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Dematerialisation and the Depository System in India: A Legal and Market-Structure Analysis

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Abstract
Dematerialisation converted the Indian securities market from a paper-based ownership register into an electronic book-entry system, and it is the reform that made every later settlement improvement possible. This paper examines the legal architecture and market consequences of that conversion. Using a doctrinal method supported by secondary market data, it analyses the Depositories Act, 1996, the relevant provisions of the Companies Act, 2013, and the SEBI (Depositories and Participants) Regulations, 2018, and traces how the two-depository structure of NSDL and CDSL operates through registered depository participants. Four findings emerge. The statutory shift of title into book-entry form under Sections 4 and 10 of the Depositories Act removed the certificate as the source of title and eliminated the categories of dispute that afflicted the paper regime. The compression of the settlement cycle from T+5 in 2001 to mandatory T+1 in January 2023 and optional T+0 from March 2024 was contingent on dematerialisation rather than merely coincident with it. Demat accounts grew from about 4.1 crore in March 2020 to roughly 23.15 crore by June 2026. The residual problems of the system are behavioural and cyber-operational rather than documentary. India's depository law is therefore infrastructurally complete but regulatorily unfinished.
Keywords — Dematerialisation; Depositories Act 1996; NSDL and CDSL; book-entry securities; rolling settlement.

1. Introduction

No longer a share certificate is a proof of the proprietorship of a listed Indian security but an entry in a depository's register does. Such change of legal fact has been brought about by the Depositories Act, 1996 and is the subject of this paper.

Depository acts as a bank does for money, but for securities. It has the responsibility to secure assets, to ensure ownership and to transfer assets from one account to another by debits and credits (NSDL, 2023). The distinction is that a depository does not contain anything physical. Securities admitted into the system are only book entries and the investor is only issued a statement of account by the depository participant as proof of holding.

Pre-1996 the Indian market was based on paper. A certificate with the company's seal, the unique numbers of the shares and the name of the registered holder constituted proof of ownership. Move the necessary physical transfer of certificate, execution of transfer deed, payment of stamp duty and transfer registration by the certificate issuing party. The system functioned at moderate levels. It wasn't successful when they weren't. Bad deliveries, forged transfer deeds, signature mismatches, lost and mutilated certificates and delays of several months in registration became the rule rather

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than the exception in the market (Shah and Thomas, 1997). The paper regime, used in the 1992 securities scam, where fake securities were used without hesitation, was not only inefficient but unsafe.

The study is limited to equity and debt securities of Indian companies that are dealt on NSDL and CDSL. It excludes commodity derivatives, international depository receipts and government securities held separately in the Reserve Bank's Subsidiary General Ledger.

1.1 Evolution of the depository system

The participation of the public in the Indian capital market was limited and the money raised by them was also not very large till the late 1980s. The reforms which started in the mid 1980s and increased after 1991 altered the mathematics. The number of stock exchanges, listed companies, intermediaries and investors grew at a rapid pace, as did the amount of paper that had to be moved, revised and registered with each trade (Echeverri-Gent, 2004).

The Depositories Ordinance was issued in September 1995 and later on replaced by the Depositories Act, 1996 which was notified on 12 August 1996 and got the Presidential assent on 10 August 1996. The Act expressly provided for more than one depository, which would provide depository services competitively instead of a statutory monopoly. Promoted by IDBI, UTI and the National Stock Exchange, NSDL was incorporated in 1996 and started its operations in November 1996. With the co-promotion of the Bombay Stock Exchange and a number of banks, CDSL received its certificate of commencement of business from SEBI in February, 1999 and commenced its operations on 15 July, 1999. It was voluntary at the beginning and then gradually made compulsory: From January 1998, it became compulsory for institutional investors and from 1999 to 2002, it was made compulsory for all investors, scrip by scrip, by SEBI.

2. Literature Survey

The literature on the topic of Indian securities market reform can be categorized into three streams and the depository is at the cross section of all three without being the main focus of any.

The first strand is the market-microstructure literature on the reconstruction of Indian's trading infrastructure since 1992. Shah and Thomas (1997, 2000) record the transition of the Bombay Stock Exchange from open-outcry, account-period system to the screen-based, nationally accessible, exchange market of the National Stock Exchange, and view settlement infrastructure as only part of a package that also involved corporatising the exchange's governance, the creation of a clearing corporation and novation. Their account makes clear that Indian market quality increased significantly during the 10-year period, and that the improvement is due to the package as a whole and not just to the depository. Thomas (2006) further argues that sequencing of financial-sector reform went in the wrong direction, as infrastructure reform preceded, not followed, the financial-sector's maturity.

The second strand is that of the political economy of reform. Echeverri-Gent (2004) examines the reason India has managed to introduce a depository and demat mandate on a well-established broking community when similar changes failed in other countries, concluding that it is due to the establishment of a new exchange and SEBI's flexibility with introducing a single deadline. Patil (2010) is more sceptical, suggesting that the “infrastructure modernisation” outstripped the “investor protection” and the “regulatory environment” of an intermediary was behind their technological development.

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The comparative and technical strand is the third strand. Gorham and Singh (2009) categorize India as part of the international shift from floor exchanges to electronic exchanges and note that in most jurisdictions, central securities depositories were not a result of the settlement time reduction, but rather a precondition. The comparative literature on paper and bearer instruments, on the other hand, considers untraceable paper shareholding as a problem of supervision in itself — as an instrument whose ownership can be transferred without having been registered, it is impossible to trace it for tax, anti-money laundering or beneficial ownership purposes.

The descriptive and quantitative data are provided from institutional publications. The mechanics of operation of the dematerialisation, the linkage of the pledge and settlement mechanism can be derived from the bye-laws and business rules of NSDL and CDSL, while the participation and settlement information can be obtained from SEBI's annual reports and monthly bulletins and the account and custody information can be obtained from the periodic statistics provided by the depositories.

There are two gaps in this literature. First, the legal structure of the Depositories Act—the legal form of distinction between registered and beneficial ownership—is typically not analysed or discussed, and its doctrinal implications for the law of transfer are generally not explored. Second, most empirical studies were written before the T+1 transition in January 2023 or the T+0 pilot in March 2024, so they can't answer the question about how much the T+1 transition relied on the depository. This paper fills both gaps.

3. Problem Definition

The problem this paper addresses can be stated in three parts.

The doctrinal problem. Indian company law continues to describe shares in the vocabulary of certificates. Sections 44, 45 and 46 of the Companies Act, 2013 are drafted around a certificated instrument, and the modifications required for book-entry holding appear partly as exceptions within those sections and partly in a separate statute. No single instrument states how title to a dematerialised security is constituted, transferred and defended. The consequence is interpretive uncertainty for practitioners and an under-analysed body of law for scholars.

The causal problem. It is commonly asserted that dematerialisation improved Indian market efficiency. The assertion is rarely tested against the alternative explanation that concurrent reforms, namely screen-based trading, the entry of the NSE, the clearing corporation, electronic funds transfer and later discount broking, would have produced similar gains. Establishing what dematerialisation specifically made possible, as distinct from what merely accompanied it, is necessary before any normative conclusion about the framework can be drawn.

The regulatory problem. The Depositories Act was drafted against the risks of a paper market: forgery, bad delivery, loss in transit and registration delay. Those risks are now closed. The risks that remain are of a different order, namely unauthorised account access, misuse of client securities by intermediaries, cyber intrusion, and the concentration of an entire market’s ownership record in two institutions. Whether a statutory framework designed for the first category is adequate to the second is an open question that the literature has not squarely put.

4. Methodology / Approach

Design. The study is doctrinal in its primary method and descriptive-analytical in its treatment of market data. Doctrinal analysis is appropriate because the central question, namely how legal title

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to a security is constituted in a book-entry system, is answered by construing statutes rather than by testing a hypothesis. Secondary quantitative data is used to establish the market consequences of the legal change.

Sources. The primary laws are the Depositories Act, 1996, Companies Act, 2013, SEBI Act, 1992, Companies (Prospectus and Allotment of Securities) Rules, 2014, the SEBI (Depositories and Participants) Regulations, 2018 and SEBI (LODR) Regulations, 2015, along with the bye-laws and business rules of NSDL and CDSL. Secondary sources are the SEBI annual reports, monthly bulletins, periodic statistics from NSDL and CDSL and academic literature surveyed in Section 2.

Period. The study covers 1996 to mid-2026, from the enactment of the Depositories Act to the most recent published depository statistics.

Analytical framework. Three lenses are applied. The first is legal: what the statute changed about the constitution of title. The second is institutional: how depositories, participants, registrars and clearing corporations divide the functions the statute creates. The third is market-structural: what happened to settlement time, participation and cost.

Limitations. Account data is account-level, not investor-level; because an investor may hold accounts with both depositories and with several participants, aggregate account numbers overstate distinct participation. The study does not attempt econometric isolation of dematerialisation from concurrent reforms, so causal claims are made as claims of necessary condition rather than of measured effect. No primary survey of investors or participants was conducted.

5. Results and Discussion

5.1 Physical and dematerialised securities compared

A physical share is a paper share certificate issued by the company with the name of the company, the nominal value, the distinctive numbers, the folio number, the name of the holder and the company's seal. These certificates are not worthless, don't require the Internet, don't require technical expertise, don't require an intermediary, and they can be pledged directly by the holder. The deficiencies were very great and in the main irreparable on paper. Certificates could be lost because of fire, floods, theft, required storage space, were subject to forgery, were slow to transfer and required a ton of paperwork, and had to be sent by mail which led to loss and delay.

A dematerialised security is one that doesn't have a certificate. It is only registered on the register of the depository and the investor's holding is determined from a periodical statement of accounts. The Depositories Act, 1996, provides that a depository is a company registered under the Companies Act and under Section 12(1A) of the Securities and Exchange Commission Act, 1992.

There are three provisions in effect. For the purpose of making a transfer on the beneficial owner's behalf, the depository shall be deemed to be the registered owner and shall have no voting or other rights with respect to the securities. All rights and benefits and all liabilities in respect of the securities held shall be of the beneficial owner pursuant to Section 10. The depository shall register transfer in the name of transferee on the receipt of intimation as required in section 7. These sections split legal and economical or beneficial ownership, with all economic and corporate rights going to the investor.

Table 1. Comparison of physical and dematerialised securities

Attribute	Physical	Dematerialised
Evidence of title	Certificate plus issuer’s register	Depository register; account statement

Statutory basis	Companies Act 2013, ss. 44–46	Depositories Act 1996, ss. 4, 7, 10
Transfer time	30–90 days, longer on objection	Same day; T+1 for market trades
Stamp duty	0.25% of consideration	Nil on demat transfer
Tradable unit	Market lot	One security
Forgery / bad delivery	High; main pre-1996 dispute	Effectively eliminated
Loss, theft, fire	Borne by holder	Not applicable
Corporate actions	Manual, by post	Automatic credit
Pledge	Delivery plus transfer formalities	Book entry to pledge account
Residual risk	Documentary fraud	Cyber fraud, broker misuse

The table isolates the core of the change. Dematerialisation did not reduce risk in general; it substituted one risk profile for another. Documentary risk, legally intractable because a forged instrument conveys no title however innocent the transferee, was replaced by operational and cyber risk, which is tractable through authentication controls, transaction alerts and supervision of participants.

5.2 The two depositories

NSDL has maintained its institutional focus. It holds total securities to the extent of Rs 520 lakh crore as of 31 March 2026, which is close to 87 per cent of industry custody value, and provides custody services to nearly 4.51 crore accounts as on May 2026 via 315 depository participants and over 57,000 service centres. CDSL had established the bigger retail base, adding more than 2.72 crore accounts in FY 2025-26, taking its tally to 18.01 crore by 31 March 2026 and 18.38 crore by May 2026 on assets under custody of around Rs 77 lakh crore.

Table 2. NSDL and CDSL compared

Attribute	NSDL	CDSL
Operations began	Nov 1996	Jul 1999
Promoters	IDBI, UTI, NSE	BSE, SBI, BOB, HDFC
Accounts (May 2026)	4.51 crore	18.38 crore
Custody (Mar 2026)	~Rs 520 lakh cr	~Rs 77 lakh cr
Share of custody value	~87%	~13%
Participants	315	585
Orientation	Institutional	Retail

The division of the market between the two is the clearest evidence that the multi-depository design in the 1996 Act worked as intended. Competition is real but segmented: CDSL competes on cost of account servicing and retail onboarding, NSDL on custody of institutional value.

Eligibility to sponsor a depository is restricted to public financial institutions, scheduled banks, RBI-permitted foreign banks, recognised stock exchanges, financial-services bodies corporate meeting a 75 per cent equity test, approved foreign financial institutions and SEBI-registered custodians. The net worth requirement is Rs 100 crore; sponsors must hold at least 51 per cent of equity; a sponsoring stock exchange may not exceed 24 per cent; and no single participant may hold more than 5 per cent.

The depository participant is the investor's only point of contact. It opens and services the beneficial owner account, forwards dematerialisation and rematerialisation requests, executes

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delivery instructions, effects pledges, and issues statements. It is the participant, not the depository, that performs know-your-customer verification and carries the first line of liability under Section 16. Because participants report continuously, the depositories hold a complete and current record of every beneficial owner's holdings, which few markets of comparable size maintain centrally, and which is the basis on which SEBI runs market-wide surveillance.

5.3 Legal and regulatory framework

A share may be certificated or otherwise, but the Companies Act, 2013 deems a share to be a share. Under section 29 of the Companies (Prospectus and Allotment of Securities) Rules, 2014 (read with Rule 9), the securities of every public company making a public offer are to be offered in dematerialised form. The provision was originally in the Companies Act 1956, as Section 68B as introduced by the Companies (Amendment) Act 2000, and was applicable to issues of more than Rs 10 crore. Compulsory dematerialisation has been expanded to unlisted public companies and from 2023 to most private companies (excluding small companies).

Section 45 stipulates that each share must have a distinctive number, except that the distinctive numbering of shares is not significant if those shares are held by a depository where the shares are fungible. Intimation to the depository of allotment under Section 56 (4). Section 38 renders personation to acquire securities an offence and Section 447 imposes a prison term between six and 10 years and a fine if a depository or a participant unlawfully transfers securities.

Through circulars, SEBI has begun the journey towards full dematerialisation of the market: compulsory demat settlement for institutional investors had been made effective from 1 January 1998, there had been a scrip-wise extension of the same from 1999 to 2002, and the prohibition on transfer of listed securities in physical form had been effective from 1st April 2019 under Regulation 40 of the LODR Regulations and subsequently extended to the transmission and transposition from 24th January 2022.

A common mistake in the secondary literature should be remedied. The relaxation that was available to allow trades to settle physically up to 500 shares was allowed in the transitional period around 1999-2001 and was withdrawn once compulsory demat settlement was implemented. No listed security transfer is possible in physical form from April 2019, however an investor might have a current certificate and can rematerialise it.

Table 3. Principal statutory provisions

Provision	Instrument	Effect
s. 4	Depositories Act	Depository registered owner for transfer only
s. 7	Depositories Act	Registers transfer on intimation
s. 8	Depositories Act	Option to hold physical or demat; rematerialise
s. 10	Depositories Act	Beneficial owner holds all rights and liabilities
s. 16	Depositories Act	Liability for negligence; indemnity
s. 29 + Rule 9	Companies Act 2013	Compulsory demat issue on public offer
s. 38, s. 447	Companies Act 2013	Personation; punishment for fraud
s. 45	Companies Act 2013	Distinctive numbering inapplicable
s. 56(4)	Companies Act 2013	Intimation of allotment to depository
s. 12(1A)	SEBI Act 1992	Registration of depositories, participants

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Reg. 40	SEBI LODR 2015	Demat-only transfer from April 2019
D&P Regulations	SEBI, 2018	Registration, net worth, governance, records

The pattern is that the Depositories Act supplies the theory of title, the Companies Act supplies the corporate-law consequences, and SEBI regulation supplies the operational compulsion. Nothing in the framework is redundant, but nothing in it is consolidated either.

5.4 Working of the system

Dematerialisation converts an existing certificate into a book entry. The holder submits a Dematerialisation Request Form to the participant with the certificates, defaced with the words “surrendered for dematerialisation”. The participant generates an electronic request and forwards the certificates to the issuer’s registrar and transfer agent. The registrar verifies against the register of members and confirms or rejects; on confirmation the depository credits the account and the certificates are destroyed. The statutory limit for issuer verification is 15 days. Rejection is common where the signature does not match the specimen held by the issuer, or where the name on the certificate differs from that on the account.

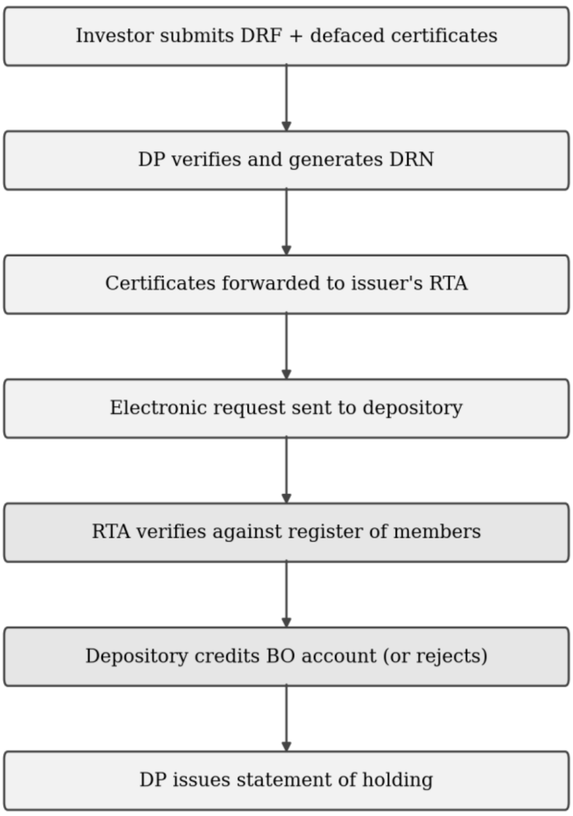

Figure 1. The dematerialisation process. The registrar, not the depository, is the control point, because only the issuer’s register can establish that a surrendered certificate is genuine.

Transfer under the depository system is a book entry, where the beneficial owner gives instructions to the participant to debit the account, the depository credits the account and the issuer is intimated. All the formalities of pre-1996 are not applicable. Transmission, the transfer of securities by operation of law upon death, insolvency or succession, is also done by book entry, and a single

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request is used to transmit securities in all issues in the account, as compared to the paper regime where the legal representative had to make a separate request to each issuer.

Market trades are settled via the clearing corporation but off-market transfers (e.g. gifts between family members) are transferred directly between beneficial owner accounts.

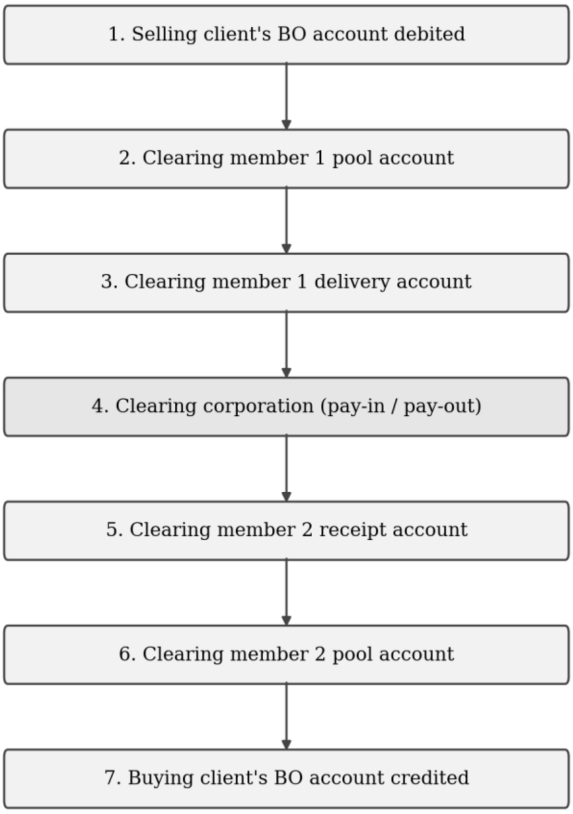

Figure 2. In a market trade, things are done with securities. Clearing banks execute transfers at pay-in and pay-out without instructions and the funds are not exchanged through the depository. SEBI now mandates that the pool account should be cleared to the client account within one working day of pay-out and securities should not be warehoused by the brokers in the pool account.

In the case of pledges, the securities are tagged as "pledged" and the securities are "booked" to a pledge/collateral account. It is initiated by the pledgor, confirmed by the pledgee and recorded in the register of the depository and on repayment, the pledge is closed by a reverse entry. One of the longstanding loopholes of using client securities as a margin was closed by SEBI in 2020 when it mandated to pledge client securities in favour of the broker instead of transferring them.

Corporate actions are dealt in two ways. The depository may provide issuer with the list of beneficial owners as on the record date and it is the responsibility of the issuer to distribute the bonus shares/ split shares and merging consideration or may credit the bonus shares/ split shares and merging consideration directly to the accounts by the depository. The most obvious service improvement for retail investors is automatic credit, which alleviates the "lost warrant" and "unclaimed dividend" issues under the paper system.

5.5 Findings

Finding 1: the statute displaced the certificate as the source of title. The legal innovation of the Depositories Act is not electronic record-keeping but the separation of registered from beneficial ownership. Because the register, not an instrument, now constitutes title, the entire category of disputes that turned on the authenticity of an instrument ceased to exist. A forged certificate could convey no title even to an innocent purchaser, and the bad-delivery mechanism could only allocate the loss; a book entry cannot be forged in the same sense, because there is nothing to forge.

Finding 2: settlement compression was contingent on dematerialisation.

Table 4. Evolution of the settlement cycle

Period	Basis	Exposure	Enabling condition
To 2000	Weekly account period	To 14 days	Physical delivery
2001	Rolling T+5	5 days	Demat compulsory, most scrips
Apr 2002	Rolling T+3	3 days	Near-complete coverage
Apr 2003	Rolling T+2	2 days	Electronic funds transfer
Jan 2023	Rolling T+1	1 day	Full demat; UPI pay-in
Mar 2024	Optional T+0	Same day	Real-time confirmation

The fourth column is the finding. Each compression required a shorter securities-delivery time than the preceding regime could support, and only a book-entry register can deliver securities within a day. India reached mandatory T+1 in January 2023, ahead of the United States, which completed the same transition in May 2024.

Finding 3: participation growth is structural rather than cyclical.

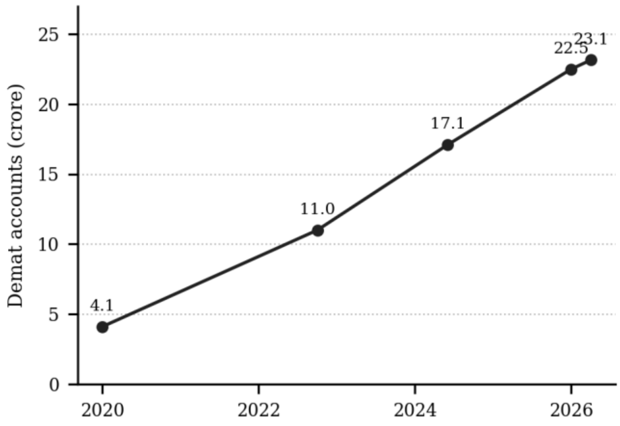

Figure 3. Growth of demat accounts, 2020–2026 (NSDL and CDSL combined; the March 2026 figure is derived from the two depositories' reported totals).

Demat accounts rose from roughly 4.1 crore in March 2020 to about 23.15 crore by June 2026, a fivefold increase in just over six years. It took 25 years from 1997 to cross 11 crore accounts; the next 12 crore took under four. The distribution is asymmetric in an instructive way: CDSL holds roughly 80 per cent of accounts but about 13 per cent of custody value, while NSDL holds the reverse. One legal framework therefore serves two distinct markets. The caveat noted in Section 4 applies: account counts overstate distinct investors.

Finding 4: the residual risk profile has changed character. The risks the Act was enacted to address are effectively closed. Those that remain are unauthorised account access, misuse of client

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securities by intermediaries, cyber intrusion, and concentration of the ownership record in two institutions. SEBI's responses, including two-factor authentication for demat debits, pledge-based rather than transfer-based margin from 2020, and the one-day pool-account limit, are addressed to this second category. The legal framework was designed for the first.

5.6 Discussion: advantages, limitations and market impact

Theft and mutilation are eliminated for the investor, so are the problem of odd lots, no need for a stamp duty to be paid for transfer, and corporate benefits are credited automatically. The broker risk of failing to settle for delivery is eliminated and reduced for bad delivery. The register of beneficial owners is available on demand and, for the issuer, printing and distribution costs are eliminated. In terms of the economy, the system brings the Indian infrastructure up to international standards, and lowers the risk of settlement for foreign portfolio investment.

The restrictions are not hypothetical – they are real and should not be glossed over in a literature that is oriented towards advocacy. It assumes digital access and literacy and an investor who can't use an online account relies on a broker or sub-broker, as was the case with several enforcement actions. The behavioural cost of frictionlessness in electronic trading is low transaction cost and instant execution, which could be one reason why a vast majority of individual traders in the equity derivatives segment lose money. It's not a defect of the depository, but it's because of the low friction environment the depository created. Concentration risk has become systemic risk: an extended outage at either depository would prevent settlement – something that a distributed paper system simply couldn't be prevented. While annual maintenance charges are negligible, they affect very small holdings in a disproportionate manner which is why SEBI came up with Basic Services Demat Account.

There are four effects that can be identified in market structure. Liquidity was improved since there was no longer a documentary risk premium in the effective spread and the tradable lot was reduced to one unit (Shah and Thomas, 2000). Clearing-corporation risk of a member default was reduced from a week of trades to one day, freeing up margin that had been used as security. Corporate governance enhanced as concentration, promoter pledging, and changes in substantial holdings are transparent in near real time thanks to the continuously updated beneficial owner register. The primary market, too, has stepped up a notch: Now the listing is done on T+3 from the close of the subscription, compared with several weeks under the paper regime.

6. Conclusion

India's depository system is infrastructurally complete and regulatorily unfinished. Dematerialisation solved the problem it was designed to solve, comprehensively and within a decade, and it made possible a settlement cycle that is now among the fastest in the world. The unfinished part is that the governing law still addresses a paper market's risks while the market's risks have become operational and digital.

Five recommendations follow. First, consolidate the statutory framework: a consolidated code, or at minimum a restatement of Sections 4, 7, 8, 10 and 16 of the Depositories Act alongside the Companies Act provisions they modify, would reduce interpretive uncertainty. Second, give Section 16 liability a statutory floor, comparable to the limited-liability regime for unauthorised electronic banking transactions, so that the investor has a determinate remedy rather than a right of action. Third, regulate depository operational resilience explicitly, with recovery-time objectives, mandatory live failover testing and a published business-continuity standard prescribed by regulation rather than left to bye-laws. Fourth, extend investor education to behavioural risks, addressing trading frequency and derivative losses and not only fraud avoidance. Fifth, review demat thresholds for unlisted and private companies against actual compliance burden.

The broader lesson for comparative securities law is that a register-based system of title is not simply a faster version of a certificate-based one. It changes what ownership is, where fraud can occur, and which institutions the market depends on. India's experience since 1996 is the clearest large-market demonstration of that proposition available.

7. Future Scope

Four lines of further work follow directly from the limitations acknowledged in Section 4.

Empirical isolation of the depository effect. The claim advanced here is that dematerialisation was a necessary condition for settlement compression. A difference-in-differences design exploiting the scrip-by-scrip sequencing of compulsory demat settlement between 1999 and 2002, with liquidity and spread measures as dependent variables, could convert that claim into a measured effect.

Evaluation of the T+0 transition. The optional same-day facility has operated only since March 2024 and its take-up has been limited. Research on participation rates, liquidity fragmentation between the T+0 and T+1 pools, and the treatment of foreign portfolio investors under a same-day cycle would establish whether instantaneous settlement is a destination or a niche.

Investor-level rather than account-level analysis. Linking permanent account number data across the two depositories would permit a count of distinct investors, a measurement of dormancy, and a geographic and demographic profile of participation that account totals cannot supply.

Comparative and resilience research. Two further questions merit study: how India's two-depository model performs against single-depository and distributed models in other large markets on cost, resilience and investor protection; and whether distributed-ledger settlement offers any advantage over a centralised register that already settles same-day, given that the legal separation of registered and beneficial ownership would have to be reconstructed in any such system.

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