



MCA BRINGS IN STRINGENT NORMS FOR PRIVATE COMPANIES – MANDATE COMPULSORY DEMATERIALISATION OF SHARES

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Recent time has seen instances of investigation by probe agencies into corporate governance failures and financial irregularities in case of unlisted companies and start-ups, which has necessitated the introduction of more strict regulatory norms for such businesses.

The tenure of Company Law Committee has also been extended to look at such issues and the committee is likely to recommend changes in existing regulatory framework by placing in more rigorous norms to keep a closer scrutiny on operations and governance practices of unlisted companies.

Towards that direction, the Ministry of Corporate Affairs ('the Ministry') has extended the rule of mandatory issuance of securities in dematerialised form by private companies other than small companies (except government companies), which prior to amendment are applicable to unlisted public companies only.

The Act defines small company as a non-public company whose paid up capital and turnover does not exceed rupees 4 crore and rupees 40 crore respectively. The exceptions to the rule are (a) a public company; (b) a holding company or a subsidiary company; (c) a company registered under section 8; or (d) a company or body corporate governed by any special Act.

Basis audited financial statement, a private company which is not a small company as on last day of a financial year, ending on or after March 31, 2023 shall, within 18 months of closure of financial year, shall comply with rule.

Let's elaborate this with the help of example.

1. A private company which is not a small Company as on March 31, 2023 basis its audited financial statement shall be required to comply with mandatory dematerialisation of securities, on or before September 30, 2024.
2. Suppose, a private company is small company as on March 31, 2023 but ceases to be small company as on March 31, 2024 basis its audited financial statement. In that case, the timeline



of 18 months begins from closure of financial year 2023-24 and compliance be made on or before September 30, 2025.

Furthermore, a private company to which the rules apply shall ensure that entire shareholding of its promoters, directors and key managerial personnels (KMPs) are held in dematerialised form before making any offer for (a) issue of any securities; or (b) buyback of securities; or (c) issue of bonus shares; or (d) rights offer.

The shareholder, of private company to which the rules apply, who intends to transfer his securities shall get those securities held by them dematerialised before transfer.

And any investor who invest into private company to which the rules apply, whether as private placement or bonus shares or rights offer shall ensure that all his securities are held in dematerialised mode, both existing one as well as proposed.

Here one aspect which is to be looked into is that private company articles restrict the right to transfer its shares, therefore Depository Participants (DPs) has to put in place some mechanism and build the system such that it ensures compliance with law of land.

As per the data available on the Ministry website, nearly 1.63 million private companies were active till 31st October 2023 which accounts to 96% of the total active companies with 37% of the total Paid-up Capital, given the fact that exact count of small companies in not known but which would surely hold major proportion. Therefore, by covering the private companies within its ambit and with mandate already-in place for public companies, the aforesaid amendment tries to regularise the dealing in securities to maximum extent.

If we speak about the current scenario, where 96% of the companies are private company, the shareholding held in such companies are basically out of financial system for the reason they are still held in paper form, where most of them are held without adhering to KYC norms. Therefore, in times to come, we may witness that the aforesaid rule is extended to cover small companies as well.

With this move, the Ministry has tried to bring-in transparency in holding of securities as well as any dealing in them and thereby lay down the foundation of robust financial system and help in enhancing the corporate governance.



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