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## **Discours de Robert Ophèle, président de l'AMF - 'Innovation and regulation: The french approach to cryptos' - 3rd Annual Fintech Conference - Bruxelles - 26 février 2019 (en anglais uniquement)**

Seul le prononcé fait foi

When Regulation meets innovation, the relationship can prove to be a tricky one. On the one hand, innovation is often stifled by regulation, whereas on the other hand, without appropriate regulation innovation generally paves the way for risky schemes and frauds, whilst destroying the confidence/trust needed to make such innovation a success.

Indeed, Regulation may well stifle innovation, either by straightforward prohibition or, more insidiously, by the imposition of administrative burden, via the setting of numerous safeguard requirements, that in turn tends to empty any business case. But let's not forget that regulation is also about customer protection and, when it comes to financial services, about financial stability, a key reason why the financial services domain is highly regulated.

In this respect, regulation could therefore quite rightly be viewed as a barrier to entry for new competitors; actually the last ten years have been characterized by both a flurry of new regulations and a major concentration of the financial services business, be it in banking, in asset management, or in post-trade market infrastructures. And inevitably, with a large and partly captive customer base, a complete knowledge of existing and sometimes pending regulations, the implicit support of supervisors for too-big to-fail institutions, it is almost impossible for new innovative entrants to seriously challenge the incumbents.



To some extent, the finance industry bears similarities with the pharmaceutical industry: on the one hand you have a few big incumbents, as a whole not very innovative, and on the other a number of innovative biotechs and medtechs busily developing new products, but open to acquisition by the big names as soon as they are reasonably successful. However, innovation in pharmaceuticals has the advantage of being strictly structured with the precise phasing of clinical trials, while the domain of finance is far less prone to provide room for experiments.

Actually, in the field of financial services, we have to solve together, a specific variety of the usual triangle of incompatibility; in this case to find a solution between innovation, profitability and regulation. It needs to be solved; so as to reduce the cost of financial intermediation and so as to remain profitable, finance needs to innovate to dramatically enhance services provided. It needs to be solved, because many innovations actually highlight the weaknesses of traditional finance: too expensive (transfer of funds, public offers of securities ...), too slow, too national, too prudent in the selection of projects to be financed, and lastly, from a cyber risk perspective, not that secure.

How to solve it? How should a regulation be designed so as to foster innovation and to instill trust, for all stake-holders: for those who intend to develop an innovative project, who intend to support it and for the customers/investors themselves. The EU has worked out a Fintech Action Plan and Roadmaps are being elaborated. I note that the Commission is about to report on best practices for regulatory sandboxes and that the Commission has also invited competent authorities at Member State and EU level to take initiatives to facilitate innovation based on identified best practices.

From this perspective, in France we have devised a bespoke and tailored framework for crypto-assets that are not financial instruments at the EU level; in fact an optional regulatory framework. Allow me to elaborate on this innovative approach.

The crypto-mania we saw in late 2017 and early 2018 seems to have faded away. The figures speak for themselves:

- On 8 January 2018, the combined market capitalization of crypto-assets peaked at an estimated \$830 billion, then fell to just under \$100 billion in mid-December 2018 before recovering to around \$110 billion on 30 January 2019;
- The value of Bitcoins, which has been divided by more than 5 in a year, has epitomized this collapse, and figures for ICOs tell a similar story: In Q3 2018, funds raised through

ICOs fell to just above \$2 billion, less than a third of the peak reached/posted in Q2 2018, and this decline continued into Q4 .

Yet, this considerable collapse should not necessarily be seen in a negative light, but rather as a natural stage of the innovation process as theorized by the Gartner hype cycle: a phase of overly inflated expectations is generally followed by a phase of disillusion.

Take the case of ICOs: many have tended to consider them as a sort of silver bullet - a quicker, cheaper, easier way to raise money while avoiding any dilution of the share capital of the company. Unfortunately, the truth is: silver bullets do not exist. According to the Gartner hype cycle, the trough of disillusionment is followed by slope of enlightenment and the plateau of productivity. And precisely, through our Unicorn program and in the many meetings with all types of stakeholders we have seen an evolution of the nature of projects from pure tech to a wider array of sectors; a professionalization trend with projects developed by issuers that have already had access to traditional methods of financing.

It is precisely our role as regulators to try to picture this middle ground, and to achieve this, we need to step back and try to grasp the structural trends that underlie the crypto-asset phenomenon. Such trends may be:

> First, the importance of DLT-type technologies: Blockchain popularity has been triggered by Bitcoin but since then we have witnessed extraordinary development of DLTs taking various forms, be they public, private, permissioned or permission-less, which propose a vast array of governance forms. Beyond proving how vibrant such ecosystem is from a pure R&D perspective, what stands out is the development of technologies based on network validation.

> Crypto-assets offer involves the possibility to transfer value in a secure way via internet. Such a possibility opens the way to boundless opportunities as practically everything may be tokenized and traded going forward.

> Other trends of the crypto-asset environment that may be worthy of note:

- The "platformisation" trend or the multiplication of platforms with an international investor base, and accessible 24/7.
- The automatization of processes, be it via smart contracts or RPA (robotic process automatization) techniques
- The willingness to lower the cost and increase the speed of financial transactions.

Such trends lead us to believe that behind the whole crypto-asset phenomenon there is a long-term structural trend that is likely to profoundly reshape the way our capital markets function. Such conviction led the French government to propose a comprehensive legal framework for crypto-assets that are not captured by any existing regulations. This framework is currently being finalized in the French parliament.

The decision to subject this environment to oversight was further motivated by the fact that this potential long-term structure does not come without risk. Some we are familiar with (risk of capital loss, risk that investors have access to inadequate information, financial crime risk, and so on), but some risks are rather new such as those linked with the use of the blockchain technology. As yet, we may not bring all the necessary responses to each and every one of these risks; however we are firmly convinced that today's total lack of regulatory framework can only exacerbate such risks.

The legislative and regulatory response that is now being finalized in France is based on the some high level principles:

> Same well known risks deserve same existing rules, but new risks merit an appropriate response: for this reason, the regime proposed as part of our PACTE law builds on the existing regulatory framework for securities and payments while introducing tailored safeguards to deal with the specific risks raised by the Blockchain environment.

> We should strive to bring a comprehensive response to the crypto-asset phenomenon rather than adopting a piecemeal approach. We therefore need to address simultaneously : money-laundering risks, investor protection issues, market abuse concerns, the need for appropriate accounting framework and for a consistent taxation regime ...

> An innovative environment requires an innovative regulatory approach: the regimes under consideration in France to a large extent offer a degree on optionality, with an optional AMF visa/approval for ICOs, and an optional Crypto Asset Service Provider license. We believe this approach is pertinent for several reasons:

- First, because today the crypto-asset environment is developing internationally to a large extent in a legal vacuum; in this regard, the optional regime shall be seen as the first regulatory step in response to the legal uncertainty this environment presents today and pending the adoption of an international regulatory stance.
- Second, even if optional, such a regime will bring better investor protection since the investor will have the possibility to resort to licensed entities. This marks a significant improvement when compared to the current situation. To some extent instead of relying mainly on black lists of dubious products and fraudulent intermediaries, we are leaning

in favor of white lists of labelled products and licensed intermediaries, providing investors with an incentive to turn their attention to these.

- Third, this environment is still very much nascent and we need to gain a deeper understanding of how it is structured. An overly prescriptive, perhaps ill-designed framework could unduly harm the development of innovation. An optional regime leaves the environment time to structure, just as it leaves the authorities time to build and strengthen our knowledge.
- Lastly, in the current environment it would be most challenging to effectively enforce a mandatory regime on a purely national basis since the territoriality criteria are obviously particularly hard to tie down in the current climate.

Allow me to share a couple of lessons learnt from our work on crypto-assets – now almost 2 years old :

> We collectively need to keep fighting against frauds carried out via Internet. In the wake of crypto-asset craze, we have witnessed a transfer of the frauds that yesterday involved CFDs and binary options or, more recently, diamonds to crypto-assets. We need to reflect upon further ways to fight against such frauds and raise investor awareness.

> Technology costs are high. And this goes for everyone, regulators included. With this in mind, sticking with a status-quo (i.e. having only a small fraction of these operations falling within our regulatory perimeter) would have certainly been easier to manage. The learning curve in the field of blockchain is relatively steep. New Questions keep cropping up every day, which forces us to adopt an agile approach and accept the fact that we will not have a response to every issue from the outset.

> Perhaps the most challenging issue lies in crypto-assets custody. Precisely an area that had little evolved over the past decade in the field of financial instruments. How to safekeep crypto-assets that are located on a blockchain? Where do the custodian legal responsibilities lie? What happens when there is a hard fork on a blockchain and the initial crypto-asset gets divided (into two separate ones)?

If the ecosystem around crypto-assets in general seems to have lost its shine, over the past few months a growing interest around the so-called security tokens has been hatching. To some extent, such a trend may be due to a new fad, comparable to the one that surrounded ICOs last year. Quite revealing in this regard is the fact that the notion of STOs has now replaced ICOs in press articles and conferences that are organized on this topic. This tends to show that we are entering a new phase of high expectations.

While security tokens, unlike currency tokens and utility tokens, are covered by security

regulation, one should review whether this regulation is indeed appropriate. The phenomenon of financial assets tokenization could bring benefits which could very well make it a long-term structural trend, profoundly transforming the financial industry, especially the post-trade industry.

ESMA highlighted some of these benefits in its advice on ICOs and crypto-assets published in early January. But it may also give rise to new types of risks, some of which are associated with the use of blockchain-type technologies, which require appropriate safeguards. In this regard, I welcome the conclusions of ESMA's analysis which called upon the European co-legislators to bring greater clarity as to the types of activities that may qualify as financial activities under EU regulatory framework in a DLT framework, as well as around the notion of settlement and settlement finality and to bring tailored responses to specific technological risks.

Obviously, European Level 1 measures, Regulations rather than Directives, are needed in order to address such issues.

Crypto-assets are only one aspect of innovation and should not be treated in isolation.

A complete overhaul of our regulatory framework to accommodate innovations is by no means desirable. We need to bear in mind that these frameworks were built in response to the risks that had materialized during the last financial crisis. In today's environment characterized by high macro-economic and financial risks, it would be hazardous to revamp the way our framework was designed.

On a different note, we need to listen attentively to the legitimate aspiration of traditional market players for more regulatory stability.

Nevertheless, we also believe that in the light of the swift pace of innovation, a regulatory status-quo might equally very well be prejudicial as in certain areas. This is all the more a problem since continental Europe is to some extent lagging behind in terms of financial innovation when compared to other parts of the world.

As rightly pointed out by Commissioner Julian King in a recent FT article , we need an EU-wide digital strategy. Although Commissioner King was particularly referring to 5G, AI, Cloud computing and the security concerns these technologies raise, the need to have a EU digital strategy spans a vast array of domains and this certainly holds true for capital markets, since our capital markets' transition to the digital era may reap significant collective benefits.

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