

Luxembourg Modernises the Custody Chain to Accommodate Blockchain Technology

Article By:

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On 31 December 2024, the Luxembourg law of 20 December 2024 amending the existing legislative framework on dematerialised securities (Blockchain IV Act) entered into force. As background, dematerialization of securities occurs with the move from physical stock certificates to electronic bookkeeping. When this occurs, actual stock certificates are removed and retired from circulation in exchange for the electronic recording. Securities are then transferred between securities accounts by book transfer.

While Luxembourg's existing framework covered some preexisting technologies, the primary focus of the amendments made by the Blockchain IV Act is to integrate new technologies, particularly distributed ledger technology (DLT), into the financial sector to enhance legal security and operational efficiency.

The Blockchain IV Act introduces the concept of a "control agent", an entity that can manage the issuance of dematerialized securities using DLT, providing an alternative to the existing (traditional) model that relies on a central account keeper and a custody chain. The control agent's role includes maintaining the issuance account, monitoring the chain of custody of dematerialized securities (while the actual securities accounts can be held with different custodians without any custody relationship with the control agent), and ensuring the reconciliation of issued securities with those held in accounts with the relevant custodians. By contrast, the traditional central account keeper maintains the issuance account and sits at the top of the custody chain.

This new model is optional for issuers and aims to provide more flexibility, security, and transparency for both issuers and investors. The amendments also seek to strengthen Luxembourg's position as a leading financial centre in the European Union (EU) for the use of DLT in unlisted debt and equity securities issuances. Beginning in 2019, Luxembourg has made a series of changes to the existing legal framework, making available the use of DLT in connection with financial instruments and recognising financial instruments issued using DLT in a growing number of fields as equivalent to traditional financial instruments.

Any credit institution (such as a chartered bank) or investment firm established in Luxembourg or any other EU member state, as well as operators of a Luxembourg security settlement system are eligible to serve as a control agent. The Luxembourg financial sector supervisory authority has been tasked

with overseeing the compliance of control agents with the new legal requirements. Overall, the Blockchain IV Act aims to modernize the legal framework for securities in Luxembourg by leveraging DLT and other technological advancements, thereby enhancing the competitiveness and attractiveness of the financial sector while ensuring robust legal protections for market participants.

Tanner Wonnacott also contributed to this article.

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