

SEBI amends LODR mandating dematerialisation

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SEBI in its meeting held on March 28, 2018¹ has decided to amend Regulation 40 of the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 ('Listing Regulations') which deals with transfer or transmission or transposition of securities. According to this proposed amendment, the requests for effecting the transfer of listed securities shall not be processed unless the securities are held in the dematerialized form with a depository. Therefore, for effecting any transfer, the securities shall mandatorily be required to be in demat form. Thereafter on June 8, 2018, SEBI vide its Notification² has amended the Listing Regulations to enforce the proposed amendment.

Benefits of the Amendment:

According to SEBI, this amendment will bring the following benefits:

- (a) It shall curb fraud and manipulation risk in physical transfer of securities by unscrupulous entities.
- (b) Transfer of securities only in demat form will improve ease, convenience and safety of transactions for investors.

Changes brought in by the Amendment

1. Regulation 7 (2) – Share Transfer Agent

“The listed entity shall ensure that all activities in relation to ~~both physical and electronic~~ share transfer facility are maintained either in house or by Registrar to an issue and share transfer agent registered with the Board.”

The deletion has been done in order to remove the significance of the word 'physical', which would otherwise mean that the shares could be held in physical form as well.

2. Regulation 40 (1) - Transfer or transmission or transposition of securities

Insertion of the following proviso:

*“Provided that, except in case of transmission or transposition of securities, requests for effecting transfer of securities shall not be processed **unless the securities are held in the dematerialized form with a depository.**”*

As per the amendment the transfer of shares shall now be processed by the company only when the shares are held in dematerialised form with the depository. Therefore, if the shares are in physical form, companies will not process the transfer.

¹https://www.sebi.gov.in/media/press-releases/mar-2018/sebi-board-meeting_38473.html

²https://www.sebi.gov.in/legal/regulations/jun-2018/securities-and-exchange-board-of-india-listing-obligations-and-disclosure-requirements-fourth-amendment-regulations-2018_39263.html

3. Schedule VII (A) (2) – Requirement of PAN

~~“For securities market transactions and/or for off-market or private transactions involving transfer of shares in physical form, the transferee(s) as well as transferor(s) shall furnish copy of PAN card to the listed entity for registration of such transfer of securities.”~~

As a consequence of the aforesaid omission, the requirement of disclosing PAN card details for effecting securities market transactions or off-market transactions for transfer of shares in physical form has been done away with, since the amended provisions does not allow transfer of shares in physical form anymore.

Commencement of the Amended Regulations

The amendment shall come into force on 180th day from the date of its publication in the Official Gazette, i.e., on December 5, 2018.

Actionables

1. For companies

The companies will have to inform their respective shareholders to convert their physical shares into demat form at the earliest so that the liquidity of shares is not affected. For this the companies may intimate the shareholder regarding such requirement through the AGM Notice, in case the same is yet to be issued.

2. For shareholders

Shareholders will have to convert their shares held in physical form before the commencement of the amended regulations, in order to protect the liquidity of the shares.

Option of issuing shares in physical form

The compulsion of holding shares in demat form for the transfer to be processed, will indirectly bound the company to issue shares in demat form only. It will be illogical to say that the company may issue shares in physical form but cannot register the transfer in case of physical shares.

However, Schedule VI of the SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009 ('ICDR Regulations') requires the company to provide the investors an option to get the shares in demat or **physical mode** in case of public issue and rights issue. Therefore, unless there is a change in the ICDR Regulations, companies will be issuing shares in both the option – i.e., physical as well as in demat form.

Consequences of the Amendment

Prior the amendment, both Listing Regulations and SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009 required the entire shareholding of promoter(s) and promoter group to be in dematerialized form. However, the same was not required for public shareholders.

It is pertinent to note that there are several security holders who hold/ prefer to hold their securities in physical form and who are not in favour of holding their securities in electronic mode. The amendment will deprive the securities holder of their fundamental right of holding their securities in their desired form.

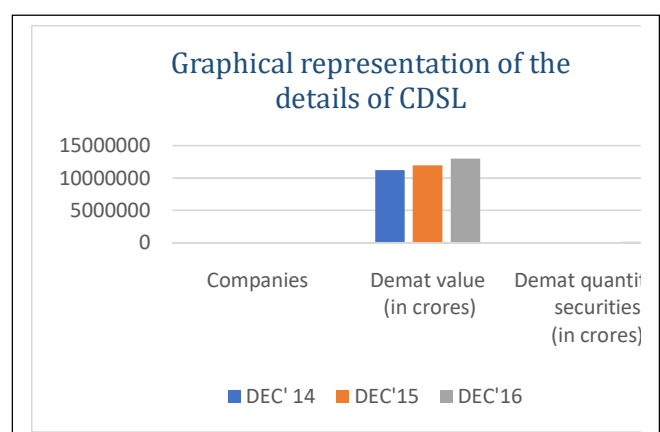
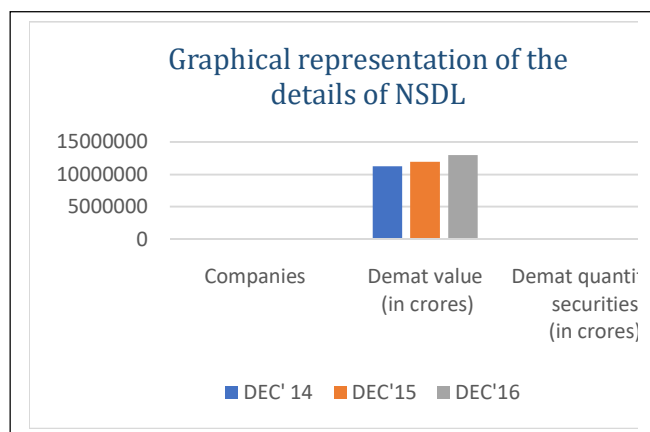
This is another instance of reactive law making. Certain instance of fraudulent transfers that came to fore in case of Shareprohas forced the regulator to do away with the option of holding securities in physical form.

Though the amendment seems to curb the option of holding of the shareholders, the same on the other hand will help to digitalize the holdings of the shareholders, which will not only help in preventing fraudulent transfers but will also reduce compliance burden on the companies.

Progress of Dematerialisation at NSDL and CDSL

Followings are the details* of progress of dematerialisation at NSDL and CDSL:

FOR NSDL				FOR CDSL			
<i>Year</i>	<i>No. of Companies</i>	<i>Demat value (in crores)</i>	<i>Demat quantity of securities (in crores)</i>	<i>Year</i>	<i>No. of Companies</i>	<i>Demat value (in crores)</i>	<i>Demat quantity of securities (in crores)</i>
DEC' 14	13470	1,12,20,526	89,073	DEC' 14	13470	1,12,20,526	89,073
DEC'15	15115	1,19,29,978	1,03,690	DEC'15	15115	1,19,29,978	1,03,690
DEC'16	17085	1,29,97,457	1,23,305	DEC'16	17085	1,29,97,457	1,23,305



*the details have been taken from SEBI's Handbook of Statistics 2016¹

Result of long plan

Though the amendment is an outcome of the meeting held on March 28, 2018 but the plan was being thought of long back since 2014. In an article of Business Standard³ on July 2014, T S Reddy, the Managing Director and CEO of CDSL, said, *“It will be good transition for the market. I doubt if any section of the market will be opposed to the idea. In my opinion, the transition will be smooth; the only hurdle will be in the case of companies that no longer function or have no trading activity.”* Further, in the same article, Mr. Nageswara Rao, Managing Director and CEO of NSDL, was quoted saying, *“Earlier (in 1996), the challenge was to convince investors holding shares in electronic form was a good idea. Now, this is no longer the issue. Investors have matured and have adapted to the demat mode adequately”.*

Therefore, SEBI with the support of various experts, had decided long back in year 2014 to bring the said amendment.

SEBI's reactive approach:

Regulation 40 (3) provides the following-

“On receipt of proper documentation, the listed entity shall register transfers of its securities in the name of the transferee(s) and issue certificates or receipts or advices, as applicable, of transfers; or issue any valid objection or intimation to the transferee or transferor, as the case may be, within a period of fifteen days from the date of such receipt of request for transfer:

Provided that the listed entity shall ensure that transmission requests are processed for securities held in dematerialized mode and physical mode within seven days and twenty-one days respectively, after receipt of the specified documents:

Provided further that proper verifiable dated records of all correspondence with the investor shall be maintained by the listed entity.”

From the above quoted provision it is clear that in case of physical transfer of the securities, the listed entities after receiving proper documents, shall register the transfer and issue certificates or receipts or advices, as applicable, of transfers; or issue any valid objection or intimation to the transferee or transferor, as the case may be, within a period of fifteen days from the date of such receipt of request for transfer.

Therefore, as per the regulation, it is the responsibility of the listed entity and its Registrar and Transfer Agent to facilitate the registration of the transfer and issue the share certificate accordingly. However, the proposed amendment relieves the Company from its responsibility and mandates the security holder to hold the securities in demat form as there is no role that a Company or an RTA plays in case of demat transfers.

³http://www.business-standard.com/article/markets/all-shares-to-be-in-demat-form-114071601181_1.html

Conclusion

Though the amendment claims to improve ease, convenience and safety of transactions for investors, the same shall also bring various difficulties to the securities holder for whom the electronic system and the demat form does not seem to be user friendly. The bonafide securities holder, holding shares in physical form, will be largely affected by such compulsion and will be left with only two options i.e., either to convert their securities in demat form, which shall be against their will or to refrain from transferring their securities ever, in both the circumstances, it is the interest of the securities holder which shall getsupressed by the law makers.