

NewsLetter No. 74 October 2007

New "hat" for Swiss securities



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The Swiss Federal Council has drafted the new Federal Law on Book-Entry Securities (*Bundesgesetz über Bucheffekten*) (BEG). The BEG creates a new, more readily transferable type of securities and conforms the transfer of Swiss securities to current international standards. The first debates of the Swiss Parliament on the draft BEG are scheduled for November 2007. Earliest entry into force is expected to occur in 2009.

Current system being out of date

Pertinent Swiss securities law mainly relies on the concept of a physical security, a paper certificate referred to in German as a *Wertpapier*. A *Wertpapier* is a certificate linked to a right which cannot be transferred or enforced without the physical transfer of the certificate. A variety of systems for simplifying the transfer of securities have evolved without act of law along with the increasing volume of traded securities. Securities such as bearer shares and bonds are either kept in global custody (*Sammelverwahrung*) or are represented by a global certificate (*Globalurkunde*). For registered shares, which have to be duly endorsed for their transfer, the printing of certificates is sometimes deferred (*aufgeschobener Titeldruck*) or even waived (*aufgehobener Titeldruck*). The latter have become so-called *Wertrechte*, i.e. rights not represented by a certificate but which serve the same function as physical securities. All of these techniques for enhancing transferability, however, are burdened with significant limitations: the transfer of *Wertrechte* legally requires written assignments, which are expensive and unsuitable for the large volume of *Wertrechte* which are now transferred. Other than the issuers of ordinary paper securities, the issuers of *Wertrechte* remain subject to a duty to verify the legal ownership of the *Wertrechte* before making payments in respect of them. Similarly, a good faith purchaser of *Wertrechte* does hardly ever have protection against the competing ownership claims of third parties. Although applicable Swiss property law provides for such protection with respect to securities kept in global custody or represented by global certificates, such protection is jeopardized by the fact that securities now are kept within cascades of custodies. Thus, it is hardly possible to firmly retrace the ownership in the securities which, however, would be required for an effective protection of a *bona fide* purchaser.

A new "hat" for traditional Swiss securities

In order to avoid such problems, the BEG recognises book-entry securities (*Bucheffekten*). They are defined as transferable claims or membership rights of a securities holder against the issuer recorded on the securities holder's securities account with a depository institution (*Verwahrstelle*). As customary, issuers either place paper securities in global custody or deliver global certificates to or register *Wertrechte* with a securities depository institution. These types of securities and rights will not be abolished but – that's the first novelty – will even be codified in the Swiss Code of Obligations. Thus, Swiss issuers may issue their securities or *Wertrechte* as hitherto but on a firm legal basis. They will not be obliged to transfer securities and rights into book-entry securities.

The second innovation of the BEG is that paper securities and rights can be credited to the holder's securities account with a depository institution, such as a Swiss or foreign bank, a securities dealer, fund manager or securities exchange, the Swiss National Bank or even the Swiss Post and the act of crediting such an account creates book-entry securities; when such securities are later delivered or printed for delivery they cease to exist. Metaphorically speaking, book-entry securities are created like putting a hat on ordinary paper securities and *Wertrechte*.

The transfer of book-entry securities

Under the BEG, a transfer of book-entry securities does not require a written assignment as required for a transfer of *Wertrechte*. The holder merely directs the depository institution to make the transfer and it then credits the book-entry securities to the recipient's account. The instruction of the holder of the securities to the depository institution becomes irrevocable, at the latest, when the book-entry securities are debited from the holder's account unless the

transfer instruction was unauthorised or fraudulent, featured an error or was not executed within the time frame which is applicable to the relevant transaction. This provision of the BEG will require an amendment of the Swiss Code of Obligations which deems a payment instruction given to an intermediary to be irrevocable in favour of the beneficiary when the instruction has been accepted by the intermediary, i.e. when the credit is made to the beneficiary's account.

Transfers of book-entry securities also may be used to deliver collateral for the benefit of a secured party. The holder directs the depository institution to transfer a specified quantity of book-entry securities to the secured party, who may hold the securities only as collateral. A transfer of book-entry securities also may be made to a secured party under an irrevocable written agreement between the securities holder and the depository institution which permits the secured party to sell or transfer the collateral securities without the consent of the securities holder.

Rights of security holders under prior law retained

The BEG does not replace ordinary securities kept in global custody, securities represented by a global note or certificate, or *Wertrechte*. The holders of securities in these forms keep the claim represented by such securities against their issuers, such as for the payment of dividends, the exercise of voting rights or the payment of interest and repayment of principal. These rights are not replaced by corresponding rights against the depository institution and thus are not subject to the BEG. Accordingly, account holders also may request the issue of ordinary paper securities if the articles of incorporation (in case of shares) or the terms of the debt issue (in case of bonds) permit it.

The depository institution's rights and duties with respect to book-entry securities

Just as banks must maintain required levels of equity capital to ensure they are able to satisfy the claims of depositors, a depository institution must maintain an inventory of book-entry securities, either directly or with another depository institution, which matches the book-entry securities it holds for its customers. If the depository institution fails to do this, it must purchase the necessary book-entry securities immediately.

The depository institution also may retain or sell customers' book-entry securities in order to collect amounts owed by the customer to the depository institution for the maintenance of the account or for

effecting securities transactions. It also may transact in book-entry securities which are held for a customer in its own name and for its own account, but only with the account holder's express written consent. This consent may not be included in the depository institution's general terms and conditions. Depository institutions' transactions effected with customer securities most likely will be securities lending or borrowing.

A glance at bankruptcy related issues

Book-entry securities can be subject to attachment and other measures against an account holder's assets. However, such measures may only be effected through the depository institution which keeps the account for the holder's book-entry securities, not at any other institution to which the account holder's book-entry securities may have been transferred later. If book-entry securities which are held as collateral may be sold to satisfy a debt, then the BEG expressly permits the so-called private sale of the relevant securities by the secured party and the secured party may purchase the collateral itself (*Selbsteintritt*), provided that such book-entry securities are traded at a representative stock market. The secured party may execute these rights even after the formal start of bankruptcy proceedings.

The ww&p NewsLetter provides comments on new developments and significant issues of Swiss law. These comments are not intended to provide legal advice. Before taking action or relying on the comments and the information given, addressees of this NewsLetter should seek specific advice on the matters which concern them.

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