

# Distribution of Cash Entitlements through Depositories



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World over, in most developed markets and several emerging markets, depositories usually distribute cash entitlements to their account holders including dividend on equity and preference shares, interest and maturity proceeds on debt instruments, etc. Depositories being registered holders of securities are entitled in law to receive cash entitlements from issuers which they

arrange to distribute to beneficial holders. In many such markets, depositories commonly hold a restricted banking license that allows them to handle cash benefits directly, although third party banks may also be used due to strategic or regulatory reasons.

In India, however, distribution of cash entitlements has evolved differently. Although non-cash entitlements such as bonus, rights etc are handled through depositories, cash entitlements are handled outside the depository system. Issuer companies arrange for distribution of cash entitlements by obtaining information from the depositories.

## Issues faced in the current process

All cash entitlement distributions are being processed outside the depository system. Thus, no information is available in the depository system with respect to entitlement of cash benefits and payment of the same to the investors.

In case any investor requires any information with respect to above transactions, they are required to approach the respective Issuer and RTA which is very inconvenient to the investors.

The present system has a number of drawbacks.

**1. Investor cannot track payments:** It is very difficult for the investors to track whether they have received all the cash entitlements due. Investor can only see a credit in his bank statement and the narration is often incomplete for the investor to understand the nature of credit. Investors need to track the corporate announcements for the entitlements due to them and correlate the same with bank credits to understand if any credits are missing. Other than custodians who carry out such work for their institutional clients for a fee, it is impractical for any investor to do the same.

- 2. No consolidated statement:** Investors do not get a consolidated statement of all cash entitlements due and paid to them. Depositories cannot provide such a statement as they do not have the information. Investors need to engage in culling out such details by browsing through their bank statements when such information is needed, for example, for tax filings.
- 3. No alerts:** Investors do not get SMS alerts or email alerts on cash entitlements paid to them. Issuer companies follow different practices in advising credit, some do and some do not, some send physical advices and some by email.
- 4. No correlation with demat transactions:** In the case of bonds and other debt instruments, securities may be debited from the client's account by the RTA but at the same time payment may not have reached the investor. It is very difficult for the investor to ensure that he has indeed received redemption proceeds unless he is alert.
- 5. No central monitoring:** As currently all information related to cash entitlements distribution is handled by Issuer Company itself or with the help of RTA, there is no central information available to regulator to monitor the same. There is no independent way to check whether the company has indeed distributed all the cash entitlements and followed legal provisions and guidelines.
- 6. Delays and defaults not known:** In debt instruments, delays or defaults in payment of interest or redemption proceeds are material information required by the market, which are however unreported.
- 7. No tracking of invalid bank details:** When electronic credit fails, such information is only available at the issuer company. No attempt is made by the issuer company to contact the shareholder to update the bank details as the issuer company simply sends a physical warrant. It is also not uncommon where electronic credit succeeds with some companies but is reported as failed by other companies. If depositories handle distribution, invalid bank details will be known to depositories and action can be initiated to advise the client to update the details (as discussed later below).
- 8. No tracking of returned undelivered:** Similarly, warrants despatched by issuer companies may be returned undelivered due to address of client not being updated. There is no central tracking of the same, as the information is only available with each company.
- 9. Information on unpaid dividend on company website:** An investor wishing to check unpaid dividend information needs to visit websites of each company

and search, whereas the natural place to hold such information is the demat account. The demat statement can conveniently show both the paid and unpaid dividend details.

**10. Investor inconvenience:** In case any investor wishes to obtain any information related to cash entitlements, he has to approach the respective Issuer companies for the same. It is inconvenient for the investor. With the demat system, for all transactions such as transfer, address and contact details change, nomination and transmission, etc, the investor is no longer required to approach each issuer company or its RTA. However, this advantage does not extend to cash entitlements where the depository plays no role. In the case of cash entitlements, investors are compelled to contact the issuer company or its RTA.

### **Distribution of Cash Entitlements through Depositories**

It is recommended that necessary guidelines are put in place to enable depositories to distribute all cash entitlements, including dividend, interest and redemption proceeds to their investors. Issuers may be required to transfer the total amount due to clients of each depository to that depository, which is also the registered holder of such securities. The depository in turn will distribute the same to beneficial owners. Details of cash entitlements will reflect in the transaction statement of the investor. Depository will also calculate TDS on taxable entitlements and inform the Issuer for filing TDS return and issuing TDS certificate. Distribution of cash entitlements will be carried out in electronic mode. Further, unclaimed cash entitlements will be disclosed on depository website to help issuer to comply with disclosure requirements of Company Act 2013. In respect of physical shares, the issuer company may continue to handle the distribution of cash entitlements or choose distribution of cash entitlements through depositories. All information will be available in depository system for further analysis and monitoring. This would help the regulator to improve the framework/guidelines.

### **Advantages of Credit through Depositories to Investors**

- 1. Investor convenience:** As information of cash entitlements for all issuers will be available centrally in depository system for any query related to cash entitlements investor can contact his DP who will be able to provide the necessary details instead of approaching various issuers.
- 2. Shorter TAT for receiving cash benefits:** As majority of cash distribution will be carried out in electronic form investor will get cash entitlements in short time. Further, in case of any rejection of electronic credit, Participant can approach investor for updation of Bank details so that investor can get credit directly to his bank account electronically.
- 3. Better enforcement of fixed pay date:** In order to enable investors to manage their cash/securities

flows efficiently and to enhance process transparency, SEBI had mandated companies to have a pre-announced fixed pay date for payment of dividends. With depositories crediting directly, better enforcement of fixed pay date can be achieved.

- 4. Immediate alerts:** Investors can receive directly from the depository SMS and email alerts on cash entitlements distributed, just as other transactions are immediately notified to clients.
- 5. Single record of all cash entitlement received by investor in his account:** Demat account statement will become a single record of all details with respect to cash entitlements such as , details of credit received in bank account, tax deducted at source, etc.
- 6. No need for safe-keeping paper related to cash entitlements:** As details of cash entitlements will become part of demat account investor will not be required to maintain papers related to cash entitlements. Investors will be able to view these details as and when required.
- 7. Simplified monitoring:** As all details related to cash entitlements are available at single place, monitoring of the same will become easy for the investor. For example in case of non-receipt of some cash entitlements investor will easily be able to identify from his demat account statement. In fact, such missed payments would be minimised as there will be central monitoring by the depository.
- 8. Better service:** Easy and hassle free receipt of cash entitlements. One point contact for all services.

### **Benefits to Issuers**

- 1. Shared infrastructure:** The need to maintain separate infrastructure to maintain cash entitlement information would reduce. For example, today in the case of companies whose shares are held in dematerialised form, no infrastructure is required on part of issuer companies to maintain shareholder data. The entire shareholder information including customer master data and transfers is maintained in the depository system which is available to the companies to download as and when required. The entitlements of such high-reliability shared infrastructure can be extended to hold the information related cash entitlements distribution resulting in cost savings.
- 2. Substantial cost savings:** At present, each issuer appoints banker for distribution of cash entitlements and sends communication to its each shareholder about credit of cash entitlements separately. In case cash entitlements distribution is carried out by depository, all information of cash entitlements will be available in demat account statements which are sent to investors at defined frequency. Therefore, issuers will not be required to send communication to each shareholder separately saving on the costs.
- 3. Savings in servicing costs:** All routine queries of customer with respect to the distribution of cash

entitlements will be handled at the account level obviating the need for each issuing entity to handle such requests. It will result in enormous cost savings for the issuers in customer servicing.

- 4. Simplified process of Reconciliation:** As complete data is available at one place reconciliation will be easy for the issuers.

- 5. Compliance with obligations of distribution, disclosure of unclaimed cash entitlements, etc under Companies Act will be automatically ensured through market infrastructure.**

The benefit of the above proposal to the investors and issuers is huge and depository would play a major role in cash as well as non-cash corporate action in the context of Indian capital market.

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