

July 2020

SECURITY TOKENS

TOWARDS A SUITABLE EUROPEAN REGULATORY FRAMEWORK

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SURVEY PRESENTATION AND CONTEXT

The [European Commission's consultation on the crypto-asset market](#), which closed in March 2020, opened the regulatory process at the European level, leading to a **reform project anticipated for the end of 2020**. Proposals by the European Commission represent opportunities for a new specific regime dedicated to currently unregulated crypto-assets activities and a **chance to adapt existing financial legislation for businesses covered by the rules in force**. This project is of particular importance as the current health crisis has highlighted the need to accelerate financial services digitalization, of which crypto-assets are an undeniable component.

France was early to position itself in the European regulatory landscape with the PACTE law and the Virtual Asset Service Provider regime (PSAN). The [recent publication by the AMF](#) (French Financial Market Authority) specifying provisions applicable to activities related to "security tokens," as well as their proposal for a **European Digital Laboratory (Digital Lab)**, confirms the desire to remain a pioneering and benchmark jurisdiction in the area of crypto-assets. A summary of this proposal is available in the annex to this report.

It is in the context of European-level discussions, and in line with the AMF's proposal, that Adan, AFTI, AMAFI and the Gide255 team lead a [consultation](#) for security token ecosystem stakeholders. This consultation ended on 15 June 2020.

This initiative aims to feed into regulatory work in progress by providing precise and accurate information about (i) security token projects and startups currently being developed, and (ii) the scope for a European digital laboratory. Only a detailed understanding of these projects will enable the competent authorities to make informed decisions on the future of applicable regulations.

At the close of the consultation, 81 responses had been collected, of which 42 directly concerned a project related to security tokens.

REPORT

SUMMARY

Security token projects are lead by players in the “crypto/blockchain” sector as well as long-standing banking and financial sector players.

There is unanimity in recognizing that these projects present vast opportunities, as evidenced by the maturity of initiatives presented and the resources – sometimes substantial – mobilized for their implementation.

Legally qualifying security tokens is a delicate exercise for market players.

While many assimilate their tokens to financial instruments within existing regulations (shares, bonds, fund units, or financial contracts), they acknowledge difficulties encountered in doing so.

The security token market is seeing significant growth and development – from initial offerings to the establishment of secondary market exchanges and a wide range of “peripheral services.” These include marketing, conservation, portfolio management, investment advisory, and advisory to project holders.

Security token initial offerings (STO) are the most represented activity, closely followed by the creation of secondary markets for these tokens.

While the responses collected indicate that security tokens trading can take various forms, most players describe their infrastructures as “trading platforms” within the definition of MiFID 2. As a result, these players must become or use a central securities depository (CSD), a situation where most significant regulatory frictions have already been identified.

Market participants express difficulties in identifying laws applicable to their activities. This explains the **interest in a European Digital Laboratory promoted by the AMF**. As such, regulatory obstacles to the advent of security tokens mainly concern two areas. The first relates to trading of these assets on regulated or organized markets. The second relates to settlement-delivery of tokens admitted to the operations of a central securities depository.

A vast majority of respondents in favor of a European Digital Laboratory also favored the issuance of a digital asset facilitating the settlement of blockchain transactions, sometimes referred to as an “on-chain euro”. Such a need is consistent with the current regulatory barriers to post-trade activities related to security tokens.

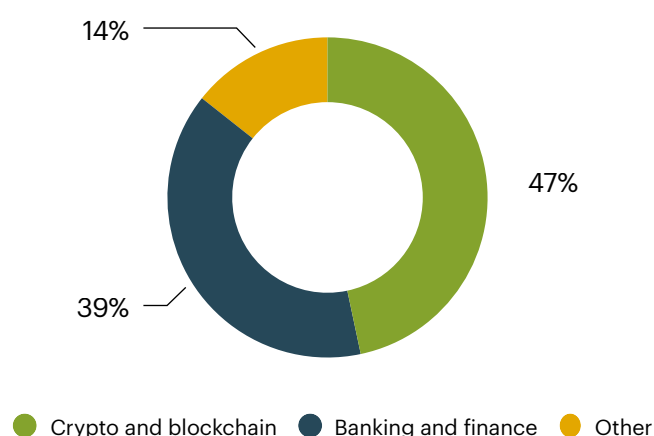
Finally, the survey reveals that the impact of COVID-19 on the development of security tokens remains challenging to measure. While most players have difficulty estimating it, others remain divided. In any event, the current economic situation reinforces the need to encourage players to pursue their projects and stimulate innovation, in terms of financial services digitization, and the broader digitalization of the economy at the end of the crisis.

RESPONDENT PROFILES

This survey's first objective was to determine how security token market actors could benefit from the experimentation program planned as part of the European Digital Laboratory project.

The vast majority of respondents define their tokenized financial instruments within the framework of current regulations, even though 36% indicate challenges in doing so.

**RESPONDENT PROFILE
BY SECTOR**

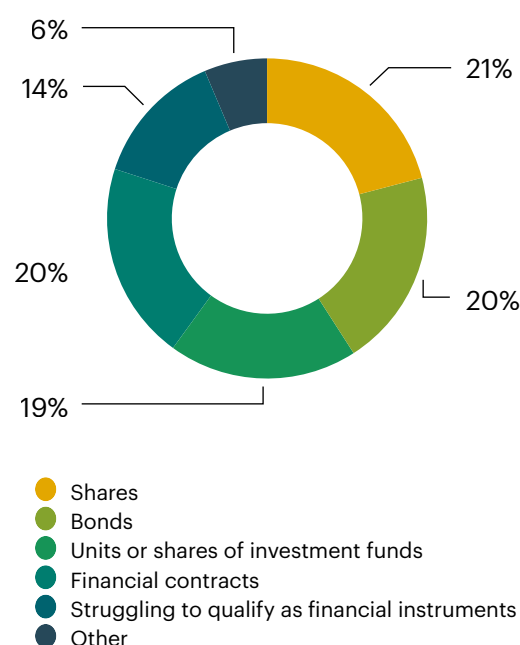


Security tokens are understood as assets registered on a blockchain and have the same legal characteristics as financial instruments (shares, bonds, units, or shares of investment funds, financial contracts).

Forty-two stakeholders were identified—their responses were used in the preparation of this report.

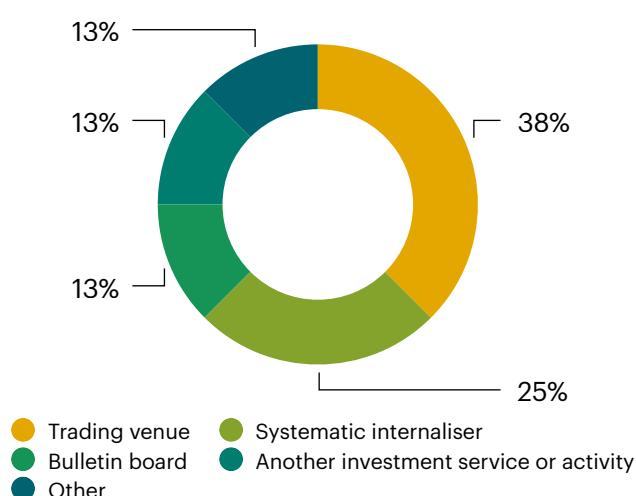
Unsurprisingly, the vast majority (57%) of the stakeholders undertaking a project or activity related to security tokens are startups in the digital asset and “crypto/blockchain” industry. However, the incumbent institutional players in the banking and financial sector also represent a substantial share of players exploring the opportunities of security tokens – they represent a third of respondents. Finally, 9.5% of respondents are companies outside banking and finance, mostly law firms.

**LEGAL QUALIFICATION OF
SECURITY TOKENS BY RESPONDENT**



Their projects and activities cover a wide range of financial instruments: equities (55%), bonds and financial contracts (52% respectively), and units or shares of investment funds (half of the participants). Nearly 17% of respondents qualify their tokens under each of these concepts. Indeed, most projects and activities cover several financial instruments categories.

CLASSIFICATION OF EXCHANGES OPERATED BY RESPONDENT



One out of 6 respondents indicates a qualification other than those proposed in the questionnaire, including valuable market units, pre-paid tradable credits, convertible units (giving as examples grams of CO2 and the CSR index), and pre-paid volumes.

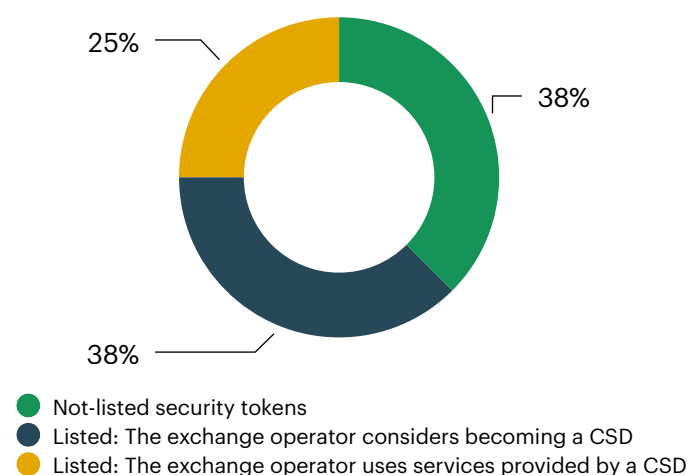
Finally, some players offer a solution that is agnostic to the qualification of their customers' crypto-asset (for example, non-custodial conservation solutions). Thus, the token's legal qualification (security tokens, cryptocurrencies, utility tokens, stablecoins) has no impact on the service offered.

Security tokens activities are heterogeneous in nature.

- ▶ Security token issuance is the most represented activity, with more than 26% of participants. The amounts reported by respondents range from €10,000 to €100M.
- ▶ Platform management for coordinating security token exchanges is in second place, with 19% of respondents.
- ▶ 37.5% qualified their platform as a "trading platform" within the definition of MiFID 2 regulations (regulated market, MTF or OTF); one-quarter, as a systematic internalizer; 12.5%, as a bulletin board; 12.5%, as another investment service (RTO, order execution); and, finally, 12.5% failed to qualify their service.

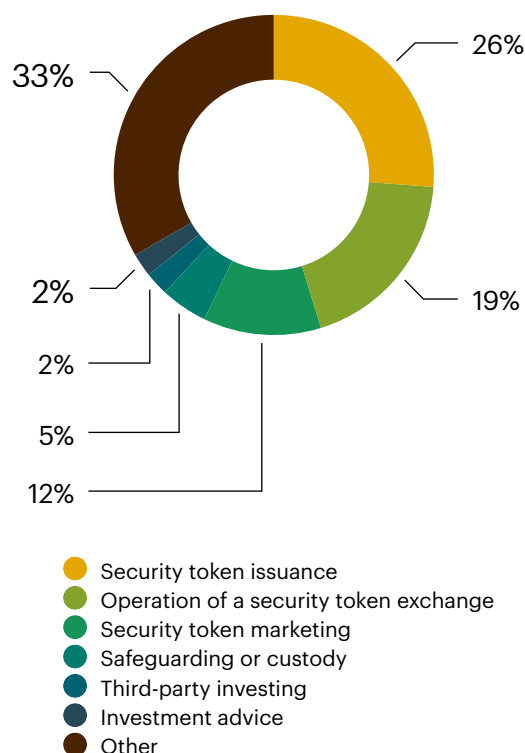
Of the players engaged in security token exchange activities 60% indicate that they want to become a central securities depository (CSD), while 40% use an existing CSD.

CLASSIFICATION OF SECURITY TOKENS TRADED ON RESPONDENTS' EXCHANGES



Stakeholders indicate that, at this stage, average annual trading volumes are difficult to estimate or confidential.

MAIN BUSINESS RELATED TO SECURITY TOKENS BY RESPONDENT



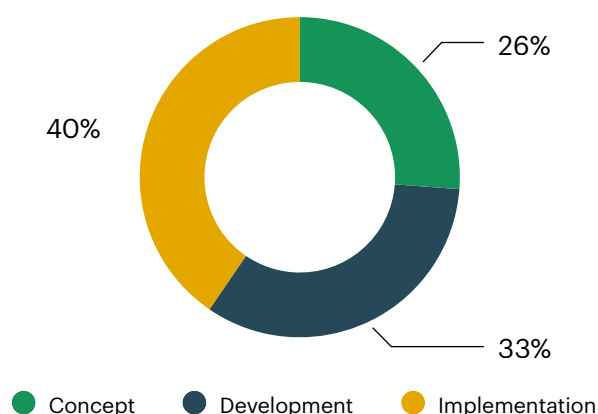
- ▶ 12% of players claim to market security tokens. They did not provide amounts.
- ▶ Security tokens custody concerns almost 5% of the players, who estimate that their projects could take on several billion euros of assets under custody.
- ▶ Investment on behalf of third parties and investment advisory (to a mixed clientele of professionals and non-professionals) each account for slightly more than 2% of project sponsors. Respondents did not report amounts of assets under management.

Finally, a third of respondents participate in miscellaneous activities:

- ▶ security tokens consulting (legal, regulatory, tax, structuring or project support);
- ▶ holding security token positions;
- ▶ providing security token market data pricing;
- ▶ lending with a security token collateral;
- ▶ providing blockchain infrastructure enabling the issuance and exchange of these tokens.

Some respondents invoked the confidentiality of their projects.

DEVELOPMENT STATE OF PROJECTS BY RESPONDENT



Projects are often at an advanced stage of maturity and no longer boil down to proofs of concept alone. Nearly 40% are in production, 33% are in development, and 28% are at the concept stage alone. The teams mobilized on these projects (project managers, developers, salespeople, etc.) reach up to 140 people.

SECURITY TOKEN PROJECT EXAMPLES

Equisafe is a digital tokenization and investment platform with a strong history in real estate. In June 2019, the platform carried out the first real estate sale via the blockchain in Europe (AnnA operation). Since May 2020, it has been working with Koytcha Immo – a property manager and administrator of unlisted properties – to ensure the bookkeeping and governance management through its solution based on blockchain technology, with a triple objective of security, the fluidity of exchange and traceability of its real estate investments.

G&T Equity is a company specialized in dematerialized register management thanks to blockchain technology. The solution aims to make shareholding in unlisted companies liquid and accessible to all. Thanks to security tokens and transfer documents dematerialization, transfer of ownership and settlement-delivery are carried out on the platform. Investors can manage their securities accounts and position themselves as buyers or sellers of registered companies that digitized their shares.

Kaiko's project is to collect market data for each STO listed on the trading platforms. By collecting these transactions, Kaiko will be able to provide greater transparency and understanding of the financial exchanges in the Blockchain and STO ecosystem. Kaiko intends to begin this development in 2021 and expand its existing catalog of digital asset market data.

In partnership with Consensys, **Mata Capital** has developed a bookkeeping (registry-keeping) tool for Real Estate Alternative Investment Funds aimed at professional investors. The real estate assets held by these FIAs (SPPPICAV, SLP, and SAS) currently represent a value of 330 million euros.

OFI is a production user of the IZNES solution, the result of the collaboration of a community of more than twenty management companies. IZNES is an international platform for subscriptions and redemptions of European UCI units, compatible with the various distribution channels. Thanks to blockchain technology, the IZNES platform enables direct contact between investors and management companies, placing orders for UCI units and their registration in the register in real-time. In production for more than two years, the platform has already carried out more than 10 billion euros of transactions and has just received a European Investment Company approval.

Société Générale - FORGE is an innovative service provider dedicated to the structuration, the custody and the exchange of financial instruments and digital assets based on blockchain technology. Two transactions have been realized recently by Société Générale group in coordination with Société Générale - FORGE: a first tokenized bond issuance by Société Générale SFH, a subsidiary of Société Générale, of €100 million on a public blockchain on 18 April 2019, and a second issuance on 14 May 2020 by Société Générale SFH of €40 million of covered bonds, issued as « security tokens » and directly registered on a public blockchain. For this second transaction, the tokens, which have been rated Aaa by Moody's and AAA by Fitch, were fully subscribed by Société Générale which simultaneously paid the issuer in a digital form of euros issued by Banque de France through a blockchain platform.

Tokeny Solutions allows financial actors operating in private markets to compliantly issue, transfer, and manage securities using blockchain technology. Issuers can utilise the fintech's secure solutions to apply control and compliance on a high functioning infrastructure, allowing them to streamline the capital raising process and offer digitally transferable assets to their investors.

We fundia est une plateforme de « crowdlending B2B » dédiée aux prêts inter-entreprises, où les entreprises se prêtent entre-elles au sein de leur filière. Elle est fondée sur la tokenisation des titres de créances (obligations, minibons, ...) émis par celles-ci. We fundia a ainsi développé Re fundia, une solution technologique permettant l'échange en gré à gré des créances entre les financeurs primaires et secondaires. Un tableau d'affichage (bulletin board) facilite l'achat/vente en gré à gré des créances tokenisées, permettant aux entreprises financeuses de recouvrer de la liquidité en cas de besoin.

STAKEHOLDER EXPECTATIONS REGARDING THE AMF'S "DIGITAL LAB" PROPOSAL

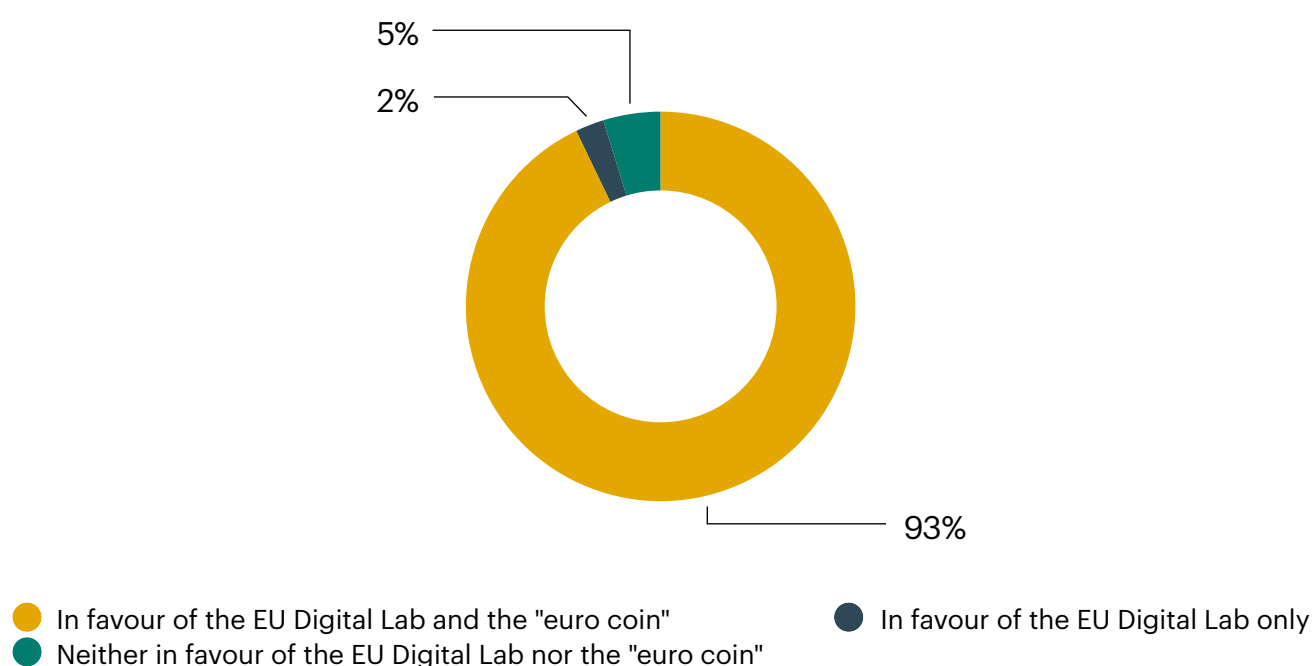
The second aim of this investigation was to understand the appetite for the AMF's European Digital Laboratory. This mechanism would provide guaranteed exemptions from specific regulatory requirements when deemed to hinder the development of their projects.

The investigation revealed a broad consensus in favor of the AMF's proposal to create a Digital Lab. It also underlined the need for an asset facilitating the settlement of transactions on the blockchain, such as an on-chain euro, probably in the form of a stablecoin or central bank digital currency (CBDC).

Nearly 93% of the survey participants expressed they would benefit from a Digital Lab. The small remainder expresses their thoughts on the subject, or – surprisingly – judge that there is sufficient regulation of tokenized assets.

Slightly more than 90% of players believe that the issuance of a legal settlement asset on the blockchain (in the form of a digitized currency settled on a blockchain) would be one way to circumvent certain regulatory requirements. For the few respondents who do not share this view, an "on-chain euro" is not considered necessary; one respondent underlines the sufficient existence of electronic money.

RESPONDENT'S EXPECTATIONS REGARDING THE EU DIGITAL LAB AND THE "EURO COIN"

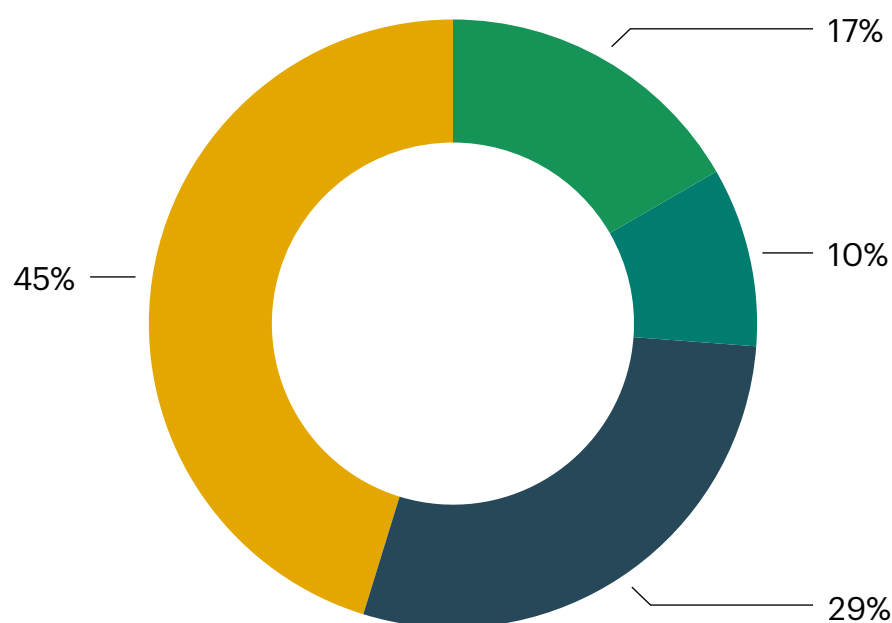


IMPACT OF COVID-19 ON SECURITY TOKEN PROJECTS

Launched in the context of an unprecedented health and economic situation, this survey has sought to identify the impact on the security token markets.

The vast majority of respondents (more than 45%) were unable to estimate the consequences of the COVID19 crisis on their project or activity. For more than 28%, the crisis had no impact. Conversely, nearly 17% report that their project/activity on security tokens has benefited from this extraordinary situation, compared to 9.5% who feel they have suffered from it.

RESPONDENTS' SITUATION IN THE COVID19 CRISIS



- My project or activity related to security tokens (in whole or in part) has increased
- My project or activity related to security tokens (in whole or in part) has decreased
- My project or activity related to security tokens has not been impacted by the crisis
- I am unable to assess the impact of the crisis on my project or activity related to security tokens.

CONCLUSIONS AND RECOMMANDATIONS

Responses to the survey make it possible to:

- ▶ **Illustrate the interest of players** - new entrants or already established - in security tokens;
- ▶ **Testify to the promising prospects** offered by these assets;
- ▶ **Underline the need to support these new projects**, in particular by facilitating their regulatory compliance through the setting up of experimentation mechanisms.

The creation of a European Digital Laboratory would address these points. It would enable projects to evolve in an appropriate regulatory environment while guaranteeing **the necessary legal security**, particularly for users and investors. The findings of this study make it possible to draw several recommendations for establishing a **useful, effective, and proportionate Digital Lab**.

- ▶ The profile of respondents highlighted a strong interest in the digital asset and blockchain industry. For this reason, the **Digital Lab must be open to any player**, without any *sine qua none* regulatory status, but according to *ad hoc* conditions specific to the system (even if these conditions may be inspired by certain existing obligations, for example, compliance with organizational rules and good conduct). While regulated entities should be able to benefit from the experiment without any prerequisite other than their authorization (e.g., investment firms, credit institutions, and digital asset service providers), care should be taken to ensure that there are no barriers to entry into the system, especially for non-regulated players.

- ▶ **The scope of the European Digital Laboratory should be as broad as possible in terms of:**

- ▶ **financial instruments admitted to the experiment.** However, it is not a question of extending the existing definition to capture other crypto-assets than just the tokenized financial instruments or those native to the blockchain;
- ▶ **activities covered by the Digital Lab**, given the strong heterogeneity of the projects, carried out by the respondents; and
- ▶ **exemptions that may be granted**, considering the main difficulties identified concerning the trading and settlement of security tokens admitted to the operations of a central securities depository. Therefore, a thorough analysis of obligations stemming from the MiFID 2 regime, Settlement Finality Directive (SFD), CSDR Regulation, and rules applicable to the asset management industry, is necessary.

- ▶ In the context of the necessary exemptions for the advent of the post-trade security token market, **the issuance of a legal settlement asset on the blockchain (“euro coin”) seems mandatory** to their implementation. All possibilities should be explored: a stablecoin, a central bank digital currency (CBDC), but also a synthetic CBDC advocated by the IMF.
- ▶ The difficulties experienced by project leaders in legally qualifying their tokens underline **the need for a closer dialogue with regulators**. In this respect, national authorities, necessarily closer to their

industry than supranational institutions, must play an important role.

- ▶ **The effectiveness and relevance of the European Digital Laboratory are correlated with the need for responsiveness and speed**, both in setting it up and granting exemptions to participants. To this end:
 - ▶ **the creation of the Digital Lab must be concomitant with (or even precede) the introduction of European regime specific to crypto-assets**, for which a legislative proposal is expected in the third quarter of 2020;
 - ▶ **exemptions must be granted by national authorities, who are closest to their industries, to ensure the system's effectiveness**. The possible scenario exemption requests for companies working in several Member States also implies **establishing a coordination mechanism** between regulator of different Member States.
- ▶ The European Digital Laboratory should not generate new forms of legal uncertainty for its participants, who may fear future regulatory regimes. A smooth and gradual transition must be able to accompany the players towards the regulation applicable to security tokens, which will have been adjusted and made proportionate on the basis of the conclusions drawn from the experience of the Digital Lab. Therefore, it is recommended that **the experiment be limited in time** to ensure its attractiveness in the eyes of the players. However, it is proposed to **include a review clause** (e.g., within three years) to allow a sufficient learning period, decide (or not) on the need for its renewal, and make any changes to the existing regulations.

Partners involved in carrying out this survey are available to discuss this report with any interested party.

ABOUT

THE PARTNERS BEHIND THIS REPORT

Adan (*Association pour le développement des actifs numériques*) is a French non-profit organisation whose aim is to promote the development of digital assets in France and Europe, in the service of a new digital economy. Its mission is to federate the digital assets industry and promote its development.

AFTI (*Association française des professionnels des titres*) is the leading association representing the post-trade businesses in France and Europe. AFTI represents through its 99 members a wide range of activities: market infrastructures, custodians, account-keepers and depositaries, issuer services, reporting and data management services with staff 32,000 people in Europe of which 16,000 in France. Our members account for 26% of the European custody activity with 55,600 billion € in safekeeping and 25 to 30% of the European fund asset servicing sector (namely depositaries and fund administrators). The French market infrastructures main figures are 29 million of settlements (CSD) and 186 million of operations cleared in 2018 (CCP).

AMAFI (*Association française des marchés financiers*) is the trade organisation working at national, European and international levels to represent financial market participants in France. It acts on behalf of credit institutions, investment firms and trading and post-trade infrastructures, regardless of where they operate or where their clients or counterparties are located. AMAFI's members operate for their own account or for clients in different segments, particularly organised and over-the-counter markets for equities, fixed-income products and derivatives, including commodities.

Gide 255: Founded in Paris in 1920, Gide is one of the leading international law firms, offering legal advice and assistance across a broad spectrum of disciplines to businesses, public and private sector institutions, investment funds and government. Within Gide, Gide 255 is the team created in 2018 and dedicated to innovation. As such, Gide 255 has developed particular expertise in the fields of blockchain, crypto-assets, security tokens and related activities, and artificial intelligence.

EUROPEAN DIGITAL LABORATORY: THE AMF'S PROPOSAL

In the context of ongoing discussions at the European level on the reforms needed to support the development of security tokens, the AMF recently proposed "European Digital Laboratory."

PURPOSE OF THE EUROPEAN DIGITAL LABORATORY

At a European level, this mechanism would allow certain players to request regulatory exemptions under specific conditions. These exceptions would help alleviate some of the burdens currently hindering the development of some projects.

The aim would thus be to:

- ▶ test the economic relevance of projects without being limited by the current regulatory framework; and
- ▶ better target regulatory provisions preventing the development of such projects, identifying precisely, and with concrete examples, the reforms necessary for the development of security tokens.

POTENTIAL BENEFICIARIES OF THE EUROPEAN DIGITAL LABORATORY

Exemptions would be subject to requirements both on the player applying for them and on the activities they would cover.

- ▶ Players likely to apply for this regime would have to (i) either be already regulated and licensed (e.g., in the context of the provision of banking, financial, or encryption services); (ii) or present guarantees in terms of honorability and organization.
- ▶ Exemptions should apply to activities that relate to financial instruments recorded in a blockchain. These should be of limited

volume. This condition would make it possible to limit the risks associated with the non-application of the regulatory requirements in force. The limited volumes would be assessed in the light of the liquidity criteria set out in the Markets in Financial Instruments Regulation ("MiFIR") on transparency requirements. Thus, these criteria would be based on the legal qualification of the security tokens involved, the volumes they represent, and the trades to which they give rise on a daily basis.

POSSIBLE EXEMPTIONS IN THE FRAMEWORK OF THE EUROPEAN DIGITAL LABORATORY

For the AMF, implementing a European Digital Laboratory should make it possible to rule out the application of the regulations currently hampering the development of security tokens activities. At this stage, the AMF considers that these exemptions could concern:

- ▶ the regulation on central securities depositories ("CSDR"); and
- ▶ certain provisions of the Markets in Financial Instruments Directive ("MiFID") .

In any case, no exemption could be granted from the obligations relating to:

- ▶ the fight against money laundering and terrorist financing; and
- ▶ to the requirements of market abuse.

COMPETENCE FOR THE IMPLEMENTATION OF THE EUROPEAN DIGITAL LABORATORY

Requests for exemptions under this scheme would be made to national regulators. They

would be responsible for ensuring close monitoring and “enhanced supervision” of the permitted experiment.

The entire system should be subject to European supervision to harmonize national regulators’ practices and ensure consistency in their approach.

The creation of the European digital laboratory is therefore intended to support the development of security token application. If it were set up at a European level, the content and operating procedures of the entire system proposed by the AMF would have to be specified. In any case, it demonstrates a new political will, reflected in an innovative approach by regulatory authorities such as the AMF. It is now up to European institutions, and particularly the European Commission, to determine whether they wish to adopt such an approach. The proposal published by the AMF also offers a unique opportunity for stakeholders to position themselves vis-à-vis such a laboratory and contributes to the European institutions’ thinking on the matter.