LEGAL ALERT

DEMATERIALIZED SECURITIES

LAW OF 6 APRIL 2013 ON DEMATERIALIZED SECURITIES

MAY 2013
I. INTRODUCTION

On 6 April 2013, the Luxembourg Parliament approved draft law No 6327 on dematerialized securities. The law on dematerialized securities (the "Law") was published in the Mémorial A, Recueil de Législation, n° 71, page 890, on 15 April 2013 and entered into force on 18 April 2013.

II. PURPOSE OF THE LAW

The Law purports to modernize the Luxembourg rules relating to securities and to promote their circulation by regulating the dematerialization of securities, which was already accepted by the Luxembourg judges and academics and covered by some legal and regulatory provisions¹.

It aims to increase the attractiveness of the Luxembourg financial center by providing investors with a comprehensive set of new rules dealing with the reality of dematerialized securities.

The approach used by the Luxembourg legislator is to create an optional system, granting the issuers the possibility to issue dematerialized securities or to dematerialize their existing securities, in contrast to some other EU Member States where dematerialized securities are the only type allowed or where dematerialization of securities is not permitted yet.

III. SUMMARY OF THE MAIN PROVISIONS

1. Main Actors

There are three main actors involved in the dematerialization of securities: the clearing houses (organismes de liquidation), the central account keepers (teneurs de compte central) and the account keepers (teneurs de compte). Account holders (i.e. the ultimate clients) may not hold an account directly with a central account keeper or clearing house and therefore must act through an account keeper in order to open an account.

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¹ Article 7(3) of the law of 22 March 2004 on securitization, as amended and article 1 of the Grand Ducal regulation of 7 February 2013 on the terms and conditions of State borrowings.
1.1 Clearing Houses and Central Account Keepers

According to the Law, a clearing house is a securities settlement system within the meaning of the law of 10 November 2009 on payment services\(^2\), appointed by the Luxembourg Central Bank and notified to the European Commission by the Luxembourg Minister for Finance, and whose system operator is located in the Grand Duchy of Luxembourg ("Luxembourg"). There are currently three securities settlement systems fulfilling these criteria in Luxembourg: Clearstream Securities Settlement System, VP Lux Securities Settlement System and Lux CSD Securities Settlement System.

Central account keepers are authorized to exercise their activities by the Luxembourg Minister for Finance subject to the fulfillment of new requirements and a new procedure, inserted in the law of 5 April 1993 on the financial sector, as amended (the "1993 Law"). Only the following entities can be authorized as central account keepers: (i) Luxembourg credit institutions and investment firms located in

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\(^2\) Law of 10 November 2009 on payment services, on the activity of electronic money institution and settlement finality in payment and securities settlement systems, as amended.
Luxembourg and (ii) Luxembourg branches of credit institutions or investment firms authorized in another Member State of the European Union.

Both clearing houses and central account keepers have a centralizing function in connection with dematerialized securities. These entities keep a single issuance account for each issuer whose securities are registered with one of them. Dematerialized securities are created by their registration on the issuance account, which records all the securities of a specific type (de même genre) that have been issued by an issuer. Clearing houses and central account keepers must ensure that the amount of securities on the issuance account always equates to that on the securities accounts that they maintain on behalf of account holders and the securities that they hold on their own account.

The main difference between clearing houses and central account keepers relates to the securities that they can register. Central account keepers have a more restricted function and can only deal with non-listed securities while clearing houses are allowed to register both listed and non-listed securities on their issuance account.

### 1.2 Account Keepers

Account keepers are any persons authorized to keep securities accounts on behalf of their clients (account holders or other account keepers) pursuant to Luxembourg law, including national or international public bodies established in Luxembourg and operating in the financial sector. In practice, account keepers will mostly consist of credit institutions, professional custodians for securities, as well as specific types of investment firms within the meaning of the 1993 Law. Luxembourg branches of foreign institutions also fall within the definition of “account keepers”.

Some provisions of the Law also apply to foreign account keepers, which are mainly foreign credit institutions and other professionals of the financial sector which maintain securities accounts and are established outside of Luxembourg.

Account keepers must hold a securities account with a clearing house or a central account keeper. This is the case, for instance, when the account keeper holds securities for its own account. Alternatively, they can open a securities account with other account keepers, which will then act as intermediaries between their clients and the clearing house or central account keeper. Therefore, it is possible to create holding chains of securities comprising several account keepers acting as sub-custodians.

The Law amends the 2001 Law (as defined below) on the circulation of securities, but confirms the rule in article 3(1) of the 2001 Law under which each account holder has a right in rem (droits réels) over the securities held on the relevant securities account. Thus, at each level of the holding chain, the relevant entity has a right in rem over the dematerialized securities, but may only assert these rights against the relevant account keeper (teneur de compte pertinent).

### 2. Issuance of Dematerialized Securities

The rules set out by the Law in respect of the issuance of dematerialized securities differ on whether they relate to equity or debt securities. Nevertheless, some provisions apply to both types of securities.

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3 Former article 6(1) of the 2001 Law.
2.1 Issuance of Dematerialized Equity Securities

The issuance of dematerialized equity securities, such as shares or units, will require that the issuer, organized as a Luxembourg capital company (société de capitaux), such as a public limited company (société anonyme) or a partnership limited by shares (société en commandite par actions), or a common fund (fonds commun de placement) amend its articles of incorporation or management regulations so that its constitutional documents expressly allow for an issuance of dematerialized securities and incorporate the applicable rules.

The issuer will also be required to register the entirety of the issuance of equity securities of the same kind with a single clearing house or central account keeper and subsequently have the name and address of said clearing house or central account keeper published in a Luxembourgish newspaper with national circulation (e.g., the Luxemburger Wort and the Tageblatt) and on its own website. In addition, an excerpt to be published in the Mémorial C. Recueil des Sociétés et Associations (the “Mémorial”) indicating the name and address of the clearing house or central account holder, must be filed with the Luxembourg Register of Trade and Companies.

2.2 Issuance of Dematerialized Debt Securities

The issuance of dematerialized debt securities of the same kind is only subject to the registration by the issuer of the entire issuance with a single clearing house or central account keeper. No publication requirement or amendment of articles of association obligation exist.

2.3 Common Provisions for Dematerialized Equity Securities and Dematerialized Debt Securities

In case of modifications pertaining to the dematerialized securities, the issuer must inform the clearing house or central account keeper in writing. A confirmation must also be transmitted to the relevant centralizing entity once the change has occurred.

Moreover, the choice of the clearing house or the central account keeper is decided by the management bodies of the issuer.

3. Conversion of Dematerialized Securities

The Law sets out detailed rules in relation to the process leading to the dematerialization of securities and the consequences for securities holders if they do not comply with the new legal requirements. The law also contains specific provisions aimed at preserving the validity of Luxembourg law pledges granted on securities which have subsequently been dematerialized.

3.1 Conversion Process

An issuer intending to convert equity securities into dematerialized equity securities must amend the articles of incorporation or management regulations to address in particular:

a. an express reference to the authorization of the issuer for the issuance of dematerialized securities;

b. the securities subject to conversion into dematerialized securities;

c. the mandatory or optional character of the conversion;

d. the procedure for conversion; and
e. if the conversion is mandatory, the time period for conversion and the penalty for not presenting the securities to be dematerialized within the required period. The conversion period cannot be less than 2 years.

The conversion process depends on the nature of the securities

a. Bearer securities which are in the physical possession of their holder are converted once they are registered in the securities account with the account keeper, the clearing house or the central account keeper. As the case may be, the party that receives the bearer securities must deposit them with a clearing house or central account keeper which holds the issuance account of the dematerialized securities and which, unless otherwise instructed, will give them back to the issuer.

b. The issuer must, upon receipt of the bearer securities from the relevant clearing house or central account keeper further to the procedure described in the preceding paragraph, destroy the bearer securities that have been given back to it. The issuer can entrust the destruction of the bearer securities to the clearing house or central account keeper.

c. Registered securities are converted by way of registration in the securities account of their holder. The holder named in the register must furnish to the issuer information regarding its account keeper or foreign account keeper and its securities account in order for the dematerialized securities to be credited to the correct securities account. This information is then transmitted by the issuer to the relevant clearing house or central account keeper, which will adjust the amount of dematerialized securities registered in the issuance account and credit the dematerialized securities to the relevant account keeper.

d. Securities which are already held with a clearing house, a central account keeper or an account keeper and which are already transferred by way of book-entry, will after a 3-month period starting from the date of publication in the Mémorial of the decision by the issuer to convert those securities into dematerialized securities, no longer be deliverable in physical form.

Voting rights attached to securities which have not been dematerialized within the relevant period are automatically suspended upon the expiration of this period, until their dematerialization occurs. The distributions are deferred until the same date, on the condition that the distributions have not lapsed. Securities on which the voting rights are suspended are not taken into account for calculating a quorum and the majority for general meetings and holders of such securities are not admitted to such general meetings.

Securities that have not been converted into dematerialized securities within a 2-year period after the general meeting deciding on the conversion can be dematerialized by the issuer and entered into a securities account opened in the name of the issuer, until such time when the holder of the securities presents itself and obtains the registration of the securities in its own name.

The articles of association, the management regulations or the conditions for the issuance of equity or debt securities may provide that securities that have not been dematerialized on the demand of their holder in a period of not less than 8 years from the date of the general meeting deciding on the conversion can be put on sale by the issuer by way of a notice of at least 3 months to be published in the same form as a notice of a general meeting. The methods of sale are laid down in the Law depending on the type of security involved. The issuer putting such securities
on sale in keeping with the provisions of the Law will not be held legally responsible except in the case of gross negligence or willful misconduct.

3.2 Preservation of Pledges

Luxembourg law governed pledges over registered or bearer securities remain valid and continue to have effect without the need for further formalities by the mere registration of the securities in a securities account in Luxembourg. Where the pledged securities are entered in a securities account opened in the name of the pledgor, the third party holder must be informed in writing of the existence of the pledge at the moment of the registration of the pledged securities in the account.

Where the pledged securities are submitted for mandatory dematerialization, the pledgor and the pledgee will decide between them who will proceed with the dematerialization within the envisaged time period. In the absence of agreement, or if in spite of an agreement the pledgor fails to proceed with the dematerialization in the envisaged time period, the pledgee can itself proceed with the dematerialization. Except where agreed otherwise, the securities will be inscribed in the securities account opened in the name of the pledgee. If the conversion is overseen by the pledgee, the pledgor must provide any necessary cooperation.

4. Transfer of Dematerialized Securities

The circulation of dematerialized securities will operate through account-to-account transfers.

If the securities accounts of the transferor and the transferee are held with two different account keepers, transfers will operate without set-off between these account keepers, via the clearing house or the central account keeper.

5. Distributions

Amounts to be paid by the issuer in relation to securities, (e.g., dividends, interests, accrued principal, other accrued amounts, free delivery of securities, and other distributions made by the issuer in relation with the securities or purchase price in case of securities buy-back by the issuer) are paid by the issuer to the clearing house or central account keeper in discharge for the issuer’s obligations. In turn, the clearing house or central account keeper is validly discharged by paying these amounts to the relevant account keeper.

6. Investigative powers of the issuer

The issuer may request from the clearing house or central account keeper and from each account keeper information as to the identity and holding of the persons who hold the issuer’s securities on their issuance or securities account with that clearing house or central account keeper or account keeper provided the articles of incorporation or the management regulations of the issuer cater for such investigative powers. The issuer may also ask the persons named on the lists it receives to confirm that they hold the securities on their own behalf (pour compte propre).

If within 2 months from the date of its request the issuer does not receive the requested information or the received information is incorrect or incomplete, the issuer may suspend the voting rights of the securities concerned, until it receives the requested information.
7. Amendments to other Luxembourg Laws

The law of 10 August 1915 on commercial companies as amended (the “1915 Law”) has been amended by the Law to bring securities issued in dematerialized form within its ambit. The articles of association must specify whether the shares are in dematerialized form. The dematerialized share is materialized by an entry in a securities account in the name of a holder of that account. Holders of shares or dematerialized securities can participate in general meetings and exercise their rights only if they hold said shares or dematerialized securities no later than midnight Luxembourg time, at the latest 14 days prior to the meeting.

Furthermore, the 1915 Law sets out that owners of bearer and registered shares or securities may, if the articles of association of the issuer allow so, request the issuer to convert them into dematerialized shares or securities. However, owners of dematerialized shares or securities can only request the conversion of these securities into registered shares or securities, except where the articles of incorporation provide for a mandatory dematerialization of shares or securities.

Likewise, the law of 17 December 2010 on undertakings for collective investment as amended and the law of 13 February 2007 relating to specialized investment funds, as amended, are also amended by the Law permitting management companies to issue units in registered, bearer or dematerialized form representing a proportion of the common fund it manages.

The Law of 1 August 2001 on the circulation of securities and other fungible instruments is renamed into “the Law of 1 August 2001 on the circulation of securities, as amended” (the “2001 Law”). Articles 1 to 5 of the 2001 Law have been repealed and replaced.

The amendments to the 2001 Law clarify the rules on investors’ voting rights and give greater protection to securities holders who hold their securities with an account keeper.

Account holders owning dematerialized securities have an intangible right in rem (droit réel de nature incorporelle) to these securities. This right is acquired as soon as the securities are registered in its securities account.

The participation of a holder of dematerialized securities at general meetings of Luxembourg companies only requires that a certificate drawn up by the relevant account keeper, confirming the amount of securities on the account, be provided. No requirement, such as, e.g., the temporary transfer of the dematerialized securities to a dedicated account before the holding of the general meeting, can be imposed in order to evidence the rights of the account holder to attend such meeting.

In addition, the Law ensures that in the case of liquidation proceedings of an account keeper, the affected holders may file an action in rem (action en revendication) with the liquidator. Such action is based on the securities, which are kept by the account keeper or on its behalf, registered by the account keeper in its name or in the name of a designated third party, or kept in a securities account of the account keeper opened with another account keeper. If there are no sufficient securities, each account holder will receive a portion thereof pro rata to his/her holding of securities with the account keeper.

Other specific rules apply in case the account keeper has disposed of the securities with the prior authorization of the account holder and those securities
have not been returned yet. In that event, the other account holders will be repaid as a priority.

Moreover, when securities of an account holder are seized on a securities account held with a specific account holder, same cannot also be carried out against, or affect, (i) a securities account of any person other than that account holder, (ii) the issuer of any securities, other than the seized securities, held in the securities account of the account holder targeted by the seizure, or (iii) any person other than the account holder or its relevant account keeper. Any seizure performed in breach of the foregoing requirements shall be null and void. These rules aim to ensure that any seizure will be carried out at the appropriate level in a holding chain of securities by prohibiting upper-tier attachments.

The 2001 Law also includes rules protecting the rights of bona fide purchasers acquiring securities in violation of the rights of a third party. In that instance, unless the purchaser knew that a third party had rights on the acquired securities, such person is protected against any competing third party rights that could be exercised on those securities. Hence, the rights of the purchaser regarding the securities will be valid and enforceable against third parties and any rights that third parties could have invoked in relation to the securities will not prejudice the acquirer. In addition, the bona fide acquirer will bear no liability towards third parties whose rights were affected by such transfer of securities.

Finally, the 2001 Law contains specific rules where an account holder as party to a transaction on securities is defaulting and the account keeper delivers the securities, or pays the price for securities, to the counterparty of that account holder. Pursuant to the law, the ownership of the consideration (cash or securities) granted by the counterparty is transferred for security purpose (transfert à titre de garantie) to the account keeper until the defaulting account holder fully satisfies its obligations.

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