



## POWER POINT

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# - DIGITIZATION OF SECURITIES AND TRANSPARENCY

The inclination of the ministry of corporate affairs (MCA) to make corporate governance practices in India more robust witnessed a new milestone with an October 2023 notification making dematerialization of securities mandatory for private companies. Dematerialisation is a multi-purpose strategy, which, in the sweep of enhanced transparency, helps regulators keep a watch on benami share transactions, conduit or shell companies, back dated allotment of securities, appropriate payment of stamp duty on share issuance or transfers, clear title to securities in pledges, etc. For investors, this alteration strengthens credibility of securities when offered as collaterals, helps achieve consolidation of holdings in a demat account, minimizes risks associated with physical share certificates such as loss, theft, mutilation, etc., and facilitates swift investment exits. Investee companies may also eventually lure perks of seamless transaction handling.

A private company which is not a "small company" as on last day of financial year (FY) ending on or after 31 March 2023 as per audited financials (qualifying companies) is required to dematerialise its securities within 18 months from end of such FY (referred to as compliance date). Therefore, for qualifying companies existing as on 31 March 2023, the compliance due date is 30 September 2024. The notification inter alia casts obligation on qualifying company to ensure that entire holding of securities of its promoters, directors, KMPs is dematerialised where any corporate action (ie offer for issue of securities or buyback of securities, bonus issue or right issue) is proposed with respect to its securities after the compliance date. Alongside, once compliance date is lapsed, security holders should ensure dematerialised holding before effecting transfers or fresh subscriptions.

For investors, this move means mandatory opening and maintenance of demat accounts with depository participants (DP). Resident investors may be less effected by the development as they are reasonably equipped with India KYC norms for opening demat accounts. However, foreign investors could have some reservations, as opening demat accounts would require them to obtain Permanent Account Number (PAN) from

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nent ACCOUNT NUMBER (PAN) from income tax authorities. This, coupled with elaborate KYC formalities including KYC of foreign directors (in corporate shareholdings), would eventually increase lead time for investments.

Companies may come to grips with the change and undertake initial transitional compliances which include appointing a Registrar and Transfer Agent (RTA), paying admission fee and security deposit to RTA and DP, obtaining International Security Identification Number (ISIN) for each type of security and the like, in the run up to implementing this mandate. However, there would be recurring costs such as annual fee to RTA/DP, compliance cost for observing provisions of Depositories Act, 1966, filing bi-annual PAS-6 form certified by a CS or CA in practice, which could mean alterations or re-allocation of budgets.

Be that as it may, private company demat rules and related practicalities may warrant cementing of some gaps. For instance, exemption to Wholly owned Subsidiaries (WoS) provided in demat rules for unlisted public companies seem to be absent for private company which is a WoS. Liberal provisions for public companies vis-à-vis private companies do not seem to synchronize with the overall tone of the Companies Act. A private company deemed to be a public company by virtue of it being a subsidiary of a public company may, therefore, require clarity on applicability of the provision.

Role of DPs and subtle discrepancies between Companies Act with Depositories Act is another area of debate. For instance, under demat regime, DPs can give effect to transfer of securities based on Delivery Instruction Slip (DIS) submitted by transferor without seeking the investee company's approval. This could put the elementary restriction on free transfer of private company's shares to jeopardy. Scaling up internal checks with special instructions to DPs for disposal of requests for transfers would thus become necessary. Undoubtedly, this move is expected to hit the right notes on transparency and ease of doing business. It would be paramount that intermediaries in demat area viz depositories, DPs, RTAs also buckle up resources and infrastructure facilities to embrace the shift gracefully and initiate the process of dematerialisation much in advance.

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