

B. Kaushik & Associates.

Company Secretaries

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Dematerialisation: Transforming Shareholding for Enhanced Transparency For Unlisted Public Companies

Dematerialisation is introduced with the objective of enhancing transparency in shareholding of Indian Companies and ease in maintaining statutory records.

The basic agenda is to smoothen the process of buying, selling, transferring and holding shares and also about making it cost-effective and reliable. All your securities are stored in an electronic form instead of physical certificates.

Background:

Section 29 of the Companies Act, 2013 mandates **Public Companies or classes of Public Companies** [Refer rule 9 of the Companies (Prospectus and Allotment of Securities) Rules, 2014] to issue their securities in dematerialized form by complying with the provisions of the Depositories Act, 1996 and the regulations made thereunder.

As per Rule 9 of Companies (Prospectus and Allotment of Securities) Rules, 2014

- The promoters of every public company making a public offer of any convertible securities may hold such securities only in dematerialised form.
{ Provided that the entire holding of convertible securities of the company by the promoters held in physical form up to the date of the initial public offer shall be converted into dematerialised form before such offer is made and thereafter such promoter shareholding shall be held in dematerialized form only}.
- Every public company which issued share warrants prior to commencement of the Companies Act, 2013 and not converted into shares shall, – ***(Inserted vide MCA Notification dated 27.10.2023 regarding Companies (Prospectus and Allotment of Securities) Second Amendment Rules, 2023)***
 - 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

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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.

c. In case any bearer of share warrant does not surrender the share warrants within the period given [i.e. *six months of the commencement of the Companies (Prospectus and Allotment of Securities) Second Amendment Rules, 2023*], the company shall convert the such share warrants into dematerialised form and transfer the same to the Investor Education and Protection Fund established under section 125 of the Act.

The Companies (Amendment) Act, 2019 removes the term Public from section 29 and **now this section 29 applies to all other classes of companies as may be prescribed (mentioned in Rule 9A of Companies (Prospectus and Allotment of Securities) Third Amendment Rules, 2018.**

As per Rule 9A of Companies (Prospectus and Allotment of Securities) Third Amendment Rules, 2018

- Every Unlisted Public Company shall issue securities only in dematerialized form and also facilitate the dematerialization of all its existing securities (on or after 02nd October 2018).
- 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 holder of securities of an Unlisted Public Company, who intends to transfer his/her securities on or after 02nd October 2018, shall ensure that those securities dematerialized before such transfer is undertaken.
- Every holder of securities of an Unlisted Public Company, who intends to subscribe to any securities of an unlisted public company through private placement/right offer/bonus shares on or after 02nd October 2018, has to ensure that their existing securities are dematerialized before such subscription.

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- 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.
- 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.
- The company shall immediately bring to the notice of the depositories when any differences observed in its issued capital and the capital held in dematerialized form.
- The grievances, if any of the security holders of unlisted public companies under this rule shall be filed before the Investor Education and Protection Fund Authority.

Non Applicability of Rule 9A:

This rule 9A of companies (Prospectus and Allotment of Securities) Third Amendment Rules, 2018, shall not apply to an Unlisted Public Company which is-

- a) Nidhi Company (as per Section 406 of Companies Act, 2013);
- b) Government Company (as per Section 2 (clause 45) of Companies Act, 2013);
- c) Wholly Owned Subsidiary of Public Company (as per Section 2 (clause 87) of Companies Act, 2013).

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As per section 2(clause 81) of Companies Act, 2013 “Securities” means the securities as defined in clause(h) of section 2(86) of the Securities Contract (Regulation) Act, 1934.

The term “Securities” include—

- i. shares, scrips, stocks, bonds, debentures, debenture stock or other marketable securities of a like nature in or of any incorporated company or other body corporate;
- ii. derivative;
- iii. units or any other instrument issued by any collective investment scheme to the investors in such schemes;
- iv. units or any other such instrument issued to the investors under any mutual fund scheme
- v. Government securities;
- vi. rights or interest in securities;
- vii. such other instruments as may be declared by the Central Government to be securities.

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 a transaction. Moreover, the investor can have access to the Demat account using a computer or smartphone.

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 helps you 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.

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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 KMP (if they haven't opened Demat Account yet)
3. Submissions of Dematerialisation Request Forms (DRF) for converting existing physical securities in Dematerialized form.

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 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.

Timeline:

The **timeline** for compliance were clearly mentioned in the rules (on or after 2nd October, 2018). This state of affairs signifies a positive regulatory environment for these entities, allowing them to focus on their operations with confidence in meeting the stipulated compliance requirements.

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

Form PAS-6 is a statement that reconciles the total issued capital of an unlisted public 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. By requiring unlisted public companies to issue securities in dematerialized form, the amendments aimed to bring them in line with the practices followed by listed companies.

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.

All the unlisted public companies shall submit E-Form PAS-6 with MCA: The form to 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 CS in practice or CA in practice. This form includes various details such as ISIN, capital structure, changes in share capital, updates to the register of members.

*** ISIN is Mandatory for filing PAS-6 (Procedure for getting ISIN is given above for your reference)**

Note: The Ministry of Corporate Affairs introduced the Companies (Prospectus and Allotment of Securities) Second Amendment Rules, 2023-on October 27, 2023, whereby several additional provisions in the Rules were introduced.

This new rule makes it mandatory for non-small private limited companies to dematerialize their existing securities and ensure that all further issuances and transfers are in Demat form. {Covering it in the next article}

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Consequences of Non-Compliance:

There is no specific penal provisions governing the non-compliance with the provisions of Section 29 read with Rule 9A of the PAS Rules, and therefore, general penal provisions under Section 450 of Companies Act, 2013 should apply, which includes fines for companies and officers in default.

According to section 450 of the Companies Act, 2013 “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”

Conclusion:

The Government verdict to make dematerialisation mandatory for all unlisted public companies marks a significant step towards the development of country's financial sector. This move of MCA aims to enhance efficiency, transparency, and security within the public sector, ultimately benefiting both Companies and investors.

It substantially reduce the risk of loss, theft, or tampering with physical certificates and acts as deterrent to fraudulent activities related to physical certificates like benami transactions, money laundering and back-dated issuance of physical certificates. Greater transparency in the securities market and effective deterrence of economic offences means providing a business conducive ecosystem for the domestic and global investors.

In short, Rule 9A of companies (Prospectus and Allotment of Securities) Third Amendment Rules, 2018 plays a pivotal role in regulating the issuance of securities, ensuring transparency, and safeguarding the interest of investors. The emphasis on detailed disclosures and adherence to procedural norms enhances investors' protection and trust in the securities market.

Companies navigating the complexities of prospectus and allotment can find in Rule 9A a valuable tool for ensuring responsible and ethical practices in their fundraising endeavours, contributing to the overall integrity of the financial landscape.