THE VIRTUAL CURRENCY REGULATION REVIEW

Editors
Michael S Sackheim and Nathan A Howell

THE LAWREVIEWS

THE VIRTUAL CURRENCY REGULATION REVIEW

Reproduced with permission from Law Business Research Ltd
This article was first published in November 2018
For further information please contact Nick.Barette@thelawreviews.co.uk

Editors
Michael S Sackheim and Nathan A Howell

THE LAWREVIEWS

PUBLISHER
Tom Barnes

SENIOR BUSINESS DEVELOPMENT MANAGER
Nick Barette

BUSINESS DEVELOPMENT MANAGERS
Thomas Lee, Joel Woods

SENIOR ACCOUNT MANAGERS
Pere Aspinall, Jack Bagnall

ACCOUNT MANAGERS
Sophie Emberson, Katie Hodgetts

PRODUCT MARKETING EXECUTIVE
Rebecca Mogridge

RESEARCH LEAD
Kieran Hansen

EDITORIAL COORDINATOR
Gavin Jordan

HEAD OF PRODUCTION
Adam Myers

PRODUCTION EDITOR
Anne Borthwick

SUBEDITOR
Janina Godowska

CHIEF EXECUTIVE OFFICER
Paul Howarth

Published in the United Kingdom
by Law Business Research Ltd, London
87 Lancaster Road, London, W11 1QQ, UK

www.TheLawReviews.co.uk

ISBN 978-1-912228-77-5

Printed in Great Britain by
Encompass Print Solutions, Derbyshire
Tel: 0844 2480 112

ACKNOWLEDGEMENTS

The publisher acknowledges and thanks the following for their learned assistance throughout the preparation of this book:

ALLEN & GLEDHILL LLP

AMERELLER

ANDERSON MORI & TOMOTSUNE

ARTHUR COX

BECH-BRUUN

BRANDL & TALOS RECHTSANWÄLTE GMBH

CLIFFORD CHANCE LLP

DENTONS

GERNANDT & DANIELSSON ADVOKATBYRÅ

GTG ADVOCATES

HARNEYS

HENGELER MUELLER PARTNERSCHAFT VON RECHTSANWÄLTEN MBB

JONES DAY

KIM & CHANG

LINKLATERS

MARVAL, O'FARRELL & MAIRAL

NISHITH DESAI ASSOCIATES

PINHEIRO NETO ADVOGADOS

RUSSELL MCVEAGH

SCHELLENBERG WITTMER LTD

SCHILTZ & SCHILTZ SA

SCHJØDT

SIDLEY AUSTIN LLP

STIBBE

STIKEMAN ELLIOTT LLP

TFH RUSSIA LLC

URÍA MENÉNDEZ

WEBB HENDERSON

YIGAL ARNON & CO

CONTENTS

PREFACE

On 31 October 2008, Satoshi Nakamoto published a white paper describing what he referred to as a system for peer-to-peer payments, using a public decentralised ledger known as a blockchain and cryptography as a source of trust to verify transactions. That paper, released in the dark days of a growing global financial market crisis, laid the foundations for Bitcoin, which would become operational in early 2009. Satoshi has never been identified, but his white paper represented a watershed moment in the evolution of virtual currency. Bitcoin was an obscure asset in 2009, but it is far from obscure today, and there are now many other virtual currencies and related assets. In 2013, a new type of blockchain that came to be known as Ethereum was proposed. Ethereum's native virtual currency, Ether, went live in 2015 and opened up a new phase in the evolution of virtual currency. Ethereum provided a broader platform, or protocol, for the development of all sorts of other virtual currencies and related assets.

Whether Bitcoin, Ether or any other virtual currency will one day be widely and consistently in use remains uncertain. However, the virtual currency revolution has now come far enough and has endured a sufficient number of potentially fatal events that we are confident virtual currency in some form is here to stay. Virtual currencies and the blockchain and other distributed ledger technology on which they are based are real, and are being deployed right now in many markets and for many purposes. The technology has matured beyond hypothetical use cases and beta testing. These technologies are being put in place in the real world, and we as lawyers must now endeavour to understand what that means for our clients.

Virtual currencies are essentially borderless: they exist on global and interconnected computer systems. They are generally decentralised, meaning that the records relating to a virtual currency and transactions therein may be maintained in a number of separate jurisdictions simultaneously. The borderless nature of this technology was the core inspiration for *The Virtual Currency Regulation Review* (*Review*). As practitioners, we cannot afford to focus solely on our own regulatory silos. For example, a US banking lawyer advising clients on matters related to virtual currency must not only have a working understanding of US securities and commodities regulation; he or she must also have a broad view of the regulatory treatment of virtual currency in other major commercial jurisdictions.

Global regulators have taken a range of approaches to responding to virtual currencies. Some regulators have attempted to stamp out the use of virtual currencies out of a fear that virtual currencies such as Bitcoin allow capital to flow freely and without the usual checks that are designed to prevent money laundering and the illicit use of funds. Others have attempted to write specific laws and regulations tailored to virtual currencies. Still others – the United States included – have attempted to apply legacy regulatory structures to virtual

currencies. Those regulatory structures attempt what is essentially 'regulation by analogy'. For example, a virtual currency may be regulated in the same manner as money, or in the same manner as a security or commodity. The editors make one general observation at the outset: there is no consistency across jurisdictions in their approach to regulating virtual currencies. That is, there is currently no widely accepted global regulatory standard. That is what makes a publication such as *The Review* both so interesting and so challenging to assemble.

The lack of global standards has led to a great deal of regulatory arbitrage, as virtual currency innovators shop for jurisdictions with optimally calibrated regulatory structures that provide an acceptable amount of legal certainty. While some market participants are interested in finding the jurisdiction with the lightest touch (or no touch), most of our clients are not attempting to flee from regulation entirely. They appreciate that regulation is necessary to allow virtual currencies to achieve their potential, but they do need regulatory systems with an appropriate balance and a high degree of clarity. The technology underlying virtual currencies is complex enough without adding layers of regulatory complexity into the mix.

It is perhaps ironic that the sources of strength of virtual currencies – decentralisation and the lack of trusted intermediaries necessary to create a shared truth – are the same characteristics that the regulators themselves seem to be displaying. There is no central authority over virtual currencies, either within and across jurisdictions, and each regulator takes an approach that seems appropriate to that regulator based on its own narrow view of the markets and legacy regulations. We believe optimal regulatory structures will emerge and converge over time. Ultimately, the borderless nature of these markets allows market participants to 'vote with their feet', and they will gravitate toward jurisdictions that achieve the right regulatory balance. It is much easier to do this in a virtual business than it would be in a brick and mortar business. Computer servers are relatively easy to relocate. Factories and workers are less so.

The Review is intended to provide a practical, business-focused analysis of recent legal and regulatory changes and developments, and of their effects, and to look forward at expected trends in the area of virtual currencies on a country-by-country basis. It is not intended to be an exhaustive guide to the regulation of virtual currencies globally or in any of the included jurisdictions. Instead, for each jurisdiction, the authors have endeavoured to provide a sufficient overview for the reader to understand the current legal and regulatory environment.

Virtual currency is the broad term that is used in *The Review* to refer to Bitcoin, Ether, tethers and other stable coins, cryptocurrencies, altcoins, ERC20 tokens, digital, virtual and crypto assets, and other digital and virtual tokens and coins, including coins issued in initial coin offerings. The term is intended to provide rough justice to a complex and evolving area of law, and we recognise that in many instances the term virtual currency will not be appropriate. Other related terms, such as cryptocurrencies, digital currencies, digital assets, crypto assets and similar terms, are used throughout as needed. In the law, the words we use matter a great deal, so where necessary the authors of each chapter provide clarity around the terminology used in their jurisdiction, and the legal meaning given to that terminology.

We hope that you find *The Review* useful in your own practices and businesses, and we welcome your questions and feedback. We are still very much in the early days of the virtual currency revolution. No one can truthfully claim to know what the future holds for virtual currencies, but as it does not appear to be a passing fad, we have endeavoured to provide as

much useful information as practicable in *The Review* concerning the regulation of virtual currencies.

The editors would like to extend special thanks to Ivet Bell (New York) and Dan Applebaum (Chicago), both Sidley Austin LLP associates, without whom *The Review*, and particularly the US chapter, would not have come together.

Michael S Sackheim and Nathan A Howell
Sidley Austin LLP
New York and Chicago
October 2018

Chapter 27

SWITZERLAND

Olivier Favre, Tarek Houdrouge and Fabio Elsener[1]

I INTRODUCTION TO THE LEGAL AND REGULATORY FRAMEWORK

i Market size

Switzerland is the home of the crypto valley in Zug, near Zurich, and has an active community of enterprises working in the crypto space. Switzerland's Minister of Economic Affairs said that Switzerland wants to be a 'crypto nation' when he spoke at a crypto finance conference for private and institutional investors in St Moritz in January 2018. While it is difficult to attribute a rank to Switzerland in the fast-moving global crypto community, Switzerland has taken the role of a pioneer in this area. In terms of amounts raised in 2017, three out of the top 10 ICOs were projects involving a Swiss issuer.[2]

ii Legal framework

Switzerland has a favourable and attractive legal framework regarding cryptocurrencies, although it does not have a separate legal framework for them. At present, the financial market legislation as applied by the Swiss Financial Market Supervisory Authority (FINMA), the rules of private law pursuant to the Swiss Civil Code and the Swiss Code of Obligations of 30 March 1911 (CO) and the rules of debt enforcement pursuant to the Swiss Debt Enforcement and Bankruptcy Code of 11 April 1889 also apply to cryprocurrencies.

FINMA has repeatedly stated that it will not distinguish between different technologies used for the same activity: that is, FINMA will apply the principle of 'same business, same rules' to any kind of new technology. In accordance with this principle, FINMA has clarified in its Guidance 04/2017[3] that initial coin offerings (ICOs) of Swiss issuers must be scrutinised under the general principles of Swiss financial market legislation.

As a reaction to Switzerland's important role in ICOs in 2017, on 16 February 2018 FINMA published further guidance on how to apply Swiss financial markets laws in its guidelines regarding the regulatory framework for ICOs (ICO Guidelines).[4] In the ICO Guidelines, FINMA clarifies how to classify cryptocurrencies and other coins or tokens (collectively with cryptocurrencies, tokens) or other assets registered on distributed ledgers under Swiss law.

---

1 Olivier Favre and Tarek Houdrouge are partners and Fabio Elsener is an associate at Schellenberg Wittmer Ltd.

2 According to www.coinist.io.

3 FINMA, Guidance 04/2017 on the regulatory treatment of initial coin offerings dated 29 September 2017 (available at https://www.finma.ch/en/documentation/finma-guidance#Order=4).

4 FINMA, Guidelines for enquiries regarding the regulatory framework for initial coin offerings (ICOs) (available at https://www.finma.ch/en/~/media/finma/dokumente/dokumentencenter/myfinma/1bewilligung/fintech/wegleitung-ico.pdf?la=en).

iii Regulatory classification of tokens

According to the ICO Guidelines, FINMA distinguishes the following categories of tokens:

a payment tokens or cryptocurrencies, which are intended only as means of payment and that do not give rise to any claims against the issuer;

b utility tokens, which provide rights to access or use a digital application or service, provided that such application or service is already operational at the time of the token sale; and

c asset tokens, which represent an asset, for instance a debt or equity claim against the issuer or a third party, or a right in an underlying asset.

FINMA has further clarified that tokens may also take a hybrid form including elements of more than one of these categories. Such hybrid tokens must comply cumulatively with the regulatory requirements applicable to each relevant token category. FINMA acknowledges that a token's classification may change over time. For the purpose of assessing the regulatory implications of an ICO, the moment of the token issuance is relevant. However, the initial classification may change post-ICO. In the event of any secondary market trading activity with tokens, their classification in the moment of the relevant trading activity must be taken into account.

Payment tokens do not qualify as legal tender or other means of payment under Swiss law. However, the Swiss Federal Council has clarified that payment tokens may be used as private means of payment if the parties to a transaction agree on the use of payment tokens as the applicable means of payment for such a transaction. In addition, the issuance of payment tokens requires compliance with the Swiss anti-money laundering rules (see Section V).

iv Enquiries to FINMA

Notwithstanding the guidance provided by FINMA, given that this field is new and the structures of token offerings are always evolving, regarding the application of the ICO Guidelines in real-life projects, it is normal practice to seek a confirmation from FINMA to the effect of obtaining a no-action comfort from the regulator.

FINMA offers the possibility to file such no-action enquiries in order to confirm the regulatory interpretation.

II SECURITIES AND INVESTMENT LAWS

i Relevance for asset tokens and certain types of utility tokens

Swiss securities laws are relevant for the issuance of asset tokens or any hybrid form of tokens involving the functionalities of asset tokens (e.g., a utility token regarding the use of a platform that is not fully developed).

However, payment tokens and utility tokens that do not represent any claims against an issuer or a third party are not subject to Swiss securities laws, as they do not represent any rights.[5] Such payment tokens and utility tokens should be classified as digital assets *sui generis* for the time being.[6]

5 Swiss LegalTech Association, Regulatory Task Force Report, 27 April 2018, p. 25 (available at http://www.swisslegaltech.ch/wp-content/uploads/2018/05/SLTA-Regulatory-Task-Force-Report-2.pdf).

6 Cf. Federal Council, Report on virtual currencies, 25 June 2014, 7 (available at http://www.news.admin.ch/NSBSubscriber/message/attachments/35361.pdf). A clarification of the legal qualification of

ii Issuance of tokens representing rights against an issuer or a third party

To the extent that asset tokens or utility tokens representing any claims against an issuer or third parties are governed by Swiss law, according to the view expressed by FINMA as well as according to the prevailing view in the Swiss market, such tokens should qualify as unncertificated securities according to Article 973c CO.[7] The creation of such uncertificated securities requires a decision from the competent corporate body as well as the registration of the first holders of the uncertificated securities in a register held by the issuer. Such register is not subject to any form requirements, and therefore it is possible to qualify the distributed ledger as such a register.

If the token sale involves a financial institution pursuant to Article 4(2) of the Swiss Federal Intermediated securities Act (FISA) acting as custodian for intermediated securities, the tokens can be issued as intermediated securities.[8] The advantage of creating intermediated securities would be that the entitlements in the tokens could be transferred by book-entry in the custody accounts of the custodians involved according to the rules of the FISA. However, given that token sales are usually structured in a way that does not involve a securities custodian, we do not explore here the further requirements to be taken into account for the issuance of tokens in the form of intermediated securities.

iii Transfer requirements for tokens

Under Swiss law, payment tokens and utility tokens that do not represent any claims against an issuer or third parties that can be validly created and transferred in accordance with the terms of the respective distributed ledger, for example, with a valid transaction between two wallets.

However, asset tokens and utility tokens representing enforceable rights against an issuer or a third party require, in addition to a valid transfer on the relevant distributed ledger, that the rights represented in such tokens are validly created and transferred to the transferee. Depending on the types of rights represented in the tokens, this could be a written form requirement for the transfer of such rights under Swiss law. Regarding the transfer of tokens representing uncertificated securities (see Section II.ii), the rules of assignments pursuant to the CO must be complied with, which require a declaration of assignment in writing by the assignor. To the extent that the tokens were registered with a financial institution acting as securities custodian, such securities could be issued as intermediated securities under the FISA, and it would be sufficient to transfer the securities by way of book entry between the custodians involved in the transaction without a transfer by way of an assignment. However, on the basis that no custodians are involved, the written form requirements for a transfer of uncertificated securities must be complied with for a valid transfer.

Under Swiss law, a written form requires that the parties must either provide a wet-ink signature, which can be delivered through a scan, or a certified electronic signature according

cryptocurrencies has been announced (cf. Federal Department of Finance, press release, 5 July 2017, available at https://www.efd.admin.ch/efd/en/home/dokumentation/nsb-news_list.msgid-67436.html).

7 Swiss LegalTech Association, Regulatory Task Force Report (fn 4), p. 26; ICO Guidelines, p. 4; see also Eggen, 'Was ist ein token?', AJP 2018, p. 558 et seqq., p. 563 et seq.; Blockchain Taskforce, position paper on the legal classification of ICOs, April 2018, p. 8 et seqq. (available at https://blockchaintaskforce.ch/wp-content/uploads/2018/06/Blockchain-Taskforce-White-Paper-Annex1.pdf).

8 Swiss LegalTech Association, Regulatory Task Force Report (footnote 4), p. 26 et seq.

to Article 14(2bis) CO. We are not aware of any distributed ledger that would currently support such certified electronic signatures; therefore, a written form requirement can, to date, not be substituted by a transaction of tokens on a distributed ledger.

As the transfer of uncertificated securities is subject to a written form requirement, to validly transfer the rights attached to asset tokens and utility tokens representing exercisable rights against an issuer or a third party under Swiss law a work-around is needed. One solution is the use of terms and conditions of the tokens specifying that the transfer of such tokens to a new token holder shall be construed as a transfer of the contractual relationship in which the new token holder assumes the entire contractual position from the old token holder. Such transfers may be made in the form of a three-party agreement between the issuer, the old and the new token holder. For the purpose of this transfer, it could be argued that all participants of a distributed ledger, including the old and new token holder and the issuer, implicitly agreed by participating in the distributed ledger of such a method of transferring tokens. However, it would be prudent to provide, at least, that the issuer must keep a record of the current token holders and communicates with the issuer in the event of any transfer. Note that this concept is untested in court to date.

iv Classification of tokens as securities

Under Swiss law, securities are defined in Article 2(b) of the Financial Market Infrastructure Act of 19 June 2015 (FMIA) as certificated and uncertificated securities, derivatives and intermediated securities, which are standardised and suitable for mass trading (securities). According to Article 2(1) of the Financial Market Infrastructure Ordinance of 25 November 2015, standardised and suitable for mass training means that the instruments are offered for sale publicly in the same structure and denomination, or that they are placed with 20 or more clients under identical conditions.

FINMA has clarified in the ICO Guidelines that it will apply these rules in connection with tokens constituting uncertificated securities (see Section II.i) as follows:[9]

a payment tokens do not qualify as securities given that they are designed to be used as means of payment according to FINMA. Payment tokens cannot fall under the definition of securities as they do not represent any rights that are exercisable against the issuer or third parties;

b utility tokens can qualify as securities if the platform where they can be used is not operationally ready at the time of the token sale, or if the tokens represent rights that may be enforced against the issuer or a third party. Such utility tokens are deemed to have an investment purpose. FINMA further clarified that a case-by-case analysis is needed to clarify whether or not a utility token can be used for its intended purpose. In particular, FINMA specifies that proof of concepts or beta versions of platforms or applications on which the utility tokens cannot (yet) be used would not suffice to fall outside of the definition of securities for the purposes of the FMIA. However, on the basis that the qualification of tokens may change over time, it is possible that utility tokens qualifying as securities will fall outside of this definition once the platform where the tokens shall be used becomes fully functional for its intended purpose; and

c asset tokens qualify as securities provided that they have been offered publicly or to 20 or more persons for sale.

9 Cf. Section 3.1 of the ICO Guidelines.

FINMA has stated that any enforceable rights of investors to receive or acquire tokens in the future resulting from a pre-sale, for instance under a simple agreement for future tokens, qualify as securities if such rights have been offered publicly or on identical terms to more than 20 persons. On the other hand, the rights issued in the context of a pre-sale do not constitute securities if the terms used in the pre-sale are not standardised or different terms are used with each investor: for example, by varying the amount of rights, the pricing or any lock-up provision.

v Prospectus requirement

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

vi Regulatory implications of classification of tokens as securities

If tokens qualify as securities, they are subject to the regulatory framework of the Stock Exchanges and Securities Trading Act of 24 March 1995 (SESTA) and the implementing Stock Exchanges and Securities Trading Ordinance of 2 December 1996 (SESTO). According to this regulatory framework, a licence as a securities dealer is required for any brokerage activities on behalf of clients (other than institutional clients) regarding such tokens, any market-making activities in respect towards such tokens, underwriting such tokens and – provided that the tokens qualify as derivatives – issuing these tokens.[10] A licence requirement is in each case triggered if such activities are executed on a professional basis.

Note that the qualification of tokens as securities has implications on the licence requirements under FMIA for any secondary trading platform where such tokens can be traded.

III LAWS ON COLLECTIVE INVESTMENTS

As regards any investments in tokens through collective investment schemes or funds or in regard to the issuance of tokens representing units in collective investment schemes, the rules of the Swiss Collective Investment Schemes Act of 23 June 2006 (CISA) and its implementing ordinances must be taken into account. For the purposes of the CISA, a collective investment scheme is a pool of assets raised from investors for the purpose of being invested collectively managed on behalf of the investors. The regulation of the CISA applies irrespective of the legal structure that has been chosen for the collective investment scheme or fund.

As a result, the issuance of tokens, as well as any business activity in relation to tokens (regardless of their classification) by which assets accepted from clients for investment purposes are pooled (i.e., there is no segregation of the investments for each investors), or where the clients' assets are managed by a third party on behalf of those clients, could be subject to the requirements of the CISA, and must be analysed from the perspective of the Swiss regulation of collective investment schemes.

10 Cf. Article 3 SESTO.

Commercial undertakings generally do not fall within the scope of the CISA. However, it is only possible to draw the line between a commercial undertaking and a collective investment scheme on a case-by-case basis.

IV BANKING REGULATION

According to the Swiss Banking Act of 8 November 1934 (SBA), a banking licence requirement is triggered if a company conducting primarily a financial activity accepts deposits from the public (i.e., from more than 20 persons) or publicly advertises such activity. According to the Swiss Banking Ordinance of 30 April 2014 (SBO), entering into any liabilities would generally qualify as a deposit-taking activity, unless one of the exceptions defined in Article 5(2) and (3) SBO applies.

In the context of token sales, the most relevant exemptions are the following:

a to the extent that the liabilities are debt securities issued as standardised products suitable for mass trading and are documented with an offering prospectus including the information required under the CO, the liabilities do not qualify as deposits; and

b to the extent that the liabilities arise from client funds held on settlement accounts with securities dealers, asset managers or similar financial intermediaries, provided that such funds are used to settle client transactions, no interest is paid on the funds and – except for accounts with securities dealers – the settlement occurs within 60 days at the latest.

Further, Swiss law provides for a sandbox exemption pursuant to Article 6(2) SBO. According to such exemption, the acceptance of deposits from the public (i.e., from more than 20 persons) up to a maximum amount of 1 million Swiss francs is permitted without a banking licence, provided that no interest is paid on the deposited amounts, they are not reinvested, and the investor has been informed before accepting the deposit that the accepting person or entity is not subject to prudential supervision by FINMA, and that the investments are not protected by any deposit protection scheme. If a company pursues an activity of a commercial–industrial nature, the restriction on paying interest and the prohibition on reinvesting the deposited amounts do not apply.

When providing storage services regarding tokens, the question arises under what circumstances the activity requires a banking licence. This depends on whether the storage of the tokens gives rise to a liability of the storage provider or not.

With regard to brokerage services provided in respect of tokens, such activity could be subject to a banking licence if the service provider accepts fiat currencies or tokens on own accounts respectively public keys in connection with such services. In this event, the service provider would need to rely on the settlement account exemption mentioned above. However, it is currently not entirely clear to what extent this exemption applies to cryptocurrency traders that execute an activity comparable to foreign exchange traders (i.e., that expose their clients to similar bankruptcy risks as foreign exchange traders do).

V ANTI-MONEY LAUNDERING

i Applicable rules

Under Swiss law, the anti-money laundering regulation consists of the Swiss Anti-Money Laundering Act of 10 October 1997 (AMLA) and the Anti-Money Laundering Ordinance of 11 November 2015 (AMLO). The AMLA applies, *inter alia*, to financial intermediaries.

Besides entities subject to prudential supervision, in brief, anyone accepting, holding or depositing assets belonging to other persons or assisting in the investment of such assets on a professional basis qualifies as a financial intermediary according to Article 2(3) AMLA. Further, the AMLA contains a non-exhaustive list of activities that are considered financial intermediation. In the context of ICOs and tokens, the issuance of means of payment that cannot be used exclusively with the issuer,[11] providing services related to payment transactions in the form of money and asset transmission services,[12] and money exchange services,[13] are relevant financial intermediation activities.

A financial intermediary in the sense of the AMLA must be affiliated with an authorised AML self-regulatory organisation (SRO) or be directly supervised by FINMA for anti-money laundering (AML) purposes. Further, a financial intermediary has to comply with the obligations defined in the AMLA, including, without limitation, identification and know your customer (KYC) obligations relating to the contracting party and its beneficial owner, and has to file reports to the Money Laundering Reporting Office in cases of suspected money-laundering or terrorism financing.

ii ICOs

Depending on the classification of the tokens to be issued within an ICO, the issuance can qualify as financial intermediation activity. FINMA provides clarity in its ICO Guidelines on this matter:

a The issuance of payment tokens is classified as an issuance of means of payment and therefore constitutes a financial intermediation activity pursuant to the AMLA.

b The issuance of utility tokens that comprise some form of payment function on the designated application or platform, for example the ability to use the utility tokens to pay for services used on such platform, usually qualifies as issuance of means of payment and therefore constitutes a financial intermediation activity pursuant to the AMLA. However, the issuance of utility tokens does not qualify as financial intermediation if a utility token does not have any form of payment function or if the payment function is exceptionally considered as an ancillary function of the utility tokens.[14] In order to benefit from such an exception, it is required that such utility tokens' main purpose is to provide access rights to a non-financial application, that the entity providing the payment functionality is also the entity operating the non-financial application and that the access to the non-financial application could not be granted without including the ancillary payment functionality embedded in the utility token. However, note that FINMA applies this exception very restrictively, and in practice, any utility token with some sort of payment function is considered as a financial intermediation within the scope of the AMLA.

c The issuance of asset tokens does not qualify as financial intermediation activity pursuant to the AMLA, provided that such asset tokens are classified as securities, and provided further that such asset tokens are not issued by a bank, securities dealer or certain other prudentially supervised entities. However, in practice, issuers of asset tokens are often

11 Cf. FINMA Circular 2011/01, Financial intermediation according to AMLA, n 64.

12 Cf. Article 4(2) AMLO.

13 Cf. Article 5(1)(a) AMLO.

14 ICO Guidelines, Section 3.6; FINMA Circular 2011/01, Financial intermediation according to AMLA, n 13 et seqq.

required to conduct some KYC and identification processes on a voluntary basis due to the compliance requirements of the banks to which the proceeds of the ICO will be transferred.[15]

The issuance of rights to acquire tokens in the future within a pre-ICO does not constitute a financial intermediation activity, provided that the issuer is not a bank, securities dealer or certain other prudentially supervised entities. However, the subsequent issue of tokens that qualifies as issuance of a means of payment under the AMLA (i.e., payment tokens and, subject to the mentioned exceptions, utility tokens) to pre-ICO investors qualifies as financial intermediation. In consequence, the obligations arising from the AMLA are triggered in the moment of issuance.

FINMA specifies in connection with ICOs that fall within the scope of the AMLA that the obligations arising under the AMLA (e.g., KYC) can be outsourced to financial intermediaries in Switzerland that are affiliated with an SRO or under FINMA supervision, provided that any funds from the ICO are accepted via such financial intermediary: that is, any tokens or fiat currencies paid by investors have to be transferred to the public keys or accounts of the outsourcing partner before being transferred on to the relevant issuer.

iii Exchange and intermediation services

Exchanging fiat currencies against tokens or vice versa or exchanging two different tokens constitutes a financial intermediation activity subject to the AMLA.

If a service provider offers the exchange services directly (i.e., acts as an exchanging counterparty to its clients), such activity qualifies as money exchange under the AMLO. Note that for such services a *de minimis* threshold of 5,000 Swiss francs applies, and transactions below this threshold are exempted from KYC or identification obligations under the AMLA.[16]

If a service provider offers exchange services with the involvement of a third party (e.g., an exchange platform for tokens), or if the service provider intermediates services relating to the transfer or exchange of tokens or fiat currencies and is involved in the payment process, such services qualify as money and asset transmitting services pursuant to Article 4(2) AMLO and the service provider qualifies as a financial intermediary under the AMLA.

iv Storage services

A storage services provider qualifies as a financial intermediary if such storage provider has the power to dispose of the private keys of the stored tokens. Further, note that such activity could trigger a banking licence requirement (see Section IV).

15 Cf. Swiss Bankers Association, SBA guidelines on opening corporate accounts for blockchain companies, September 2018 (available at https://www.swissbanking.org/library/richtlinien/leitfaden-der-sbvg-zur-eroeffnung-von-firmenkonti-fuer-blockchain-unternehmen/?set_language=en).

16 Cf. Article 51(1)(a) FINMA Anti-Money Laundering Ordinance for entities that are subject to FINMA supervision or the relevant regulations of the SROs.

VI REGULATION OF EXCHANGES

i Tokens qualifying as securities

Exchanges for securities are regulated under the FMIA, which distinguishes between stock exchanges, multilateral trading facilities (MTFs) and organised trading facilities (OTFs). Stock exchanges and MTFs are trading venues allowing for the multilateral trading of securities, where trades are entered into on the basis of non-discretionary rules. Stock exchanges, as opposed to MTFs, further require a listing of securities, that is, a formal application process in order to be admitted on the stock exchange. Stock exchanges and MTFs qualify as financial infrastructures and require a FINMA licence according to Article 4 FMIA.

An OTF is a trading facility providing either for a multilateral trading of securities according to discretionary rules or of other financial instruments according to discretionary or non-discretionary rules, or for bilateral trading between the participants and the operator of the OTF. According to Article 43 FMIA, OTFs can only be operated by supervised banks, securities dealers, stock exchanges or MTFs that are authorised by FINMA to operate an OTF. Note that the term other financial instruments comprises in particular derivative instruments that do not qualify as securities.

A trading venue for asset tokens and utility tokens that qualify as securities would need to be licensed as a stock exchange or MTF or, if the trading activity qualifies as the operation of an OTF, the operator would require a licence as a bank or securities dealer with an approval from FINMA to operate an OTF.

ii Other tokens

In regards to the regulation of exchanges for payment tokens and utility tokens that do not qualify as securities, there are no licence requirements under Swiss law to operate such business in addition to ensuring compliance with Swiss AML requirements (see Section V). However, as the operation of such exchanges usually implies the acceptance of fiat currencies or such tokens on accounts or public keys of the exchange operator, a banking licence requirement could be triggered as an acceptance constituting an acceptance of deposits from the public (see Section IV).

Similar to the provision of brokerage services, an exchange may benefit from the exemption for settlement accounts if the clients' funds accepted on own accounts or public keys are used solely for the execution of trades on the exchange, are not interest-bearing and are transferred on within 60 days. Further, this exemption would only be applicable if the clients were not exposed to an increased bankruptcy risk similar to clients of a foreign exchange trader (see Section IV).

Further, an exchange can benefit from the sandbox exception pursuant to Article 6(2) SBO if fiat currencies and tokens with a value of less than 1 million Swiss francs are accepted from the exchange participants and if the participants are informed of the absence of any prudential supervision over the exchange operator and any protection from a deposit protection scheme.

In any event, the operation of an exchange for tokens constitutes a money and asset transmitting service pursuant to Article 4(2) AMLO. Therefore, an exchange operator qualifies as a financial intermediary that is, in particular, subject to the affiliation obligation with an SRO or a licence requirement by FINMA as a financial intermediary.

VII REGULATION OF MINERS

i Role of mining in virtual currency

In an unrestricted decentralised network (such as the Ethereum or Bitcoin blockchain), the mining of the native tokens of the relevant distributed ledger, usually a payment token, plays an essential role in the record-keeping of transactions on the distributed ledger as there is no central authority monitoring transactions. To secure financial transactions and ensure that there is no fraud, the miners (or crypto miners) must verify transactions and add them to the distributed ledger.

The work of the miners is open to the entire ecosystem of the distributed ledger: everybody can potentially participate on this network and mine tokens. For each block of transactions, miners use mathematical protocols to verify transactions and validate them before sharing the result across the entire network. This process creates virtual currency as the miners are awarded with new virtual currency for their mining activity.

ii Regulatory framework

There is currently no specific legislation addressing the regulatory status of miners in Switzerland. As of today, mining of tokens (self-issuance of tokens) does not trigger a licence requirement under Swiss law provided that the miner does not perform any activity falling within the scope of the regulated activities described in Sections II to VI.

Note that the self-issuance of tokens qualifying as securities is generally not subject to a licence requirement as securities dealer under the SESTA. This conclusion holds also true in the unlikely event that such tokens would qualify as derivatives provided that there is no offer of such derivatives to the public on a professional basis.

iii FINMA scrutiny and enforcement proceedings in connection with mining

FINMA has generally a favourable approach towards blockchain technology, but it monitors cautiously all market participants to ensure that the Swiss blockchain network remains free of fraud, in particular in the context of ICOs. FINMA regularly highlights the risks involved for investors, and is committed to take actions against ICO business models violating or circumventing regulatory laws.

The most recent example is the launch in July 2018 of enforcement proceedings by FINMA against a Swiss mining company owing to evidence of beach of regulatory laws. More precisely, the proceedings examined possible breaches of the SBA and potential unauthorised acceptance of public deposits in the context of an ICO.[17]

As the regulatory status of activities in connection with the mining of tokens may raise some issues, a no-action letter from FINMA, for example with regards to specific activities of a miner, is always advisable in order to obtain legal certainty that the contemplated activity complies with all regulatory laws (see Section II.iv).

17 https://www.finma.ch/en/news/2018/07/20180726-mm-envion/.

VIII REGULATION OF ISSUERS AND SPONSORS

i Issuers

In regards to the legal form for issuers of tokens, two types of forms are generally used: a foundation and a joint-stock corporation.

A foundation offers the complete independence and control of the board of the foundation as there are no shareholders. However, its assets must be used in line with the purpose of the foundation as stated in the deed of foundation. Therefore, the distribution of profits is limited to that purpose and it is not possible to distribute profits to the founders. In addition, every foundation is further subject to governmental supervision. Note that certain tax exemptions are available for foundations or stock corporations with public or non-profit purposes alike. However, the conditions for obtaining such exemptions are very restrictive and are usually not met by entities pursuing an ICO.

In the context of an ICO, to the extent that there is, at least partially, a commercial purpose, and the issuer is not pursuing a non-for-profit purpose, the legal form of the Swiss foundation is most of the time not suitable. Its rigid structure does not allow the flexibility that is generally needed, in particular as the founders have no ownership or any other control over the foundation's assets or funds and have no legal means to influence the foundation's conduct of business. Instead, a joint-stock corporation is the more suitable type of corporate form for issuers of ICOs.

An issuer of an ICO incorporated as a joint-stock corporation must have – unless it is incorporated with a contribution in kind – a paid-in capital of 50,000 Swiss francs (with a minimum share capital of 100,000 Swiss francs) deposited with a Swiss bank. However, following the incorporation, there is no restriction as to the place where the account is held. The issuer may also have an account with a foreign bank.

Note that the issuer must comply with the regulatory requirements, to the extent applicable to the issuer, as set out in Sections II to VI.

Depending on the classification of the tokens issued, an issuer of tokens may be subject to the AMLA if it carries out financial intermediation activities (see Section V.ii). In the context of ICOs and tokens, the issuance of means of payment that cannot be used exclusively with the issuer, the provision of services related to payment transactions in the form of money and asset transmitting services or money exchange services are, for example, financial intermediation activities (see Section V).

ii Sponsors

As long as there is no activity performed falling into the scope of the regulated activities described in Sections II to VI, the sponsorship of tokens – including the marketing, publicity and promoting of tokens – is currently not subject to licence requirements in Switzerland.

However, this is subject to the following:

a licence requirement under the SBA or the SESTA: if the sponsored company has a foreign regulatory status as a bank or securities dealer because it has the relevant regulatory status under the foreign legislation, it carries out activities qualified as banking or securities dealing under Swiss legislation or it uses the terms bank or securities dealer in its company name, any marketing activities in or from Switzerland for such foreign bank or broker-dealer – provided that such activities are performed

by individuals engaged in Switzerland, on a professional and permanent basis – may bring the foreign bank or broker-dealer within the scope of a FINMA branch office or representative office licensing requirement; or

b prospectus requirement: the public offering of tokens, if they qualify as equity or debt instruments, may be subject to the prospectus requirement in accordance with the CO.

IX TAX

The tax consequences of an ICO or token sale basically depend on whether the sold tokens qualify as debt or equity instruments. It is becoming apparent that the token categories developed by FINMA in its ICO Guidelines will also be applicable for tax purposes. Hence, the taxation of tokens depends primarily on whether they qualify as payment tokens, utility tokens or asset tokens. In this context, it should be mentioned that from a tax point of view no hybrid tokens will probably exist. Furthermore, it is important to know that there is currently no relevant case law, no uniform tax practice and no unanimous doctrine, which is why the following explanations are to be taken with caution. It is also expected that both the Federal Tax Administration as well as the cantonal tax administrations will publish practice guidelines on the taxation of tokens. Therefore, it is generally advisable to consult a Swiss tax adviser before an ICO or token sale. In many cases it will be also advisable to obtain an advance tax ruling from the competent tax authority in order to mitigate any adverse tax consequences.

A token sale can have the following tax consequences:[18]

i Corporate income tax

The corporate income tax (CIT) treatment of tokens depends on their legal nature. Proceeds from the sale of equity-based asset tokens should qualify as CIT-neutral capital contributions. Proceeds from the sale of debt-based asset tokens can be compared with taking out a loan that is not subject to CIT. In contrast, profits generated by the sale of utility tokens qualify as taxable income basically subject to CIT. However, in most cases the issuer will be obliged to use these proceeds for a specific product development. This obligation is likely to justify the recognition of a provision in the amount of the proceeds collected, which will reduce the taxable income accordingly. Thus, the token sale has no direct CIT consequences. The provision must be reversed in the course of product development. This reversal leads to taxable income, which is offset against the current expenses for product development. If the product development is not carried out by the issuer itself, but is outsourced to a third party, the tax authorities expect a minimum profit of cost plus 5 to 10 per cent to be left with the issuer, which implies that more provisions have to be released than actually necessary. Any profit of the issuer is subject to CIT at the federal, cantonal and municipal levels. Depending on the registered office of the issuer, the combined effective income tax rates currently range

18 The tax consequences described in this section are limited to those for issuers in connection with token sales. Any tax consequences for investors or employees (e.g., due to the allocation of tokens) are not addressed for space reasons. In addition, we have focused on the taxation of utility tokens and asset tokens.

between 12 and 24 per cent.[19] Finally, it should be noted that it will generally not be possible for the issuer to obtain an exemption from CIT, since an exclusively non-profit purpose is hardly ever pursued with a token sale.

ii Capital tax

Capital tax is only levied at the cantonal and municipal levels, and not at the federal level. It is based on the corporation's taxable equity. Proceeds from the sale of debt-based asset tokens are therefore not subject to capital tax, whereas proceeds from the sale of equity-based asset tokens are subject to capital tax. Gains from the sale of utility tokens are also subject to capital tax because such gains are ultimately recognised in the company's equity. The ordinary capital tax rates currently vary between 0.001 and 0.525 per cent, depending on the registered office of the issuer. Some cantons offset CIT against capital tax (i.e., capital tax is not levied in the amount of CIT).

iii Issuance stamp tax

Equity contributions to Swiss corporations are basically subject to issuance stamp tax of 1 per cent on the fair market value of the contribution. Accordingly, issuance stamp tax must be considered in particular for equity-based asset tokens. In contrast, it should not be possible to levy the issuance stamp tax on other tokens as there is typically no equity contribution.

iv Securities transfer tax

Securities transfer tax is levied on the transfer of taxable securities if a Swiss securities dealer in the sense of the Swiss Stamp Duty Act is involved in the transaction as a contracting party or as intermediary. Securities transfer tax amounts to 0.15 per cent on securities issued by a Swiss resident. Taxable securities include, but are not limited to, shares and bonds. The tokens will generally not qualify as shares but may qualify as bonds for securities transfer tax purposes. This applies in particular to debt-based asset tokens. However, it should be noted that primary market transactions such as issuance and redemption are not subject to securities transfer tax. Therefore, securities transfer tax is to be considered in particular at a later sale of the tokens by the investors.

v Withholding tax

The sale of equity-based asset tokens is not subject to withholding tax (WHT). However, any distributions made to the holders of those equity-based asset tokens are subject to WHT of 35 per cent. In the case of distributions on utility tokens in the form of a profit or revenue share, a case-by-case examination must be made as to whether WHT may have to be levied on these distributions as well. Distributions on debt-based asset tokens may also be subject to WHT if the asset token qualifies as a bond for WHT purposes.

vi Value added tax

Revenues from the sale of goods and services within Switzerland and Liechtenstein are generally subject to VAT at the standard rate of currently 7.7 per cent. The sale of pure payment tokens is considered as an exchange of payment means and not as a sale of goods

19 The effective income tax rates are to be reduced as a result of the corporate tax reform. According to the current planning status, the maximum CIT rate will be around 19 per cent.

and services. Accordingly, such a sale is not subject to VAT. The sale of asset tokens is also exempt from VAT. In contrast, the sale of utility tokens is regarded as a taxable service, which is why VAT of 7.7 per cent must be levied on the utility tokens sold to Swiss and Liechtenstein investors. The sale of utility tokens to foreign investors, on the other hand, is not subject to VAT, as this regularly qualifies as a non-taxable export of services.

X LOOKING AHEAD

Going forward, a banking licence 'light' will be introduced for entities accepting deposits from the public up to a maximum amount of 100 million Swiss francs without paying interest and reinvesting such deposits. With the banking licence light, an entity will – among other exemptions from the regulatory requirements otherwise applicable to banks – have less burdensome capital requirements than under a full banking licence. The new regime will be introduced in the context of the adoption of the Swiss Financial Services Act and the Swiss Financial Institutions Act. We expect that it will be available as of the beginning of 2020 and may be an interesting option for entities active in the crypto space that intend to take deposits from the public.

Swiss law is also about to be aligned in certain respects with the EU rules of MiFID II, PRIIPS and the EU prospectus rules under the Swiss Financial Services Act that is scheduled to enter into force at the beginning of 2020. In this context, the rules of the public offering of securities in primary markets and the disclosure requirements for financial instruments will be changed. This will also have to be taken into account for the purposes of token sales.

Finally, further legislative developments will have to be monitored in the future as the supervisory authorities are paying more attention to the compliance of token issuances with securities and financial markets laws generally.[20]

20 For a recent example in Switzerland, reference is made to the FINMA enforcement proceedings regarding the Envion ICO (see https://www.finma.ch/en/news/2018/07/20180726-mm-envion/).

Appendix 1

ABOUT THE AUTHORS

OLIVIER FAVRE

Schellenberg Wittmer Ltd

Olivier Favre is a partner in Schellenberg Wittmer's banking and finance group in Zurich. Olivier focuses on derivatives, structured finance and capital markets transactions, and advises clients on financial services, securities, commodities, fund and insurance regulation. He also advises clients on FinTech solutions and their legal implementation. He acts for a broad range of clients, including financial institutions, buy-side firms, issuers, insurance companies and industry associations. Olivier is an authorised representative at the SIX Swiss Exchange.

Olivier obtained a doctorate degree in law from the University of Zurich in 2003 (*iur*, 2003) and a master's degree in law from Harvard Law School (LLM, 2004). For his doctorate thesis, he received the Issekutz Award for outstanding achievements in business law from the University of Zurich.

Prior to joining Schellenberg Wittmer in 2009, Olivier practised as a lawyer in London, specialising in OTC derivatives and structured finance transactions, fund products and capital markets transactions. From 2004 to 2007, he was an associate in Allen & Overy LLP's London-based derivatives practice group. From 2007 to 2009, Olivier was legal counsel in the derivatives and structured finance group at Goldman Sachs International in London.

TAREK HOUDROUGE

Schellenberg Wittmer Ltd

Tarek Houdrouge is a partner in Schellenberg Wittmer's banking and finance, and corporate and commercial group in Geneva. Tarek's main areas of expertise are banking and finance, transactions and corporate law, combining banking and finance expertise with an M&A practice. He advises banks and financial institutions on regulatory matters and clients on financing and M&A, in particular involving regulated financial institutions. Tarek's practice also covers commercial contracts and commercial transactions, including restructuring, private equity and joint ventures.

Following his Swiss Bar admission in 2006, Tarek obtained a master of laws from Northwestern University School of Law (Chicago) in 2010 and was admitted to the New York State Bar in 2011. Prior to joining Schellenberg Wittmer, where he has been a partner since 2017, Tarek worked at another big business law firm in Geneva.

FABIO ELSENER

Schellenberg Wittmer Ltd

Fabio Elsener is an associate in Schellenberg Wittmer's banking and finance group in Zurich.

Fabio Elsener studied law at the University of Zurich (master of law 2013) and at the Maastricht University in the Netherlands (LLM 2012). During his studies he worked as a legal associate in a FinTech startup in Zurich and completed internships in law firms in Zurich and Paris, France.

Following the completion of his studies, Fabio Elsener gained experience as a legal intern at the Enforcement Division of FINMA, the Swiss Financial Market Supervisory Authority, in Berne.

Fabio Elsener joined Schellenberg Wittmer in 2014 as a trainee lawyer. After his admission to the Bar he rejoined the firm as an associate in 2016.

SCHELLENBERG WITTMER LTD

15bis, rue des Alpes
PO Box 2088
1211 Geneva 1
Switzerland
Tel: +41 22 707 8000
Fax: +41 22 707 8001
geneva@swlegal.ch
tarek.houdrouge@swlegal.ch

Löwenstrasse 19
PO Box 2201
8021 Zurich
Switzerland
Tel: +41 44 215 5252
Fax: +41 44 215 5200
zurich@swlegal.ch
olivier.favre@swlegal.ch
fabio.elsener@swlegla.ch

www.swlegal.ch

ISBN 978-1-912228-77-5