Activities carried out for share transfer during book closure:
  - i. Signature verification
  - ii. Checking correct value of transfer stamps
  - iii. Verifying genuineness of certificates
  - iv. Signature of Director for confirmation of transfer

The best answer to all above questions or problems was to set up an electronic book entry system in Pakistan. Due to above problems, which have been led to the establishment of Central Depository Company of Pakistan Limited. This company developed to manage and operate the Central Depository System (CDS) in Pakistan.

The depository system provides a wide range of service for markets which are:

- i. "Primary market services" by acting as a link between issuers and the prospective shareholders.
- ii. "Secondary market services", by acting as a link between the investors and the clearing house of the exchange to facilities the settlement of security transactions of security transactions through book keeping entries.
- iii. "Ancillary services", by providing services such as collecting dividends and interest reporting corporate information and crediting bonus rights shares and so on.

These all above services lead to a reduction in both time and cost. The benefits arising from above services ultimately benefits the investors, issuers, intermediaries and the nation as whole.<sup>201</sup>

#### 4.3 Role of central depository company in the development of capital markets:

Information Technology has overturned every field of human effort and work. A major development in the Pakistani capital market has been setting up of Depository system. The speedy enhancement in number, volume and value of securities in the Pakistan capital market uncovered the limitations of handling and settlements in securities in the physical, scrip method; the flaws of the market became apparent in terms of bad deliveries, irregular settlement and delays in transfer and etc. depository brought the solution for all those kinds of problems.

The Central Depository Company was incorporated for the implementation of Central Depository System. Because during the last decade there was huge increase in trading volumes, the physical handling of paper- based shares or certificates not only became laborious but also time consuming. Central Depository Company was established to operate the Central Depository System (CDS) for equity, debt and other financial instruments that are traded in the Pakistani Capital Market. However, with the passage of time and development of Pakistan's Capital Market, this company now also provides services that are beyond the traditional depository services. The company record and maintain securities and their transfer's registration. The system changes the ownership of securities without any physical movement or endorsement of certificates and execution of transfer instruments. Central Depository Company provides depository services to Capital Market participants which includes Brokers, Asset Management

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<sup>201</sup> V S Rama Rao, "Depository System" (December 10, 2008), Available at <<http://www.citeman.com/4579-the-move-on-depository-system-in-india.html>> (Last accessed January 25, 2012).

Companies, Banks (including Custodian Banks) and general retail investors. It also helps to connect the Issuer companies and Registrars of securities and the market for the reason of implementing corporate actions for example distribution of corporate benefits and performing fusions or amalgamations and divisions.<sup>202</sup> The aim of Central Depository Company is to operate as a central securities depository on behalf of the financial services industry so as to contribute to the country's ability to support an effective capital market system which will attract institutional and retail level investors from Pakistan and abroad.<sup>203</sup>

The most important characteristics of a mature capital market is an effective and fully developed depository system which is maintaining and enhancing market efficiency. The old manual system of settlement and transfer has almost failed to handle the growing volume of paper that has loaded the market. So, the elimination of paperwork, facilitate scrip less trading and electronic book entry of the transfer of securities, shorten settlement periods, and to improve liquidity in the stock market. For the growth of capital markets there was a strong need to replace the old system of transfer and settlement with the new and modern system of depositories. Central Depository Company has expanded its operations in the following services for taking another step towards capital markets development. These services are as follows:

1. Investor Account Services (IAS) was launched in 1999 and allows retail investors to open and maintain securities' accounts directly with CDC.
2. Trustee and Custodial Services (T&C) were introduced in 2002 and enlists Open-end and Closed end Mutual Funds and Voluntary Pension Schemes.
3. Share registrar services (SRS) was launched in 2008 and provides issuing companies

<sup>202</sup> "CDC" Available at <<http://www.cdcPakistan.com/>> (Last accessed November 20, 2011)

<sup>203</sup> "Financial Services" Available at <[http://www.s-iii.com/cust\\_industry\\_fs.htm](http://www.s-iii.com/cust_industry_fs.htm)> (Last accessed January 9, 2012).

“taste of the art” facilities of registrar and transfer agent services, including registration and verification of shares and records and customer dealing on behalf of issuer companies.<sup>204</sup>

As far as the transfer of securities is concerned, the process which has been accepted today is the same as the old process. Securities are bought and sold through brokers there is no any change in the existing trading practices. The only change is at the time of settlement because instead of physical deliveries, electronic book entry settlement will be made. The dematerialization process has advantages for all the parties which are involved in the capital market operations and for the capital market in general. Now it is expected that progressive dematerialization of shares through national depository system will change the face of the primary market and lead to greater integration of markets and equitable treatment of investors. The depository system provides safeguard and solution to all the problems in the existing system. So as a result, the small and medium investors are motivated to invest and trade in the securities of the capital market.<sup>205</sup>

Central Depository Company has been the leading force in Capital Market development through programs for the creation of an efficiently functional marketplace and making a remarkable difference to how it operates. Due to CDC's efforts, “synergy among the top 6 constituents of the Pakistan Equity and Capital Markets has been achieved”. These are Securities and Exchange Commission of Pakistan (SECP), State Bank of Pakistan, country's three stock exchanges which are Karachi Stock Exchange (KSE) in particular, National Clearing Company

<sup>204</sup> Available at <<http://www.scribd.com/doc/24886796/Central-Depository-company-of-Pakistan>> (Last accessed January 12, 2012).

<sup>205</sup> O. Kajipet, “Contemporary issues in Business Finance” Available at <[http://books.google.com.pk/books?id=23jaNfEc0YC&pg=PA9&dq=SEBI+\(Depositories+and+Participant\)+Regulations+1996&hl=en&sa=X&ei=yv4lT-faJYvdOpj\\_krVE&ved=0CEIQ6AEwBIDgK#v=onepage&q=SEBI%20\(Depositories%20and%20Participant\)%20Regulations%201996&f=false](http://books.google.com.pk/books?id=23jaNfEc0YC&pg=PA9&dq=SEBI+(Depositories+and+Participant)+Regulations+1996&hl=en&sa=X&ei=yv4lT-faJYvdOpj_krVE&ved=0CEIQ6AEwBIDgK#v=onepage&q=SEBI%20(Depositories%20and%20Participant)%20Regulations%201996&f=false)> (Last accessed February 24, 2012).

(NCCPL), Central Depository Company (CDC) itself and most importantly, the market, which comprises of brokers, AMCs, mutual funds and investors. Truly speaking, Central Depository Company has directed all its efforts towards integrating people, processes and systems. The company focused primarily on empowering the people, safekeeping their assets and investments and secondarily on the improvement of markets and systems.<sup>206</sup>

#### 4.4 National Clearing and Settlement System (NCSS):

Established by the CDC administration or management, National Clearing Company runs a system called as National Clearing and Settlement System (NCSS), which is another capital market infrastructure mechanism, offering settlement and clearing opportunities to all three exchanges for transactions and business deals in eligible securities.

“Clearing and settlement are among the most important aspects in the operation of the securities business. It is the process of reporting, matching, correcting securities transactions and the ultimate delivery or receipt of net balances”<sup>207</sup>

Previously controlled and managed by the CDC management, NCCPL is registered as a different legal entity and now severally manages the National Clearing and Settlement System. To recapture the Investor’s trust in the Capital Market workings, NCCPL in collaboration with many other products and functionalities has launched an exclusive product UIN Information System (UIS), for the sake of the investors. With the execution of UIS, Investors of the Capital Market can check their deals, trading, settlement and other things and can also stop their UINs from any wrong use and un-authorized implementation of trades/transactions.

<sup>206</sup> “Capital market development” Available at <<http://www.cdcPakistan.com/UserPanel/AboutUs/ViewContent.aspx?m=au&type=0011>> (Last accessed February 24, 2012).

<sup>207</sup> *Ibid.*

#### 4.5 Corporate Debt market:

An inspiring manifester of Pakistan's corporate debt market is the comparatively broad spectrum of issuers. Investors who are in corporate debt have also been of different backgrounds. The greatest or biggest volume of investment comes from a sector called as the financial sector which includes investment banks commercial banks, insurance companies and mutual funds. Some curiosity or involvement is now being seen from large public sector funds and government entities. Employee provident are Also included in the investor base, pension funds and gratuity,. Charities and trusts also invest from time to time. Individuals remain a very small category although it is wished that this section will increase as time goes ahead.

The introduction of the central depository system has made it much more convenient for investors to hold corporate debt than was previously possible. The electronic custody system has made it easier for issuers to relay payments to holders while giving holders the benefit of safe and secure electronic storage. The depository system also makes it easier to trade corporate debt securities in the secondary market and to obtain funding against them.<sup>208</sup>

#### 4.6 Major Institutional Developments:

The major developments of the capital market in Pakistan were;

- (i) Establishment of Central Depository System;
- (ii) Automation of trade in all the three stock exchanges and;
- (iii) Establishment of Credit Rating Agencies.

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<sup>208</sup> M Imran Rjn, "Development Bond Market in Pakistan" Available at <<http://kinzulemaan.blogspot.com/2011/06/developing-bond-market-in-pakistan.html>> (Last accessed February 25, 2012).

Securities & Exchange Commission of Pakistan (SECP) has streamlined its procedure for issuance of Fixed Income Securities. Many policy decisions have been taken to encourage capital formation through stock exchanges and liberalize investment procedures. Some of the important developments in the corporate sector which have greatly increased the size and profoundness of the capital market include: rehabilitation of sick industrial units, permission for companies to buy back their own shares, assets securitization, etc. The SECP has issued the legal frame-work for securitization of assets. By introduction of this concept, Pakistan has entered in an era where financial markets could reap the advantages of this mode from which the developed markets have benefitted to a great extent. Securitization is an emerging funding option for non-bank financial institutions (NBFIs), especially in the current state of the financial markets.<sup>209</sup>

#### 4.7 Future Development Programmes for Capital Markets:

The SECP has prepared a forward looking road map for future development of capital market in Pakistan. The salient features of the road map are summarized as follows:

1. All listed companies are being motivated to enter the central depository system for further improvement of market infrastructure and ensure efficient trading.
2. A national clearing and settlement system is being established. The SECP has drafted a take-over law which is under consideration of the Government. It is also strengthening its investigative unit by qualified and trained staff.
3. An Enforcement Division has been created in the SECP under a full-fledged Commissioner to monitor performance of listed companies.

<sup>209</sup> B. Fiscal and Monetary, Chapter 7 "Capital Market" Available at <[http://www.paksearch.com/Government/STATISTICS/Survey00/CH\\_7.htm](http://www.paksearch.com/Government/STATISTICS/Survey00/CH_7.htm)> (Last accessed January 9, 2012).

4. A report on master plan for automation of the SECP has been finalized which will be approved after necessary scrutiny.
5. The SECP is already hosting a web site in which all the rules and current circular are being made available to the general public.
6. The SECP is designing a system for internet trading along with a regulatory frame work.
7. In order to bring transparency in the business of stock market, brokerage houses, and members (broker/dealer), a proper system of inspection of books and records of such brokerage houses/brokers is being established.
8. To facilitate internet trading necessary amendments in the existing software at the three stock exchanges regarding automated trading would be made.
9. The SECP has notified and prescribed cost accounting records for companies engaged in production of cooking oil, ghee and cement to inter-alia, facilitate process of audit. Similar rules for sugar industry have been notified for obtaining public opinion.
10. Code of conduct and ethics for stock brokers will be prepared. The stock exchanges as self-regulatory organizations would be required to enforce the code of conduct and ethics.
11. The SECP would ensure that the system works smoothly.
12. An advertisement in the summary form is being published to guide the small investors against various market risks. A complete guide has been prepared which would be published by SECP and made available to the general public at a nominal cost.
13. To broad-base the capital market, linkages to cities other than Karachi, Lahore and Islamabad would be established. The SECP is in the process of developing a policy framework so that the operation is extended to such cities.

14. Softwares at all the stock exchanges are to be up-graded so that the trading from the small cities through the communication linkage is facilitated. System design to be prepared on the above basis.
15. New set of rules are being developed to ensure smooth operation of Employees Stock Options. Rules on different classes of shares have been published for obtaining public opinion. It would be ensured that such shares furnish for various needs of the market.<sup>210</sup>

The Pakistani capital market has seen an unparalleled enhancement in the past few years, which has become possible by the new trends and ways in the trading and settlement systems. Automation of the trading and settlement mechanism has provided a trading system comparable with the best in the world. The formulation of a settlement guarantee mechanism abolished eliminated the counter party risk in stock exchanges. Though the coming into being of automated trading brought with it many connected advantages such as transparency in trading and equal opportunity for market players all over the country; the problems connected to settlement of trades like many cases of bad deliveries and long settlement cycles have continued.<sup>211</sup>

<sup>210</sup> B. Fiscal and Monetary, Chapter 7 "Capital Market" Available at <[http://www.paksearch.com/Government/STATISTICS/Survey00/CH\\_7.html](http://www.paksearch.com/Government/STATISTICS/Survey00/CH_7.html)> (Last accessed January 9, 2012).

<sup>211</sup> Capital Market, "Dematerialization" Available at <<http://capitalinmarket.webtutorials4u.com/home/2009/12/dematerialisation/>> (Last accessed February 1, 2012).

## CHAPTER 5

### CONLUSION AND RECOMMENDATIONS

#### 5.1 Conclusion:

On the basis of above discussion it can be concluded that the depository institutions smoothly made the transition from the paper based trading of securities to the demat based trading of the securities. But the whole system is still full of lacunas especially on the part of Depository Participants and small Investors and last but not the least the central depository itself but these problems can be solved and can make the whole system of depository institutions more successful. An analysis of the progress of dematerialization process in Pakistan shows that depository system has slowly and steadily taking firm roots in the capital markets. The issuer of securities gains much from the system of dematerialization. Depository system gives a less risky settlement with implementation of collateral bases payment systems and greater profits from increased trading volumes. The cost of bad deliveries, forged share certificates and unproductive back office activity were vanishing for corporate sector. The depository system will bring a sea change in corporate democracy, particularly in corporate management etc.

The reasons behind the formation of depositories are the limitations and problems which are associated with paper based ownership of Securities and settlement. The paper based trading system was neither investor friendly nor scalable and was challenged with problems of bad deliveries, delays, loss of certificates, forgery and failure of settlements occasionally. I must say that in case of absence of depositories every share transfer is required to be accomplished by physical movement of share certificates to, and registration with, the company concerned. This

process involves long delays and a significant portion of transactions and ends up as "bad delivery" due to faulty completion of paperwork. On the other hand the brokers also gain from the depository system on account of reduction in office expenses incurred in serving the investor clients. Once the system is adopted in financial markets to the full extent, the entire community will be benefited in one way or other through its latent and patent impacts and linkage advantages. But on other hand, dematerialization of shares is an option and an investor still has the choice of holding shares in the physical form of certificates. This system improves internal system effectively.

I must say that the Central Depository System to some extent remove the poverty problems through the creation of additional employment in the country. The expected increase will make current employers increase the number of investor agents, security dealers, clerks and investments analysts. Mostly people thinks that because of the introduction of Central Depository System employers will lose their jobs but here I would like to remove this fear that people will gain more job opportunities as a result of introduction of this new system.

This system will also facilitate the inflow of foreign investment which we really need for the economic growth of our country. This system is easy to monitor. In the future, there are plans to establish a clearing corporation somewhere down the line which will further bring the three exchanges closer together and geographical boundaries will more or less cease to exist. It may take time to be fully optimized but there is no doubt that this is the best future for this system. A more technologically advanced system was needed to maintain records of all the transactions. The government of Pakistan decided to bring a fully automated system for book-keeping, in order to eliminate all the risks that came along with the paper based certificates.

To conclude I must say that, Central Depository System will bring tremendous efficiency and growth in the Capital Markets of Pakistan. It will also enhance the image of our Capital Markets globally. We are following a very aggressive target to bring all the listed companies into Central Depository System. The Central depository Company already declared forty companies as eligible security for our Central Depository System and intends to bring the remaining listed companies into this system within the next two years.

It is fact that dematerialization plays a vital role in the Pakistan Capital Market. The investors are able to know risk and return of the share by using dematerialization. It benefits not only the investor but also helps a lot to the nation in maintaining a sound capital market system. spread of the obligatory demat list will enhance the investment choices of the investors by offering investor a chance to pick up high priced securities to branch out the investor's portfolio clean title of shares, more liquidity and buying odd lots are three important aspects of scrip less trading.

On the other hand, the major drawback of the system is to winning the confidence of the investors by Depository Participant. The Depository Participants should be more accountable and responsible to the investors. The role and performance of the depository participants needs to be regulated and supervised. Central Depository Company needs to be strictly regulated and supervised in order to remove the existing flaws of the system. Heavy penalties should be imposed on the depository and the depository participants in case they flout the provisions of the law regulating the central depository system in Pakistan. Additional safety measures should be provided to make the system more effective. The experiences of the developed countries, those who had introduced the depository system, shows that there have been around 5 to 6 times

increase in the turnover. This happens due to investor indulging more in buying and selling even for marginal trading profits. Here are some suggestive measures, to adopt all these measures we can make a better depository system throughout the world.

## 5.2 Recommendations:

### 5.2.1 IT Strategic Planning:

I don't think we have done enough background work in preparation for the introduction of the central Depository system. We should join the age of the information technology. We want to keep up with the rest of the world in this technology. Central Depository Company needs to develop its IT Strategy so that IT schemes can be prioritized according to the business needs of CDC. Association of IT strategy, with the business strategy is very important so that IT can accommodate the needs of business. This approach provides technology directions that Central Depository Company needs in order to fulfill its business objectives. IT strategic planning will allow Central Depository Company to look at the current IT operating environment and make projections about the future IT operating environment based on Central Depository Company evolving business requirements. It will help Central Depository Company to optimize the use of IT resources and ensure the availability of trained IT personnel.

### 5.2.2 Annual Inspection:

Every depository must have enough mechanisms for reviewing, monitoring and evaluating the depository's controls, systems, procedures and safeguards. The depository should conduct an annual inspection of these procedures and forward a copy of the inspection report to CDC.

**5.2.3 Back Up of all records:**

The depository is also required to ensure that the integrity of the automatic data processing systems is maintained at all times and the depository also take all precautions which are necessary to ensure that the records are not lost, destroyed or alter. But if any data has been lost than there should be a sufficient back up of records which should be available at a different place. Sufficient measures should be taken, including insurance, to protect the interests of the beneficial owners against any risks.

**5.2.4 Extend its co-operation to the beneficial owners:**

Every depository should extend all such co-operation to the beneficial owners, issuers, issuers' agents, custodians of securities, other depositories and clearing organizations, because it is necessary for the effective, prompt and accurate clearance and settlement of securities transactions and conduct of business.

**5.2.5 Monitoring Scheme by the government of Pakistan:**

There should be a strong monitoring scheme by the government of Pakistan. As the government should permit the dematerialization of government securities as they are the largest players in the financial market.

**5.2.6 Investigation without delay:**

The cases of discrepancies due to negligence, fraud, etc., should be investigated without any delay.

### 5.2.7 Investor's Confidence:

Adequate compensation should be made payable to the aggrieved party. This will boost the investors' confidence in the system. There are many cases in which brokers are negligent on their side and investor's confidence is lost because of these problems these cases are mentioned in this dissertation.

### 5.2.8 Independence of Share Registrar and Depository:

In order to achieve credibility and maximum investor confidence it is important that the independence of the share registrar and depository be guaranteed. Ideally, the share registry should be maintained by an independent third party, not the company itself. Similarly, the depository should be independent of the government and control of private groups.

### 5.2.9 Supervisory Mechanism:

There should be check and balance on the working of the participants because strict check and balance will build the confidence among the investing public. That is why the CSDL from time to time should release the names of registered depository participants with whom the investors have to open the account. There should be some element of supervisory mechanism. The operations of these depositories should be put on some check on a regular basis.

### 5.2.10 Limitation Act 1908:

Clauses regarding depository system should include in the Limitation Act 1908.

### 5.2.11 Data Processing System:

The efficiency of the system depends upon the electronic communication system. The automated data processing systems should be adopted and be connected among themselves by

the depository, participants, companies and exchanges. Appropriate data processing system with necessary security features has become one of the conditions for selecting securities for dematerialization.

#### **5.2.12 Effective and Economical Services:**

The cost of dematerialization process should be minimized. The effective and economical services attract both investors and companies in opting for the services.

#### **5.2.13 Dematerialization Process should be compulsory:**

The dematerialization should be made compulsory not only in respect of few scrips and institutional investors but also for other scrips and individual investors and companies within a certain time frame. In fact dematerialization should be one of the conditions for listing of securities by the exchanges.

#### **5.2.14 The Advantages should be made in notice to all investors:**

The advantages of the system should be brought to the notice of investors especially the small and medium investors who are shy of investing in demt scrips.

#### **5.2.15 Flexibility for the Investors who want to withdraw:**

The system should be flexible enough to allow investors who wish to withdraw their certificates from the central Depository system on condition that such certificates will be redeposit whenever they are to be traded to the stock exchange.

#### **5.2.16 Qualification and good management:**

The integrity of any financial system depends on good management and also, in ensuring that the players go by the rules. We want to make sure that there is continued confidence in our stock

markets. The qualification of the people who run the central depository system should be as they all people should be of integrity.

#### **5.2.17 CDS for Capital Markets:**

There is an urgent need to establish the central Depository system (CDS) for the capital markets to enable rapid transactions. The system is of special importance both to foreign and local investors because it allows free transactions, which boost domestic saving. The Central Depository System can, therefore, be a vehicle of attracting an inflow of both direct foreign investment and short term investment.

#### **5.2.18 Awareness through Advertisement:**

There is a need to strengthen this depository system by spreading awareness through advertisement and by expanding the more branches of this system all over the country and also by tapping the potential customers through innovative means.

#### **5.2.19 Regular statements of holdings:**

Regular statements of holdings should be made available at regular intervals. The statement of holdings should be provided with the sale and purchase of the shares. Services system provided by the Depository Participants must be updated regularly to suit the requirements of the investor like accurate information and guidance to the investor.

#### **5.2.20 Deductions should be provided in Black and White:**

Clear picture of the deductions made by depository participant or the charges levied on the customers should be provided in black and white.

**5.2.21 Proper feedback:**

Proper feedback should be taken into consideration. e.g. calls should be made when the account is opened.

**5.2.22 Processing should be fast:**

The processing of the demat account opening should be made fast. Aggressive efforts should be made by sales team to tap the potential customers and to increase the customer base.

**5.2.23 Internally Connection:**

Depository Participants should be connected internally with each other.

**5.2.24 Transaction taxes:**

There should be eliminating of transaction taxes.

**5.2.25 E-broking Services:**

The e-broking service should be introduced. Customers should be made aware about the services like phone banking, net banking, bill pay, dematerialization etc. an instruction manual telling about how to use their services can also be given to the customer to make these advanced services more popular.

**5.2.26 Publicity among people:**

There is a less awareness about this system in public. People are not introduced with the financial terms of this system. People have only limited knowledge about this system and not get sufficient profit from this system. So there should be publicity among the people.

**5.2.27 Awareness about rules and services of the system:**

Depository participant has to make awareness to investors about rules and services provided to the investors.

**5.2.28 Reduction of transaction time:**

Depository participants services should be made available to the investors round the clock and efforts must be made to reduce the transaction time.

**5.2.29 Link with International Financial Markets:**

The Depository system should be made linked up with international financial markets in order to provide easy access of the investors around the globe.

**5.2.30 Problems relating to Multiple Demat Accounts:**

To solve the problem relating to the issues of excessive multiple demat accounts. Multiple accounts have been made legal in the system. There could be some restrictions like only 2 or 3 demat accounts are allowed should be introduced. Every customer should have a unique identification number so that not only his transactions be traced easily but also the problem of excessive demat account would have been solved fully.

**5.2.31 Electronic based Services:**

There should be more efforts to improve the electronic based service.

**5.2.32 Proper arrangements for Investor's Education:**

Investor's education is an area of concern. There should be proper arrangements for investor's education. There are two ways which would be served. Firstly, Investors would be better off and

the second is that more and more people might be interested in investing securities market. This would in turn make the number of people and amount invested in the securities market, high.

#### **5.2.33 Procedure should be made less exhaustive:**

Procedure of becoming Depository Participant should be made less exhaustive. It should be made user friendly. Instead of making the procedure strict adhesiveness to all the instructions to the Depository Participants should be made more stringent and punitive action kind of policies should be made for the help of poor Investors.

#### **5.2.34 Management Control System:**

Management control system (MCS) should be developed for Depository Participants for their better performances. Depository Participants should be very clearly stipulated that what is expected of them. Their performances should be checked on those grounds and accordingly they should be rewarded or punished as the case may be.

#### **5.2.35 Development of Research wings:**

There is no mechanism to facilitate research and academic inputs in the affairs of depositories. Depositories should develop their own research wing so that they could understand the issues directly from the Investors.

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