SPOTLIGHT[1] ON:

Physical shares and securities issued by entities governed by the Companies Act, 2013 (and earlier versions of the Companies Act)

1 Spotlight sections draw upon https://bit.ly/2WeoH2P written by Pramod Rao and incorporate inputs from ARIA

Foreword

Mr. K V Kamath
Former-President
New Development Bank

The Covid-19 pandemic has brought us face to face with mortality. Many of us have suffered the loss of loved ones which is truly saddening and stressful for spouses and families. At such times, engaging with and completing the formalities for transmission of assets to the rightful heirs translates into an unbearable experience.

The transmission process is neither centralised nor uniform, nor does it have defined turnaround times. As a result, the bereaved family has to deal separately with individual institutions, each with their own set of forms, processes and procedures. If nominations have been made by the deceased person, then the nominees can get control of the assets in a reasonable time frame. But in all cases such transmission needs to be validated through an overburdened court or legal process.

Some of the constraints and authentication requirements laid down in the nominations process may indeed have been required at a time when technology was not developed and KYC and other processes where not present. But today, India is at the leading edge of technology with the India Stack allowing everyone from governments to commercial enterprises to seamlessly provide benefits and services to the billion plus Indian population. The recent launch of the account aggregator framework also signals that a new era of interconnectedness and interoperability among financial institutions is here.

There is no reason why the same technology stack and these emerging platforms cannot be used to reduce the friction points and streamline nominations and transmission of assets on the death of a person.

All that this needs is a short and coordinated effort of say six months, from all the parties involved, and if required, facilitated by the Regulators who could consider modifying the regulations to enable the institutions to use these new approaches. Where necessary, in just a few areas, the government might need to modify the governing law to give primacy to the wishes of the deceased as expressed in her nominations.

Pramod[1] had written a brilliant paper analysing nominations and joint ownership of financial assets and spelt out the need to make the whole succession process smoother and simpler. When Harsh[2] approached me for support for the #ARIATrulycares initiative, I requested him to work with Pramod to collaborate in this effort. Pramod has since written the white paper with inputs from ARIA and has also helped draw up spotlight papers on bank accounts, safe deposit lockers, dematerialised securities and mutual fund units. Specific recommendations on other assets such as NPS, provident funds, small saving schemes and immovable property are likely to be added soon.

A smoother and simpler succession process will provide quick transmission of assets. It will also relieve the courts of the unnecessary burden of uncontested and undisputed succession matters. Financial institutions will also get discharge from their liability and this will go a long way in mitigating the pain and sorrow of the family and heirs.

I hope and trust that financial institutions and supervisory bodies would consider the suggestions outlined in the White Paper on the nomination facilities and do a quick reset of the process.

1 Pramod Rao is the Group General Counsel of ICICI Bank and a leading thinker on legal and governance matters

2 Harsh Roongta runs an investment advisory firm and is the Vice chair of Association of Registered Investment Advisers (ARIA) – a section 8 not for profit company

Executive Summary of the White Paper

Reimagining Nominations:
Making Succession Smoother and Simpler

For multiple reasons as outlined in the paper, the process of claims by successors of deceased financial consumers remains difficult to navigate, especially at a time when the family and those surviving the individual are coping with the loss of a loved one and still grieving.

Nomination facilities have provided a level of succour to the successors. However, these reflect an outdated point-of-view that was more relevant when the facilities were instituted and require a fresh review and update as per the needs of the financial consumers and citizenry. Both the level of unclaimed funds or the tedious and time-consuming legal process and the current situation brought on by Covid-19 signal that a deeper review and recast is all too necessary.

The white paper proposes the expectations for updated, revised and revamped nomination facilities in terms of three policy objectives:

- Convenience to financial consumers and to their successors
- Due discharge for financial services providers upon providing access to and an ability to transact in the financial assets or transmission of the financial assets to the successors
- Eliminating or reducing references to an overburdened judiciary, where litigants face considerable costs and delays

The white paper reimagines the nomination facilities keeping the three policy objectives paramount and also uses the lens of providing ease and convenience harnessing the technological advancements and frameworks which are available today.

The paper outlines 15 measures for financial services providers, financial sector regulators and lawmakers to consider in respect of nomination facilities, more succinctly captured in the Annexure.

Spotlight Papers in Volume 1 Version 1:

1. Current Accounts, Savings Accounts and Fixed Deposits with Banks and Safe Deposit Lockers
2. Securities Held in Demat Accounts
3. Mutual Funds
4. Physical shares and securities issued by entities governed by the Companies Act, 2013 (and earlier versions of the Companies Act)
5. Employees' provident fund, Employees' Deposit Linked Insurance and Employees' Pension Scheme
   Provident funds governed by Employee Provident Funds Act, 1925
   Public Provident Funds

Mr. Pramod Rao 8

About ARIA 8

ARIA
Association of
Registered Investment Advisers

SPOTLIGHT[2] ON:

Physical shares and securities issued by entities governed by the Companies Act, 2013 (and earlier versions of the Companies Act)

Even as the holding of securities in dematerialised form is being encouraged or mandated by policymakers and regulators, investors continue to hold share certificates, bond or debenture certificates issued by companies, corporations, and entities incorporated under the Companies Act 2013 (or earlier versions of the Companies Acts) for a variety of reasons. These can be of:

- listed companies
- unlisted companies or
- private limited companies.

This spotlight paper examines nomination facilities for such physical shares and securities.

Nominations for physical shares and securities

Making a nomination is possible for shares and securities held in physical form. However, only a single nominee is contemplated in section 72 of the Companies Act, 2013 and the relevant rules thereunder[3].

Joint owners of shares may jointly nominate any person to whom all the rights in the securities shall vest in the event of death of all the joint holders.

Joint owners of shares may jointly nominate any person to whom all the rights in the securities shall vest in the event of death of all the joint holders

Whilst not specified in the statute or the rules thereunder, nominations for physical shares and securities can be made only by individuals, and only another individual or a natural person can be specified as a nominee[4].

A minor can be a nominee. Whilst a guardian is not required to be specified (in terms of the statute or the rules[5]), a successive nominee can be specified who becomes entitled to the securities in event of death of the nominee during his minority[6].

Nomination can be varied or cancelled and fresh nomination made[7].

Nominee = Owner OR Nominee = Trustee

Section 72 of the Companies Act, 2013 (in line with sections 109A and 109B of the Companies Act 1956, added to that statute in 1998) states that the securities would vest in the nominee "*notwithstanding anything contained in any other law for the time being in force or in any disposition, whether testamentary or otherwise,..*" and the nominee "*become(s) entitled to all the rights in the securities,..., to the exclusion of all other persons, unless the nomination is varied or cancelled...*".

2 Spotlight sections draw upon https://bit.ly/2WeoH2P written by Pramod Rao and incorporate inputs from ARIA

3 Rule 19 of the Companies (Share Capital and Debentures) Rules, 2014

4 This appears to have been derived from language used in section 72 mentioning death (and disposition on death) and hence limited to individuals

5 The form as prescribed requires the specification of guardian's name and address

6 See section 72(4) and Rule 19(11) of the Companies (Share Capital and Debentures) Rules, 2014; however the prescribed Form doesn't appear to be designed for this purpose

7 See Rule 19(9) and Form SH.14 of the the Companies (Share Capital and Debentures) Rules, 2014

A logical understanding of the above provision and specific language can be to consider the nominee as the legal heir or successor to the securities.

However, courts in general, have taken the view that the nominee does not constitute the successor or inheritor of such securities[8]. This would imply that the successors or legal heirs (*either in terms of the will executed by the shareholder and bond holder and debenture holder, or as per the personal laws of succession governing the shareholder and bond holder and debenture holder who die intestate*) are entitled to claim their rightful share from the nominee[9].

Table 2: **Physical shares and securities**[10]

In the event of:	Transmission in favour of:	
	Nomination provided	Nomination not provided
Death of a single holder	Nominee (holding in trust or custody for benefit of legal heirs)	Legal heirs (as per succession certificate / probate / letters of administration)
Death of one of the joint holders	Surviving joint holder(s)	Surviving joint holder(s)
Death of all the joint holders	Nominee (holding in trust or custody for benefit of legal heirs)	Legal heirs (as per succession certificate / probate / letters of administration)

Clarity & Reforms Required

One key reform is doing away with the limitation of one nominee and permitting percentage allocation among the nominees. Such a change would allow the shareholders and bond holders and debenture holders to specify, as far as possible, their successors as nominees together with the desired percentage allocation among them. It would help reduce or remove possible friction and burden that the nominee may have in dealing with the legal heirs, successors and claimants. This would also be consistent with the law that permits and recognizes multiple owners (or joint owners) of shares and securities.

Further key reform is reiterating and reaffirming that nominees do indeed inherit absolutely as successors (as envisaged in section 72 of the Companies Act 2013 and earlier sections 109A and 109B of the Companies Act 1956), and not as trustees or custodians for other claimants.

The judicial decisions quite so often conflate varying approaches adopted in different statutes or laws governing different financial assets, or cite case law or legal definitions that may not be relevant in today's day and age, and at times, despite legislative intent to the contrary, read down the letter of the law[11]. Hence, express wordings and explicit communication by the legislature (as done for insurance policies[12]) are desired in specifying nominations leading to succession as a third mode of inheritance[13] and as a measure of promoting Ease of Living. Such a measure will also decongest courts (avoiding probate or issuance of succession certificates), and lead to reduced time and costs for the citizenry for succession related matters.

8 See *Jayanand Jayant Salgaonkar v Jayashree Jayant Salgaonkar* which extensively reviewed various court decisions and authorities; the Supreme Court had an opportunity to settle the issue (whether Section 72 has an overriding effect on the law of Succession or not) but did not do so - see *Aruna Oswal v Pankaj Oswal*: and cited in https://taxguru.in/income-tax/sc-dispute-inheritance-shares-civil-dispute-decided-companies-act.html)

9 Specification in the will that the nominee is the beneficiary can obviate challenges or issues from arising

10 Having regard to *Jayanand Jayant Salgaonkar v Jayashree Jayant Salgaonkar* and authorities cited therein

11 Mere usage of the word 'vesting' or even using a notwithstanding clause which override testamentary dispositions or succession laws within the statutes don't appear to cut it with the courts in general; Further the courts in general appear to view: (a) nominations as only assisting in discharge, release and 'valid quittance' of the issuers, depositories or financial institutions, etc; (b) statutes embedding provisions on nomination as having a broader objectives and hence such embedded statutory provisions not being intended to changing laws of succession; (c) nomination procedures not being on par with testamentary disposition procedures and hence not capable of being an alternative to testamentary disposition (ignoring safeguards or procedures that did get instituted in different assets over the years). It is noted that certain court decisions did uphold nominees being successors though appear to be exceptions to the general set of rulings - see https://indiankanoon.org/doc/762343/, https://indiankanoon.org/doc/1285014/

12 See section 39(7) of Insurance Act, 1938, substituted vide the Insurance Laws (Amendment) Act, 2015 w.e.f. December 26, 2014

13 The other two modes being Intestate (without a will, hence succession in terms of personal laws, as applicable) or by a Will and Testament, which requires probate

The above two reforms outlined would need to be in addition to the broader measures outlined in the White Paper and specified in the Annexure to this spotlight paper.

Incidentally, even for situations where probate is undertaken, the issuer of the shares and securities (whether such issuers be listed, unlisted, or private limited companies) or its registrars and transfer agents delay or defer the transmission process, or impose highly unreasonable or unfair conditions on the beneficiaries[14]. For such situations, policymakers and regulators can consider laying down strict norms for listed companies and unlisted public companies and the registrar and transfer agents to abide by nomination or of probate, without imposing any conditions and doing so within a specified period.

Policy on Physical v Digital

One key issue for policymakers and regulators to consider is whether physical shares and securities are indeed desirable, or whether we could move to completely digital and dematerialized shares and securities from the stage of issuance, holding or transfer or transmission.

For listed companies and unlisted public companies, all incremental issuance, subscription, or transfer of securities, after appointed dates, are required to be in dematerialized mode. Hence, the transmission had been the exception. From January 2022, SEBI requires that the transmission or transposition of securities held in physical or dematerialized form shall be effected only in dematerialized form[15]. Accordingly, a key policy measure implemented is that shares and securities of listed companies are to be transmitted in dematerialized mode when the nominee notifies of death of the holder, or when legal heirs approach for transmission. This measure also extends to unclaimed shares or securities, which will be released to the rightful claimant only in dematerialized form. These measures will ensure incrementally physical shares and securities are reduced and eventually eliminated. Furthermore, the option of rematerialisation should be done away with so that securities once dematerialised, are not issued/reissued in physical form thereafter.

In respect of private limited companies, the key legal requirement is that its Articles of Association are required to restrict the right to transfer shares. Depositories, based on board resolutions and indemnities, provide this facility for private limited companies. This could be mandated by the law to pave the way for bringing all the shares and securities of private limited companies into digital and dematerialized mode. Such a measure will be useful for the shareholders in as much as being able to make nominations or undertake pledges of the shares that are available for dematerialized securities.

The Benefits of dematerialization are manifold for corporates, investors, markets, society and the government[16], and not being dwelled in this spotlight paper.

Way forward

Bringing necessary clarity and reforms *as well as* exercising the policy choice on physical certificates giving way to digital and dematerialization can prove transformative. Additionally, implementing the other measures recommended in the white paper, having regard to the assessment appended should be considered.

If indeed, physical shares and securities certificates are continued for any reason, the measures outlined (and addressing the two key items mentioned as requiring clarity and reform) will still be necessary for ensuring ease in the succession process via nominations.

Bringing necessary clarity and reforms *as well as* exercising the policy choice on physical certificates giving way to digital and dematerialization can prove transformative

14 See articles by Rajat Dutta on the issues faced here and here: These could be in violation of section 56 of the Companies Act, 2013, particularly the timelines laid down in section 56(4). Furthermore, only upon loss of instrument of transfer or if the duplicate share certificates require being issued is when indemnity has been specified in the statute and no other or further requirements. Requiring sureties or imposing other conditions are indeed excessive when viewed from such a perspective.

15 See Regulation 40 (1) of SEBI (Listing Obligations & Disclosure Requirements) Regulations, as amended by SEBI in January 2022: https://www.sebi.gov.in/legal/regulations/jan-2022/securities-and-exchange-board-of-india-listing-obligations-and-disclosure-requirements-amendment-regulations-2022_55526.html

16 See here https://nsdl.co.in/guidedtour/investor2.php or https://ww1.cdslindia.com/issuer/issuer-benefits.html

Assessment of measures recommended for physical shares and securities issued by entities governed by the Companies Act, 2013 (and earlier versions of the Companies Act)

	Who can implement the recommended measures		
	SEBI[17]	Ministry of Corporate Affairs[18]	Parliament [19]
Easy, uniform and simple process to check status of nominations and to make or change nominees	☑	☑	
Simple, common nomination form/e-form across all issuers of physical shares/securities	☑	☑	
Ability to specify any number of nominees			☑ Currently restricted to 1. Should be unlimited
Ability to specify percentage allocation among nominees	☑	☑	☑
Ability to specify successive nominees	☑*	☑*	☑*
Ability to make single scrip/folio/security level nominations			
Mandating comprehensive e-nomination facilities, especially within the website or mobile apps of such securities issuer • Option for completing or updating KYC of nominees at any time			☑ ☑
Extending nomination facilities for addressing situations of incapacitated financial consumer	☑	☑	☑
Ability to specify minors as nominees (with or without specifying an adult or guardian during the minority of the nominees) • Ability to defer the age of vesting (as regards minor nominees)	☑ ☑	☑ ☑	
Making nominations mandatory for all physical securities (including in respect of legacy physical securities in a time bound manner)	☑	☑	☑
Centralized Reporting of demise or incapacitation of a financial consumer + reliance upon the information reported and documents uploaded + trigger proactive outreach by securities issuers to the nominees	☑		
Unclaimed funds and accumulations thereon that are earmarked for education, awareness or welfare of financial consumers should spread awareness and educate on advantages and benefits of nomination. On reimagined nomination facilities becoming operational, further awareness campaigns can also take place	☑	☑	
Elevating or equating nominees to being legal and beneficial owners of the financial asset (upto to the percentage allocation as specified) and doing away with concept of regarding nominees as trustees or custodians for legal heirs in respect of financial assets	☑	☑	☑

*= Can be made available even as the law is being amended to allow for more than 1 nominee. Currently available only for minor nominee where nominee dies during minority: as noted the designated form does not provide for this possibility

17 For listed public companies

18 For unlisted public companies and private companies

19 For legislative measures as outlined

Mr. Pramod Rao

Pramod is serving as an Executive Director at the Securities and Exchange Board of India, handling the Department of Debt and Hybrid Securities (DDHS), and Enquiries and Adjudication Department (EAD). The white paper — "Reimagining Nominations: Making Succession Smoother and Simpler" was written by Pramod in his personal capacity prior to joining the Securities and Exchange Board of India.

Pramod has extensive experience in the Indian financial services sector, having served as Group General Counsel at ICICI group, General Counsel for Citi South Asia cluster, as a partner at IndusLaw and as General Counsel of ICICI Bank, with many professional accomplishments in such roles.

He has also served as a member of the Board of Directors of ICICI Securities Ltd, ICICI Prudential Trust Ltd, ICICI Trusteeship Services Ltd, and as a member of the National Committee for Regulatory Affairs of the Confederation of Indian Industry (CII), of the Advisory Council of Sahamati & of the SEBI Subcommittee for Regulatory Sandbox.

Pramod has a deep interest in Fintech, LawTech & startups: He has co-founded a LawTech enterprise, & served as a Board member of 2 startups. He also advised & mentored startups under the aegis of ICICI Bank's Startup Engagement Team & its Innovation Lab, NSRCEL of IIM Bangalore, SINE of IIT Bombay & of No Changemaker Left Behind program by Agami. He has also led piloting and adoption of innovative approaches and technology-led solutions for various business, operational and legal requirements. He has collaborated on certain iSPIRT projects including Sahay-GeM and the Sahamati AA Ecosystem.

He has played a pivotal role in conceptualizing & adoption of online dispute resolution (ODR) at ICICI Bank & digital ecosystems such as Sahamati, Sahay GeM, Sahay GST and ONDC. He also engaged with policy makers, the government & the judiciary on ODR, which culminated in the Niti Aayog constituted committee report on Designing the Future of Dispute Resolution: The ODR Policy Plan for India, available at https://bit.ly/3AVS247, & in the launch of ODR Handbook, available at www.disputeresolution.online

Pramod has also been associated with IDIA – Increasing Diversity by Increasing Access – an NGO dedicated to assisting students from underprivileged backgrounds in attending premier law schools in India. He has served as a founding member of the Governing Board of the NLSIU Alumni Association from 2015-2020.

He has participated in & contributed to various law and regulatory reform initiatives of the government, regulators & industry forums, and written or contributed to several papers containing his personal view and opinions on matters of law and policy including for SCC Blog, IndiaCorplaw Blog, ARIA and for reputed digital business news platforms.

About ARIA

The Association of Registered Investment Advisers (ARIA) was born out of the need to support the development of the investment adviser community post the introduction of the investment adviser regulations by SEBI in 2013. ARIA was set up as a part of the inaugural RIA summit in 2017 from where an RIA Task force emerged to enable the development of the RIA profession, and bring it to the standards of other established professions that have been in existence since multiple decades. ARIA members come from different parts of the country and are a mix of individuals and corporates who are focussed on doing what is right for the investor without conflict of interest or high levels of disclosure.

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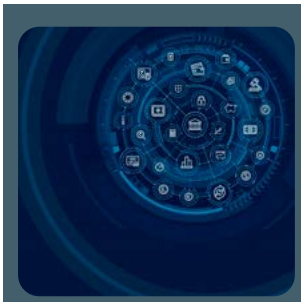

More Spotlight sections to follow soon

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