

CHAPTER

11

DEPOSITORIES

Covering-

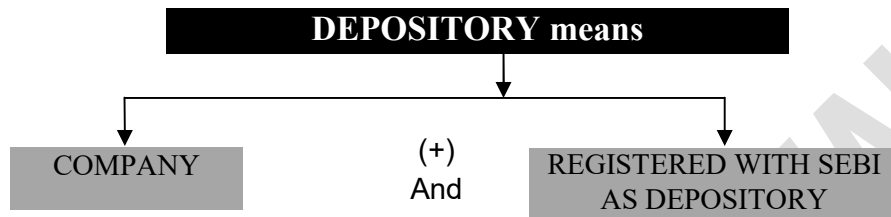
- ABC Analysis
- Depository – Meaning
- Depository Participant (DP) – Meaning
- Depository – Legal Framework
- Eligibility Condition for Depository
- Bye-Laws of a Depository
- Depository System
- Rights and Obligations of depositories and its constituents
- Depository – Services
- Benefits of Depository System
- Models of Depository
- Dematerialization & Rematerialisation
- Immobilisation
- Pledge or Hypothecation of Securities held in a Depository
- Rights of Depositories and Beneficial Owner
- Register of Beneficial Owner (Section 11)
- Basic services Demat Account (BSDA)
- Audit Under SEBI (Depositories and Participants) Regulations, 2018
- Offences and penalties under the Act
- Power to Grant Immunity
- Self Test Questions
 - From Past CS Examination Questions
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**EXPECTED
MARKS COVERAGE
(5 to 10)**

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DEPOSITORIES

ABC Analysis (CIS - Exam Point of view)

A	<ol style="list-style-type: none"> 1. Depository System 2. Dematerialization & Rematerialisation 3. Pledge or Hypothecation of Securities held in a Depository
B	<ol style="list-style-type: none"> 4. Benefits of Depository System 5. Models of Depository
C	<ol style="list-style-type: none"> 6. Rights of Depositories and Beneficial Owner 7. Register of Beneficial Owner (Section 11) 8. Basic services Demat Account (BSDA)



Depositories gave a new dimension and a new scope for conducting transactions in capital market-primary as well as secondary, in a more efficient and effective manner, **in a paperless form on an electronic book entry basis**. It provided electronic solution to the problems of bad deliveries and long settlement cycles.

The main objective of a Depository is to minimize the paper work involved with the ownership, trading and transfer of securities.

Depositories Act, 1996 and SEBI (Depositories and Participants) Regulations, 2018 provide the regulatory framework for the depositories.

BENEFITS OF DEPOSITORY SYSTEM / ELECTRONIC SHARES

(a) Elimination of bad deliveries .
(b) Elimination of all risks associated with physical certificates .
(c) Immediate transfer and registration of securities.
(d) Faster disbursement of non cash corporate benefits like rights, bonus, etc.
(e) Reduction in handling of huge volumes of paper and periodic status reports to investors on their holdings and transactions, leading to better controls.
(f) Elimination of problems related to change of address of investor, transmission, etc.
(g) No stamp duty on transfer in secondary market.
(h) No odd lots problem .

DEPOSITORY-MEANING

A Depository is an organisation like a Central Bank **where the securities of a shareholder are held in the electronic form** at the request of the shareholder **through the medium of a Depository Participant**.

According to Section 2(e) of the Depositories Act, 1996,

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“Depository means a company formed and registered under the Companies Act, 2013 and

which has been granted a certificate of registration under Section 12(1A) of the Securities and Exchange Board of India Act, 1992”.

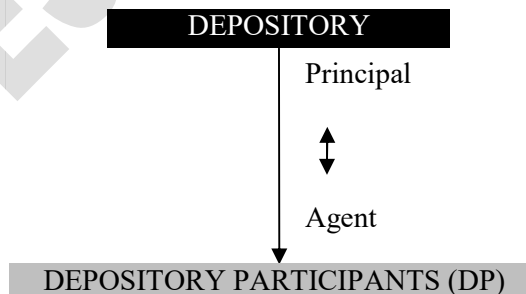
There are two Depositories functioning in India, namely the **National Securities Depository Limited (NSDL)** and the **Central Depository Services (India) Limited (CDSL)**.



DEPOSITORY PARTICIPANT (DP)-MEANING



Just as a brokers act an agent of the investor at the Stock Exchange; a **Depository Participant (DP)** is the **representative (agent) of the Depository** in the depository system providing the link between the Company and investor through the Depository.



WHO CAN BE A DP?

Public financial institutions, scheduled commercial banks, foreign banks operating in India with the approval of the Reserve Bank of India, state financial corporations, custodians, stock-brokers, clearing corporations / clearing houses, NBFCs and registrar to an issue or share transfer agent complying with the requirements prescribed by SEBI can be registered as DP.

CHARACTERISTICS / FUNCTION OF A DP

- Transmission requests/nomination
- Acts as an Agent of Depository
- Customer interface of Depository
- Functions like Securities Bank
- Account opening

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• Facilitates dematerialisation/rematerialisation
• Instant transfer on pay-out
• Enables off market transfers
• Settles trades in electronic segment
• Pledge/enforcement of pledge etc.

DEPOSITORY- LEGAL FRAMEWORK

The legal framework for a depository system has been laid down by the Depositories Act, 1996 and is regulated by SEBI. The depository business in India is regulated by –

(a) The Depositories Act, 1996
(b) The SEBI (Depositories and Participants) Regulations, 2018
(c) Bye-laws of Depository
(d) Business Rules of Depository.
(e) Apart from the above, Depositories are also governed by certain provisions of:
(f) The Companies Act, 2013
(g) The Indian Stamp Act, 1899
(h) Securities and Exchange Board of India Act, 1992
(i) Securities Contracts (Regulation) Act, 1956
(j) Benami Transaction (Prohibition) Act, 1988
(k) Income Tax Act, 1961
(l) Bankers' Books Evidence Act, 1891

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DEPOSITORIES ACT, 1996

OBJECTIVES OF DEPOSITORIES ACT, 1996

The depositories' legislation as per the Statement of Objects and Reasons appended to the Depositories Act, 1996 aims at providing :

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|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| (a) A legal basis for establishment of depositories to conduct the task of maintenance of ownership records and effecting changes in ownership records through book entry; |
| (b) Dematerialisation of securities in the depositories mode as well as giving option to an investor to choose between holding securities in physical mode and holding securities in a dematerialized form in a depository; |
| (c) Making the securities fungible ; |
| (d) Making the shares, debentures and any interest thereon of a public limited company freely transferable ; and |
| (e) Exempting all transfers of shares within a depository from stamp duty in secondary market. |

CERTIFICATE OF COMMENCEMENT OF BUSINESS

No depository shall act as a depository unless it obtains a **certificate of commencement of business from the SEBI** in such form as may be specified by the SEBI (Depositories and Participants) Regulations, 2018. The SEBI shall not grant a certificate unless it is satisfied that the **depository has adequate systems and safeguards to prevent manipulation of records and transactions**. However no certificate shall be refused unless the depository concerned has been given a reasonable opportunity of being heard.

ELIGIBILITY CONDITION FOR DEPOSITORY

Any company or other institution to be eligible to provide depository services must:

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| (a) be formed and registered as a company under the Companies Act . |
| (b) be registered with SEBI as a depository under SEBI Act, 1992. |
| (c) has framed bye-laws with the previous approval of SEBI. |
| (d) has one or more participants to render depository services on its behalf. |
| (e) has adequate systems and safeguards to prevent manipulation of records and transactions to the satisfaction of SEBI. |
| (f) complies with Depositories Act, 1996 and SEBI (Depositories and Participants) Regulations, 2018. |

BYE-LAWS OF A DEPOSITORY

Depository is required to frame its bye-laws **with the prior approval of SEBI**, consistent with the provisions of the Act and the regulations made by SEBI thereunder. SEBI has, however, the power to direct the depository to amend or revoke any bye-laws already made, wherever it considers expedient to do so.

Contents of the bye-laws

As per Sub-section 2 of Section 26 of the Act, the bye-laws of a depository would include:-

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| (a) the eligibility criteria for admission and removal of securities in the depository. |
| (b) the conditions subject to which the securities shall be dealt with . |
| (c) the eligibility criteria for admission of any person as a participant. |

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(d) the manner and procedure for dematerialisation of securities .
(e) the procedure for ensuring safeguards to protect the interests of participants and beneficial owners.
(f) the conditions of admission into and withdrawal from a participant by a beneficial owner .
(g) declaration, shareholder meetings and other matters of interest to the beneficial owners .
(h) the manner of distribution of dividends , interest and monetary benefits received from the company among beneficial owners.
(i) the manner of creating pledge or hypothecation in respect of securities held with a depository.
(j) the internal control standards including procedure for auditing, reviewing and monitoring

DEPOSITORY SYSTEM

The Depository System **functions** very much like the **banking system**.

BANK - DEPOSITORY- AN ANALOGY

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| (a) A bank holds funds in accounts whereas a Depository holds securities in accounts for its clients. |
| (b) A Bank transfers funds between accounts whereas a Depository transfers securities between accounts. |
| (c) In both systems , the transfer of funds or securities happens without the actual handling of funds or securities. |
| (d) Both the Banks and the Depository are accountable for the safe keeping of funds and securities respectively. |

In the depository system, share certificates belonging to the investors are to be dematerialised and their names are required to be entered in the records of depository as **beneficial owners**. Consequent to these changes, the investors' names in the companies' register are replaced by the name of depository as the registered owner of the securities. The **beneficial owner continues to enjoy all the rights and benefits and is subject to all the liabilities** in respect of the securities held by a depository.

DIFFERENCE BETWEEN DEPOSITORY AND CUSTODIAN

Both depository and custodial services are responsible for safe keeping of securities

but they are different in the sense that the **Depository can legally transfer beneficial ownership, which a custodian cannot**.

The main objective of a Depository is to minimize the paper work involved with the ownership, trading and transfer of securities.

ELIGIBLE SECURITIES REQUIRED TO BE IN THE DEMAT MODE

Section 8 of the Depositories Act gives **the option** to the investors to receive securities in physical form or in dematerialised mode.

It is not necessary that all eligible securities must be in the depository mode. In the scheme of the Depositories legislation, the **investor has been given supremacy**. The investor has the **choice of holding physical securities or opts for a depository based ownership record**.

However, in case of **fresh issue of securities** *all securities issued have to be in dematerialized form*. However, after **that investor will also have the freedom** to switch from depository mode to physical mode and *vice versa*. The decision as to whether or not to hold securities within the depository mode and if in depository mode, which depository or participant, would be entirely with the investor.

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Is dematerialization of securities compulsory?

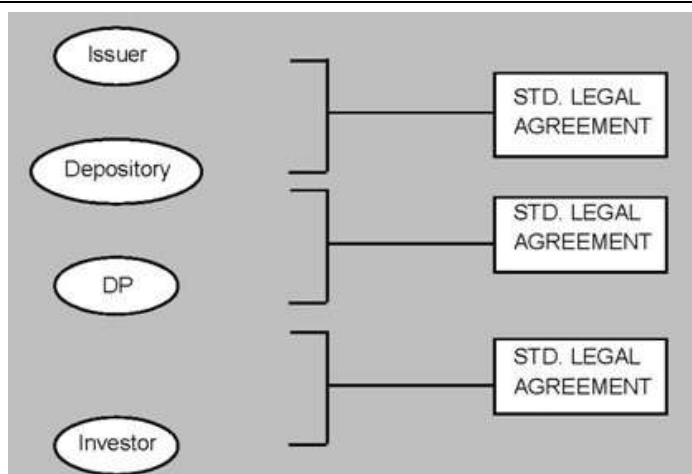
According to the Depositories Act, 1996, an **investor has the option** to hold securities either in physical or electronic form. Part of holding can be in physical form and part in demat form. **However, SEBI** has notified that settlement of **market trades in listed securities** should take place only in the demat mode.

What type of instruments are available for demat at Depository?

All types of equity/ debt instruments viz. equity shares, preference Shares, partly paid shares, bonds, debentures, commercial papers, certificates of deposit, government securities (G-SEC) etc. irrespective of whether these instruments are listed / unlisted / privately placed can be dematerialized with depository, if they have been admitted with the depository.

RIGHTS AND OBLIGATIONS OF DEPOSITORIES AND ITS CONSTITUENTS

- (a) Every depository is required to **enter into an agreement** with the issuer.
- (b) The depository is **also required to enter into a tripartite agreement** with the issuer, its transfer agent and itself where company has appointed a transfer agent.
- (c) Every depository is required to maintain **continuous connectivity** with issuers, registrars and transfer agents, participants and clearing house or clearing corporations.
- (d) Depositories should take adequate measures including insurance to **protect the interest of the beneficial owners**.
- (e) Every depository is required to maintain the following records and documents namely:
 - (a) records of securities dematerialised and rematerialised;
 - (ii) the names of the transferor, transferee, and the dates of transfer of securities;
 - (iii) a register and an index of beneficial owners;
 - (iv) details of holding of the securities of the beneficial owners as at the end of the each day;
 - (v) records of instruction(s) received from and sent to participants, issuers' agents and beneficial owners;
- (a) Subject to the provisions of any other law, the depository shall preserve records and documents for a minimum period of **EIGHT years**



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DEPOSITORY-SERVICES

Depository Functions

(a) Account opening
(b) Dematerialisation
(c) Rematerialisation
(d) Settlement
(e) Initial Public Offers (IPO's), corporate benefits
(f) Creation of encumbrance

To utilize the services offered by a depository, the investor has to open an account with the depository through a participant, similar to the opening of an account with any of the bank branches to utilize services of that bank.

FUNGIBILITY OF SHARES

Section 9(1) of the Depositories Act, 1996 specifies that all securities held in a depository shall be dematerialized and shall be in a fungible form. It means that *all certificates of the same security are interchangeable in the sense that investors lose the right to obtain the exact certificate they surrender at the time of entry into depository.*

It is like withdrawing money from bank without bothering about the distinctive number of currencies.

MODELS OF DEPOSITORY

1. Immobilisation
2. Dematerialisation

DEMATERIALISATION & REMATERIALISATION

Dematerialisation is a process by which the physical share are converted into electronic shares at the request of the investor. Dematerialisation of shares is optional and an investor can still hold shares in physical form.

Rematerialisation is a process by which the electronic share are converted back into physical shares at the request of the investor

DEMATERIALISATION PROCESS & REMATERIALISATION PROCESS

Dematerialisation process	Rematerialisation process
1. Investor opens account with DP	1. Client submits Rematerialisation Request Form (RRF) to DP
2. Fills Dematerialisation Request Form (DRF) for registered shares	2. DP intimates Depository
3. Investor lodges DRF and certificates with DP	3. Depository intimates the Registrar/Issuer
4. DP intimates the Depository	4. DP sends RRF to the Registrar/Issuer
5. Depository intimates Registrar/Issuer	5. Registrar/Issuer prints certificates and sends to Investor
6. DP sends certificates and DRF to Registrar/Issuer	6. Registrar/Issuer confirms remat to Depository
7. Registrar/Issuer confirms demat to Depository	7. Investor's account with DP debited.
8. Depository credits investor a/c.	

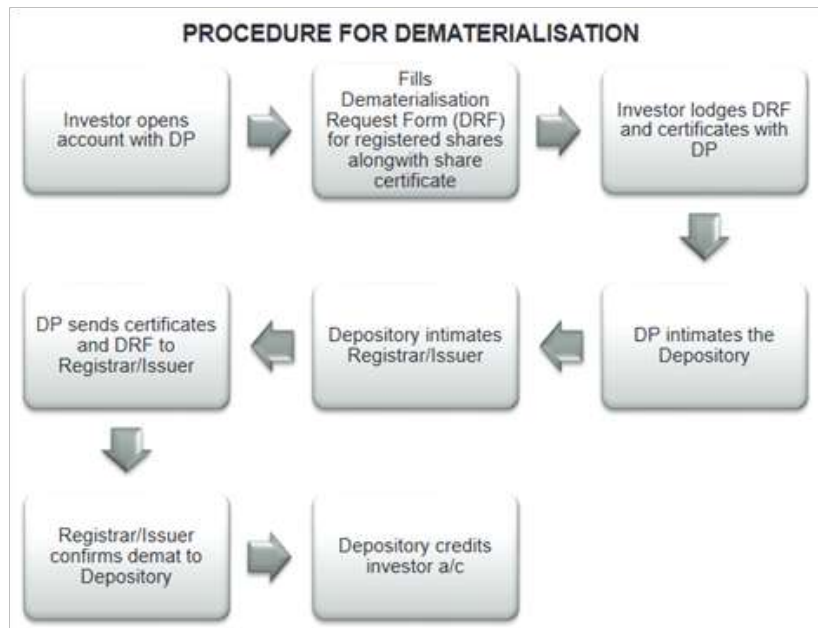
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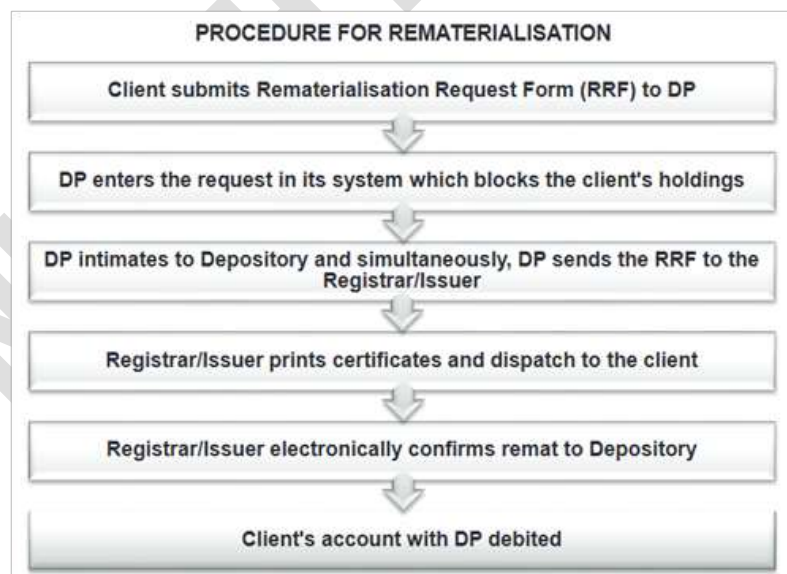
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DIAGRAMMATIC REPRESENTATION OF REMATERIALISATION PROCESS



IMMOBILISATION

Immobilisation takes place when **physical share certificates are kept with the depository for safe custody**. All subsequent transactions in these securities take place in **book entry form**. The actual owner has the right to withdraw his physical securities as and when desired.

The immobilization of fresh issue may be achieved by issuing a jumbo certificate representing the entire issue in the name of depository, as nominee of the beneficial owners.

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PLEDGE OR HYPOTHECATION OF SECURITIES HELD IN A DEPOSITORY

A beneficial owner may with the previous approval of the depository create a pledge or hypothecation in respect of a security owned by him through a depository. **Every beneficial owner should give intimation of such pledge or hypothecation to the depository participant** and such depository is required to make entries in its records accordingly. Any entry in the records of a depository should be evidence of a pledge or hypothecation.

ELECTRONIC CREDIT IN NEW ISSUES

(a) Investor opens account with DP
(b) Submits application with option to hold securities in depository giving DP-Id and Client-Id
(c) Registrar uploads list of allottees to Depository
(d) Depository credits allottee's account with DP
(e) Refunds sent by Registrar as usual.

CORPORATE ACTIONS

Dividends/cash benefits, these benefits are directly forwarded to the investors by the company or its registrar and transfer agent.

Non-cash benefits, viz. Bonus, Rights Issue, etc. these benefits are electronically credited to the beneficial owner's account through Depository.

Question: How would Mr. X get Bonus Shares if he holds shares in Demat Form?

Answer: The concerned company obtains the details of beneficiary holders and their holdings from Depository (NSDL or CDSL) as on the record date. The number of shares he is entitled for, are credited to his demat account by the company / its RTA.

RIGHTS OF DEPOSITORIES AND BENEFICIAL OWNER

A depository should be deemed to be the registered owner for the purposes of effecting transfer of ownership of security on behalf of a beneficial owner. **The depository as a registered owner should not have any voting rights or any other rights** in respect of securities held by it. **The beneficial owner is entitled to all the rights and benefits** and be subjected to all the liabilities in respect of his securities held by a depository.

REGISTER OF BENEFICIAL OWNER

Section 11

Every depository is required to **maintain a register and an index of beneficial owners** in the manner provided in the Companies Act. Companies Act, 2013 provides that the register and index of beneficial owners maintained by a depository Depositories Act, 1996 shall **be deemed to be an index of members and register and index of debenture holders**, as the case may be, **for the purposes Companies Act, 2013.**

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SEBI (DEPOSITORIES AND PARTICIPANTS) REGULATIONS, 2018

AUDIT UNDER SEBI (DEPOSITORIES AND PARTICIPANTS) REGULATIONS, 2018 / RECONCILIATION OF SHARE CAPITAL AUDIT

Regulation 76 of SEBI (Depositories and Participants) Regulations, 2018 provides that *every issuer* shall submit audit report on a **quarterly basis** to the concerned stock exchanges audited by a **practicing Company Secretary or a qualified Chartered Accountant, for the purposes of reconciliation of**

the total issued capital,
listed capital and
capital held by depositories in dematerialized form,
the details of changes in share capital during the quarter
and the in-principle approval obtained by the issuer from all the stock exchanges where it is listed in respect of such further issued capital.
The audit report is required to give the updated status of the register of members of the issuer and confirm that securities have been dematerialized as per requests within 21 days from the date of receipt of requests by the issuer and where the dematerialization has not been effected within the said stipulated period, the report would disclose the reasons for such delay.

INTERNAL AUDIT OF OPERATIONS OF DEPOSITORY PARTICIPANTS

The two Depository service providers in India, viz., National Securities Depository Ltd. (NSDL) and Central Depository Services (India) Limited (CDSL) have allowed **Practicing Company Secretaries** to undertake internal audit of the operations of Depository Participants (DPs).

Every Depository Participant shall ensure that an internal audit in respect of the operations of the Depository is conducted at intervals of not more than **three months** by a qualified Chartered Accountant or a Company Secretary holding a certificate of Practice and a copy of the internal audit report shall be furnished to the Depository.”

Checklist of Internal Audit of Operations of Depository Participants:

(a) Account opening
(b) Reporting to BOs
(c) Dematerialisation of Securities
(d) Rematerialisation of Securities
(e) Market Trades
(f) Off Market Trades
(g) Transmission
(h) Returns to Depository
(i) Grievance Redressal Mechanism
(j) Collateral Security
(k) Assignment of Business
(l) Freezing of Account
(m) Closure of Account
(n) Pledge and Hypothecation

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(o) Invocation of Pledge/Hypothecation by Pledgee
(p) Lending and Borrowing of Securities
(q) Records to be Maintained by DPs
(r) Disclosure and Publication of Information
(s) Supervision by DP
(t) Code of Ethics for DPs
(u) Branch of Depository Participants

CONCURRENT AUDIT

Depository Participants are subject to concurrent audit by a **Practising Company Secretary or qualified Chartered Accountant**. However, the participants in case **they so desire, may entrust the concurrent audit to their Internal Auditors**

Concurrent Audit **includes audit of process of demat account opening, control and verification of delivery instruction slips.**

The scope of concurrent audit with respect to control and verification of DIS **cover the areas given below:**

(I) Issuance of DIS

The procedure followed by the Participants with respect to:

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| (a) Issuance of DIS booklets including loose slips. |
| (b) Existence of controls on DIS issued to Clients including pre-stamping of Client ID and unique pre-printed serial numbers |
| (c) Record maintenance for issuance of DIS booklets (including loose slips) in the back office. |

(II) Verification of DIS

The procedure followed by the Participants with respect to:

- | |
|-------------------------------------------------------------------------------------------------------------------|
| (a) Date and time stamping (including late stamping) on instruction slips. |
| (b) Blocking of used/reported lost/stolen instruction slips in back office system/ manual record. |
| (c) Blocking of slips in the back office system/manual record which are executed in DPM directly. |
| (d) Two step verification for a transaction for more than `5 lakh, especially in case of off-market transactions. |
| (e) Instructions received from dormant accounts. |

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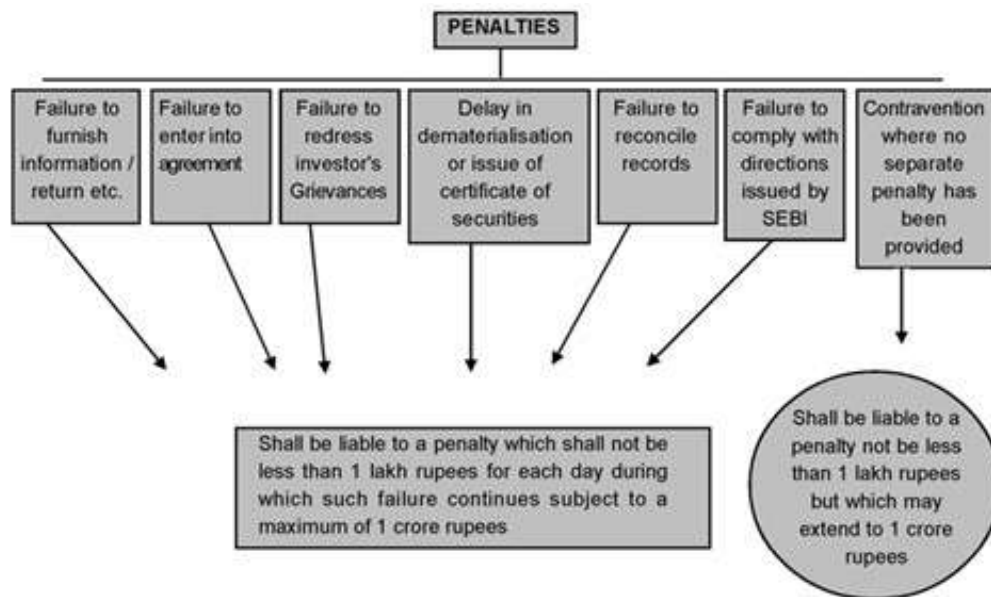
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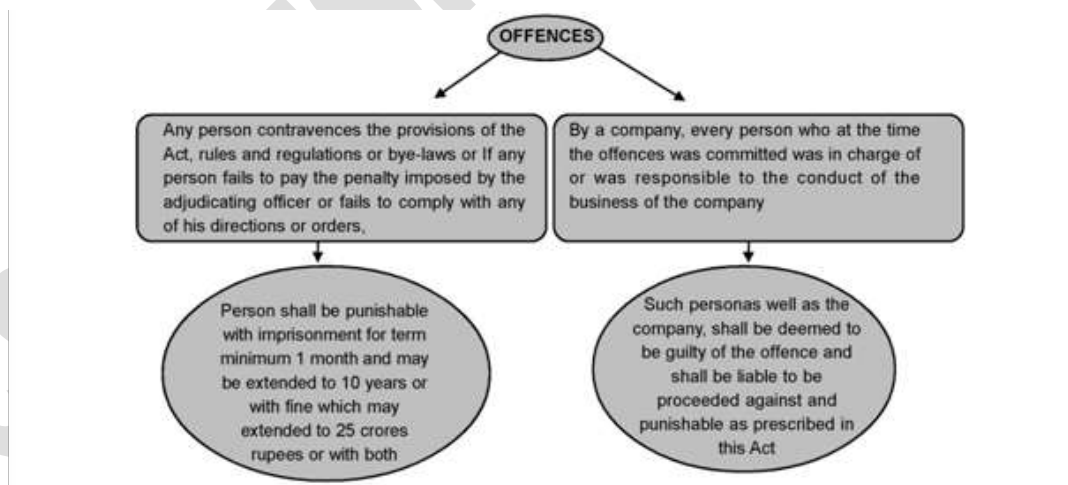


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OFFENCES AND PENALTIES UNDER THE ACT



Section 20 provides that without prejudice to any award of penalty by the adjudicating officer under this Act, if any person contravenes or attempts to contravene or abets the contravention of the provisions of this Act or of any rules or regulations or bye-laws made there under, he shall be punishable with imprisonment for a term which may **extend to ten years**, or with fine, which may extend to **twenty-five crore rupees**, or with **both**.



OFFENCES BY COMPANIES

Section 21 provides that where an offence under this Act has been committed by a company, **every person who at the time the offence was committed was in charge** of, and was responsible to, the company for the conduct of the business of the company, as well as the company, shall be deemed to be guilty of the offence and **shall be liable to be proceeded against and punished accordingly**.

The proviso to the section also provides that nothing contained in this sub-section shall render any such person liable to **any punishment** provided in this Act, if he proves that the offence was committed **without his knowledge or that he had exercised all due diligence** to prevent the commission of such offence.

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Where an offence under this Act has been committed by a company and it is proved that the offence has been committed with the consent or connivance of, or is attributable to any neglect on the part of, any **director, manager, secretary** or other officer of the company, **such director, manager, secretary or other officer shall also be deemed to be guilty** of the offence and shall be liable to be proceeded against and punished accordingly

POWER TO GRANT IMMUNITY

Section 22B of Depositories Act, 1996 empowers the **Central Government** to grant immunity, **on recommendation by the SEBI**, if the Central Government is satisfied, that any person, who is alleged to have violated any of the provisions of this Act or the rules or the regulations made there under, **has made a full and true disclosure in respect of alleged violation**, grant to such person, subject to such conditions as it may think fit to impose, **immunity from prosecution** for any offence under this Act, or the rules or the regulations made there under or **also from the imposition of any penalty** under this Act with respect to the alleged violation.

No such immunity shall be granted by the Central Government in cases **where the proceedings for the prosecution for any such offence have been instituted before the date of receipt of application** for grant of such immunity.

Recommendation of SEBI under this sub section **is not binding upon the Central Government**.

The immunity granted to a person may, at any time, **be withdrawn by the Central Government**, if it is satisfied that such person had, in the course of the proceedings, not complied with the condition on which the immunity was granted.

NOTE:-Section 23-O of SCRA, 1956 also deals with the power to grant immunity.

ROLE OF COMPANY SECRETARY

- (a) **Right to Legal Representation** (Section 23C of the Act): In case of any decision of the SEBI, **the aggrieved entity/ company** (the appellant) may either appear in person or authorise one or more chartered accountants or **company secretaries (PCS)** or cost accountants or legal practitioners or any of its officers **to present his or its case before the Securities Appellate Tribunal (SAT)**.
- (b) **Internal Audit of Depository Participants**: The 2 (two) Depository services providers in India, viz., National Securities Depository Ltd. (NSDL) and Central Depository Services (India) Limited (CDSL) **have allowed Company Secretaries** in Whole-time Practice to **undertake internal audit** of the operations of Depository Participants (DPs). [Ref: NSDL Circular No. NSDL/POLICY/2008/0072 dated October 17, 2008 and CDSL Bye Law 16.3.1]
- (c) **Reconciliation of Share Capital Audit**: Company Secretary is authorised to **issue quarterly certificate** with regard to reconciliation of the total issued capital, listed capital and capital held by depositories in dematerialized form, details of changes in share capital during the quarter, and **in-principle approval obtained by the issuer** from all the stock exchanges where it is listed in respect of such further issued capital under SEBI (Depositories and Participants) Regulations, 2018. [**Regulation 76 of SEBI (Depositories and Participants) Regulations, 2018**]
- (d) **Concurrent Audit of Depository Participants**: Practising Company Secretary is authorized to carry out **concurrent audit of Depository Participants** which covers audit of the process of demit account opening, control and verification of Delivery Instruction Slips (DIS).

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SELF TEST QUESTIONS

FROM PAST CS EXAMS



- Write short notes on the following:
 - Fungibility
 - Depository agreement
 - Depository participants
 - Concurrent audit of depository participants.
- “Depository system is a boon to capital market and investors, both.” Elucidate the statement and bring out the advantages of the dematerialization of securities.
- Explain the term ‘demat’. State the benefits of demat securities.
- What do you mean by ‘dematerialisation of securities’? State its benefits.
- Explain the Depository participant.
- Comment on the following statements:
 - “Depository system works very much like a banking system.”
 - “Dematerialisation and immobilization are distinct activities.”
 - Dematerialisation and immobilization are distinct activities.
- Explain the powers of the Central Government to grant immunity under the Depositories Act, 1996.
- Briefly explain the role of a Practicing Company Secretary in concurrent audit of depository participants.
- Distinguish between the following:
 - ‘Dematerialisation’ and ‘re-materialisation’.
 - ‘Depository’ and ‘custodian’.

FROM ICSI MODULE



Answer the following:

- Briefly outline the concept of Depository system in India.
- Enumerate the enquiry, inspection and penalties under the Depositories Act, 1996.
- Explain in detail the power of depositories to make by-laws under the Depositories Act, 1996.
- Give an overview of the rights and obligations of Depositories, Participants and issuers under SEBI (Depositories and Participants) Regulations, 2018.
- Explain in detail the Statement required to be sent to the beneficial owner by a DP under BSDA facility?
- Write short note on:
 - Dematerialisation charges.
 - Models of Depository.
 - Internal Audit of Depository Participants.
 - Concurrent Audit.



Answers to be analysed in Classroom

Q. 1.

Answer to Question No. 1:-

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Answers to be analysed in Classroom

Q. 2.

Answer to Question No. 2:-

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