L'ASSOCIATION POUR LE DÉVELOPPEMENT DES ACTIFS NUMÉRIQUES

# ADAN's contribution

## *Consultation on a new digital finance strategy for Europe / FinTech action plan*

Paris, 26 june 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 35+ 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.

ADAN also contributed to the Paris EUROPLACE's answer.

**References used in the ADAN's answer**

Adan's contribution to the EC's consultation *on a EU framework for markets in crypto-assets*, March 2020:
https://www.adan.eu/actualites/adan-publishes-its-answer-to-the-eu-consultation-on-crypto-assets

Adan's contribution to the EC's consultation *on the review of the MiFIDII/MiFIR regulatory framework*, May 2020:
https://www.adan.eu/actualites/reponse-a-la-commission-europeenne-sur-la-revision-du-cadre-reglementaire-mifidii-mifir

Adan, *Survey for a regulation adapted to security tokens*, May 2020:
https://www.adan.eu/actualites/reglementation-adaptee-security-tokens

Adan, *COVID19 and the financial industry's revolution*, April 2020:
https://www.notion.so/adaneu/COVID19-et-transformation-de-l-industrie-financi-re-Note-de-l-ADAN-93a22dbf71f94057a0276dee5bcfedfa

The French financial market authority (AMF), *Review and analysis of the application of financial regulations to security tokens*, March 2020:
https://www.amf-france.org/sites/default/files/2020-03/legal-analysis-security-tokens-amf-en_1.pdf

## General questions

Question 1. What are the main obstacles to fully reap the opportunities of innovative technologies in the European financial sector?

**Adan's has identified three major stumbling blocks to let the European financial sector benefit from the opportunity of blockchain and crypto-assets:**

a) **Difficult relations between banks and new entrants**
b) **Legal uncertainty for crypto/blockchain actors due to the lack of an EU regime**
c) **Barriers from "GAFA" companies to promote crypto/blockchain innovations**

a) *Please refer to our answer to Q15.*

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

- (i) The lack of legal qualification and classification of crypto-assets.
- (ii) Required legal adjustments for crypto-assets that qualify under existing regulations, such as security tokens.
- (iii) A missing EU regulatory regime for other crypto-assets that do not qualify under existing regulation.

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 <u>not to</u> 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.

i) 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 qualify as security tokens. **Crypto-assets that do not qualify as existing legal instruments should be treated as new "cryptocurrencies" or "tokens"/"(programmable) crypto-assets"**. To this end, a clear and homogeneous definition of "financial instruments" and the scope of assets that they cover is crucial across member States.

ii) 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.

Adan has already highlighted some frictions within the existing financial regulations: *please refer to our answer to question 4*.

iii) **Crypto-assets that do not qualify as existing legal instruments ("cryptocurrencies" or "tokens"/"(programmable) crypto-assets"**) should 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: https://www.adan.eu/actualites/adan-publishes-its-answer-to-the-eu-consultation-on-crypto-assets.

Such crypto-assets, like stablecoins or central bank digital currencies (CBDCs), are one central pillar of new financial products and services developed on blockchain, called "decentralized finance" (DeFi).

**c) EU players in crypto-assets and blockchain face discriminatory barriers when they wish to launch marketing campaigns using the tools offered by the "GAFA" (Google, Amazon, Facebook and Apple).** As a reminder, these players are also payment service providers.

Indeed, to date, no French player has managed to use GAFA's "Ads" services. For instance, Google's policy regarding the promotion of activities on crypto-assets is very restrictive. Only promotional ads on two types of activity are allowed, namely :

- products and services for the extraction of cryptocurrencies, but under many conditions: the explicit consent of the customer has been collected, the provider is approved (which makes no sense in the current state of regulations which does not provide for such approval), and Google has certified the account of this provider.
- "Cryptocurrency exchange platforms", but only in the United States and Japan. It is therefore impossible for EU platforms to promote their services in the EU.

In addition, the following activities are explicitly refused, and cannot benefit from Google Ads' services: any promotion of offers to the public of crypto-assets (ICOs), any purchase/sale activity and exchange of crypto-assets outside the scope of the "cryptocurrency exchange platforms" defined above, crypto wallets, investment advice on crypto-assets, as well as other market information services such as the provision of trading signals or broker reviews.

Very concretely, such policy has a detrimental effect since legitimate actors cannot put forward their products and services where scammers can try to pay with the rules. For example, some entities pretend not to be crypto companies (either exchange or custodians) and will put forward websites that would not include any terms like "crypto" or "coins" on the landing page to get referenced. The follow up pages would include these terms. In that scenario, where the publisher is a scammer, this is even more concerning. Our members would be pleased to provide concrete examples of what they witness on a recurring basis. Exclusion of some actors is not justified (for example crypto wallets) or is outdated (for example exchanges as numerous countries have now set a licensing system beyond the US and Japan).

Question 2. What are the key advantages and challenges consumers are facing with the increasing digitalisation of the financial sector (please mention no more than 4)? For each of them, what if any are the initiatives that should be taken at EU level?

Over the past decade, blockchain has opened up promising prospects for financial services and payments :

**i) Programmable "money", such as stablecoins and central bank digital currencies (CBDCs)**

Both stablecoins and CBDCs are intended to be used as a medium of exchange to settle transactions, and differ from "cryptocurrencies" - such as bitcoin and ether - because they always display a stable value. Stablecoins are issued by private entities and aim at a parity with one (or a basket of) legal tender currency(ies): the best known are for example Tether's USDT and MakerDAO's DAI - already in circulation - and of course the Libra project carried by Facebook. CBDCs are a new form of scriptural money, issued by central banks on the blockchain: last March, the Banque de France launched a call for projects in order to launch its own experimentation.

The interest of programmable "money" differs according to its "wholesale" or "retail" scope. In the first case, it lies in the immediate finality of transactions settled by the stablecoin or the MDBC (where it can take up to two or three days via traditional payment systems). In the second case, these new payment methods allow peer-to-peer exchanges, accessible to a wider public (including under- or unbanked populations) and thus support financial inclusion.

It may be important to underline the enthusiast position of the International Monetary Fund (IMF) on these innovations, which even advocates a hybrid solution of "synthetic CBDC" issued by private entities and guaranteed by Central Bank reserves.

**ii) Crypto-assets payment networks such as Lightning Network (on Bitcoin) or Loopring, Raiden, Starkware, MatterLabs and Optimism (on Ethereum)**

These networks allow a much higher transaction throughput than the blockchain, and may eventually be used as alternatives to current networks such as Visa and MasterCard through the use of stablecoins and CBDCs.

These new payment services foster innovation and the development of new use cases, as the integration of cash leg processing on the blockchain significantly accelerates the automation of the entire value chain and stimulates the use of the services and assets deployed on the blockchain. Among such innovations, this promotes the growth of decentralized finance, or open finance (known as "DeFi").

**iii) Decentralized finance (DeFi) or Open finance**

Decentralized finance (DeFi) is a new financial system based on blockchain and crypto-assets that is developed in parallel with the existing financial system. It differs strongly from traditional financial system because it is natively digital, it is built and runs on open source and permissionless infrastructures - so everyone can use it and participate in its improvement.

DeFi allows for the emergence of new financing tools based on crypto-assets: exchanges, funds, savings, loans, derivatives, sustainable finance, predictive markets, portfolio management, etc. Those tools being open and interoperable by nature can easily be integrated with with each other (so-called "composability"), allowing to overcome the limits of the current financial system (unequal access, counterparty risks, opacity, etc.).

The DeFi field was born in 2018 and most of the existing products are still in development. As of today, there are still risks associated with their use but this is a fast-growing industry with approximately 1.5 billion USD of value (defipulse.com).

**iv) Interoperability between services**

Another innovation brought by blockchain lies in the possibility and freedom given to the actors to create technological bricks and/or to use those developed by other actors. This interoperability is consistent with the current trend to open up traditional players to new entrants and thus promote the advent of innovative services: this is notably the idea of "open banking" in the second Payment Services Directive (PSD 2).

# I. Ensuring a technology-neutral and innovation friendly EU financial services regulatory framework

Question 4. Do you consider the existing EU financial services regulatory framework to be technology neutral and innovation friendly? Yes, **No**, Don't know / no opinion / not relevant

**Technological neutrality**, meaning that regulations do not favor nor discourage the use of any technology, **is not achieved regarding crypto-assets**. To the contrary, the current state of regulations prompt market participants not to use blockchain and crypto-assets.

i) As security tokens qualify as financial instruments, they must comply with the relevant regulations; however, as described in our answer to question 1 some frictions arise between current rules and the reality of markets in security tokens that may prevent people from using them:

- **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.**
- **The development of security token exchanges allowing settlement and delivery entirely on the blockchain is impossible for financial instruments that are admitted to the operations of a Central Security Depositories (CSD).** This problem has been clearly identified by the AMF in their Review and analysis of the application of financial regulations to security tokens: https://www.amf-france.org/sites/default/files/2020-03/legal-analysis-security-tokens-amf-en_1.pdf

Therefore **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.

ii) In the universe of crypto-assets that do not fall under existing legal definition, missing an *ad hoc* appropriate and proportionate regulatory regime is a major source of legal uncertainty that discourages actors to investigate relevant use cases to improve financial services, like the issuance of stablecoins.

Question 6. In your opinion, is the use for financial services of the new technologies listed below limited due to obstacles stemming from the EU financial services regulatory framework or other EU level regulatory requirements that also apply to financial services providers? Please rate each proposal from 1 to 5:

| | **1 (irrelevant)** | **2** | **3** | **4** | **5 (fully relevant)** | **N/A** |
|---|---|---|---|---|---|---|
| Distributed Ledger Technology (except cryptoassets) | | | | | | |
| Cloud computing | | | | | | No position |
| Artificial Intelligence/Machine learning | | | | | | No position |
| Internet Of Things (IoT) | | | | | | No position |

| | | | | | | |
|---|---|---|---|---|---|---|
| Biometrics | | | | | | No position |
| Quantum computing | | | | | | No position |
| Other | | | | | | **Crypto-assets** |

If you see other technologies whose use would be limited in the financial services due to obstacles stemming from the EU financial services legislative framework, please specify and explain:

As described in our answers to questions 1 and 4, the growth of crypto-assets is severely hampered by legal uncertainty. For crypto-assets that do not qualify under existing regulations, this stems from the lack of an *ad hoc* EU regime for these new assets. For security tokens, this is due to the inappropriateness of some current requirements for financial instruments.

Question 6.1 Please explain your answer to question 6, specify the specific provisions and legislation you are referring to and indicate your views on how it should be addressed:

a) For crypto-assets that fall within the legal definition of financial instruments, a gradual regulatory approach in the areas of trading, post-trading and asset management concerning security tokens is the best one in order to determine necessary legal adjustments for security tokens based on guarantees brought by the technological features of DLT (in terms of efficiency, security, reliability, privacy, liquidity, etc) and adapt rules, either because they cannot prevail in security token markets or to make them simpler thanks to blockchain benefits.
To that end, the guarantees brought by crypto-assets' technological specificities must be carefully defined in order to lay the foundations of such legal adjustments.

**To conduct such analysis, Adan agrees with and supports the French financial regulator's approach to create a "digital laboratory at European level allowing the national competent authorities to remove, in return for appropriate guaranties, 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".** A short presentation is available here: https://drive.google.com/file/d/1M-7dVSXJIw13td2DDDzRqA42YeFTJ8EY/view

The Digital Lab should help **create a favourable environment for crypto/blockchain solutions to develop and to prove their efficiency and safety**. 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.

In order to provide 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 consulted 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://www.adan.eu/actualites/reglementation-adaptee-security-tokens

**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.**

b) For crypto-assets that do not fall within any existing legal definition, Adan advocates the following approach:

- to distinguish "cryptocurrencies" from all other forms of tokens (as they have a unique set of characteristics), and
- to establish a broad "(programmable) crypto-asset" or "tokens" class and to define a scalable regulatory framework in which very granular requirements would be (or not) applicable depending on:
    - the technological features of the crypto-asset: cryptocurrency or programmable asset,
    - its inherent characteristics: native or not, fungible or not, etc. (see b) above),
    - the activity/services operated on such crypto-assets,
    - their economic function(s),
    - a risk analysis of the combination of all these elements, that is comparing the risk profile of the actor with the guarantee that they provide regarding: financial stability, user protection, fair competition.

**"Crypto-assets" that do not qualify under existing legislation should then be analysed on a case-by-case basis and a bottom up logic. This should be the function of a new regulatory or self-regulatory body dedicated to crypto-asset markets.**

Question 7. Building on your experience, what are the best ways (regulatory and non-regulatory measures) for the EU to support the uptake of nascent technologies and business models relying on them while also mitigating the risks they may pose? Please rate each proposal from 1 to 5:

| | **1 (irrelevant)** | **2** | **3** | **4** | **5 (fully relevant)** | **N/A** |
|---|---|---|---|---|---|---|
| Setting up dedicated observatories to monitor technological and market trends (e.g. EU Blockchain Observatory & Forum; Platform Observatory) | | | | | | |

| | | | | | | |
|---|---|---|---|---|---|---|
| Funding experimentation on certain applications of new technologies in finance (e.g blockchain use cases) | | | | | | |
| Promoting supervisory innovation hubs and sandboxes | | | | | | **For security tokens, the AMF’s idea of a Digital Lab** |
| Supporting industry codes of conduct on certain applications of new technologies in finance | | | | | | **For example, Adan is currently building one on to AML/CFT for the crypto industry** |
| Enhancing legal clarity through guidance at EU level for specific technologies and/or use cases | | | | | | |
| Creating bespoke EU regimes adapted to nascent markets, possibly on a temporary basis | | | | | | **Or on a permanent basis, such as for crypto-assets that do not** |

| | | | | | | |
|---|---|---|---|---|---|---|
| | | | | | | **qualify as existing legal instruments.** |
| Other | | | | | | |

Please specify what are the other ways the EU could support the uptake of nascent technologies and business models relying on them while also mitigating the risks they may pose:

As explained in our answer to question 15, **the main obstacle to the development of the crypto/blockchain sector is the difficult relations between the latter and banking institutions.**

- From a regulatory point of view, **an effective non-discriminatory access to banking services for crypto-asset actors is crucial** and should be guaranteed in the coming European framework (when they comply with all underlying requirements).
- From a "fair competition" point of view, the situation should be analysed by competent authorities to determine whether such deadlocks should qualify as restrictive practices attributable to the banking sector.

**The development of the crypto/blockchain sector in the EU also requires sustained investment** in the form of major application projects on an industrial scale, like the USA and China has already engaged.

Question 9. Do you see specific financial services areas where the principle of "same activity creating the same risks should be regulated in the same way" is not respected?

**For crypto-assets that do not qualify as existing instruments, applying the whole AML/CFT package designed for banks and financial institutions would be inefficient because crypto-asset activities do not bear the same level of ML/FT risks**, - as it has been recognised by the French Treasury - (a) **and do not materialize through the same practices** (b).

a) In their "National Analysis of Money Laundering and Terrorist Financing Risks in France" published in September 2019, the French Treasury attributes a "moderate level of risk" (on a scale of "low" to "high") to crypto-assets. They make the following observations:

- The illicit use of crypto-assets for M/FT purposes is not a preferred option by criminals. Indeed, some factors - such as the specific knowledge and technical expertise required to use them, as well as their volatility - deter them from using these assets. For this reason, very few cases where crypto-assets were used for illicit purposes have been reported.
- "Crypto-crypto" activities are less exposed to BC-FT threats than "crypto-fiat" activities, as they do not imply the re-injection of funds into traditional economic channels.
- In many scenarios, the information stored on and off chain allow for the identification of customers and the monitoring of transactions.

Moreover, the conclusions of a public consultation led by Adan on the crypto-crypto activities carried out from France corroborate this analysis. Please refer to this report: https://uploads-ssl.webflow.com/5dfaa2b2c716435b9b9c4a1f/5e8209bf1fde7d949cfa79b8_ADAN-Ra pport-Activite%CC%81s-entre-actifs-nume%CC%81riques-re%CC%81alise%CC%81es-depuis-la-France.pdf

Adan is currently drafting a dedicated paper to explain why the financial AML/CFT requirements are not suitable for the crypto-asset industry and how they could be adjusted to better apply to this specific ecosystem.

b) **The risk estimation is largely ill-estimated as far as crypto-assets are concerned**. The main reason why is that the same matrix used for money is being applied, assuming that the only and main purpose of crypto-assets is payment means. This is a wrong assumption. Crypto-assets represent a new asset class on their own that will continue to shape up in the future.

At the same time, crypto-assets are entering in collision with some aspects of existing financial activities. The risks of disruption are very real. Those activities being regulated, unfortunately the trend is to apply the same regulations to disruptive technologies. But this often makes no sense. For instance, how to apply existing rules to decentralised exchanges? While crypto-assets do need regulation, applying existing regulations to them is the best way to:

- **Overestimate the risks of crypto-assets.** For example, many financial reports are inducing a very high level of illegal activities on crypto-assets because they are not respecting traditional financial activities rules on tracking the funds, which makes no sense for "crypto-crypto" actors that do not deal with legal money.
- **Increase illegal activities on crypto-assets**. While people and companies will reduce their activities on crypto-assets, outlaw people - that do not want anyways to respect laws - will use the crypto-assets quite freely because the regulator will be looking somewhere else.
- **Leave the necessary parts unregulated**.
- At the very end, **prevent innovation**.

That is why our main recommendations are:

- **Focus the regulator on the deep analysis of how illegal activities are technically leveraging crypto-assets to perform transfer of funds.** Numerous companies and tools are now available that have been successfully used by different policies (FBI, CIA, OCRGDF from the French Ministry of Interior, etc.) in the world. This can be done through a task force that will gather and be on the vanguard in terms of technical knowledge.
- Through best practices, **iterate on the best ways to counter illegal activities by detecting the use of crypto-assets.**
- When best practices are consensually agreed as efficient, **transpose them into the regulations via regular updates of the EU directives on the AML/CFT**.

Adan is currently writing a set of best practices that are technologically compatible with the crypto-asset class that would serve as a base to upgrade the regulations in a meaningful and efficient way.

## II. Removing fragmentation in the single market for digital financial services

Question 15. According to you, and in addition to the issues addressed in questions 16 to 25 below, do you see other obstacles to a Single Market for digital financial services and how should they be addressed?

**The main obstacle to the development of the crypto/blockchain sector is the difficult relations between the latter and banking institutions.**

This issue is not novel, and has its origin in the advent of blockchain technology: in France, this starts with the creation of the first crypto-asset exchange platform in 2011 (Paymium). From the very beginning, this company had difficult relations with banks and has seen several bank accounts closed in France. Since then, all French actors have encountered the same obstacles to establishing and developing their business.

These deadlocks between the established players in the banking system and the new entrants is seen at different levels:

- At the level of the company operating an activity related to crypto-assets and blockchain. When a company wishes to open a bank account with an institution, words like "blockchain", "cryptocurrencies" or even "crypto-assets" in the applicant's name or corporate purpose are systematically prohibitive for their interlocutor who then refuses to open an account (both payment and escrow). At this stage, in order to overcome this obstacle, the French crypto/blockchain players have to turn to non-French banks or find convoluted formulations in the company's activity. Once the account has been opened, the slightest transaction that leads the bank to suspect that the company is buying, selling or acting as an intermediary in the purchase or sale of crypto-assets leads to a warning or closure of the bank account without prior notice. This makes it all the more difficult for businesses to find another bank, often within a very short period of time and with all the suspicions that a previous closure would place a burden on the business at the start of the new banking relationship.

In practice, this leads to a situation where more than 90% of the players in the French crypto-asset sector do not have a bank account opened with a French bank, or a very limited account through which they refrain from transiting the bulk of their business flows (which then pass through an account established with a foreign bank). This causes many practical problems: difficulty for customers to make payments or transfers to foreign banks, impossibility to enter foreign IBANs in the French administration's departments, suspicions when entering into relations with partners, etc.

This situation was also extremely damaging during the COVID19 crisis. Indeed, State-guaranteed loans were *de facto* inaccessible for these "unbanked" entities. A survey carried out by Adan last April showed that only 26% of the requests for such loans made by crypto/blockchain entities were processed by banking institutions (this does not mean that they were accepted, but that actors received a response from their bank)[1].

[1] Adan, *The state of the crypto/blockchain industry during the COVID-19 crisis,* June 2020 : https://www.adan.eu/publications/letat-de-lindustrie-crypto-blockchain-pendant-la-crise-du-covid-19

In addition, and for similar reasons, crypto/blockchain companies are faced with the refusal of financial players when they wish to access their payment services. In France, this is particularly damaging for exchange platforms: under the French banking supervisor's position, they must be authorized as a Payment Service Provider ("PSP") or act as an agent of an existing PSP. In the current situation, they turn to foreign PSPs, which are often costly and with the practical difficulties already mentioned.

- At the customer level. Users of the crypto/blockchain products and services are also affected by the tensions encountered with the banking sector, and are partially or entirely prevented from using them. For example, when a client wishes to transfer funds to a crypto-asset exchange platform, it very regularly happens that his bank simply blocks the payment or asks the customer to sign a release whose content intends to discourage the operation by providing partial information, exaggerating the risks encountered. Conversely, when he receives funds from a platform, the account to which they are credited is often closed by the bank, as of the first transaction and without giving the client the opportunity to transmit any information relating to the origin of these funds.

Last but not least, some crypto/blockchain entrepreneurs were closed the personal accounts of the entire household!

Thus, both in the normal conduct of their business and in a context of economic crisis, the banking sector's opposition in principle to the emergence of new crypto/blockchain players is jeopardizing this young and therefore fragile ecosystem, which must rely on established players to prosper. From Adan's discussion with associations from other Member States, the whole EU crypto/blockchain ecosystem faces a similar situation.

Question 20. In your opinion (and where applicable, based on your experience), what is the main benefit of a supervisor implementing (a) an innovation hub or (b) a regulatory sandbox as defined above?

**Adan agrees with and supports the French financial regulator's approach to create a "digital laboratory at European level allowing the national competent authorities to remove, in return for appropriate guaranties, 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".** A short presentation is available here: https://drive.google.com/file/d/1M-7dVSXJIw13td2DDDzRqA42YeFTJ8EY/view

The Digital Lab should help **creating a favourable environment for crypto/blockchain solutions to develop and to prove their efficiency and safety**. 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**.

In order to provide 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 consulted 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://www.adan.eu/actualites/reglementation-adaptee-security-tokens

**Preliminary results show that more than 93 % of respondents are in favour of implementing such Digital Lab**.

Question 21. In your opinion, how could the relevant EU authorities enhance coordination among different schemes in the EU? Please rate each proposal from 1 to 5:

| | 1 (irrelevant) | 2 | 3 | 4 | 5 (fully relevant) | N/A |
|---|---|---|---|---|---|---|
| Promote convergence among national authorities in setting up innovation hubs and sandboxes, through additional best practices or guidelines | | | | | | **Like the AMF's proposal for a Digital Lab for security tokens.** |
| Facilitate the possibility for firms to test new products and activities for marketing in several Member States ("cross border testing") | | | | | | |
| Raise awareness among industry stakeholders | | | | | | |
| Ensure closer coordination with authorities beyond the financial sector (e.g. data and consumer protection authorities) | | | | | | |

| | | | | | | |
|---|---|---|---|---|---|---|
| Promote the establishment of innovation hubs or sandboxes with a specific focus (e.g. a specific technology like Blockchain or a specific purpose like sustainable finance) | | | | | | **Like the AMF's proposal for a Digital Lab for security tokens.** |
| Other | | | | | | **Better explore the "28th regime" option** |

Please specify how else could the relevant EU authorities enhance coordination among different schemes in the EU:

**Regarding the missing EU regime for crypto-assets that do not qualify as existing legal instruments, an alternative could be the creation of a "28th regime" at the EU level**. Recital 14[2] of the Rome 1 Regulation allows for designing an "optional instrument" (or "28th regime") that would be a second regime "providing parties with an option between two regimes of domestic contract law"[3]. According to article 3 of the Rome 1 Regulation, parties can choose the law by which their contract shall be governed. In this scenario, national regimes when there are could co-exist with an EU crypto-asset regime.

Question 21.1 If necessary, please explain your reasoning and also provide examples for each case you would find relevant:

**Designing such "28th regime" in the more proportionate and innovation friendly way would foster its adoption by actors within the European Union then favour regulatory convergence and coordination among regulators, especially at a time when most jurisdictions do not have a national regime.** This 28th regime would either inspire NCAs to implement the same one (or very similar), or make them recommend the adoption of the 28th regime to their national ecosystem.

[2] "Should the Community adopt, in an appropriate legal instrument, rules of substantive contract law, including standard terms and conditions, such instrument may provide that the parties may choose to apply those rules."

[3] Opinion of the European Economic and Social Committee on "The 28th regime — an alternative allowing less lawmaking at Community level" (own-initiative opinion): https://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ%3AC%3A2011%3A021%3A0026%3A0032%3AEN%3APDF

Question 22. In the EU, regulated financial services providers can scale up across the Single Market thanks to adequate licenses and passporting rights. Do you see the need to extend the existing EU licenses passporting rights to further areas (e.g. lending) in order to support the uptake of digital finance in the EU?

In the perspective of new financial services allowed by the emergence of blockchain and crypto-assets (decentralised finance), existing licenses and passporting rights should be extended to them. These new activities should be defined in the perspective of adjusting financial regulations to security tokens, for which we recommend the creation of a EU Digital Lab.

In the perspective of the new regime for crypto-assets in the EU, licenses and passporting rights should be possible for all new services on crypto-assets.

Question 23. In your opinion, are EU level initiatives needed to avoid fragmentation in the Single Market caused by diverging national measures on ensuring non-discriminatory access to relevant technical infrastructures supporting financial services?

To ensure access to banking and payment services provided by traditional actors and requested by new ones, an effective non-discriminatory right to benefit from banking services is crucial and should be guaranteed in the coming European framework (when they comply with all underlying requirements).

Regarding the situation described in our answer to question 15, competent authorities should analyse whether current deadlocks between banking actors and crypto/blockchain entities are deemed to be restrictive practices.

Question 24. In your opinion, what should be done at EU level to achieve improved financial education and literacy in the digital context?

| | **1 (irrelevant)** | **2** | **3** | **4** | **5 (fully relevant)** | **N/A** |
|---|---|---|---|---|---|---|
| Ensure more affordable access at EU level to financial data for consumers and retail investors | | | | | | |
| Encourage supervisors to set up hubs focussed on guiding consumers in the digital world | | | | | | |

| | | | | | | |
|---|---|---|---|---|---|---|
| Organise pan-European campaigns and advisory hubs focusing on digitalisation to raise awareness among consumers | | | | | | |
| Collect best practices | | | | | | |
| Promote digital financial services to address financial inclusion | | | | | | |
| Introduce rules related to financial education comparable to Article 6 of the Mortgage Credit Directive, with a stronger focus on digitalisation, in other EU financial regulation proposals | | | | | | |
| Other | | | | | | |

Question 25. If you consider that initiatives aiming to enhance financial education and literacy are insufficient to protect consumers in the digital context, which additional measures would you recommend?

**Financial and "Fintech" education should start with the education of financial players. Therefore, making consumers benefit from technological innovation while guaranteeing their protection implies that the traditional financial system better understand such technologies.**

**Regarding the specific crypto/blockchain area, this requires that incumbent actors develop their 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.

**This also means that the financial and banking system should accelerate their technological updating:**

- 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.).

**Finally, this should prompt financial players to upgrade their offer:**

- 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.

# IV. Broader issues

Question 46. How could the financial sector in the EU contribute to funding the digital transition in the EU? Are there any specific barriers preventing the sector from providing such funding? Are there specific measures that should then be taken at EU level in this respect?

The current crisis is emphasizing the need to speed up the digitalisation of the 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[4]. **Therefore, the financial sector in the EU could accelerate the digital**

[4] In April, ADAN published its "COVID19 and the financial industry's revolution" paper describing - and illustrating with concrete proposals - how the crypto-asset industry can help the financial system

**transition in the EU by promoting the development of crypto-assets (financing, partnerships, coordinated projects, etc.).**

In this perspective, *as described in our answer to question 25*, some prerequisites are crucial to foster the adoption of crypto-assets by the traditional financial industry:

- **Developing knowledge of crypto-assets and the EU ecosystem of crypto-assets at all levels of activity** by:
    - 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** by:
    - 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** by:
    - 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 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.

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overcome some challenges of the crisis in the short run, and how actors can the post-crisis digital innovation in the long run : https://www.notion.so/adaneu/COVID19-et-transformation-de-l-industrie-financi-re-Note-de-l-ADAN-93a22dbf71f94057a0276dee5bcfedfa

- Informing customers about their rights and the technical procedures for exercising their rights on the blockchain platforms of developed services.

However, some structural barriers prevent optimistic perspectives.

- **Crypto-assets companies are still unable to open bank accounts and benefit from payment services offered by traditional actors** (see our answer to question 15). That is why we do hope that aforementioned first steps will help improve relations between the traditional banking and financial sector and the crypto/blockchain players thanks to a better understanding of the latters' real risks, needs and constraints. But from a regulatory point of view, **an effective non-discriminatory access to banking services for crypto-asset actors is crucial** and should be guaranteed in the coming European framework (when they comply with all underlying requirements). Indeed while the French regime for digital asset service providers aspire to tackle this issue, banks are still reluctant to enter into business relationships with actors even when they are registered with the French financial regulator (that is, even when their AML-CFT arrangements were checked and found compliant a priori) .
- **The development of competitive solutions in the EU also requires sustained investment** in the form of major application projects on an industrial scale, like the USA and China has already engaged.

Question 47. Are there specific measures needed at EU level to ensure that the digital transformation of the European financial sector is environmentally sustainable?

The asymmetry between impact and social responsibility (CSR) is abyssal in finance. This is not out of sheer cynicism but also because it is an industry that was not designed to carry this responsibility. Finance is going to have to reinvent itself to adapt to new social and ecological challenges. **Crypto-assets are at the centre of all attention and the recent enthusiasm of central banks for stable corners is just one of many indicators of this. The emergence of programmable money offers an incredible opportunity to better capture value and allocate it to finance environmental issues.** The emerging digital asset industry has all the characteristics to embody this paradigm shift and to take the leadership of responsible finance : a DNA free from the dogmas, a new industry free to incorporate virtuous practices, a technology that creates transparency, and IT protocols (smart contract) likely to become tools to serve this ambition.

The EU needs to give this industry better recognition and better access to financial infrastructures to encourage its development.

# Additional information

Should you wish to provide additional information (e.g. a position paper, report) or raise specific points not covered by the questionnaire, you can upload your additional document(s) here:

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 promote 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

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