





DR GEORGE THEOCHARIDES: AS REGULATORS, WE NEED TO BE PROACTIVE

The emerging crypto industry is still uncharted waters in many regards. But the Cyprus Securities and Exchange Commission is working towards eliminating the regulatory gaps and ensure the highest level of investor protection. The Successful Business Magazine asks the Commission head, Dr George Theocharides, about the current crypto landscape in the EU and in Cyprus and the recent and forthcoming regulatory developments.

In your opinion, what are the greatest regulatory risks that Cyprus faces today?

The trends that we have seen in the last decade or so in financial services are more digitalisation, more online and mobile trading platforms. We have also seen more sophisticated technologies, such as artificial intelligence, algorithmic trading, blockchain technologies, machine learning, Big Data Analytics, Robo-Advisors and social trading.

Obviously, these global trends bring many opportunities, but at the same time, they come with risks – risks relating to the protection of the investors, to cases of money laundering and terrorist financing and risks around cybersecurity. As regulators, we need to be proactive in understanding these new technologies and how they impact financial services in order to mitigate the risks and protect investors. It is essential

that investors understand these risks before proceeding with any investment, so they are not lured into unsuitable investments based on inaccurate or incomplete information. Inconsistent liquidity, unregulated price discovery mechanisms, insider dealing and market abuse in relation to crypto-assets, lack of pre and post trade transparency rules, all undermine investor protection. The nature of cryptoassets, which means they are to some extent anonymous or pseudo-anonymous and can be used in the context of electronic contactless transactions and from anonymous crypto-wallets and other emerging products, also makes them vulnerable to the risk of money laundering and the financing of terrorism.

What's the solution then?

When it comes to digital assets and cryptoassets, the regulation is evolving.



There is a lot of work being done both at the national and European level. A few months ago, the Cyprus Securities and Exchange Commission (CySEC) issued a Policy Statement on the Registration and Operations of Crypto Asset Service Providers (CASP) to outline its finalised rules for CASPs under the AML/CFT Law. Additionally, we issued the CASP Registration Directive and the Directive for the Prevention and Suppression of Money Laundering and Terrorist Financing, which elaborates on the next steps for CASPs and CySEC's expectations. We expect Crypto Asset Services Providers to abide by their obligations stemming from CASP Rules, including but not limited to their obligations among others on:

- the fitness and probity of the CASP Beneficiaries and persons holding a management position;
- performing Know Your Client and other client due diligence measures;
- drawing the economic profile and identifying the source of funds of their clients;
- identifying and reporting suspicious transactions; and
- undertaking a comprehensive risk assessment in relation to their clients and activities and take proportionate measures per client, activity and cryptoasset in question.

Details can be found on the CySEC website, www.cysec.gov.cy. CySEC also continues to analyse market practices and will assess the effectiveness of existing rules. Where necessary, we will act to issue further guidance to ensure the compliance of supervised entities

with the regulatory framework. CySEC expects these kinds of initiatives to alleviate some, but not all, of the risks involved in cryptoasset space, and we welcome developments at EU level, under the proposed Regulation on Markets in Crypto Assets (MiCA).

In September 2020, the European Commission proposed a new regulation on cryptoassets (MiCA). This regulation will form part of the EU's Digital Finance Strategy and is expected to significantly impact the operation of the crypto market in the EU. It will increase consumer protection by establishing clear crypto industry conduct and introduce new licencing requirements. This proposal, which covers cryptoassets falling outside existing EU financial services legislation, as well as e-money tokens, has four general and related objectives.

The first objective is one of legal certainty. For cryptoasset markets to develop within the EU, there is a need for a sound legal framework, clearly defining the regulatory treatment of all cryptoassets that are not covered by existing financial services legislation. The second objective is to support innovation. The development of cryptoassets and the wider use of DLT requires a safe and proportionate framework to support innovation and fair competition. The third objective is to instil appropriate levels of consumer and investor protection and market integrity given that cryptoassets not covered by existing financial services legislation present many of the same risks as more familiar financial instruments. Finally, the fourth objective is to ensure financial stability. Cryptoassets are continuously evolving. While some have a quite limited scope and use, others, such as the emerging category of 'stablecoins', have the potential to become widely accepted and potentially systemic. This proposal includes safeguards to address potential risks to financial stability.

I should also mention that – until MiCA becomes effective – a national Bill has been drafted by the Ministry of Finance (an Umbrella Law) to regulate



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THE EU MICA REGULATION WILL INCREASE CONSUMER PROTECTION BY ESTABLISHING CLEAR CRYPTO INDUSTRY CONDUCT AND INTRODUCE NEW LICENCING REQUIREMENTS

the development of DLT-Blockchain Technology/Smart Contracts and provide legal certainty to this market. Under this Bill, CySEC is empowered to draft other legislative amendments if it deems necessary for further regulating the provision of investment services in this space.

Cyprus has attracted a number of large CIF companies and some concentrate in CFDs. These tend to have hundreds of thousands of trading accounts and millions of transactions every day. Are you confident that Cyprus current regulatory system is adequate to protecting investor interests in companies like this?

EU financial regulation applies uniformly to all EU Member States, save for certain minor Member State discretions provided for in the respective EU legislation. As a result, investment firms domiciled in any of the EU Member States must abide to the same rules and in return, benefit from the right to freely provide their services throughout the EU. The regulatory and supervisory landscape of the financial sector in Cyprus mirrors that of the rest of the EU so that investors benefit from the high standards of protection we enforce.



Dr George Theocharides

Chairman of the Cyprus Securities and Exchange Commission (CySEC)

Dr Theocharides served as CySEC's Vice Chairman since July 2020 and was appointed new Chairman in 2021. As an Associate Finance Professor at the Cyprus International Institute of Management (CIIM) and Director of the MSc in Financial Service Programme from September 2010 until July 2020, he has extensive work experience in the wider financial sector.

Prior to joining CIIM, he worked as an Assistant Professor of Finance at the Sungkyunkwan University of South Korea and as an International Faculty Fellow at the Sloan School of Management of the Massachusetts Institute of Technology (MIT).

In the past, he served as a member of the Board of the Cyprus Securities and Exchange Commission, a member of the Interim Board of Bank of Cyprus, Chairman of the Board of the Cyprus Blockchain Technologies Ltd, as well as a member of the Board of Directors of the Cyprus -Kuwait Business Association. He also served as a member of the Training/HR Committee of the Cyprus Investment Funds Association (CIFA), as well as a non-executive member of the Board of Directors for a number of organisations and companies in the financial services sector. He is also an Associate member of the Chartered Institute for Securities & Investment (CISI) and a Research Associate at the UCL Centre for Blockchain Technologies (UCL CBT).

Dr Theocharides holds a degree of BEng (Hons) in Electrical Engineering & Electronics from the University of Manchester (U.M.I.S.T.), an MBA from the University of San Diego, and a PhD in Finance from the University of Arizona.



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Clearly, there is a high level of demand globally for these products. CySEC has always held the belief that regulating these products appropriately is the safest, most diligent way of allowing these firms to provide these services, and is most in line with serving investors' interests. We continually assess and monitor regulated entities to tackle any concerning practices to ensure that investors' protection is not compromised. Since 2015, CySEC applies a risk-based supervisory approach, which governs how we determine the entities and market segments that pose the greatest risks to investors, and which are subject to the closest scrutiny.

Our risk-based supervisory approach follows the same blueprint for supervision of other European supervisors and we have been in constant and close collaboration with ESMA and IOSCO.

According to our annual Supervisory Action Plans, each year both on-site inspections and desk-top reviews are undertaken on supervised entities, together with full audit inspections or thematic or targeted basis. As a result, CySEC imposed more than €10 million administrative fines only for CIFs. It also suspended the licence of more than 30 CIFs, which had significant problems and called upon them to take a number of corrective measures to improve their internal procedures, regulations and practices in order to fully comply with their legal obligations. In addition, CySEC revoked the operating licence of more than 15 CIFs, in which serious violations of the legislation were identified and a significant number of CIFs voluntarily resigned from the licence they held. CySEC will continue to conduct in-depth audits and take all the appropriate actions to safeguard investor protection and the smooth functioning of the market.

Also, we are in the process of developing new procedures and a methodology to conduct data-driven supervision, which will allow us to identify any irregularities and risks in the market at an early stage. In this respect, CySEC is responding to the need to manage Big Data with RegTech systems that will use Artificial Intelligence and Cloud Computing. These solutions will enable CySEC to quickly screen data, representing large and varied trading volumes, in order to automatically detect risks and irregularities at an earlier stage and, thus, be able to react more quickly against these risks.

A recent CySEC Policy Statement essentially required investment services to be ring-fenced from crypto-asset activities, what is the rationale underpinning this approach?

There is very straight-forward reason for this – we don't want to see issues spill over into investment services from other activities such as cryptoasset activities that are not fully regulated.

Do investors in Cyprus understand the risks of investing in cryptocurrencies? Is CySEC educating investors about these risks?

Right now, what we are seeing around the globe is a lot of hype around cryptoassets; I would even call it irrational exuberance. This is understandable because in the financial markets a new product creates a lot of attention similar to the dot.com bubble in the late 1990s or the complex, securitised financial products in the 2000s. But I think the market still has a lot of information to digest and understand, particularly in terms of what cryptocurrencies are, how the mechanics of cryptocurrency



work, what their purpose is and what the risks are.

There is a general lack of knowledge among investors around the globe in terms of cryptoassets. Providing knowledge and education around cryptoassets and improving financial education and skills in general is part of the role of the regulators. CySEC undertakes various educative actions and initiatives, through publications on its website and in the media. CySEC participates in World Investor Week 2021, with the aim of contributing to the global drive to educate and protect investors. Over the past year, CySEC has been part of a national effort and is participating at the ad-hoc Committee for Financial Literacy and Investor Education, together with the Central Bank of Cyprus, the Ministries of Education and Finance and our two state universities to create a national strategy for financial literacy. The aim is to submit the national strategy to the Council of Ministers in early 2022. But while education is part of our mandate, it's also the responsibility of market participants and the professionals of the industry to educate investors about these types of assets by providing them with the necessary information in order to understand if the assets match their needs.

What can investors do to identify/avoid crypto and CFD fraud and scams?

The most important thing investors must do when considering an investment is to do some research into the company offering the product or service, and consider whether seeking independent professional advice from another regulated entity might be appropriate. CySEC has a full list of all the companies it regulates on its website, which is

easy to check. If a company is not listed by CySEC or another EU competent authority and is fraudulently claiming to be a licenced firm, investors will not have the same protections they would have had with a regulated entity. It is critical that investment firms classify their clients in an appropriate manner so that more sophisticated, and often higher-risk products and services are only targeted at professional investors. This marketing process must be fair and not misleading.

CySEC regularly updates its 'Warnings' website on prevalent scams and nefarious operators. Investors are encouraged to keep an eye on this so they are aware of what types of fraud and scams are being tried.

Typically, investors should be especially wary if they feel under pressure to make a decision to invest quickly (such as a time-limited offer), or are offered returns on their investment that sound too good to be true, or are told about products or services that don't adequately explain the risk of losing money.

CFD trading is inherently speculative, and firms must uphold their responsibility to warn their clients that their capital is at risk. Aggressive cold-calling tactics either by phone, email, online pop-ups, or on social media are also likely to be perpetrated by unscrupulous providers rather than by reputable players in the market. In the past, we have also observed cases where people have fraudulently presented themselves as CySEC representatives in an effort to defraud investors. For this reason, CySEC has issued several announcements informing the public that it never sends unsolicited correspondence to investors or members of the public, nor does it ever request any personal data, financial or otherwise.



PROVIDING KNOWLEDGE AND EDUCATION AROUND CRYPTOASSETS AND IMPROVING FINANCIAL EDUCATION AND SKILLS IN GENERAL IS PART OF THE ROLE OF THE REGULATORS



As we move into a more digital world, the number of risks to investors is growing constantly. This is not only due to platform-related fraud or illicit activity, but also due to hacking and cybersecurity. Does CySEC take cybersecurity into account when auditing regulated firms that use investors deposits or accounts? Will you be doing this in the future?

Data security is an organisational requirement under the investment law. CIFs must have sound security mechanisms in place to guarantee the security and authentication of the means of transfer of information, minimise the risk of data corruption and unauthorised access, and prevent information leakage in order to maintain the confidentiality of the data at all times. It's part of CySEC supervisory action plan each year.

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CYSEC HAS RECEIVED FUNDING APPROVAL FROM THE EU RECOVERY AND RESILIENT FUND TO EXPLORE THE OPPORTUNITY OF TRANSFORMING ITS INNOVATION HUB INTO A REGULATORY SANDBOX



What are your plans for the nearest six months? What to expect from CySEC?

Our goal as CySEC is to continue acting as a protective shield for investors through effective supervision and guiding the sound development of the sector. As part of our mission we are increasing the level and the frequency of supervision, particularly of online trading platforms, by expanding our internal resources. Given the international and largely web-based nature of the activities of CIFs, CySEC has acquired a supervisory system for monitoring the supervised entities' online marketing activities/materials. This tool will therefore further enhance CySEC's ability to collect, analyse, and monitor the marketing communications of CIFs. In term of policy making our aim is to consult on enhancing the clients' money rules by mid to late 2022.

In addition, we have received funding approval from the EU Recovery and Resilient Fund to explore the opportunity of transforming our Innovation Hub into a Regulatory Sandbox. In this controlled environment, fintech startups and other entities will be able to test their innovative products or services in real conditions under the regulator's supervision.

We are also launching the Trust Register Portal which will keep the details of the beneficial owners of express trusts and similar legal arrangements. The Portal is an additional tool to improve transparency and combat money laundering and terrorist financing.

CySEC is also introducing new exams for the providers of financial information in regulated entities as part of the financial education of industry professionals to ensure a high standard of service.

In 2020, CySEC added a new regulatory category, Mini Managers, and a new investment product, Crowdfunding. What has been the reaction to these so far? Is there scope to introduce other new regulatory categories?



Although the initial reaction has been fairly slow, we have recently approved the licence of the first mini manager and also pre-approved the licence of the first crowdfunding platform. Once these new entities start operating, and if they end up being successful, I do see a trend towards more applications in the future for both mini-manager and crowdfunding platforms.

CySEC is also introducing a new regulatory category for fund administrators. The draft law will be submitted to the Ministry of Finance in 2022. The fund administration is not regulated at EU level; however, we believe that regulating these entities will contribute to enhancing investor protection and market integrity by ensuring authorisation and supervision throughout the delegation chain.

We are also looking at loan origination and loan participation for the funds industry. In many countries, there are restrictions on these so we are being cautious to make sure we address the relevant risks.

Environmental, social and governance-related factors are rapidly being integrated into the institutional framework of the capital markets. How ready are the regulated entities to adopt the specific criteria?

As in the case of any new regulation not only in Cyprus but at EU and global level, we expect that there will be challenges in the application of ESG until a level of maturity is reached. Market participants and investors are not fully informed about what ESG entails and while some regulations have been passed in Europe, there's still no uniformity of regulatory practices and approaches. There is always the risk of greenwashing or mislabelling investments towards ESG. If you have an investment that labels itself as ESG, somebody needs to approve it, somebody needs to rate it, but the criteria for this are not clear yet. More work needs to be done at national and EU level to create sustainable growth in this market.



MARKET PARTICIPANTS AND INVESTORS ARE NOT FULLY INFORMED ABOUT WHAT ESG ENTAILS AND THERE'S STILL NO UNIFORMITY OF REGULATORY PRACTICES AND APPROACHES

In Cyprus, although we are yet to see a large-scale shift towards responsible investments, we have already signed up a few alternative investment funds with an investment policy focusing on ESG factors. Data gathered from asset managers in Cyprus showed that €40.2 million of funds under management have a sustainable investment strategy, which is indeed a very promising step in the right direction. To encourage and assist investors and regulated entities in this regard, and in line with the EU action plan for financing sustainable growth, CySEC has confirmed its commitment to fostering compliance with sustainable finance standards, and in early 2021 we created a dedicated section on our website on sustainable finance, which gives information on the legislative measures being introduced at the EU level. ■