

Depositories – Challenges Ahead



Vijay V. Raut
Managing Director & CEO
Central Depository Services
(India) Ltd.

The Depositories Act, 1996, ushered in an era of efficient 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. Perhaps, no other

single act has had such profound all round impact on every single stakeholder in the Indian Capital Markets. This legislation envisaged multiple depositories in India to ensure benefits of competition for the users of the depository system. Probably, India is only country in the world which has two depositories holding the same instruments. This competitive environment has been instrumental in reduction of charges from 0.05% of the transaction value in 1997 to Rs. 6/- per debit in 2005.

Internationally, depositories dematerialize securities or immobilize securities i.e. store the securities in large vaults and give a corresponding credit into the investors account. The depositories in India have adopted the dematerialization system and thus the problems of physical storage of securities associated with immobilization have been done away with. Moreover, the depositories in India have adopted a BO level (i.e. investor level) accounting model as against the participant level accounting model adopted by depositories in some of the advanced markets. This model has helped to eliminate problems associated with the dissemination of beneficial (share) holder details to the issuers for corporate actions.

Today, the depositories offer DP services through their Depository Participants (DPs) which are on par with world standards. These services include internet based access to the demat account and SMS alerts and email based information on transactions, IPO corporate actions and also corporate announcements. However, they are faced with the challenges which are India centric. The major such challenges are:

1. Today CDSL has 475 participants which service 5.6 million investors across 30000 pin code locations. However, a large percentage of investors reside in the metros. For a DP and Depository, the major challenge is therefore to increase the DP footprint

across the country, at the same time ensuring that it is financially viable without compromising on infrastructure & compliance requirements.

2. Managing risks associated with errors due to omission and commissions and employee fidelity is another challenge. In order to mitigate such risks, CDSL conducts stringent audits of its DPs and also conducts Compliance training for DP's and auditor's staff. Further, the DP by itself has to submit concurrent audit & half yearly audit reports to the Depository. Both the depositories have revised the penalty structure; and made uniform, so as to ensure better compliance and eliminate regulatory arbitrage.
3. With the increase in volumes and the volatility in capital market and induction of new investors, a major challenge for the depositories is making optimal use of their existing systems to meet peak loads, while ensuring at the same time not to create excess capacity which remains un-utilized. At CDSL, we monitor system utilization on daily basis and initiate timely action when the system reaches a certain threshold capacity utilization.
4. With increasing volumes, there is a constant increase in the size of the database, which in turn has effects on business continuity plans. The challenge here lies in updating data at the Disaster Recovery Site (DRS) and seamless shifting of users to the DRS in case of disaster. CDSL transmit logs to the DRS site every 2 minutes. Moreover, drills for shifting to DRS are conducted every 2 months. CDSL has fine tuned the shifting procedure to enable users to connect and operate from disaster recovery site within 1.5 hrs. of initiation of the shift. Moreover, CDSL has also set up a third site from which all critical activities can be carried out in case physical access to the main premises is restricted.
5. Another major challenge is linkages to international depositories to facilitate Cross Border transactions. In India, both the depositories have already established an online inter-depository mechanism, which enables transfer of securities from an account in one depository to an account in another depository. This could be replicated with international depositories to facilitate cross border transactions.
6. India is probably the only country where record of commodities (i.e. warehouse receipts) is held in electronic form and these are permitted to be delivered on the commodity exchanges. However, the time involved from the time the commodities are delivered to the warehouse to the time the credit is given in the BO account needs to be reduced, so that an efficient and cost effective settlement for spot commodities market could be implemented.

As the depositories have made substantial investments in infrastructure, going forward the depositories could be utilizing their existing systems and infrastructure to provide services to investors and Government. The

need of the hour is to piggy back on the existing set up by leveraging on the systems and infrastructure, so as to provide efficient and cost effective solutions.
