

Luxembourg passes law allowing the use of blockchain in the issuance and circulation of securities

The law of 1 March 2019 amending the General Securities Law brings clarity to the legal status of security tokens

Executive Summary

- > A new law amending the law of 1 August 2001 on the circulation of securities was approved by the Luxembourg parliament on 14 February 2019.
- > The new law entered into force on 5 March 2019.
- > The new law validates the principle of technological neutrality by allowing the use of secure electronic registration mechanisms for the issuance and circulation of securities.
- > The new law provides clarity to the legal framework of security tokens in Luxembourg by confirming that securities can be held through digital ledger technologies such as blockchain.
- > A new form of security is available in the Luxembourg tool box.

The Luxembourg legislator marks a milestone for the use of new technologies in the issuance, holding and circulation of securities. On 27 September 2018, the Luxembourg minister of finance filed with the Luxembourg parliament a draft law amending the law of 1 August 2001 on the circulation of securities. The new law was passed by the Luxembourg parliament on 14 February 2019, enacted on 1 March 2019 and entered into force on 5 March 2019 (the "Blockchain Law"). Although it applies to any kind of secure electronic registration mechanisms, its immediate application is to recognise blockchain-type digital ledger technologies. This amendment is another step towards the modernisation of the financial sector legislation in Luxembourg. The amendment provides legal certainty to the financial market participants who wish to take full advantage of

options offered by new technologies for the issue and circulation of securities.

1. The previous legislative framework in Luxembourg regulating the circulation of securities

The legislation with respect to securities currently in force is provided principally by two laws. First, the Luxembourg law dated 1 August 2001 on the circulation of securities, as amended (the "General Securities Law"), which gives the general legal framework for the circulation of securities. Second, the Luxembourg law dated 6 April 2013 on dematerialised securities, as amended (the "Dematerialised Securities Law"), which introduced a new form of securities to the legislative framework, the dematerialised securities.

The adoption of the Dematerialised Securities Law represented at the time a favourable approach towards technological advancements. Pursuant to the Dematerialised Securities Law, the security is held by an account holder through a securities account opened with an account keeper, which is registered in a securities issuance account. This securities issuance account is opened with a central account keeper or a settlement institution. However, since the adoption of the Dematerialised Securities Law, the financial sector has adapted to the use of new innovative technologies, namely through creating instruments such as virtual currencies, Initial Coin Offerings and security tokens, leaving the legal framework open for interpretation.

2. The position of the CSSF and of ESMA on security tokens

Following the fact that financial market participants have rapidly adopted these new trends, the CSSF issued a warning to the public related to Initial Coin Offerings (“ICOs”) on 14 March 2018. In its warning, the CSSF outlined risks related to ICOs and drew attention to the absence of specific protective regulation and guarantees at the national and European level.

Without taking an official position as to the qualification of security tokens as securities, CSSF warned that despite the absence of specific regulation applicable to ICOs, the activities related to or implied by the creation and trade of tokens, the collection or raising of funds, these activities may, depending on their characteristics, be subject to certain legal provisions in Luxembourg and therefore to certain supervisory requirements.

The CSSF affirmed that it will not hesitate to extend its analysis to the objectives pursued by these fundraisings in its evaluation whether it is a maneuver to circumvent the applicable regulation, in particular the provisions of the Law of 10 July 2005 on prospectuses and the law of 5 April 1993 relating to the financial sector. Furthermore, in all cases of such fundraising, the initiators must put in place procedures to prevent money laundering or terrorist financing operations.

ESMA took a similar position on its Advice on Initial Coin Offerings and Crypto-Assets of 9 January 2019 by stating that security tokens could potentially be subject to a range of legal provisions potentially applicable to crypto-assets when they qualify as financial instruments, such as the Directive 2003/71/EC as amended (the “Prospectus Directive”), the Directive 2013/50/EU amending Directive 2004/109/EC (the “Transparency Directive”) and the Directive 2014/65/EU (“MiFID 2”).

3. The Blockchain Law provides legal certainty and technological neutrality

The lack of clear regulation applicable to security tokens and the CSSF’s warning implicitly qualifying certain security tokens as transferable securities resulted to a call for legal certainty. The Luxembourg legislator took action and introduced Art. 18bis in the General Securities Law in order to

allow the use of secure electronic registration mechanisms for the secured registration and circulation of securities. This includes notably digital ledger technologies such as blockchain-type distributed registers or private electronic ledgers or databases.



According to the parliamentary works, the purpose of the Blockchain Law is to enable financial market participants to take full advantage of the opportunities offered by new technologies in the circulation of securities. The Blockchain Law validates the principle of technological neutrality by allowing the general use of secure electronic registration mechanisms for the holding and circulation of securities, thus allowing also the issuance of security tokens. In addition to digital ledger technologies such as blockchain, market participants will be able to take advantage of future technological developments.

The recourse by the account keeper to this type of technology is an alternative to the methods of dematerialisation that have been in place since the Dematerialised Securities Law was enacted.

4. Characteristics of the security tokens

The parliamentary works of the Blockchain Law label the operation of the securities accounts in blockchain-type distributed registers by using the concept of a token. The commentary of the new Art. 18bis defines tokens as essentially digital assets stored in a blockchain which, like a paper security or a conventional dematerialised security, represent the securities. From a technological point of view this is a new type of security, i.e., a dematerialised security not represented by a global certificate and without a central securities

depository, but from a legal point of view the token would have the same rights attached to it as conventional securities. Art. 18bis will indeed allow this and other forms of digitally represented securities, to the extent that they are registered in a secure electronic registration mechanism. Similarly to securities cleared via clearing systems, the Blockchain Law recognises that transfers of securities are perfected by registration in the relevant account held with the secure registration mechanism.

The traceability of transactions on a general level is an inherent property of the blockchain type distributed ledgers or databases, as all the transactions are traced in the blockchain and cannot be changed once they have been included in a block. However, the use of the blockchain does not call into question the fungibility of tokens as only the number of tokens held by an address is stored. Although tokens in a blockchain are univocally identified, the new article emphasises that the use of these new mechanisms for holding securities does not affect the fungibility of the securities. The new article further specifies that transfers recorded in these new mechanisms are considered transfers between securities accounts.

4. Concluding remarks

No clear recognition of tokens as securities has been made so far at the European level. A few other European financial supervisory authorities have taken similar approaches as ESMA and the CSSF, warning about the need to meet relevant regulatory requirements and declaring a case-by-case approach for the classification of tokens as securities. Luxembourg law already allowed the issue of security tokens, but within the boundaries of existing regulation. The Blockchain Law marked a milestone on the European level of enabling the use of new technologies in the issuance and circulation of securities. Luxembourg is among the first European countries to have a clear legislative framework in the area, therefore strengthening the position of Luxembourg as a centre of competence in the field of fintech.

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