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The AMF publishes an in-depth legal analysis of the application of financial regulations to security tokens

Given the growing interest in the issuance of financial instruments on a blockchain, the Autorité des Marchés Financiers has examined the legal obstacles to the development of security tokens. The possible solutions that it has put forward include a European "digital lab" that would enable national authorities to waive certain regulatory requirements subject to appropriate guarantees.

In addition to Initial Coin Offerings (ICOs), which are public offers of tokens regulated by the PACTE law, actors of the blockchain ecosystem and traditional players have shown a keen interest in Security Token Offerings (STOs) and, more generally, the listing of financial instruments on the blockchain. The AMF considers that the "tokenisation" of financial assets could be a long-term trend in line with the automation of the post-trade chain.

The legal analysis by the AMF concerned both the issuance and trading of security tokens, as well as in the ability for investment funds to invest in them. With respect to issuance, the Prospectus Regulation seems compatible with STOs. In the asset management space, European and national regulations do not prevent the development of security tokens. Investment management companies that wish to develop this activity should apply for an authorisation from the AMF or update their programme of operations.

However, the trading of security tokens faces major legal obstacles due to the decentralised nature of blockchain technology.

Regulatory changes required to enable the tokenisation of the securities processing chain

Current financial regulations could be applied to security token trading without too much difficulty. Platforms could provide certain security token investment services (reception and transmission of orders on behalf of third parties, execution of orders on behalf of third parties) by applying for authorisation as an Investment Services Provider (ISP) or a Financial Investment Adviser (FIA), provided that they have an identified manager. This therefore excludes decentralised platforms.

To offer a genuine secondary market in security tokens and operate a trading venue within the meaning of MiFID II, they would need an authorisation to operate as a multilateral trading facility (MTF) or an organised trading facility (OTF). This therefore also rules out decentralised platforms.

However, the AMF has today published a position specifying the extent to which some security token interfaces that enable the display of buying and selling interests without matching orders would not need authorisation as trading venues within the meaning of MiFID II.

As regards delivery of securities versus payment (settlement-delivery), although the Blockchain Order of 8 December 2017 has already made this possible for unlisted securities, it poses major difficulties for the other security tokens. Current regulations (European Regulation on Central Securities Depositories (CSDR), Settlement Finality Directive, account-keeping and custody obligations) do not allow for full settlement-delivery on the blockchain. Consequently, a platform that lists security tokens should either go through an intermediary approved as a central depository or be itself approved as a central depository.

It therefore seems necessary to adapt the CSDR to allow settlement and delivery in cryptocurrency.

A European exemption system to create a secure environment

The possibilities proposed by the AMF include a proposal to create an exemption system at the European level, which might be described as a digital lab that would enable national competent authorities to waive, in return for the appropriate guarantees, certain requirements imposed by European regulations and identified as incompatible with the blockchain environment. This exemption would be granted on condition that the entity benefiting from it abides by the key regulatory principles and is subject to enhanced oversight.

Such a system would enable the emergence of security token market infrastructure projects that could develop in a secure legal environment. It would be subject to specific oversight at European level (ESMA).

This experimentation carried out within a “digital laboratory” would make it possible to envisage the necessary adjustments to European financial regulations at the end of a three-year review clause, drawing on the expertise acquired by national authorities and ESMA.

About the AMF

The AMF is an independent public authority responsible for ensuring that savings invested in financial products are protected and that investors are provided with adequate information. The AMF also supervises the orderly operations of markets. Visit our website <https://www.amf-france.org>

Read more

- Legal analysis on the application of financial regulations to security tokens and
✚ precisions on bulletin board
- Position DOC-2020-02 : Clarifications regarding the notion of trading venue,
✚ applicable in particular to financial instruments registered in a distributed ledger

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