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Newsletter

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BANKING & FINANCE

Regulation of Swiss Initial Coin Offerings (ICOs)

The Swiss Financial Market Supervisory Authority (FINMA) published guidance on how to apply Swiss financial markets laws in the context of Swiss ICOs. Such guidance assists in how to structure the sale of tokens and coins in Switzerland.

1 INTRODUCTION

In Switzerland – as in many other jurisdictions – ICOs are **not governed** by a regulatory framework **specifically designed** for such transactions. Rather, FINMA has repeatedly stated that it will not distinguish between different technologies used for the same activity (*Technologieneutralität*), i.e. that FINMA will apply the principle of "same business, same rules" to any kind of activity in connection with blockchain-based tokens or coins.

In its Guidance 04/2017 dated 29 September 2017 (available on https://www.finma.ch/en/documentation/finma-guidance/#Order=4), FINMA stated that ICOs of Swiss issuers must be scrutinized under the **general principles** of Swiss financial market legislation. The relevant laws that may be applied are the banking legislation for any deposit-taking activity, the securities legislation for tokens classified as securities, the anti-money laundering legislation for any activity of a financial intermediary for AML purposes, and the collective investment schemes legislation for any fund management or related activity. The determination whether ICOs or other activities in connection with blockchain-based assets such as tokens or coins fall into the scope of such legislation may only be made on a **case-by-case basis.** In order to ensure compliance with the applicable laws, it has become common practice for Swiss issuers to seek interpretative guidance in the form of **no-action letters** from FINMA prior to launching an ICO.

On 16 February 2018, FINMA now published **further guidance** on how to apply Swiss financial markets laws in the context of Swiss ICOs in its guidelines regarding the regulatory framework for initial coin offerings (the "**ICO-Guidelines**", available on https://www.finma.ch/en/news/2018/02/20180216-mm-ico-wegleitung/).

2 CONTENT OF ICO-GUIDELINES

2.1 SCOPE

The ICO-Guidelines cover inter alia the following **topics:**

> how to seek no-action comfort from FINMA in connection with a Swiss ICO;

> categorization of tokens;

> scope of securities laws; and

> scope of the Swiss anti-money laundering laws.

2.2 TOKEN CATEGORIZATION

In order to assess the application of Swiss financial market laws, FINMA distinguishes the following **categories of tokens:**

> **Payment tokens or cryptocurrencies:** tokens that are intended only as means of payment for acquiring goods or services and that do not give rise to any claims against the issuer.

> **Utility tokens:** tokens that are providing access rights to a digital application or service.

> **Asset tokens:** tokens that represent an asset, for instance a debt or equity claim against the issuer or a third party.

Tokens may also take a **hybrid form** including elements of more than one category. Also note that for the purpose of assessing the regulatory implications of a Swiss ICO, the moment of the token issuance is relevant. However, FINMA acknowledged that the classification of a token may change over time.

"The ICO-Guidelines explain how to seek no-action comfort from FINMA in connection with a Swiss ICO."

2.3 TOKENS AS SECURITIES (*EFFEKTEN*)

One of the key questions in connection with the issuance and the qualification of tokens is the question whether such tokens qualify as **securities** (*Effekten*) (for the respective consequences see section 2.5 below). FINMA establishes that tokens qualify as securities (*Effekten*) if they fall into the definition of securities pursuant to the Financial Market Infrastructure Act (**FMIA**). According to this definition, the tokens would have to be (i) "standardized and suitable for mass trading" and (ii) would need to represent certificated or uncertificated securities, derivatives or intermediated securities.

To meet the requirement of (i), the tokens need to be **publicly offered** for sale in the same structure and denomination to 20 or more clients under identical conditions.

To meet the requirement of (ii), FINMA does not require that the tokens are a digital representation of underlying certificated or uncertificated securities, of intermediated securities or of derivatives. Rather, it appears that FINMA would treat any right represented in the tokens as "**uncertificated securities**", which would require that the securities are registered in a register (*Wertrechtebuch*) (in the sense of Art. 973c of the Swiss Code of Obligations) for the valid creation of such uncertificated securities. In the view of FINMA, such register may be kept in digital form on a blockchain. As a result, such "uncertificated securities" would be classified as securities (*Effekten*), as long as they are "standardized and suitable for mass trading".

Applied to the different categories of tokens, FINMA concludes that the following categories of tokens would be **classified as securities**, if they are "standardized and suitable for mass trading":

> **Payment tokens:** Given that payment tokens are designed to be used as a means of payment, they do at the moment not qualify as securities. This is based on the assumption that payment tokens do not constitute a digital representation of any rights of token holders exercisable against the issuer.

> **Utility tokens**: If the purpose of such tokens is to provide access to a digital platform or application and the utility tokens can actually be used in some form at the moment of their issuance, they do not constitute securities. Note that FINMA expressed an intention to apply this operational readiness requirement restrictively. According to FINMA, a utility token requires a functional application on which such token can be used for its intended purpose at the time of the issuance. Therefore, proof of concepts or beta-versions on which the tokens cannot (yet) be used, would not suffice. If utility tokens cannot be used for their intended purpose at the moment of issuance, they would be deemed to have an investment purpose and would be treated as securities. However, it should be discussed with FINMA on a case-by-case basis to what extent a platform is sufficiently developped to allow a classification as a utility token or whether the token should be deemed to have an investment purpose and be classified - at least initially - as a security.

> **Asset tokens**: FINMA qualifies such tokens as securities.

2.4 RIGHTS TO TOKENS FROM PRE-SALE

As regards the rights of investors resulting from a **pre-financing** or **pre-sale** of tokens (e.g. under a Simple Agreement for Future Tokens or "SAFT"), FINMA would also classify such rights as securities (*Effekten*) in accordance with the FMIA, if such pre-financing or pre-sales confer an **enforceable right** to acquire tokens in the future – regardless of their qualification as payment tokens, utility tokens or asset tokens – and if such rights are "**standardized and suitable for mass trading**". Therefore, to ensure that the rights resulting from a pre-sale of tokens do not result in the issuer falling into the scope of application of Swiss securities regulation, the rights conferred in such pre-sale arrangements must not be offered in identical form to 20 or more investors.

2.5 CONSEQUENCES OF A QUALIFICATION AS SECURITIES

As a result of a qualification of tokens as **securities** in accordance with the FMIA, the regulatory framework of the Stock Exchanges and Securities Trading Act (**SESTA**) must be complied with. Under the rules of the SESTA, certain

activities with securities are subject to **licensing requirements** by FINMA. This would for instance be the case for brokerage activities on behalf of clients (other than institutional clients), market making activities in respect of such tokens, underwriting such tokens and issuing such tokens classified as derivatives.

2.6 PROSPECTUS REQUIREMENT

Regardless of the classification of tokens as securities, as regards any tokens constituting a digital representation of rights that are exercisable against an issuer, the question arises whether such tokens are subject to a **prospectus requirement**. This would for instance apply if the rights forming part of the tokens are classified as equity instruments or bonds.

> "As a result of a qualification of tokens as securities, the regulatory framework of the SESTA must be complied with."

2.7 CLASSIFICATION AS DEPOSITS

To the extent that any activity was classified as a deposit taking activity pursuant to the Swiss Banking Act (**BA**), this would require a **banking license** by FINMA.

This would for instance need to be taken into account when providing brokerage or storage services in relation to tokens in a way that the service provider can dispose of the client's tokens and, as a result, the tokens would be part of the service provider's bankruptcy estate in its bankruptcy.

2.8 RELEVANCE OF THE SWISS ANTI-MONEY LAUNDERING ACT (AMLA)

A "financial intermediary" in the sense of the AMLA must be affiliated with an authorized AML self-regulatory organization or be directly supervised by FINMA for AML purposes. In the ICO-Guidelines, FINMA clarifies in what cases the issuance of a token is deemed to be a "payment service" or "issue of a means of payment" qualifying as **financial intermediation** activity pursuant to the AMLA:

- **Payment token**: The issuance of a payment token is classified as a financial intermediation activity pursuant to the AMLA. This also applies to any trading activity regarding such tokens.

- **Utility tokens**: The issuance of a utility token falls outside of the scope of application of the AMLA if the main purpose is to provide access rights to a non-financial blockchain application. However, the issuance of such tokens would still be subject to the rules of the AMLA in the event that the utility token may be used as a means of payment outside the respective non-financial application or if a utility token additionally provides access to an application in the financial sector.

- **Asset tokens**: On the basis that such tokens are classified as securities, the issuance of asset tokens is not subject to the AMLA (unless issued by a bank, securities dealer or certain other prudentially supervised entities).

If an issuer of a Swiss ICO is a financial intermediary in the sense of the AMLA, note that it may meet these requirements by having the funds accepted through a financial intermediary in the sense of the AMLA. In such event, the issuer does not itself need to be affiliated with a recognised SRO or be licensed directly by FINMA for AML purposes.

Note that the AMLA is not only relevant when issuing tokes, but it may also become relevant for other activities in connection with tokens. Brokerage or exchange activities in connection with payment tokens, i.e. the exchange of cryptocurrencies for fiat money or for another cryptocurrency, as well as the provision of transfer services or storage services for tokens would be subject to the AMLA.

3 INCORPORATING ISSUERS

As regards the legal form for token **issuers** in Switzerland, aside of regular **stock corporations** (*Aktiengesellschaften*) or **limited liability companies** (*Gesellschaft mit beschränkter Haftung*), some market participants have used the legal form of a Swiss **foundation** (*Stiftung*). This was mainly due to tax considerations, given that foundations with a public or non-profit purpose may have a beneficial tax treatment.

A **foundation** is established by dedicating assets to the stated purpose. The assets of a foundation must exclusively be used pursuant to the stated purpose (which can only be modified in very limited circumstances). Other than any other company form, every foundation is subject to governmental supervision. The dedication of assets to a certain purpose gives the foundation legal and factual independence from its founder. The founder has – after the establishment of the foundation – no longer ownership or any other control over the foundation's assets and has no legal means to influence the foundation's conduct of business. However, a founder may have a *de facto* influence by having a direct or indirect representative in the foundation's board.

To the extent that an ICO has, at least partially, a commercial purpose and the respective issuer and the initiators of the ICO are not pursuing a purely public or non-profit purpose, for most of the Swiss ICOs the legal form of the Swiss foundation is **not suitable**. Its structure does not allow the flexibility that is generally needed and wanted for an issuer of an ICO. In such circumstances, the legal form of a stock corporation or a limited liability company is more appropriate, as it provides the legal framework and structure granting the necessary control and flexibility.

4 CONCLUSION

The ICO-Guidelines provide **helpful guidance** to market participants in assessing the regulatory implications of an ICO or an activity in connection with tokens.

However, we note that questions remain open regarding the regulatory implications of issuing utility or asset tokens. As a result, any issuance, trading or storage of such tokens must be analysed on a case-by-case basis.

Further, we note that – despite FINMA's classification of tokens as securities – a transfer of uncertificated securities must, as a principle, be executed in writing under Swiss

law. In addition, it is in our view unclear whether a register of uncertificated securities (*Wertrechtebuch*) can be validly kept on a blockchain. To further increase legal certainty, it would be beneficial to codify that tokens can be transferred by way of entry on a digital ledger without the need to comply with a written form requirement.

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The content of this Newsletter does not constitute legal or tax advice and may not be relied upon as such. Should you seek advice with regard to your specific circumstances, please contact your Schellenberg Wittmer liaison or any of the following persons:

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