

MCA notified dematerialization of securities by private limited companies

The Ministry of Corporate Affairs (“MCA”) came up with an amendment to the Companies (Prospectus and Allotment of Securities) Rules, 2014 vide its notification dated 27th October 2023. Through said amendment, a new rule 9B is inserted in the Companies (Prospectus and Allotment of Securities) Rules, 2014.

As per the provisions of the aforesaid rule 9B, every private limited company would require issuing the securities only in dematerialized form going forward and facilitate the dematerialization of all its existing securities in pursuance to the provisions of the Depositories Act, 1996 and regulations made thereunder. However, the lawmaker kept small companies outside the purview of rule 9B of the Companies (Prospectus and Allotment of Securities) Rules, 2014 (“Rules”). It means small companies won’t be required to comply with the provisions of rule 9B of the Rules and can nevertheless issue its securities in physical mode also.

As per section 2(85) of the Companies Act, 2013 (“Act”), small company is considered as a company which is not a public company and has:

- a. a paid-up share capital equal to or below INR 4 crore or such a higher amount as may be specified but not exceeding INR 10 crore.*
- b. a turnover equal to or below INR 40 crore or such a higher amount as may be specified but not exceeding INR 100 crore.*

Nonetheless, the definition of small companies does not include the following category of companies:

- a. a holding or a subsidiary company;*
- b. a company registered under section 8 of the Act; and*
- c. a body corporate or company governed by any special statute.*

Formerly, MCA vide its notification dated 10th September 2018 by inserted rule 9A to the Rules and had made it mandatory for public limited companies also to issue its securities only in dematerialized form and to facilitate dematerialization of all its existing securities in accordance with provisions of the Depositories Act, 1996 and regulations made thereunder.

To interpret further, let’s say, a private limited company whose financial year ended on 31st March 2023, would require complying with the provisions of mandatory dematerialization of securities within a period of 18 (eighteen) months from the end of financial year 2022-23, i.e., on or before 30th September 2024. Moreover, in case a company ceases to be a small company after 31st March 2023, the timeline of 18 (eighteen) months will be considered from the close of the financial year during which it ceases to be a small company. For example, if a company ceases to be a small company at any time point of time during the financial year 2023-24, the timeline of 18 (eighteen) months will be taken from 31st March 2024.

After period of 18 (eighteen) months given for compliance, a private limited company making any offer of securities or buyback of securities or issue of bonus shares or rights offer or private placement or preferential offer shall ensure that before making such offer, the entire holding of securities of its promoters, directors, key managerial personnel has been dematerialized.

After completion of the abovementioned timeline i.e., 18 (eighteen) months from the closure of financial year within which dematerialized of securities needs to be done, every holder of securities of private limited companies would also require to get their securities dematerialized before any intended transfer of securities held. Further, in case of subsequent subscription of securities, the subscriber shall ensure that all his existing securities are held in dematerialized form before such subscription.

Implications in case securities of the company are not dematerialized:

As per the provisions of section 450 of the Companies Act, 2013, the company and every officer of the company who is in default will be liable to a penalty of INR 10,000 with a further penalty of INR 1,000 for each day during which the contravention continues. However, the maximum penalty amount for the aforesaid contravention would be INR 2 lakh for the company and INR 50,000 for the officer who is in default.

The term ‘officer who is in default’ would include the following:

- a. Managing Director;
- b. Wholetime Director;
- c. Director;
- d. Company Secretary;
- e. Chief Executive Officer;
- f. Chief Financial Officer etc.

In addition to the aforesaid, the company cannot make further allotment of securities, buy-back of its securities and shareholders of the company cannot transfer their securities unless the company gets its existing securities dematerialized within the aforesaid prescribed time frame.

References:

- a. www.mca.gov.in/bin/dms/getdocument?mcs=ZvNqoKdfvPrRcgeoGzGdDg%253D%253D&type=open
- b. www.mca.gov.in/Ministry/pdf/CompaniesProspectus3amdRule_10092018.pdf
- c. www.mca.gov.in/content/mca/global/en/actsrules/ebooks/acts.html?act=NTk2MQ==#Definitions
