

B. Kaushik & Associates.

Company Secretaries

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Dematerialisation: Transforming Shareholding for Enhanced Transparency **Issue of securities in dematerialised form by Private Companies**

On October 27, 2023, the Ministry of Corporate Affairs (“MCA”) ushered a significant change with the introduction of **Rule 9B through the Companies (Prospectus and Allotment of Securities) Second Amendment Rules, 2023** (“PAS Rules”).

The recent amendments align with the on-going shift towards digital transformation in the corporate sector. It emphasizes the Ministry of Corporate Affairs (MCA) dedication to improving transparency and efficiency in the securities market. The change reflects a commitment to modernize practices within companies, making processes more accessible and streamlined.

Background:

- **Earlier in 2018, the Government had mandated Unlisted Public Companies in India to issue securities and facilitate dematerialisation of all its existing securities.**
- **Every Unlisted Public Company** before making an offer for the issue of any securities or buyback of securities or issue of bonus shares or right offer shall ensure that the entire holding of its promoters, directors, and KMP has been dematerialized.
- **Every Unlisted Public Company** shall get an **International Security Identification Number (ISIN)** for each type of securities and also inform all its existing security holders about such a facility.

***Note:** ISIN (International Securities Identification Number) is a unique 12 digit alphanumeric identification number allotted for a security.*

- **Every Unlisted Public 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 maintains security deposit at all times 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.
 - c. It complies with the directions or regulations or circulars, if any which are issued by the Securities and Exchange Board or Depository from time to time with respect to dematerialisation of shares of unlisted public companies and matter related thereto.

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- **Every Unlisted Public Company** shall file Form **PAS-6 (Reconciliation of Share Capital Audit Report)** to the registrar within 60 days from the conclusion of each half-year (i.e., 30th September and 31st March of every year) duly certified by a company secretary in practice or chartered accountant in practice.

Similarly the Ministry of Corporate Affairs vide notification dated 27th October, 2023 has now published the Companies (Prospectus and Allotment of Securities) Second Amendment Rules, 2023.

This notification has introduced Rule 9B of Companies (Prospectus and Allotment of Securities) Second Amendment Rules, 2023 requiring Private Companies to issue securities only in dematerialized form and facilitate demat of all its existing securities in accordance with Depositories Act, 1996 and regulations made thereunder with the time specified (i.e. before 30th September 2024)

Applicability

- Every 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 (**i.e. before 30th September 2024**) :
 - a. issue the securities only in dematerialised form; and
 - b. facilitate dematerialisation of all its securities issued to its promoter, directors and key managerial personnel.
- Every security holder **after expiry of 18 months** from the Financial year ending 31st March, 2023 intends to transfer such securities, shall get such securities dematerialized before the transfer.
- Every security holder who subscribes to any securities of the concerned Private Company whether by way of private placement or bonus shares or rights offer **after expiry of 18 months** from the financial year ending 31st March 2023 shall ensure that all his securities are held in dematerialised form before such subscription.

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***Definition of Small Company Section 2 (Clause 85)**

“Small company” means a company, other than a public company, -

- i. Paid-up Share Capital of which does not exceed **Four Crore Rupees**; and
- ii. Turnover of which as per profit and loss account for the immediately preceding financial year does not exceed **Forty Crore Rupees**.

Provided that nothing in this clause shall apply to:

- (A) a holding company as defined under Section 2(clause 46) or a subsidiary company as defined under Section 2 (clause 87);
- (B) a company registered under section 8; or
- (C) a company or body corporate governed by any special Act.

- Further the provisions of sub rule (4) to (10) of Rule 9A of Companies (Prospectus and Allotment of Securities) Third Amendment Rules, 2018 (which were for Unlisted Public Companies) shall also apply to the dematerialisation of securities under this rule (for Private Companies).

These provisions of sub rule (4) to (10) of Rule 9A of Companies (Prospectus and Allotment of Securities) Third Amendment Rules, 2018 talks about the following:

- ***getting International Security Identification Number (ISIN) for each type of security;***
- ***making timely payment to depository and Registrar to an issue and Share transfer agent;***
- ***Filing of Form PAS-6 to the registrar within sixty days from the conclusion of each half year (i.e., 30th September and 31st March of every year) duly certified by a Company Secretary in practice or Chartered Accountant in practice.***

Note: Click on the link given herewith to read Rule 9A of Companies (Prospectus and Allotment of Securities) Third Amendment Rules, 2018

<https://www.mca.gov.in/bin/ebook/dms/getdocument?doc=MTM5NDk=&docCategory=Notifications&type=open>

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Compliance by Public Companies with respect to Unconverted Share Warrants-

It provides for the relinquishment of share warrants previously issued by public companies prior to the inception of the Companies Act, 2013 and not converted those warrants into shares, they shall :

- a. within a period of three months of the commencement of the Companies (Prospectus and Allotment of Securities) Second Amendment Rules, 2023 inform the Registrar about the details of such **share warrants in Form PAS-7**; and
- b. within a period of six months of the commencement of the Companies (Prospectus and Allotment of Securities) Second Amendment Rules, 2023, require the bearers of the share warrants to surrender such warrants to the company and **get the shares dematerialised in their account** and for this purpose the company shall place a notice for the bearers of share warrants in **Form PAS-8** on the website of the company, **if any** and shall also publish the same in a newspaper in the vernacular language which is in circulation in the district and in English language in an English newspaper, widely circulated in the State in which the registered office of the company is situated.

Non Applicability of Rule 9B of Companies (Prospectus and Allotment of Securities) Second Amendment Rules, 2023

Exemptions from the applicability of Rule 9B of the Companies (Prospectus and Allotment of Securities) Rules, 2014 are:

- **Small Companies** characterised by a paid-up share capital of **INR 4 crores and turnover of INR 40 crores**. [Defined under Section 2 (clause 85)].
- **Government Companies** are exempt, as recognize by their unique regulatory framework and governance structure. [Defined under Section 2 (clause 45)].

Note: A clarification regarding the applicability of Rule 9B of Companies (Prospectus and Allotment of Securities) Second Amendment Rules, 2023 on Section 8 Companies.

As Section 8 Companies are not covered under the definition of Small companies, therefore, the provisions of Rule 9B shall also be applicable to them.

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Benefits of Dematerialisation of Shares

a) Demat Accounts Facilitates Transactions Electronically

There is no need for you to be physically present at the broker's place to settle transaction. Moreover, the investors can conveniently access to the Demat account using a computer or smartphones.

b) Ease in Receiving Corporate Benefits

Demat account streamlined the process of receiving various corporate benefits like dividends, interest, refunds, etc. All the benefit amount gets directly credited into the Demat account. Moreover, other benefits like stock splits, bonus shares, rights shares, etc. get directly updated into the Demat account.

c) Safe and Secure

Demat Account is the most secure and safest way to carry out transactions by electronic means. All the risks like theft, damage, loss of share certificates, etc. that were associated with holding shares in physical form are completely eliminated.

d) Avail Loan Facility

The Demat account enable the investors in availing loans against the holdings of securities in dematerialized form. The securities held in Demat Account can be kept as collateral and loan can be taken against such securities.

PROCEDURE FOR DEMATERIALIZATION OF SECURITIES:

The entire dematerialization procedure is divided into the following 3 steps:

1. Getting International Security Identification Number (ISIN) for each type of security.
2. Opening Demat accounts of all promoters, directors, and Key Managerial Personnel (KMP) (if they haven't opened Demat Account yet)
3. Submissions of Dematerialisation Request Forms (DRF) for converting existing physical securities in Dematerialized form.

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PROCEDURE FOR GETTING INTERNATIONAL SECURITY IDENTIFICATION NUMBER (ISIN):

Step 1

- I. Selection of depository (either NSDL/CDSL or both) for obtaining the ISIN;
- II. Company is required to convene Board Meeting & pass the Board Resolution for appointment of Registrar and Share Transfer Agent (RTA)
- III. Submission of documents by the company to RTA as per documents listed below:
 - a. Board Resolution;
 - b. GST Certificate. If not available GST Declaration is required;
 - c. Net worth Certificate from Chartered Accountant;
 - d. Part I-Issuer Details;
 - e. Part II-Security Details for Equity Shares;
 - f. RTA-Client Mandate Letter;
 - g. Undertaking;
 - h. Memorandum of Association (MOA) & Articles of Association (AOA);
 - i. Certificate of Incorporation;
 - j. Aadhaar & PAN Card of Directors.

Step 2:

- I. RTA shall scrutinised the documents as submitted by the Company;
- II. Once RTA is satisfied then ARN (Application Reference Number) is allotted;
- III. Payment of Annual Maintenance Fee of RTA & Depository by the company to RTA is required to be paid in advance depending on the paid up share capital held of the Company;
- IV. Other details (if any) as requested by RTA is to be provided by Company

Step 3:

- I. Signed tripartite agreement (Between Depository, RTA & Company) & RTA shall submit it to NSDL/CDSL
- II. Once Registrar and Transfer Agent (RTA) are appointed and securities are admitted, inform all members that Company is providing a facility for the dematerialization of shares.
- III. The entire current holding of Promoters, Directors, and Key Managerial Personnel (KMP) to be converted in electronic form.

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- IV. Thereafter, converting all remaining shares (other than all promoters, directors, and KMP) in electronic form as and when required or at the time of transferring existing shares.

NOTE: ISIN will be allotted within 3 to 10 working days from the date of payment of fees to RTA.

Half yearly compliances for companies- Filing of Form PAS-6

Form PAS-6 is a statement that reconciles the total issued capital of a company as per its records with the depository's records, in case the company has issued any securities in dematerialized form.

It was introduced to enhance transparency, reduce the risk of fraudulent practices, and streamline the process of issuing and managing securities.

The introduction of the **Reconciliation of Share Capital Audit Report** was aimed at ensuring that the records of the company's share capital were accurate and up-to-date.

As part of the on-going regulatory compliance framework, **every Private Company** is required to submit Form PAS-6 (Reconciliation of the Share Capital Audit Report), a half-yearly return designed particularly for reporting shares held in a dematerialised form. This submission must be made to the Registrar of Companies within 60 days from the conclusion of each half year (**i.e, 30th September and 31st March of every year** duly certified by a Company Secretary in practice or Chartered Accountant in practice.

This form includes various details such as ISIN, capital structure, changes in share capital, updates to the register of members.

Conclusion

In short, Under Rule 9B of the amended (**Prospectus and Allotment of Securities) Second Amendment Rules, 2023** (PAS Rules) which discussed about the issuance of securities in dematerialized form, every private company which is not a small company must ensure that every bearer of the shares surrender such shares to the company and get the shares dematerialized in their accounts on or before 30th September 2024.

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Moreover, any company subject to the amended **Prospectus and Allotment of Securities) Second Amendment Rules, 2023** (PAS Rules) initiating an offer for the issuance of securities, buyback of securities, or the issuance of bonus shares or rights offer **on or after 30th September 2024**, must ensure that the entire holding of securities **belonging to its promoters, directors, and key managerial personnel has been dematerialized**.

However, the amendment doesn't explicitly forbid holding shares of a private company in physical form, the individuals with such shares must convert them into dematerialized form if they intend to transfer them after 30th September 2024.

As per the amendment to **Prospectus and Allotment of Securities) Second Amendment Rules, 2023** (PAS Rules), Private Companies are obligated to undertake a series of crucial action items. They must acquire the International Securities Identification Number ("ISIN") for all securities they have issued.

Private Companies are tasked with actively promoting, facilitating, and encouraging the dematerialization of their existing securities held by shareholders. **Once the share capital has undergone dematerialization, it is imperative that any future issuances of securities be exclusively in dematerialized form.**

Furthermore, Private Companies are required to ensure that securities held by their promoters, directors, and key managerial personnel are already in dematerialized form before any new securities are issued.

Emphasizing regulatory adherence, it is crucial to fulfil mandatory obligations by promptly filing Form PAS-6 Reconciliation of the Share Capital Audit Report to the Registrar of Companies (ROC). The form must be submitted within 60 days from the conclusion of each half year (i.e, **30th September and 31st March of every year**) duly certified by a Company Secretary in Practice or Chartered Accountant in Practice. This form includes various details such as ISIN, capital structure, changes in share capital, updates to the register of members.