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The end of bearer securities and the end of unlimited liability of auditors

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Abstract

This short article assesses two new Belgian laws. The first law abolishes bearer securities. The transition period has different steps and will be finalised at the end of 2015. Not all transition problems have been resolved. It is unclear who will bear the costs for destroying the bearer shares.
The second law limits liability of auditors for legal audits and other assurance work and amends the professional secrecy rules. As in the former law, not all issues have been resolved. An audit term lasts three years. There is no indication how to deal with different damage claims.

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Report from Belgium
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1. The Law of 14 December 2005 concerning the abolishment of bearer securities

1. Introduction

1. One of the most rapidly evolving and booming topics in financial law the past few decades, has been securities legislation.

Especially since the 1980's legislators and practicians worldwide have been aiming at modernising the well functioning of securities markets. Dematerialised securities are becoming increasingly important, taking into account the decreased risks of theft or loss they entail; and the cost-effectiveness in transferring and depositing these securities. The awareness of the negative features entailed by the physical nature of bearer securities, such as fraud and financial criminality, encouraged this evolution even more.[1]

2. In light of this, the Belgian Law of 14 December 2005[2] aims at eliminating bearer securities, albeit through a phasing-out regime rather than a "big bang", hence promoting the issuance of dematerialised securities.
Up to this long awaited piece of legislation, Belgian company law allowed for securities[3] to be issued in bearer[4], registered[5] or dematerialised form[6]. Bearer securities have always been commonly used in Belgium, because of their easy transferability, and because of the anonymity conferred upon the owner[7].

2. The abolishment of bearer securities

3. The categories of securities falling within the scope of the aforementioned law, are threefold: the companies' securities, as specified in art. 460 of the Belgian Companies Code[8]; the debt securities issued by companies under public law, and finally a residual category, including all securities issued by a Belgian issuer, representing a claim against this issuer. Other types of commercial bills (such as bills of exchange, cheques, promissory notes, et al.) are explicitly excluded (art. 2).

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[1] The Financial working group against money laundering, rooted in the OECD has made 40 recommendations in this perspective; Explanatory Memorandum., *Parl. Preparations.* (51), Chamber of representatives, 1974/001, p.4-5.
[2] *Official Gazette,* 23 December 2005 (see www.staatsblad .be)*; Parl. P.* (51) Chamber, 1974/001.
[3] For a description of securities ("effecten"/ "valeurs mobilières"), see: J. VAN RYN & J. HEENEN, *Principes de droit commercial*, Brussel, Bruylant, t. III, nrs. 95.
[4] Bearer securities are securities which are issued as a physical document, which incorporates the rights attached to the security. He who holds the document is presumed to be the owner of the rights materialised into this document.
[5] L. FREDERICQ, *Traité de droit commercial belge*, t. IV, Gent, Rombaut, 1946, nr. 332-333. Ownership of registered securities appears from a register, held by the issuing company.
[6] Explanatory Memorandum, *Parl. P.* (51) Chamber, 1974/001, p. 11. Dematerialised securities are registered into a securities account held by a clearing institution / financial intermediary. The person in whose name the account upon which the securities are placed, is opened, is considered to be the owner. The clearing houses referred to are CIK- Euroclear or the NBB. The financial intermediaries allowed to open securities accounts with these clearing houses, are specifically designated by the law. See: Royal Decree nr. 62- footnote 9.
[7] This brought about several advantages concerning the applicable tax regime (in particular to avoid taxes levied on liberalities or heritages) and several civil law aspects (e.g. to deceive creditors seeking an attachment)
[8] E.g. [all types of] shares, bonds, certificates, e.g.

4. The first phase in the elimination process starts 1 January 2008.
From this day on, issuers under Belgian law will only be allowed to issue registered or dematerialised securities (art. 3).

Moreover, bearer securities, registered into a securities account at this date, and bearer securities, issued outside of Belgium or by a foreign issuer, cannot be delivered anymore from then onwards. Only individual or global securities fall outside the scope of this delivery prohibition if they are delivered with a view to be immobilised in a securities account (art. 4).
It is important to note that the prohibition to deliver physical securities is extended to bearer securities issued by a foreign issuer or a securities governed by foreign laws, although these securities were excluded from the scope of the law.

Certain securities, such as those issued by listed Belgian companies, which are already deposited into a securities account (which is possible in Belgium since 1968 due to the reknown Royal Decree nr. 62 of 10 November 1967[9]), will be converted ipso jure[10] into dematerialised securities from 1 January 2008. This implies that the bylaws of the companies involved will have to be adapted by 31 December 2007 (art. 5 en 6). The Belgian companies code requires the company's bylaws to state which form its securities will assume.

5. After 1 January 2008 , all holders of securities which have not been converted de jure, must request the conversion of their bearer securities, either to the issuer (if converting to registered securities) or to a designated account holder (if converting to dematerialised securities).
Depending on the time of issuance of the bearer securities, different transformation periods have been provided (art. 7 en 8). The first one, applicable to all holders of bearer securities issued before the announcement of this law, expires on 31 December 2013. The second term, intended for the holders of bearer securities issued after publication of this law in the Belgian Official Journal, terminates a year earlier , on 31 December 2012.

6. However, if the holder has neglected to request conversion within the assigned time frame, the securities will be transformed ipso jure into dematerialised securities, which will then be registered into an account in the name of the issuer of these securities. The issuer may also decide to convert the bearer securities into registered securities (art. 9).

Neither kind of conversion implies that the issuer acquires the property right to the securities. Moreover, every right incorporated into these securities (such as voting rights, or any other corporate actions) will be suspended until the true owner emerges and demands to be registered as the owner of the securities, provided he can deliver proof of his ownership (art. 10).

7. If the owner would remain unknown on 1 January 2015, the Law grants the issuer the right to sell the securities, albeit under certain conditions (art. 11).
The yields of this sale will be deposited with the "Deposit and Consignment Office"[11]. The securities which remain unsold on 30 November 2015, will also be placed with this Office.

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[9] R.D. nr. 62 of 10 November 1967 concerning the deposit of replaceable financial instruments and the settlement of transactions with these instruments, *O.G.* 23 February 2002.
[10] Any costs relating to this conversion may not be charged to the account holder.
[11] "Deposito- en Consignatiekas/ Caisse des dépôts et consignations" is an administrative organ, part of the Treasury of the Belgian Federal government, which is designated to deposit certain deposits of money or objects.

From this date on, the owner of the securities who claims his securities or their yields from the Deposit and Consignment Office will be subjected to an administrative fine.

3. Other significant changes brought about by the Law of 14 December 2005

8. The major part of the changes made to the Companies Code are mere adaptations to the abolishment of bearer securities. Most of these adjustments will enter into force on 1 January 2014. For instance, a legislative novelty is the possibility bestowed upon the general meeting of shareholders to decide upon installing an electronic shareholder's register for its registered shares. This will facilitate the transferability of registered shares, especially since it will no longer be possible to transfer registered securities using the simplified procedure of art. 1690 C.C. (the procedure concerning transfer of claims).

9. At the time of the introduction of dematerialised company securities in 1995 in Belgian company law, the Conseil d'Etat[12], and several scholars[13], pointed out the lack of protection for third parties, acquiring dematerialised securities in good faith. In cases of fraud or defaulted bank transfers, the bona fide purchaser would remain subject to vindication claims by the true owner.
This, of course, would impede the smooth functioning of the securities market, especially since securities transfers occur swiftly and instantaneously.
The law now explicitly grants such a protection by imposing articles 2279 and 2280 of the Civil Code to dematerialised (and immobilised) securities (art. 21 *resp.* 19). Both articles bestow a safeguard against any claims from the alleged owner upon the bona fide acquirer of these securities.

10. Unfortunately, the law is inflicted with various deficiencies. It is, for instance, not clear who will bear the costs of destroying the bearer securities when converted into dematerialised securities. Moreover, several other associated issues, such as the tax implications of dematerialised securities, or the adaptations of RD nr. 62 to the immobilisation of registered securities, have not been regulated [yet].

2. Limited Liability for Auditors

1. Introduction

11. Enron, Worldcom and other collapses like L&H in Belgium terrified the business community. Regulators all over the world issues new rules to restore confidence in the capital markets: Sarbanes-Oxley Act, the 8th Company law directive, the transparency directive to name but a few.
The Belgian legislator issued a new corporate governance act in 2002 which amended the relationship between the auditor and the audited company. First, it is forbidden to the auditor to offer a list of services to the audited entity. The list is similar to the list of services that need audit committee approval in the Sarbanes-Oxley Act: bookkeeping services, information

[12] Law of 7 April 1995, *O.G.* 18 May 1995**.**
[13] Cfr. M. TISON, "De uitgifte van gedematerialiseerde vennootschapseffecten – bemerkingen bij de wet van 7 april 1995", in X, *Het gewijzigd vennootschapsrecht 1995,* Antwerpen, Maklu, 1996, nrs. 33-35; J. TYTECA, "De dematerialisatie van aandelen en obligaties", in X, *De nieuwe vennootschapswetten van 7 en 13 april 1995,* Kalmthout, Biblo, 1995, p. 80-81.

technology services and the like. Next, the auditor cannot become an employee of the company for a period of two years after an audit term.

Recently, it started to be argued that regulators imposed suffocating burdens on companies and accountants. In particular, the Belgian Institute of Registered Auditors complained it could no longer buy insurance for its members. Insurance companies were no longer prepared to offer professional liability insurance to all the Institute's members.

2. Auditor's liability cap

12. The Belgian legislator responded to the criticism of exaggerated rulemaking. Parliament issued a new law to limit liability of auditors for legal audits and other assurance work. Accountants can be liable for audit and other services for an amount of maximum 3 million euro or 12 million euro in case the services are rendered for a listed company. In the explanatory memorandum it is argued that the amendment of the law was necessary due to:
- unlimited liability does not improve the quality of the audit work; an auditor cannot be responsible for the mistakes or fraudulent activities of the management and board ;
- the fear of a too high concentration of the audit industry;
- the number of insurance companies which offer services to the audit profession diminish
- the amount and different kinds of insured risks diminish whereas liability risks of auditors increas.

The arguments are far from convincing. It cannot l be expected that audit quality improves in the case that auditors only have limited liability. The only other factor at stake is reputation. Although of major importance, unlimited liability requires the auditors to deliver high quality services. Whether insurance is available is a derivative question which should not be used as an argument to limit liability. As far as we could discover, the number of registered auditors did not diminish dramatically.
An important argument is not mentioned. Unlimited liability creates an adverse selection problem. Auditors will no longer offer audit services to "high risk" companies.

13. The parliamentary memorandum argued that other countries, like Germany limited the civil liability of auditors. Section 323 of the German "Handelsgezetsbuch" limits liability claims *of the company or a related entity* to 1 or 4 million euro. The new Belgian rule limits the auditors' liability against any third party. It converted an important Belgian legal tort premise that everybody is (unlimited) liable for his mistake that causes damage to a third party.

14. The liability cap needed more careful consideration. Contrary to many other countries, a Belgian auditor is appointed for a fixed term of three years. The liability cap is valid for the period of three years as a legal audit service covers three successive audits. In case the auditor commits different mistakes in different audits within the same legal audit term, there are no rules how the different damage claims should be treated: first come, first served; all equal, apply proportionality.

15. An improvement in the Belgian legislation is the amendment of the professional secrecy rules. Belgian had an extremely strict regime. Any breach of the professional secrecy rules can be punished with criminal sanctions. This regime is also applicable in case the group auditor of the parent company needs assistance, information or additional help of the auditor of one or more of the subsidiaries of the group. The law is modified and allows the auditors to exchange information. A similar exception exists for successive auditors.

Financial Law Institute

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