AUTORITÉ DES MARCHÉS FINANCIERS

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Discours de Robert Ophèle, Président de l'AMF - AFME European Compliance and Legal Forum : « Ai, Blockchain & Cryptoassets - Disruptive Technology shaping the future of regulation & compliance » - 3 octobre 2019 à Paris (en anglais uniquement)

Seul le prononcé fait foi

The idea that disruptive technologies, such as AI or DLT are about to profoundly reshape the financial industry has already been discussed for quite some time; and many have considered that such disruption was not realistic, only conceivable in the very distant future. The title of an FT article this week was “Blockchain: disillusionment descends on financial services”.

Nevertheless, when I see the reactions triggered by the announcement of the LIBRA project, it is very clear to me that the financial market community now takes these technologies most seriously, be they private intermediaries or public authorities.

I will not discuss the LIBRA project now, even if a French company Iliad is a member of the consortium. Let us wait for the clarification of some fundamental outlines of this project, in particular the rights carried by Libra holders, the investment rules, the modalities for generating income for the system and its associated financial equilibrium. These clarifications are indeed necessary to determine the legal qualification of the activity; it could be a bank, a payment institution, a money market fund... or another animal. It will also determine the

appropriate regulatory framework with regard to liquidity management, levels of capital, governance, management of conflicts of interest, etc... But the Libra project takes Blockchain applications to a new dimension and demonstrates that innovation should no longer be considered as a marginal subject, a matter for a few experienced computer scientists, but as a strategic issue, with the associated sovereignty and competitiveness dimensions.

I will therefore not discuss LIBRA but the necessity for Financial Authorities to rapidly adapt their regulatory stance to these possibly disruptive technologies in order both to suppress the regulatory barriers blocking their experimentation and to mitigate the new risks they triggered; in short, to facilitate their development in a secure regulatory framework.

In order to better understand the trends at work and the possible disruptions in the field of financial innovation, we have just carried out, at the AMF, a kind of “innovation diagnosis”. Instead of turning to the vast number of fintechs we regularly meet, we held meetings with around twenty French traditional players to discuss their innovation projects and how they see their business evolving in the coming years.

What stands out from this analysis is the following:

- The first driver for developing and deploying technological innovation is the dwindling profitability of financial intermediation. In Europe, market participants have to face the threefold challenge of supporting first significant cost increases, largely due to post-crisis regulatory changes, second the difficulty of generating profits in a low-interest and flat yield curve environment and third the competition of large US firms backed by the profitability of their domestic market. In this context, technological innovation is widely seen as a way to reduce costs while improving the quality of the service provided.

- It has led to profound transformations that affect all business lines under the remit of a financial market regulator.

> In the corporate finance area, debt is preferred to equity; IPOs are becoming less and less frequent and occur later in the life of companies, with companies preferring to use private financing for as long as possible. Industrializing private financing, organizing a secondary market for non-listed companies or turning to marketplaces allowing the trading of equity securities of companies before their initial public offering (take the model in the US of EquityZen) are trends questioning the fundamental distinction between listed companies and unlisted companies on which lies a large part of our entire regulatory frameworks.

> In the trading area, the landscape of market players has also changed considerably. Several investment banks have ceased trading activities. Others have responded by investing heavily in technology to automate their trading procedures, developing new algorithms based on a

more extensive use of AI. However, the most impressive innovation trend is in the post-trade area: to date, a large part of the technological investments no longer focuses on front-office activities but on the middle and back-office segments with the aim of simplifying procedures and reducing transaction times. The tokenization of assets by the use of DLT or other types of network technologies is a major trend covering crypto-assets and ultimately targeting all types of securities. This reflects a desire to increase the efficiency of post-trade infrastructures and opens the way to the possibility of exchanging an increasing number of goods and services in a near financial manner.

> In the asset management space, the trend towards polarisation between active management that is losing market share to passive strategies has continued, leading asset managers to invest in new technologies in order to remain competitive in a rapidly changing industry. These investment efforts focus mainly on the distribution segment and the development of customer relations. The emergence of the platform model is a trend that suggests the change in the role of market intermediaries (distributor and underwriter). In the retail investor universe, this trend is reflected in the development of robo-advice platforms or the emergence of "one stop shops" offering an investor access to a range of services providing a 360° vision of assets thanks to aggregation services, and offering the client the ability to choose between several types of investment: crowdfunding, money market funds, crypto-assets, socially responsible investment, equities, ETFs, loans, grants, etc. While few companies have yet emerged in this segment in France, those that have ventured into it have often moved from a B2C model to white label formats for traditional players. Actually, the "B2C" sector, where companies offer financial services directly to individual customers, is a difficult segment to address in France given our distribution model, which remains concentrated around large institutions.

These trends reflect a number of inefficiencies in our financial system: too costly for the clients despite being not sufficiently profitable for the financial institutions, too slow, too national in unachieved banking and capital markets union and, in some cases, too cautious in the way in which the projects to be financed are selected.

In this respect, it seems essential that our financial institutions address these issues. These elements call for several considerations on our part, as regulators:

- How can we support the transformation of the model of our institutions in order to adapt it to the new digital models?
- How to reconcile the challenge of protecting investors with the need to support innovation? In other words, should regulatory frameworks be adjusted to encourage the development of new practices?

- To what extent does the current regulation hinder the development of innovative projects in the field of financial services?

The transformations that the digital economy implies require us to think of new tools. In this respect, let me come back to one of the trends on which we have been working particularly hard in recent years, namely the phenomenon of tokenisation of assets, whether financial or not.

The development of crypto-assets is not a recent phenomenon and it is quite clear that it is not likley to disappear. The AMF took up this subject at an early stage. Its expertise accumulated through numerous exchanges with the crypto-asset community and through a large public consultation on ICOs in 2017 has led the government to propose new regulatory frameworks as part of the Pacte Law now in force.

Without going into the details of this new framework, I would like to make a few remarks:

- The first concerns the scope of these new regimes, which covers all crypto-assets that are not financial instruments, and is therefore an environment that has not yet been regulated, largely in a legal vacuum at the European and international level. This is therefore a significant improvement for investors who will be offered the possibility of using service providers approved by the AMF or of subscribing to an ICO vetted by the AMF.

- That is why we welcomed the partly optional nature of these regimes. This innovative approach is justified because of the cross-border nature of the crypto-active environment and the speed with which it evolves. An outright ban, or the desire to impose a framework, would have fostered the development of projects abroad that could nevertheless offer services to French investors via the Internet.

- I would like to point out, however, that although a large part of these regimes is optional, a robust anti-money laundering and anti-terrorist financing mechanism has been provided for with the transposition of the measures proposed by the fifth European AML/CFT directive .

- Finally, it is a comprehensive framework that covers both primary and secondary market aspects, and provides for robust investor protection.

The ICO regime is now operational, and we have started to receive some applications. The implementation of the Digital Asset Service Provider regime depends on the publication of a decree, expected in the coming days. At this stage, we have already received several expressions of interest from credible stakeholders.

This framework however only covers a small part of the financial perimeter, the one that is not yet regulated at the European level. The bulk of the possible DLT use cases lies in the field of securities. In recent months, we have noted real enthusiasm regarding the potential benefits of using DLT in the field of financial instruments. These benefits include the desire to reduce the costs, increase the efficiency of market infrastructures, reduce their risks and improve the liquidity of certain asset classes. Several projects are under development in France.

These projects raise a number of regulatory issues as the market infrastructure sector is subject to regulations developed at European level, which are the result of long decades of shaping the post-trade industry, and which are not adapted to the DLT environment. The development of industry projects in this field will depend on our ability to remove these obstacles and regulatory obstacles at European level.

If our prospectus regulation appears compatible with STOs, asset management regulations, trading, settlement and delivery regulations (in short MIFIR-MIFID, EMIR, CSDR and the Settlement Finality Directive) do not allow for tokenized listed securities and the use of DLT in the secondary market.

In fact, such projects are questioning the very structure of our regulatory frameworks and a number of fundamental concepts and distinctions on which lies our entire regulatory framework: currency vs. financial instrument, for example or non-listed vs listed securities.

Faced with these transformations, public authorities cannot avoid understanding these phenomena and must consider their role either as catalysts or as inhibitors.

We believe that it is important to remain vigilant and open-minded at the same time, as it is ultimately very difficult to determine precisely what the financial landscape of tomorrow will look like and how long this transition will take. The penetration of new technologies is not linear; the trends noted are certainly at an early stage but they can emerge and become widespread very quickly and it is important that France and the EU do not fall behind in these areas for reasons of inappropriate regulations or resistance from some established players.

This should lead us to reflect on our tools and frameworks, in order to make them more agile and able to support these developments while not sacrificing the protection of our investors and the security of our financial system. This discussion should happen at the European level since our regulatory framework for financial instruments and market transactions is European and I believe it is time to review these regulations. New regulatory tools should be designed to serve the dual purpose of (1) fostering the emergence of new players by lowering the cost of entry associated with heavy regulatory requirements, (2) encouraging existing European players to leverage on opportunities offered by innovation.

Each of these two objectives involves different tools:

- The emergence of start-ups can be promoted by introducing greater proportionality into our regulatory framework; the ESA review has strongly highlighted the need to introduce more proportionality in our Level 2 and Level 3 Rulebook; ESMA will implement it in its perimeter of responsibility.

- The ability of our large groups to innovate can be encouraged by creating “experimentation areas” on a European scale. These will introduce the possibility to lift certain requirements imposed by the European regulations and identified as incompatible, provided that the entity benefiting from this exemption complies with the key principles of the regulations and is subject to enhanced monitoring by the national competent authority of the reference Member State. This would require the establishment of a governance mechanism at European level so that national competent authorities can exchange and harmonise their practices.

Such a mechanism seems essential in the context of experiments related to the use of DLTs in the field of financial services. DLT offers the possibility of instant settlement and, in this respect, has the potential to significantly increase the efficiency of our market infrastructures and potentially reduce the fragmentation of European industry in this area. They should be encouraged. Beyond the purely regulatory aspect, the emergence of efficient DLT settlement infrastructures presupposes the existence at European level of an interbank settlement instrument compatible with this technology: actually an interbank stable settlement coin.

Facilitating the development of AI and DLT-based services should obviously be accompanied by an appropriate management of the implied risks.

We at the AMF are dedicated to facilitate the emergence of this regulatory European framework that will avoid stifling innovations but allow them to develop progressively, gradually, in a safe environment.

In order to allow a proper supervision of DLT-based services, it appears necessary to implement internationally recognized technical standards. One could consider such standards as an essential prerequisite for the use of the DLT on a larger scale. Work is ongoing in this regard at the level of the ISO standards committee; it is essential that Europe participate in the definition of these standards.

Beyond the blockchain, another strategic issue is related to the storage and the protection of data. The extensive use of data can bring significant benefits by streamlining procedures, making it possible to offer more personalised services to investors and, ultimately, by making our financial players more competitive from an international point of view. In order to serve

these objectives, a pooling of resources on certain subjects such as KYC/AML may be fruitful since the fragmentation of practices hinders the effectiveness of our financial institutions. The regulator can have a role in promoting the emergence of such market initiatives.

While from a strictly regulatory point of view, it seems premature to regulate strictly the use of AI or ML, which remain at early stages of development in EU, however, developments in this area will need to be closely monitored in order to contain the risks they may generate in terms of market integrity and investor protection. This monitoring will also focus on the transparency of the process – which data are used by which algorithm - and on the alignment of AI usage with the ethical standards and code of conduct of the institution.

The associated risks are exacerbated by the growing reliance on cloud computing, actually on cloud services provided by a limited number of third-party providers, largely non-European. In fact, the issue of data is a sovereignty issue that affects all economic sectors and cannot be solved by financial regulators alone. It deserves to be high on the European agenda.

I would like to thank Mrs Domitille Dessertine, Head of Fintech, Innovation and Competitiveness at the AMF, for her skillful contribution to this speech.

Thank you for your attention.

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