



A new era of Securities Law has begun

Electronic Securities Act (eWpG) comes into force

12 May 2021

On 6 May 2021, the German Bundestag adopted the Electronic Securities Act (**eWpG**) in the form proposed by the Finance Committee. The introduction of electronic securities is intended to make the German financial market more viable in the future and, at the same time, to protect the integrity, transparency and functioning of the markets. The eWpG will enter into force on the day after its promulgation.

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In line with other European countries, Germany will now also make it possible to issue electronic securities – including cryptosecurities based on the blockchain technology. The central point of the new

provisions is the abandonment of the requirement of the documentary securitisation of securities, which can be replaced henceforth by an entry in an electronic securities register. To preserve the legal certainty of the acquisition and transfer of securities which has grown in practice and theory over the decades, electronic securities will be legally equated with securities securitised in documentary form.

The eWpG will in a first step allow the issuance of electronic bearer bonds as well as, in a limited form, of unit certificates for special assets, and it does allow for a future extension to cover other bearer

instruments, e.g. stocks. At the same time it will remain possible to issue securities securitised in a documentary form. Issuers will thus have the choice to either securitise newly issued securities in a documentary form or to issue electronic securities.

The paper document from the 19th century

German law has required since the 19th century that securities be issued in a securitised form as a physical document. Although investors today no longer actually hold paper documents in their hands, as they are traded digitally, a physical global certificate does continue to exist and is held in central custody by Clearstream Banking AG. Co-ownership of the global certificate held in collective custody is acquired through a complex system of constructive possession arrangements, and is transferred by book entry. Securities have thus been immobilised in Germany so far but, with the exception of federal and state bonds, not dematerialised. This follows from the fact that German laws did not know any electronic creation of rights and it was therefore not possible to acquire and transfer title to securities without a paper document.

Welcome in the 21st century

The eWpG now gives issuers of bearer bonds the possibility to use an electronic securities register for paperless issuance. This electronic register can have the form of a central register with a central securities depository or custodian bank or of a decentral cryptosecurities register. The latter is intended to allow the issuance of cryptosecurities (so-called blockchain bonds).

To preserve the legal certainty of the transfer of securities which has grown in practice and theory over the decades in line with the principles of the law of property, the eWpG equates electronic securities with things within the meaning of civil law (sec. 2 para. 3 eWpG). Electronic securities are thus covered by the tried and tested provisions of the law of property governing the transfer of securities and therefore also by the principles of good faith protection. This means that the acquirer can trust in principle that he will in fact acquire the

electronic security from the bearer, provided the latter is shown as the bearer in the register, as the bearer of an electronic security is the person identified in the electronic securities register (sec. 3 para. 1 eWpG), and the content of the register is deemed to be complete and accurate (sec. 26 eWpG). As a result of these novel provisions, electronic securities have become negotiable. Moreover, in case of insolvency or enforcement, investors enjoy protection of property.

Central register

The eWpG aims in a first step at the paperless issuance of bearer bonds by replacing the securitisation in the form of a document by the registration in a central electronic securities register (so-called central register securities). The central register is to be kept by a central securities depository or by a custodian licensed to operate the depository business in Germany (sec. 12 para. 2 eWpG). For electronic central register securities transferable by book entry, Clearstream Banking AG will in practice generally remain the registration entity for these purposes.

Apart from the collective registration in the name of a central securities depository or of a custodian as the holder, there is also the possibility of individual registration in the ultimate holder's name which, however, should play a subordinate role in practice, except for private placements. Collective registration in the central register of a central securities depository, which is especially relevant in practice, is largely similar to the current system of central custody, without the interim step of the issuance of a paper document. The central securities depository or the custodians as the titular owners have direct possession, on behalf of the co-owners of the collectively held securities, of the fictitious thing "collective securities" without, however, themselves becoming the beneficiary. As in the case of a global certificate, they can handle interest and principal payments for the collectively held securities.

Cryptosecurities register

The second novelty consists of the introduction of bearer bonds created by an entry in a cryptosecurities register (so-called cryptosecurities).

However, the reasons stated by the legislator for the law make clear that, in addition to an entry in the cryptosecurities register, the creation of a cryptosecurity also requires an agreement between the issuer and the holder on the issuance of a security. This currently excludes existing claims on the basis of the distributed ledger technology. Given the current state of the art, it is primarily the recording systems based on the distributed ledger technology, which also supports blockchains, that may serve as cryptosecurities registers. But this technology is not compulsory. The design of the recording system is basically technology-neutral provided certain minimum requirements are satisfied. As opposed to the central register, the cryptosecurities register is kept by the issuer or can be delegated to a service provider. However, a permit in accordance with the Banking Act is needed to keep the register, as the keeping of a register is regarded as a financial service, so that cost aspects make it probable that the registers will be kept by specialised service providers.

Detailed provisions dealing with the registers will be contained in regulations to be issued separately. So far, the possibility of issuing crypto unit certificates will also have to be dealt with in regulations to be issued separately. Supplementary amendments have been made by the eWpG to the Exchange Admissions Regulation, the Securities Prospectus Act, the Custody of Securities Act, the Debt Security Act, and the Banking Act, among others, in order to ensure the harmonisation of securities within the existing legal framework.

Evaluation and outlook

The introduction of electronic securities sounds the bell for a new era of German securities law. However, this turn of time is not happening in the form of a revolution. Instead, the eWpG rests on a cautious further development of the existing system in the sense of an opening for electronic securities. Issuers are to be able to choose henceforth whether they wish to issue documentary securities or electronic (crypto) securities, with a possibility to also transfer old securities into central securities registers without the consent of the holders of the rights. Practice will show to what extent these possibilities will be used.

The eWpG will merely mark the starting point for the further digitization of the securities law. Further legislative measures will have to follow. To be especially eagerly anticipated are the proposals for electronic stocks. The legislator viewed the effort and expense for that conversion as too great in the current legislative period, but one would hope that this will be undertaken soon. Efforts to harmonise the various securities laws are to be expected also at the European level and will have to be taken into consideration.

Contacts



Dr Knut Sauer
Partner
Tel +49 69 2648 5375
knut.sauer@allenoverly.com



Tatiana Marzoli
Senior Associate
Tel +49 69 2648 5668
tatiana.marzoli@allenoverly.com



Dr Stefan Henkelmann
Partner
Tel + 49 69 2648 5997
stefan.henkelmann@allenoverly.com



Dr Daniela Schmitt
Senior Associate
Tel + 49 69 2648 5475
daniela.schmitt@allenoverly.com

Allen & Overy (Deutschland) LLP

Dreischeibenhaus 1, 40211 Düsseldorf, Germany | Tel +49 211 2806 7000 | Fax +49 211 2806 7800

Bockenheimer Landstraße 2, 60306 Frankfurt am Main, Germany | Tel +49 69 2648 5000 | Fax +49 69 2648 5800

Kehrwieder 12, 20457 Hamburg, Germany | Tel +49 40 82 221 20 | Fax +49 40 82 221 2200

Maximilianstraße 35, 80539 Munich, Germany | Tel +49 89 71043 3000 | Fax +49 89 71043 3800

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