

ADAN's contribution

European Commission's consultation on the review of the MiFID II/MiFIR regulatory framework

v.1

Paris, le 18 mai 2020

Introduction

ADAN is a 1901 non-profit organisation whose mission is to bring together and animate the digital assets industry in France and in Europe. With 30 corporate members, including Ark Ecosystem, Blockchain Partner, Coinhouse, Coinhouse Custody Services, ConsenSys France, iExec, Kaiko, Ledger, LGO Markets, Nomadic Labs and Woorton, ADAN is the most important French organization in the digital assets field.

ADAN is thankful to the European Commission for allowing the expression of industry players in this open consultation. The Association's objectives are to help create the more favourable environment in the EU for the development of a crypto-asset industry competitive with other regions of the world. The Association is available for any additional commentary or work related to digitalisation and crypto-assets.

References used in the ADAN's answer:

- ADAN's answer to the European Commission's consultation "on an EU framework for markets in crypto-assets":
<https://www.adan.eu/actualites/adan-publishes-its-answer-to-the-eu-consultation-on-crypto-assets>
- ADAN's paper "COVID19 and the financial industry's revolution":
<https://www.notion.so/adaneu/COVID19-et-transformation-de-l-industrie-financi-re-Note-de-l-ADAN-93a22dbf71f94057a0276dee5bcfedfa>
- "Security tokens & Digital Lab" survey launched by ADAN in cooperation with AFTI, AMAFI and Gide:
<https://bitcoin.fr/enquete-aupres-des-acteurs-impliques-dans-le-developpement-du-marche-de-s-security-tokens/>
- AMF's legal analysis on the application of financial regulations to security tokens:
<https://www.amf-france.org/en/news-publications/news/legal-analysis-application-financial-regulations-security-tokens-and-precisions-bulletin-board>

Contacts:

Simon Polrot, Président: simon.polrot@adan.eu

Faustine Fleuret, Head of Strategy and Institutional relations: faustine.fleuret@adan.eu

Website: www.adan.eu

Twitter: [@adan_asso](https://twitter.com/adan_asso)

Media Kit: <https://adan.link/presskit>

IX. Digitalisation and new technologies

Question 86. Where do you see the main developments in your sector: use of new technologies to provide or deliver services, emergence of new business models, more decentralised value chain services delivery involving more cooperation between traditional regulated entities and new entrants or other? Please explain your answer:

The blockchain and crypto-asset industry is laying the foundations for a new economic and financial paradigm

a) For years now, blockchain and crypto-assets have been building new opportunities for the financial and banking system. They can bring great benefits in the current functioning of financial markets and market infrastructures:

- **Digitalisation.** For assets which are not already digitalised (in France, all securities have had to be dematerialised since 1981), tokenisation can prompt generalization of paperless financial instruments then automation of many processes. This constitutes a good starting point to reduce operating errors due to manual processing, then the global costs of human errors, and to increase efficiency.
- **Automation.** The smooth functioning of financial markets is based on many record-keeping held by various parties. Automation through smart contracts would help manage them and guarantee continuous and right reconciliations among them.
- **Transparency and trustworthiness.** Smart contracts enable the automatic execution of operations when (and only when) all conditions are met, as they were initially encoded in the smart contract. All authorized parties can access the ledger to check which operations have been executed, and smart contracts to verify how they were programmed. This is a substantial confidence enhancer for all interested parties, from counterparties to transactions, business partners to regulators if they wish to use blockchain in their supervision missions.
- **Traceability.** Traceability of transactions is a very strong attribute of public blockchain-based use cases that can bring benefits to various transactions executed on blockchain at the stage of execution, but also and especially after the execution stage. It has already been proved extremely useful to audit blockchain-based application behaviours after bugs or exploitation, to monitor the evolution of a specific service, or to analyse major transaction flows that help better understand the structuring of blockchain-based use cases.
- **Liquidity.** Tokenisation can boost - or even create - liquidity for some intrinsically illiquid assets. This can cover shares that are not traded on secondary markets, venture capital and real estate industries.
- **Cyber-resilience.** Distributed ledgers are the “single version of the truth” kept in a decentralized way so no central point of failure can be identified in the context of cyber-attacks. This is a very substantial benefit for crucial activities that financial ones are, even more when they pose a systemic risk to financial stability.

b) The current crisis is emphasizing the need to speed up the digitalisation of economy in Europe, both within its institutions and private companies. Crypto-assets can accelerate such technological mutations and turn the economic and financial system more secure, more efficient in the allocation of

its resources and the services delivered to citizens, and more concerned regarding current societal and environmental challenges.

In April, ADAN published a paper describing - and illustrating with concrete proposals - how the crypto-asset industry can help the financial system overcome some challenges of the crisis in the short run, and how actors can the post-crisis digital innovation in the long run. Briefly summarizing:

- In the short term, innovative mechanisms based on crypto-assets can provide efficient answers for the financing of companies and people impacted by the crisis, either supplementing or replacing conventional financing.
- The COVID 19 crisis has highlighted existing market failures, that financial players could turn into opportunities to bring about substantial structural changes. That is why in the long term, the crypto-asset industry aims to be part of a sustainable turning point initiated by the economic and financial system. This new panorama can be described as below:
 - Supporting businesses that create value and jobs (in particular SMEs) is crucial to stimulate the EU post-crisis economy, that is why actors should rely on new funding opportunities.
 - A change in the current financial paradigm is in progress, around long-awaited developments (such as responsible and green finance) but also more radical innovations (decentralized or open finance)
 - Traditional financial players will develop new synergies with crypto-asset actors, in a win-win relationship, respectively: fostering innovation and efficiency in the financial and banking system (with the development of new uses and the optimization of current processes), and for supporting the growth of the crypto-asset industry.
 - The use of blockchain and crypto-assets will make it possible to revise or optimize some processes in order to overcome the identified limits and failures in financial markets.

Details about all the crypto-asset solutions proposed in response to the aforementioned short- and long-term challenges can be found in our "COVID19 and the financial industry's revolution" paper (in French for the moment, but translation in English is in progress) :

<https://www.notion.so/adaneu/COVID19-et-transformation-de-l-industrie-financi-re-Note-de-l-ADAN-93a22dbf71f94057a0276dee5bcfedfa>

Based on our observations and to spur the digitalisation of the financial and economic system thanks to blockchain and crypto-assets, ADAN released some recommendations:

- **Developing knowledge of crypto-assets and the EU ecosystem of crypto-assets at all levels of activity:**
 - Identifying the players in the crypto-asset industry: who they are, their activities, their professions, their regulatory status if so (e.g PSAN in France).
 - Understanding the concept, modalities and benefits of: tokenized money (cryptocurrencies and stablecoins), programmable crypto-assets, security tokens, decentralized finance.
 - Understanding the value of crypto-assets to meet customer needs in order to determine the services to be developed.
 - Understanding how crypto-asset transactions and custody work.
 - Developing useful partnerships and consortia.

- **Accelerating the technological updating with the financial and banking system:**
 - In collaboration with market players, developing an AML-CFT market and consumer protection risk analysis model for crypto-assets and deploy this model in compliance departments.
 - Developing the expertise of internal teams in creating crypto-assets and deploying smart contracts, or entering into partnerships with qualified technology providers.
 - Using a crypto-asset wallet, or developing an internal solution with qualified technology providers.
 - Creating the required platforms to implement new use cases (exchanges of crypto-assets, shared KYC, etc.).
 - Representing securities on-chain (“tokenization”).
 - Deploying an internal blockchain and carrying out a gradual transition of all asset representations used in banking and finance activities on this ledger.
 - Deploying all the services and functions (operational activities, audit, compliance, etc.) on this blockchain by using the advanced functionalities (programming, data analysis using artificial intelligence, etc.).

- **Upgrading the offer of financial players:**
 - Developing an internal offer linked to crypto-assets in one or more fields of activity of banks (deposit, investment advice, loans, etc.) or market institutions (exchanges, financial products ...).
 - Assisting clients (current and prospective) in the safeguarding of their crypto-assets.
 - Raising customers’ awareness about dematerialized identity and signature, and assisting them in setting up their digital identity and their electronic signature.
 - Informing customers about their rights and the technical procedures for exercising their rights on the blockchain platforms of developed services.

Question 87. Do you think there are particular elements in the existing framework which are not in accordance with the principle of technology neutrality and which should be addressed?
Please explain your answer:

The development of the crypto-asset industry is hampered by several regulatory stumbling blocks:

- The lack of legal qualification and classification of crypto-assets (see a) below).
- Required legal adjustments for crypto-assets that qualify under existing regulations, such as security tokens (see b) below).
- An EU regulatory regime for other crypto-assets that do not qualify under existing regulation (for more details, see the ADAN’s answer to the European Commission’s consultation on an EU framework for markets in crypto-assets: <https://www.adan.eu/actualites/adan-publishes-its-answer-to-the-eu-consultation-on-crypto-assets>).

This is very detrimental to the crypto-asset industry as, adding to the inherent difficulty encountered by innovation (in any form) to develop, such legal uncertainty prevents from a wide adoption of blockchain and crypto-assets. Therefore to a certain extent, **such regulatory obstacles are not in accordance with “technology neutrality” as they prompt market participants not to use blockchain and crypto-assets.**

To remove these barriers, **an EU regime for crypto-assets that brings the necessary clarifications for crypto-asset actors, while ensuring proportionality by adapting to their specificities**, is crucial.

a) Building an EU regime requires convergence on the foundations of this regime. Among them, **the first and most important one is the common understanding of the legal qualification of crypto-assets, among them security tokens.**

In line with our recommendations to the European Commission about an EU framework for markets in crypto-assets, crypto-assets that qualify as existing legal instruments should not be subject to another new qualification. In this view, security tokens should be understood as crypto-assets that enter into the list of “financial instruments” as given by MiFID 2, annex I section C, and for some comply with the current definition of “transferable securities” under article 4.1.15 of MiFID 2. *A contrario*, crypto-assets that would exhibit “investment-type” characteristics but not formally fit into these two legal concepts should not fall qualify as security tokens. To this end, a clear and homogeneous definition of “financial instruments” and the scope of assets that they cover is crucial across member States.

Crypto-assets that do qualify as existing legal instruments should be treated as new “cryptocurrencies” or “tokens”/“(programmable) crypto-assets”, and comply with the future regulatory regime applying to them, for which we recommend an unified regime. More details about the ADAN’s recommendations about such new regulatory regime can be found in our answer to the European Commission’s consultation on an EU framework for markets in crypto-assets.

b) If crypto-assets that qualify as existing legal instruments (such as financial instruments or transferable securities) should not be subject to another new qualification, then fall under current financial rules (among them the MiFID2/MiFIR regime), **legal adjustments are necessary to adapt these rules, either because they cannot prevail in crypto-asset markets or in order to make them simpler thanks to blockchain benefits.** Such adjustments should rely on the guarantees brought by the technological features of crypto-assets (in terms of efficiency, security, reliability, privacy, liquidity, etc). To that end, the guarantees brought by crypto-assets’ technological specificities must be carefully defined and/or listed.

To conduct such analysis, ADAN supports the French financial regulator’s approach to create a **“Digital Lab” at European level** allowing the national competent authorities to remove, in return for appropriate guarantees, certain requirements imposed by European regulations and identified as incompatible with the blockchain environment, provided that the entity benefiting from this exemption respects the key principles of the regulations and that it is subject to increased surveillance by the national competent authority of the reference Member State”:

<https://www.amf-france.org/en/news-publications/news/legal-analysis-application-financial-regulation-s-security-tokens-and-precisions-bulletin-board>.

In the short term, this would enable actors to get a greater clarity on the regulatory regime applying to them, this one being simpler and more proportionate. In the long run, regulators will get the necessary hindsight to adapt the current financial regulation to crypto-asset activities according to their specific opportunities and risks.

ADAN has already highlighted some frictions within the existing financial regulations:

- **The current list of investment services and activities established in MiFID II is not fully appropriate for security tokens.**

- One key problem is the structuration of secondary markets for security tokens. Not all exchanges can fit into one of the proposed services listed for operating a venue. Such is the case, firstly, of decentralized platforms. For all types of crypto-platforms, as participants are usually individuals, being qualified as regulated markets or multilateral trading facilities (MTF) or organised trading facilities (OTF) would create regulatory frictions considering the requirements that participants must be authorized entities.
- Moreover, reception and transmission of orders and execution of orders do not illustrate the current functioning of crypto-assets markets. There is currently no use of such services and defining a regulatory framework for these providers should not be a priority.

Therefore this appears essential to clarify the list of investment services and activities that are relevant in the context of security tokens, and perhaps adding new ones to better reflect the reality behind the functioning of security token markets.

- Today, individuals are granted direct access to crypto-exchanges and are not intermediated by another actor. This allows faster transactions and cost-reduction (especially regarding brokerage fees). When trading security tokens, **the opportunity to involve the same intermediaries as for traditional financial markets should be questioned regarding the additional guarantees in terms of security, liquidity, transparency, etc. brought by DLT.**
- As blockchain allows for atomicity of transactions, and therefore the realization in one computing operation of all the trades and the post-trade operations, **the regulatory separation of those two functions could alter the interest of interesting new business models.**

Question 88. Where do you think digitalisation and new technologies would bring most benefits in the trading lifecycle (ranging from the issuance to secondary trading)?

Please explain your answer:

As described above (see answer to question 86), DLT and smart contracts will significantly impact all the value chain of securities, from their issuance to the operation of trading venues and post-trade financial market infrastructures (CCPs, CSDs). This relies on the automation and integration of processes on blockchain, and gains in terms of transparency, reliability, liquidity and cyber-resilience.

However **permissionless blockchain and decentralized platforms allow for those specific benefits**, that do not exist in centralized / private blockchains :

- auditability and transparency of the operations ;
- probabilistic finality of the transactions, that cannot be altered after being executed ;
- composability of the services, allowing the use of multiple building blocks built by other companies to develop a new product or a new service using securities.

That is why **the EU legislation should provide for more regulatory flexibility for stakeholders to develop trading and post-trading solutions using for example permissionless blockchain and decentralised platforms.**

The “Digital Lab” at European level promoted by the AMF should allow creating a favourable environment for such solutions to develop and to prove their efficiency and safety.

Question 89. Do you consider that digitalisation and new technologies will significantly impact the role of EU trading venues in the future (5/10 years time)?

1 - Disagree

2 - Rather not agree

3 - Neutral

4 - Rather agree

5 - Fully agree

Don't know / no opinion / not relevant

Question 89.1 Please explain your answer to question 89:

Please refer to our answers to questions 86 and 88.

Question 90. Do you believe that certain product governance and distribution provisions of the MiFID II/MiFIR framework should be adapted to better suit digital and online offers of investment services and products?

1 - Disagree

2 - Rather not agree

3 - Neutral

4 - Rather agree

5 - Fully agree

Don't know / no opinion / not relevant

Question 90.1 Please explain your answer to question 90:

In any aspect of regulation, legal certainty is favourable for the economic development of an industry.

In order to determine the appropriateness of the whole financial regulatory package (including product governance and distribution provisions of the MiFID II/MiFIR framework) in the context of security tokens then the need for adapting current rules, **ADAN is currently consulting actors involved in the development of the security token market, thanks to “Security tokens & Digital Lab” survey** prepared and conducted in cooperation with two professional associations of the French financial markets (AFTI and AMAFI) and Gide : <https://bitcoin.fr/enquete-aupres-des-acteurs-impliques-dans-le-developpement-du-marche-des-securit-y-tokens/> (in French, an English version is in progress).

In line with the AMF’s “Digital Lab” idea, this initiative aims at providing French and European authorities with precise and concrete details on (i) projects involving security tokens being developed by the actors and (ii) the scope of required legal adjustments that the “Digital Lab” should cover. **ADAN thinks that only a clear understanding of these projects and the regulatory obstacles that project holders face will enable authorities to design a proportionate, accurate and efficient regulatory framework.**

Question 91. Do you believe that certain provisions on investment services (such as investment advice) should be adapted to better suit delivering of services through robo-advice or other digital technologies?

1 - Disagree

2 - Rather not agree

3 - Neutral

4 - Rather agree

5 - Fully agree

Don't know / no opinion / not relevant

Question 91.1 Please explain your answer to question 91:

In any aspect of regulation, legal certainty is favourable for the economic development of an industry.

In order to determine the appropriateness of the whole financial regulatory package (including provisions on investment services) in the context of security tokens then the need for adapting current rules, **ADAN is currently consulting actors involved in the development of the security token market, thanks to the "Security tokens & Digital Lab" survey** prepared and conducted in cooperation with two professional associations of the French financial markets (AFTI and AMAFI) and Gide : <https://bitcoin.fr/enquete-aupres-des-acteurs-impliques-dans-le-developpement-du-marche-des-securit-y-tokens/> (in French, an English version is in progress).

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