

Meeting in Paris 19 December, 2000

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*Dematerialisation : Advantages and questions to be addressed*

A dematerialised system is a *simpler, cheaper and faster* system. It has proved *effective* in France and in other countries. It is a *modern* system which relies on modern technology. Dematerialisation is inevitable: it first transformed paper money into bank money. It is now transforming paper securities into book-entries.

On the other hand, it must be acknowledged that such a system depends on technology: if technology fails, the whole system can no longer work. Moreover, a dematerialised system depends on the integrity and efficiency of the persons with whom the accounts are held. As everything depends on book-entries, one must be sure that book-entries are correct. But this is also true of bank money. Furthermore, dematerialisation raises important legal questions that must be addressed.

*1° Advantages:*

- Very fast and easy trading of securities: no need to deliver physical certificates across long distances. Securities can be traded and given as a security with a simple book-entry
- Lower cost (no need to print certificates and to handle them)
- As a result, increased number of transactions

- No problem to determine whether it is the global bond, the certificates or the book-entry that can prove the entitlement: only the book-entry can prove the entitlement. The legal analysis is thus much simpler. The very difficult questions which were raised by the Maxwell case<sup>1</sup>, for example, would no longer exist. In this case, share certificates that did not belong to the pledgor were deposited in England as security for moneys lent to the pledgor. The shares were afterwards registered in the central depository system of New York in the names of the banks holding them as a security. In determining the question of priority between the claim of the plaintiff and that of the banks, it was necessary to know what law was applicable. The presence of physical certificates in one country and of book-entries in another country highly complicated the problem.  
This contrasts with the solution that prevails in a dematerialised system where securities are logically located where the account is located.

## 2° Problems to be addressed<sup>2</sup>

- In a dematerialised system, everything depends on book-entries. Therefore, one must be sure that book-entries are correct. Computer systems must be very efficient. The integrity and efficiency of the persons with whom the accounts are held must be ascertained.
- In a dematerialised system, it is easier to identify investors. That is a problem because investors often want to preserve their anonymity, for fiscal reasons in particular. One must be certain that dematerialisation does not deter investors from investing on European markets (knowing that in the U.S.A., it is possible to hold certificated securities anonymously).
- How is it possible to trade dematerialised securities on markets which do not know this form of securities (like Asian markets for example) ?
- A set of new rules must be prepared to deal with dematerialised securities: the rules governing tangible movables cannot apply to intangible movables (or choses in action).

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<sup>1</sup> Millett J., *Macmillan Inc. v. Bishopgate Trust plc. and others* [1995] 1 W.L.R. 978; *Macmillan Inc. v. Bishopgate Trust plc. and others, Court of Appeal (Civil Division)*, [1996] 1 W.L.R. 387

<sup>2</sup> For a comprehensive analysis of these problems in French law see Frédéric Nizard, *La notion de titre négociable, Thèse Paris II, juin 2000*, [www.droit21.com](http://www.droit21.com)

Therefore, the rules concerning : (i) the creation and perfection of a security over dematerialised securities must take into account the intangible nature of such securities. There can be no physical delivery nor possession of dematerialised securities. The perfection of a security over dematerialised securities can only occur by book-entry.

(ii) distraints of securities must take into account the fact that no physical certificate can be seized. The easiest way to proceed is to say that in order to seize dematerialised securities, creditors must contact the bank with which the account is held.

(iii) the protection of the *bona fide acquirer for value* must be adapted in countries which, like France, only protect the *bona fide acquirer for value who obtained **physical delivery** and therefore has physical possession*.

**The question is therefore to know whether book-entry can play the role of possession.** More precisely, what kind of book-entry can play the role of possession?