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Physical to Demat: A move from opacity to transparency

CS Vinita Nair & CS Nikita Snehil

Corporate Law Services Division

corplaw@vinodkothari.com

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MCA continues with its efforts to make ownership structure of companies transparent, first notifies rules on significant beneficial ownership of shares, followed with mandating issuance of securities only in dematerialized form for unlisted public companies. Presently, only public issue of securities needs to be mandatorily done in dematerialized mode as per Section 29 of Companies Act, 2013 ('Act').

MCA issued Companies (Prospectus and Allotment of Securities) (Third Amendment) Rules, 2018 on September 10, 2018¹ ('Amendment Rules') pursuant to power under Section 29 (1) (b) of Act, 2013 by inserting Rule 9A dealing with issue of securities in dematerialised form by unlisted public companies. Every Unlisted Public Company ('UPC') shall issue securities (equity, preference, debentures) only in dematerialized form and will facilitate dematerialization of all its existing securities.

Demat of existing holding: whether mandatory?

Entire holding of promoters, directors, KMP shall be required to be dematerialized in case an unlisted public company intends to make any issue of any securities or buy-back the securities.

For other shareholders, dematerialization is mandatory only in following two cases:

- a) if the shareholder intends to transfer such securities. Any transfer on or after October 2, 2018 shall be permitted only where the securities are held in demat mode.
- b) If the shareholders intend to subscribe to any securities of an unlisted public company on or after October 2, 2018, existing holding shall be converted into dematerialized form before such subscription.

Mandatory dematerialization of entire holdings of shareholders cannot be enforced, in view of Section 8 of Depositories Act, 1996² which stipulates that every person subscribing to securities offered by an issuer shall have the option either to receive the security certificates or hold securities with a depository.

¹ http://www.mca.gov.in/Ministry/pdf/CompaniesProspectus3amdRule_10092018.pdf

² <https://www.sebi.gov.in/acts/act03a.pdf>

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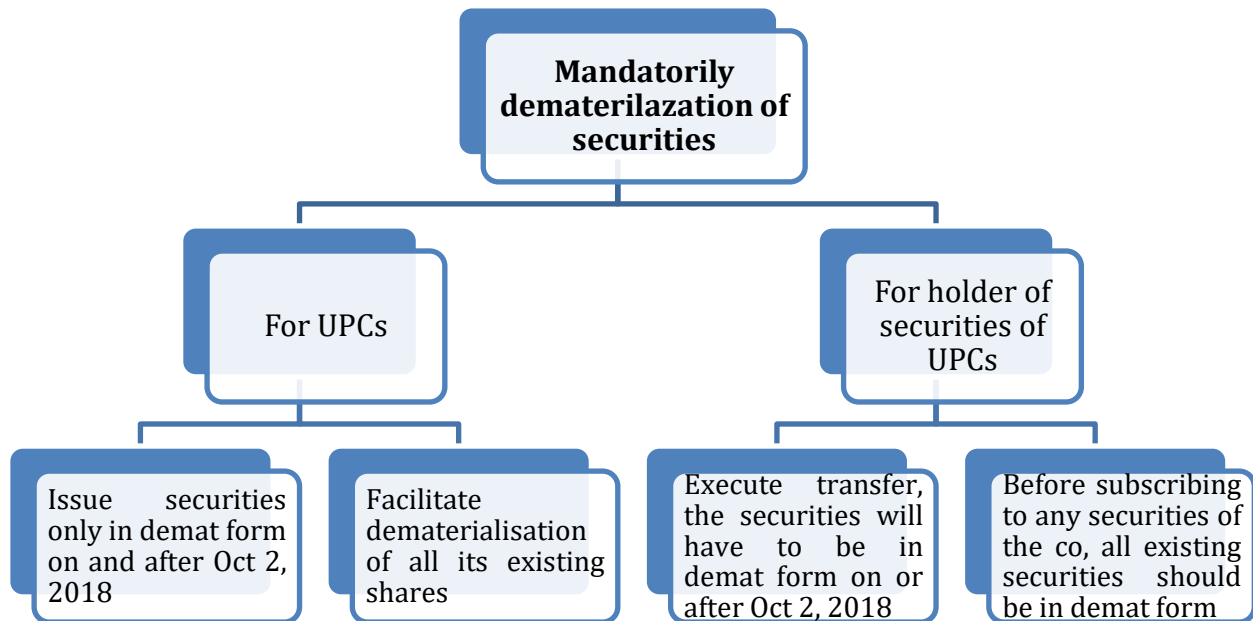


Figure 1: Requirement of mandatory dematerialization

Scope of Section 29

The applicability of Section 29 of the Act can be divided in the following way:

- 29(1)(a): applicable on every co. making public offer;
- 29(1)(b): Such class of public companies as may be prescribed;
 - No class of cos has been prescribed yet.
- 29 (2): other than a co. mentioned in 29(1), i.e., private companies.

The Amendment Rules have been introduced pursuant to the powers conferred by 29 (1)(b), therefore, the same is applicable on public companies only.

Scope of the expression 'UPCs'

Section 2 (52) of the Companies Act, 2013 ('Act'), provides the definition of listed cos-

*"listed company means a company which has **any of its securities** listed on any recognised stock exchange"*

Where any of the securities gets listed on a recognized stock exchange, the company becomes a listed company. Accordingly, the term 'unlisted companies' shall mean such companies which has not listed any of its securities on any recognized stock exchange. Therefore, where a public company has listed any of its securities, such as: equity, debentures, preference shares, shall not be covered by the Amended Rules.

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Immediate action point for UPCs

Every UPCs shall facilitate dematerialization of all its existing securities and shall secure International Security Identification Number (ISIN) for each type of security. Thereafter, it shall inform existing security holders about such facility.

Continual compliances for UPCs

- a) Timely payment of fees to Depository and RTA;
- b) Maintaining security deposit of atleast two years' fees with the Depository and RTA;
- c) Comply with regulations, directions, guidelines or circulars issued by SEBI with respect to dematerialization of shares of unlisted public companies.
- d) Submit audit report as per Regulation 55A of SEBI (Depositories and Participants) Regulations, 1996 on a half yearly basis to the Registrar of Companies.
- e) Comply with provisions of Depositories Act, 1996; SEBI (Depositories and Participants) Regulations, 1996; and SEBI (Registrars to an Issue and Share Transfer Agents) Regulations 1993 to the extent applicable in the context of unlisted public companies.

Consequence of default by UPCs

Such companies shall be eligible to make further issue of any securities/ buy-back any securities only after payments has been made to Depositories and RTA.

Current statistics

As per the monthly information bulleting on Corporate Sector of June 2018³ issued by MCA, 11,89,826 are active companies. Out of the 11,89,826 active companies, 11,81,877 are limited by shares; 7,518 are limited by guarantee and 431 are unlimited companies.

³ http://www.mca.gov.in/Ministry/pdf/MIB_June_2018.pdf

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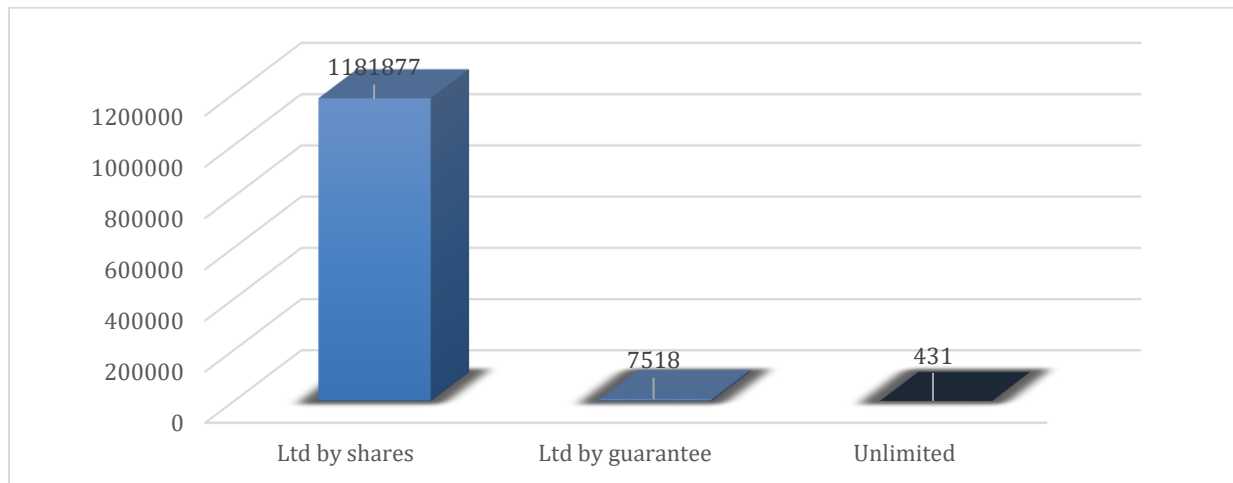


Figure 2: Data of Active Companies

Out of the companies limited by shares, 71,506 are public, 11,10,371 are private including 18,153 one-person companies. Among the public limited companies, 7,213 are listed.

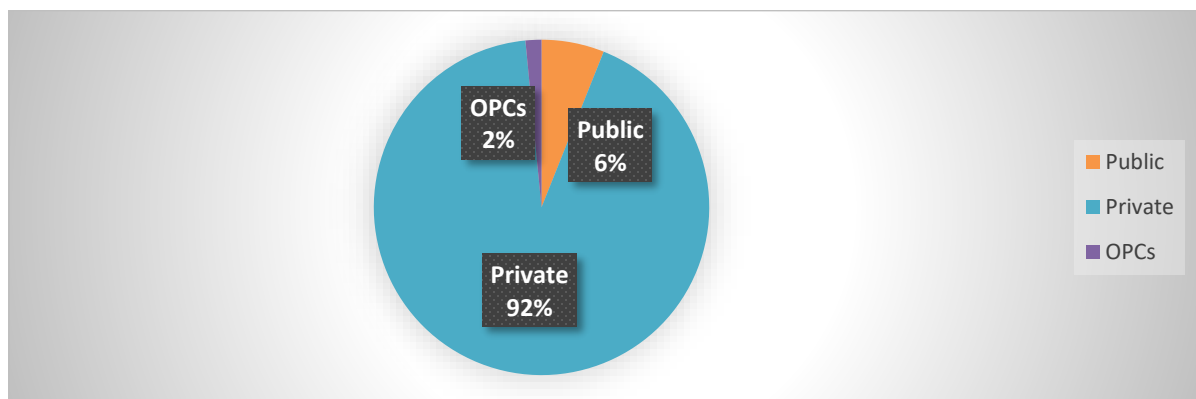


Figure 3: Segregation of companies ltd by shares

The private companies also include wholly owned subsidiaries of public companies that are constitutionally private companies but are deemed as public companies for the purpose of provisions of the Act. Accordingly, compliance will be required to be ensured even by such companies.

This will surely be a tedious exercise involving additional cost for the issuer companies.

Transition time

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The transition time prescribed by MCA are much shorter than the time prescribed by SEBI⁴. Where SEBI has provided a transition time of almost six months, the transition time provided by MCA is even shorter than a month.

Result of long plan

The mandate on dematerializing the shares of unlisted companies is not a sudden imposition, rather the government has been vocal about its proposal of mandating dematerialization of shares for unlisted companies, as part of black money control in the Indian economy, since last year.

Digital India – benefit to the regulators

Dematerialization will lead to linking of the PAN no. and Aadhar no. of the holder of the securities, which will further help the regulators to keep a track on the holders of the securities. This will further benefit the government to identify the chain of benami transactions to a greater extent, shell cos, untraceable shareholders etc.

As a whole, dematerialization will help the government to organize and regularize the functioning of UPCs.

Conclusion

The intent behind such mandate is to curb the black money and to identify the owners' holding. The dematerialization will also facilitate the government's aim in identifying the real owner of the shares, as the transparency will provide a real time data to the government. However, there are numerous genuine holders of securities who prefer their shares in physical form, who shall be unhappy with such mandate. However, it shall be very interesting to witness how companies facilitate the transition and how the holders of the securities comply with the requirements.

⁴ SEBI vide its Circular dated 8th June, 2018 has amended the provisions of Regulation 7 of SEBI (LODR) Regulations, 2015, pursuant to which the transfer of securities can be processed by the Company only when the securities are held in dematerialised form with the depository. The amendment is effective from December 5, 2018. To know more click [here](#).