FOCUS ON

LAW OF MARCH 1st 2019 AMENDING THE LAW OF AUGUST 1st 2001 ON THE CIRCULATION OF SECURITIES

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SUMMARY

BACKGROUND

As announced in a previous information letter dated September 25th 2018, the Luxembourg legislator was working on a bill of law (**PL7363**) aimed at modernising the law of August 1st 2001 (the **2001 Law**) on the circulation of securities and other financial instruments, which had already made significant progress upon amendment by the law of April 6th 2013 on the dematerialisation of securities.

PL7363 was adopted on February 14th 2019 by the Luxembourg Chamber of Deputies and the law of March 1st 2019 was published in the *Mémorial A* dated March 5th 2019 (the **Law of March 1st 2019**).

THE INFLUENCE OF NEIGHBOURING COUNTRIES

Luxembourg was under certain pressure to maintain itself in the lead of new technologies, whereas France, very active, had taken the lead as early as 2016 with the *ordonnance* n°2016-520 of April 28th 2016 (known as the "Minibons" *ordonnance*), recently supplemented by the Decree of December 24th 2018 (known as the "Blockchain Decree") adopted pursuant to the Minibons *ordonnance*, specifying the conditions for using "shared electronic recording devices" pursuant to Article L.223-12 of the Monetary and Financial Code.

HISTORY

The financial sector is not immune to the rapid evolution of modern technologies, which are undergoing cyclical, essential and often brutal transformations, aiming at a progressive but inexorable dematerialization as a whole. Without going into a detailed history, to date, it is possible to distinguish a three-step evolution:

First, bearer securities, paper securities constituting the physical representation of the share containing identification elements that were transferred from hand to hand between the parties by the effect of the "*traditio*".

Thereafter, a desire to reduce risks by eliminating paper-based securities and transaction costs, together with the fight against money laundering, has led to the creation of a new category of so-called dematerialised securities allowing the development of the notion of "*book entry securities*".

Time is flying and it has not taken long for a new law to modify the existing legal framework with the view to strengthen and ensure legal certainty in order to take into account technological developments in secure electronic recording, such as distributed ledger technology (DLT) and, in particular, the blockchain type.

PURPOSE OF THE SINGLE ARTICLE 18 BIS

The purpose of the Law of March 1st 2019 is to extend the scope of the 2001 Law to allow account holders to **hold** securities accounts and **register securities** by means of secure electronic recording devices (DLTs) including distributed electronic registers or databases such as blockchain.

Secure electronic recording devices are at the centre of operations and may be used by account holders to **hold** securities accounts and **realise corresponding registrations** thereon such as transfers.

This being said, it seems important to emphasize that the scope of the Law of March 1st 2019, only covers the holding and registration of transfers of securities but in no case the issuance of securities.

TECHNOLOGICAL NEUTRALITY

The Law of March 1st 2019 takes particular care in referring to "*secure electronic recording devices, including distributed electronic registers or databases*", thus ensuring technological neutrality with regard to the various protocols constituting the infrastructure of the blockchain. This neutrality is understandable and necessary in order not to link a legal regime to a specific technology that could evolve rapidly; flexibility must prevail.

LEGAL FICTION

As with the last amendment to the 2001 Law in 2013 and the creation of dematerialised securities, the Law of March 1st 2019 operates a legal fiction, essential for its proper functioning, by providing that "[...]*[t]he successive transfers recorded in such a secure electronic recording system are considered as transfers between securities accounts*". In this way, the Law of March 1st 2019 recognises that successive registrations of securities in a blockchain have the same effects as those resulting from a registration of securities between securities account.

MAINTAINED FUNGIBILITY

Understanding this issue requires to revert to the definition of blockchain which can be defined as a "*mode of recording continuously produced data, in the form of blocks linked to each other in the chronological order of their validation, each of the blocks and their sequence being protected against any modification*". As a consequence, blockchain is distinguished by three main characteristics that are the antithesis of preconceived ideas: (i) its transparency, (ii) its immutability and (iii) its security.

Therefore, since all transactions are tracked in the blockchain, it is impossible to modify them once they have been saved in a block. However, this traceability is ensured at the level of transactions after registration, but not at the level of a particular token, which would also jeopardize their fungibility (if this would be the case).

Consequently, it is logically and precisely for the sake of legal certainty that the Law of March 1st 2019 expressly provides that "*The holding of securities accounts within such a secure electronic registration system or the registration of securities in securities accounts by means of such a secure electronic registration system shall not affect the fungibility of the securities concerned.* »

IMPACT ON EXISTING LEGISLATION

Finally, the Law of March 1st 2019, with a view to ensuring consistency of the rules read as a whole and legal certainty, clearly states that the holding of securities accounts or the registration of securities in securities accounts through a secure electronic registration system will not affect the application of the 2001 Law, nor the position of securities that continue to be with the relevant account holder, nor the validity or enforceability of securities or guarantees created in accordance with the amended law of August 5th 2005 on financial collateral arrangements.

FUTURE

Luxembourg, pragmatic and diligent, has (as always) been able to react promptly to the legal developments of neighbouring countries, while remaining cautious. This is the subject of the Council of States remark acknowledging (regretting?) that PL7363 was limited to a partial recognition of this new form of dematerialization.

Changes are ongoing and the 4th step will most likely arrive quickly. To this, will the Law of March 1st 2019 be the first step towards the

emergence of a new form of financial securities, a dematerialized security represented by a token in the blockchain? A necessarily more global reflection on the law applicable to this new title will certainly emerge in the coming months: the opposability to third parties of this property?, the relationship between the issuer holding the title registered on the blockchain?, the regime in the event of a pledge on this new title?, the right of ownership for these new titles?, the law applicable in the event of a dispute?...

FOR MORE INFO

Pierre-Alexandre Degehet
Partner
padegehet@bsp.lu

Corporate M&A / Fintech & Startup

Capital Market

Banking & Financial Services

Head of French Desk