

# Material changes in Dutch Securities Book-Entry Transfer Act

On 1 January 2011 material amendments to the Securities Book-Entry Transfer Act (*Wet giraal effectenverkeer*; "**WGE**") came into force. The WGE deals with the holding and transferring of securities held through intermediaries. The WGE constitutes a legal basis for the book-entry transfer of securities and provides protection for investors against the risk of an intermediary's insolvency.

The amendments mainly concern (i) increasing investor protection against (the risk of) insolvency proceedings opened in respect of their securities intermediary ("**intermediary risk**") and (ii) increasing the degree of dematerialised securities held through such intermediaries. Another notable amendment regards the issuance of securities directly into the book-entry system. This client briefing discusses these changes and their impact for investors, issuers and securities intermediaries.

## Increased investor protection against intermediary risk

The WGE protects investors against intermediary risk through a construction of joint ownership (*gemeenschap*). The investors registered in the intermediary's books are jointly and *pro rata* entitled to so-called collective depots (*verzameldepots*). Such a collective depot, a separate pool, exists for each type of eligible securities. A collective depot includes the securities held in custody by the intermediary itself and the intermediary's holding of such securities through the Dutch central securities depository, Euroclear Netherlands, or through other intermediaries. Since the securities in a collective depot belong to the investors in joint ownership, the securities are not part of the assets of the intermediary. Consequently, creditors of the intermediary have no recourse against the securities, neither in nor outside the intermediary's insolvency.

Before 1 January 2011 an investor was protected under the WGE only if its investment (i) concerned securities admitted to the book-entry transfer system by Euroclear Netherlands and (ii) was held through an intermediary admitted to Euroclear Netherlands (*aangesloten instelling*). The amendments largely remove both restrictions:

- The category of eligible securities is broadened to most types of financial instruments within the meaning of the Financial Markets Supervision Act (*Wet op het financieel toezicht*, "**FMSA**"). These include transferable shares, bonds, convertibles, money-market instruments and units in collective investment undertakings. The legislator's initial proposal to extend investor protection to derivatives has been put on hold.
- Protection is expanded to investors that hold securities through investment firms and banks which are authorized to provide investment or banking services on the basis of the FMSA, subject to such investment firms or banks actually administering securities accounts for their clients in The Netherlands.

As a result, protection against intermediary risk has become available to investors (i) in non-admitted securities and (ii) in securities held by non-admitted intermediaries.

The amendments specifically aim at rendering special securities depositories (*effectenbewaarbedrijven*) and giro investment systems (*beleggersgiro's*) redundant. Banks and investment firms may therefore want to consider closing down their special securities depositories or giro investment systems. These entities, currently maintained

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by banks and investment firms to provide investor protection against intermediary risk, may have become redundant, at least partially, as a result of the extended scope of protection under the WGE.

Special securities depositories and giro investment systems are *as such* not brought within the protective scope of the WGE. The securities held by such special securities depositories will have to be transferred to the bank or investment firm in order to let their clients benefit from the increased protection. Such transfer will have both legal and practical implications. It may also have tax implications such as the payment of stamp duty. Account names will need to be changed and custody agreements will need to be amended or transferred. The transfer of securities may result in re-registration and other transfer considerations in the countries where the securities are presently held by securities depositories.

Custodian banks and investment firms will therefore need to consider if the advantages of bringing these securities within the scope of the WGE outweigh such transfer issues. First and foremost, however, will they need to verify which securities are eligible for protection under the WGE. This cannot be assumed for all securities currently held by their securities depositories. For instance, non-transferable and non-listed hedge fund shares fall outside the protective scope of the WGE.

Non-Dutch custodians (which are not authorised under the FMSA and do not administer client accounts in the Netherlands) which make use of Dutch sub-custodians for the holding of securities, will need to be aware that the additional protection now provided for by the WGE does not affect their clients. The amendments to the WGE do not fully eliminate the intermediary risk in such structures.

Custodians with branches outside of The Netherlands will need to be aware that securities accounts held with such branches will be outside the scope of the revised WGE. Securities administered in such accounts will therefore need to be held by a separate depository and cannot be held in the name of the custodian.

## Dematerialisation of securities

Another objective of the amendments is to achieve a larger degree of dematerialisation of securities held through intermediaries. Dematerialisation in this respect means the

elimination of physical documents representing securities. The legislator has chosen for a mandatory - yet limited - degree of dematerialisation through requiring and promoting the use of securities in global form.

Bearer securities in definitive form admitted to the book-entry transfer system by Euroclear Netherlands, such as K- and CF-certificates, must be converted either into registered securities or securities in global form by 1 January 2013. Bearer securities in definitive form that are not converted within this time frame can no longer be transferred by way of book-entry. An exception applies to foreign securities whose governing law does not allow such a conversion.

Intermediaries and Euroclear Netherlands have statutory powers to convert the bearer securities in definitive form they are holding, but only after consent of the issuing company. With regard to maintaining the transferability of these securities, issuing companies should monitor a timely conversion and permit a conversion by intermediaries or Euroclear Netherlands.

Furthermore, the physical delivery of securities (both in definitive and global form) held through intermediaries will be banned after a transition period of six months. This means that securities are in principle immobilised with the central securities depository or intermediaries. An exception applies in case securities are transferred to a foreign central securities depository or all issued securities of the same type are transferred to another (Dutch or foreign) intermediary. Delivery to an investor will only be permitted to the extent required for the investor to exercise its rights attached to the securities.

## Issuance of book-entry securities

The amendments to the WGE expressly facilitate the issuance of new securities directly into the book-entry system operated by Euroclear Netherlands. Issuers can now transfer newly issued securities directly to an intermediary or Euroclear Netherlands for inclusion in the book-entry system, without the need of an issuing agent. However, the assistance of issuing and paying agents may still be required for other aspects regarding the delivery of new securities into the book-entry system. ■

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