



Dematerialization of Securities – Mandatory for Private Limited Companies

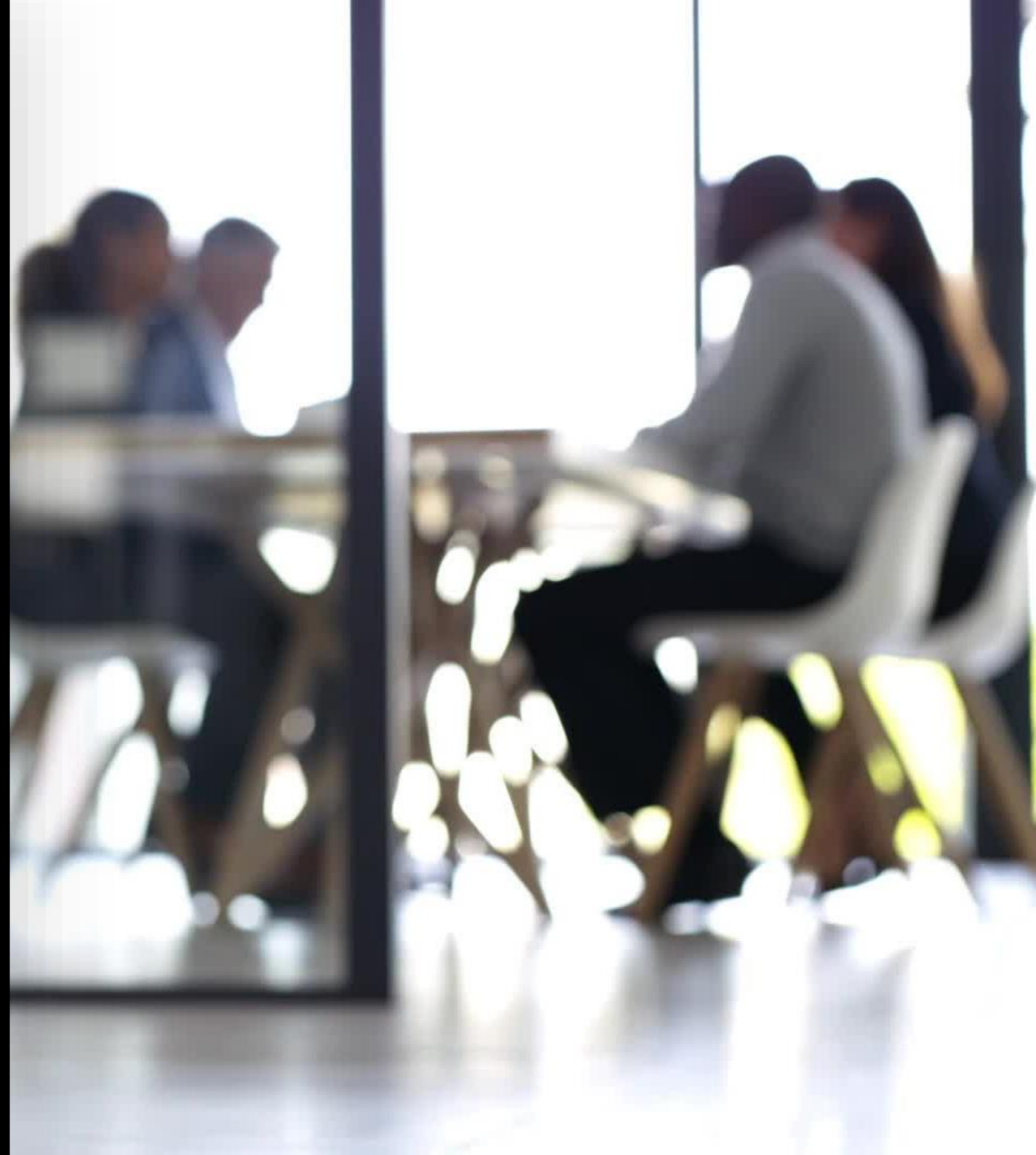
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Welcome

- ▶ Dematerialization of shares :
Mandatory for Private Limited
Companies
- Explore the latest MCA amendment,
- The process
- Implications and consequences
- Compliance & professional
opportunities.



Introduction

- ▶ The Ministry of Corporate Affairs (MCA) has introduced a **significant change with the Companies (Prospectus and Allotment of Securities) Second Amendment Rules, 2023 (PAS Amendment Rules)** as notified by notification no. GSR 802(E) dated 27th October 2023.
- ▶ This mandates private companies, excluding small ones, to **convert physical securities into dematerialized (demat) form within eighteen months** of their financial year ending March 31, 2023.

Rule -9B- Issue of securities in dematerialized form by private companies

1. Every private company, other than a small company, shall within the period referred to in sub-rule (2) –
 - a. **issue** the securities only in dematerialized form; and
 - b. **facilitate** dematerialization of all its securities,in accordance with provisions of the Depositories Act, 1996 (22 of 1996) and regulations made thereunder.
2. A private company, which as on last day of a financial year, ending on or after **31st March 2023, is not a small company** as per audited financial statements for such financial year, shall, **within eighteen months of** closure of such financial year, comply with the provisions of this rule.
3. Every private company referred to in sub-rule (2) making **any offer for issue of any securities or buyback of securities or** issue of bonus shares or rights offer, after the date when it is required to comply with this rule, shall ensure that before making such offer, **entire holding of securities of its promoters, directors, key managerial personnel** has been dematerialized in accordance with the provisions of the Depositories Act, 1996 (22 of 1996) and regulations made thereunder.



Continued

4. **Every holder of securities** of the private company referred to in sub-rule (2),-
 - a. who **intends to transfer** such securities on or after the date when the company is required to comply with this rule, shall get such securities **dematerialized before the transfer**; or
 - b. who **subscribes to any securities** of the concerned private company whether by way of private placement or bonus shares or rights offer on or after the date when the **company** is required to comply with this rule shall **ensure that all his securities are held in dematerialized form** before such subscription.
5. The provisions of **sub-rules (4) to (10) of rule 9A** shall, mutatis mutandis, apply to the dematerialization of securities under this rule.
6. The provisions of this rule shall **not apply** in case of a **Government company**.

Note – For the sake of brevity, “private company other than small company” shall be referred to as “Applicable Company” in this session.



Continued.

- ▶ The new amended definition of a **small company** is provided under Section 2(85) of the Companies Act, 2013.
- The Act defines a small company as a company that is not a public company and has:
 - A paid-up share capital equal to or below Rs.4 crore or such a higher amount specified not exceeding more than Rs.10 crores.
 - A turnover equal to or below Rs.40 crore or such a higher amount specified not exceeding more than Rs.100 crore.

However, the concept of small companies does not apply to the following companies:

A holding or a subsidiary company.

A company registered under section 8 of Companies Act.

A body corporate or company governed by any special act.

Rule - 9A

4. Every Applicable company shall facilitate dematerialization of all its existing securities by **making necessary application to a depository** as defined in clause (e) of sub-section (1) of section 2 of the Depositories Act, 1996 and shall secure International security Identification Number (**ISIN**) for each type of security and **shall in-form all its existing** security holders about such facility.
5. Every Applicable company shall ensure that-
 - a. it makes **timely payment of fees (admission as well as annual)** to the depository and registrar to an issue and share transfer agent in accordance with the agreement executed between the parties;
 - b. it **always maintains security deposit, of not less than two years**, fees with the depository and registrar to an issue and share transfer agent in such form as may be agreed between the parties; and
 - c. it **complies with the regulations or directions or guidelines or circulars**, if any, issued by the **Securities and Exchange Board or Depository** from time to time with respect to dematerialization of shares of Applicable companies and matters incidental or related thereto.

Continued

6. No Applicable company which has **defaulted in sub-rule (5)** shall **make offer of any securities** or buyback its securities or issue any bonus or right shares **till the payments** to depositories or registrar to an issue and share transfer agent are made.
7. Except as provided in sub-rule(s), **the provisions of the** Depositories Act 1996, the securities and Exchange Board of India (Depositories and participants) Regulations, 2018 Regulations, 1996 and the securities and Exchange Board of India (Registrars to an Issue and share Transfer Agents) Regulations, 1993 **shall apply** mutatis mutandis to dematerialization of securities of Applicable companies.
8. Every Applicable company governed by this rule shall **submit Form PAS-6** to the Registrar with such fee as provided in Companies (Registration Offices and Fees) Rules, 2014 **within sixty days from the conclusion of each half year duly certified by a company secretary in practice or chartered accountant in practice.**
 - a. The company shall immediately bring to the **notice of the depositories** any difference observed in its issued capital and the capital held in dematerialized form.
9. The **grievances, if any, of security holders** of Applicable companies under this rule shall be filed before the Investor Education and protection Fund Authority.
10. The Investor Education and protection Fund Authority shall **initiate any action against a depository or participant or registrar to an issue and share transfer agent after prior** consultation with the securities and Exchange Board of India.

Dematerialization of shares Mandatory for Private Limited Companies

Key parameters of dematerialization mandate as implemented under the PAS Amendment Rules

- Recently, MCA has extended such requirement to private companies & inserted Rule 9B in PAS Rules providing for mandatory dematerialization of securities of private companies also.

The Rule enlists the prescribed classes of companies that are required to comply with the provisions:

- ▶ Private Company, other than a small company, as of the financial year ended on or after 31st March 2023;
- ▶ Small Companies as defined under section 2(85) of the Companies Act, 2013 are excluded from the ambit of PAS Amendment Rules

Obligation for Dematerialization of securities on applicable company

- File a return in form PAS-6 with ROC on a half yearly basis within 60 days from conclusion of each half of the financial year, with respect to reconciliation of the share capital of the company;
- Bring to the notice of the depositories, any difference in the issued capital by the company and the capital held in dematerialised form;

Compliance Timeline

- Within eighteen months of the conclusion of the financial year ending on March 31, 2023 i.e., latest by September 30, 2024 (“Due Date”).



Consequences in case of non-dematerialization

On the Applicable Company

- ▶ In the event an Applicable Company fails to undertake dematerialization of its securities on or before the Due Date, **it shall not be able to make any offer for the issue of any securities or buyback of securities or issue of bonus shares or rights offer after such Due date unless entire holding of securities of its promoters, directors, key managerial personnel has been dematerialized** in accordance with the provisions of the Depositories Act, 1996 (22 of 1996) and regulations made thereunder

On the Security Holders

- ▶ In the event, security holders of the Applicable Company fail to undertake dematerialization of its securities on or before the Due Date, and **who intends to transfer such securities on or after the Due Date shall not be able to transfer, purchase, subscribe to any securities of the Applicable Company whether by way of private placement or bonus shares or rights offer, unless** such securities are dematerialized before transfer, purchase or subscription, as the case may be.



Procedure to be followed by Applicable Company

Step 1: Pass a Board Resolution & Check AOA

Step 2: Select Depository -NSDL / CDSL / BOTH

Step 3: Appoint Registrar and Share Transfer Agent ("RTA")-

Step 4: Enter into a tripartite agreement with the depository (e.g., NSDL or CDSL in India, as the case may be) and RTA

Step 5: Activate International Securities Identification Number ("ISIN") ,
Inform to Holders & Ensure the completion of Demat process & Record updation.

Documentation : For Applicable Company

Certified True Copy of Board Resolution for dematerialization of securities along with the list of authorized signatories and request letter for dematerialisation;

Application in prescribed format for admission as Issuer of Eligible Securities provided by the Depository;

Details of shares to be converted into demat form;

Net Worth Certificate issued by a Chartered Accountant;

Certified true copies of the Memorandum of Association and Articles of Association along with the Certificate of Incorporation of the Company;

Certified true copy of audited annual report for the last financial year;

GST Certificate, If Applicable & PAN Card

Company has issued equity shares after latest balance sheet in that case, such company shall provide certified true copy of PAS-3.

If there is any Variation in the face value of shares or Reduction in the capital after the last balance sheet date in that case, provide a certified true copy of form SH-7;

List of Directors & Undertaking in the prescribed format.

Any other additional document as may be required by the DP

Procedure to be followed --by the shareholders

- **Step 1** : Select a Depository Participant (“DP”)
- **Step 2** : Open a demat account -The shareholders shall provide their Know Your Customer (“KYC”) documents to their selected
- **Step 3** : Submit Dematerialization Request –Dematerialization Request Form (“DRF”) along with the physical share certificate and other supporting documents as may be required
- **Step 4** : Verification of DRF
- **Step 5**: Confirmation and Record Update

Documentation For shareholders

- Know Your Customer (“KYC”) details
- Original Share Certificates
- Other documents as per the specific requirement of the selected DP



Penal Consequences

- ❖ Since no specific penalty/fine is prescribed under rule 9B,
- ❖ So penal provisions as per Section 450 of the Companies Act shall apply, which state,
- ❖ Section 450. Punishment where no specific penalty or punishment is provided
 - ▶ the company and every officer of the company who is in default or such other person shall be punishable with fine which may extend to ten thousand rupees, and
 - ▶ where the contravention is continuing one, with a further fine which may extend to one thousand rupees for every day after the first during which the contravention continues,
 - ▶ subject to a maximum of two lakh rupees in case of a company and fifty thousand rupees in case of an officer who is in default or any other person.



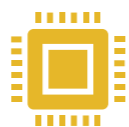
Implications of the present amendment

- Many companies will be forced to move towards dematerialization of shares.
- Barely any securityholder (particularly shareholders) will remain outside the purview of the same.
- ▶ **Compliance**
 - Filing of Half-Yearly Returns as per Rule 9A(8), every Applicable company -governed by this rule must submit Form PAS-6 ' Reconciliation of Share Capital Audit Report Form ' to the Registrar with the fee as provided in the Companies (Registration Offices and Fees) Rules, 2014, within 60 days from the conclusion of each half-year, duly certified by a company secretary in practice or chartered accountant in practice.

Below are some of the **challenges/ issues** that different stakeholders might face in the **light of the PAS 2023-Amendment**:



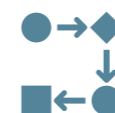
First, it should be noted that the PAS 2023-Amendment is in effect increasing the threshold of compliance required for holding securities but providing **18 (eighteen) month window to comply** with the same.



-it also needs to be assessed whether the NSDL and CSDL systems and their corresponding **IT infrastructure** are ready to deal with an increased influx of applications for conversions of physically-held securities to the demat form.



Second, for account holder's KYC, there would be an increased requirement **for non-residents** to obtaining PANs and also verify PAN details of the resident account holders, which could become challenging.



Third, the **KYC and following dematerialization process** is bound to slow down the overall process.



Last, it also impose **logistical challenges** for securities holders who might have changed their names, addresses, or their residential status or where the securities were jointly held by people who have since died, with no nomination or paperwork to claim the securities in question.

Applicability on a wholly-owned subsidiary

Rule 9B of the PAS Rules, enforcing mandatory dematerialization of the securities of private companies, is applicable on all private companies other than the following:

- Small company, and
- Government company

In case of unlisted public companies, sub-rule (11) of Rule 9A extends a similar exemption from dematerialization requirements. The said sub-rule covers the following public companies –

- Nidhi company,
- Government company, and
- A wholly owned subsidiary.



Continued

| Nature of wholly-owned subsidiary | Nature of holding company | Applicability of Dematerialization Provisions |
|-----------------------------------|---------------------------|---|
| Public company | Public company | Exempt under Rule 9A(11) |
| Public company | Private company | Exempt under Rule 9A(11) |
| Private company | Private company | Covered under Rule 9B as of now |
| Private company | Public company | <p>The same being a deemed public company, there is no clarity on whether Rule 9A applies or Rule 9B.</p> <p>If considered to be a private company – covered under Rule 9B</p> <p>If considered to be a public company – exempt in terms of Rule 9A(11)</p> |

Conclusion :

The new MCA notification, mandates the dematerialization of shares for Applicable private companies

1

It ensuring transparency and compliance with the changing financial landscape.

It is Progressive, increased Protection.

2

While this shift may pose challenges for large private companies, understanding and adhering to the rules is crucial.

Reduce Risk of Disputes & Litigation, Theft, Forgery etc.

3

To avoid penalties and ensure a smooth transition to dematerialized securities.

Efficient format aid to Regulatory Bodies.

Disclaimer

- ▶ This is my original work.

Sanjeevlata Samdani

Thank you!