

# UPDATE

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## Increasing Transparency in Share Capital: One Step at a Time

The Ministry of Corporate Affairs (**MCA**) has *vide* its notification dated 27 October 2023, introduced certain important provisions which particularly impact private limited companies.

In this update, we bring to you a snapshot of the key amendments to the Companies Act 2013 and rules thereunder in order to assess its impact on your organisation. All amendments stated below have been made effective as on 27 October 2023.

### **Update #1: Dematerialisation of Securities of Private Companies**

The MCA has amended the Companies (Prospectus and Allotment of Securities) Rules 2014 (**PAS Amendment**) to insert new Rule 9B which mandates **private limited companies** to:

- issue securities in dematerialized form only; and
- facilitate dematerialization of all its securities.

**Implementation Timeline:** Every private limited company is required to comply with both of the above diktats within a period of 18 (eighteen) months from the closure of the financial year ending on or after 31 March 2023 i.e. by 1 October 2024 (**Specified Date**).

**Restrictions on Transfer and Further Issue:** New Rule 9B also stipulates that on or after the Specified Date:

- Every private limited company which makes any offer for issue of any securities or buyback of securities or issue of bonus shares is required to ensure that the entire securities' holding of its promoters, directors and key managerial personnel is in dematerialized form.
- Every security holder of a private limited company is required to get his/ her securities dematerialized as a prerequisite to a proposed transfer of his/ her securities.
- Every security holder who intends to subscribe to the securities of a private limited company by way of private placement / bonus issue / rights issue must ensure that the securities are in dematerialized form prior to such issue and allotment.

The PAS Amendment also clarifies that a private limited company is required to comply with process of dematerialization as applicable to unlisted public companies under Rule 9A of the PAS Rules 2014 including compliance with Depositories Act 1996, SEBI (Depositories and Participants) Regulations, 2018 and SEBI (Registrars to an Issue and Share Transfer Agents) Regulations, 1993.

Notably, all private limited companies, on and from the Specified Date, are required to file form PAS-6 (*Reconciliation of Share Capital Audit Report*) for the half years ended 30 September and 31 March in every financial year. The form records changes in share capital including details of dematerialization.

<sup>1</sup> As per Section 2(85) of the Companies Act, 2013, "small company means a company, other than a public company,—

(i) paid-up share capital of which does not exceed fifty lakh rupees or such higher amount as may be prescribed which shall not be more than ten crore rupees; and

(ii) (ii) turnover of which as per profit and loss account for the immediately preceding financial year] does not exceed two crore rupees or such higher amount as may be prescribed which shall not be more than one hundred crore rupees

## **Update #2: Conversion of Share Warrants of Public Companies issued under Companies Act 1956**

The PAS Amendment has inserted a new sub-rule 9(2) which mandates every public company that had issued share warrants under the Companies Act 1956 and which have not been converted to shares to:

- inform the Registrar about the details of the outstanding warrants in Form PAS-7 (*Details of Pending Share Warrants*) within 3 (three) months of the date of commencement of the PAS Amendment i.e., on or before 27 January 2024; and
- require bearers of share warrants to surrender their share warrants and get their shares dematerialised within 6 (six) months of commencement of the PAS Amendment i.e., by 27 April 2024. To such extent, the relevant public company is required to publish a notice in Form PAS-8 (Notice for Bearers of Pending Share Warrants) on its website, if any, as well as in a vernacular language newspaper which is circulation in the district and an English language newspaper with wide circulation in the State where the company is registered.

Consequence of non-surrender of share warrants: As per Rule 9(2) of the PAS Amendment in case the bearer of the share warrant does not surrender its share warrants within the prescribed time above, the said public company shall convert the share warrants into dematerialised form and transfer the same to the Investor Education and Protection Fund.

### **Our Analysis:**

Penalty for Non-compliance with Rule 9B of the PAS Amendment: It is pertinent to note that since there is no specific penalty provided for failure of such private limited companies to comply with Rule 9B of the PAS Amendment, the penalty provided under Section 450 of the Companies Act, 2013 shall be applicable which can extend to a maximum of INR 2,00,000 (Indian Rupees Two Lakhs only) in case of default by the company and INR 50,000 (Indian Rupees Fifty Thousand only) in case of default by officer or any other person.

Wholly-owned Subsidiary: While unlisted public companies which are wholly owned subsidiaries are exempted from mandatory dematerialisation of their securities under Rule 9A of the Companies (Prospectus and Allotment of Securities) Rules 2014, private companies which are wholly owned subsidiaries are not exempted from mandatory dematerialisation under Rule 9B of PAS Amendment. In the event, a private company is a wholly owned subsidiary of a public company then as per *proviso* to Section 2(71) of the Companies Act 2013, it shall be deemed to be a public company for purposes of the Companies Act 2013, and in our view, this gives rise to a situation where such companies shall continue to be exempted from mandatory dematerialisation under Rule 9A of the Companies (Prospectus and Allotment of Securities) Rules 2014.

Bearer Share Warrants: This move is in line with India's commitment to reduce corruption and increase transparency based on Financial Action Task Force (FATF) recommendations. In our view, the new rule 9(2) dealing with share warrants refers to 'bearer share warrants' which were issued under the erstwhile Companies Act 1956. In any event, under the Companies Act 2013 bearer securities cannot be issued as Section 88(1) of the Companies Act 2013 read with Rule 4 of Companies (Management and Administration) Rules, 2014 requires name of the holder of share warrants to be disclosed.

All the aforesaid amendments are in line with the FATF recommendations in a move to combat corruption, money laundering and terrorist financing risks by increasing transparency of share capital.

*Provided that nothing in this clause shall apply to—*  
(A) a holding company or a subsidiary company;  
(B) a company registered under section 8; or  
(C) a company or body corporate governed by any special Act."

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