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New Swiss legal framework for digital assets on distributed ledgers

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Key Take-aways

- 1.** The new Swiss DLT Act aims at improving the legal framework for digital assets held on distributed ledgers by amending various existing laws rather than regulating digital assets in a separate stand-alone regulation.
- 2.** The DLT Act introduces DLT rights as a new concept for rights registered on distributed ledgers. It also expands the right of investors to set-aside crypto-assets held in custody.
- 3.** The DLT Act will amend the current Swiss regulation by introducing a new licence category for trading venues where securities registered on distributed ledgers may be traded.

1 Introduction

As regards regulatory compliance, digital assets issued on a distributed ledger (**Tokens** or **Crypto-Assets**) and applications using the distributed ledger technology (**DLT**) are currently subject to Swiss laws and regulations that have existed long before the first DLT applications were developed. The Swiss Financial Market Authority (**FINMA**) applies such laws and regulations in a **technology-neutral** manner to Crypto-Assets and DLT applications on the basis of the 'same risks, same rules' principle. Switzerland will not depart from this approach going forward. As regards the classification of Tokens, the classification into **cryptocurrencies**, **utility tokens** and **asset tokens** will continue to apply. Please see in this respect the [FINMA Guidelines of February 2018 on ICOs](#) and of [September 2019 on stablecoins](#) and our earlier newsletters from March [2018](#) and [2019](#).

However, Swiss **securities laws** in their current form are a limiting factor as regards the issuance and trading of capital markets instruments in the form of Crypto-Assets. Aiming at expanding the potential use-cases of such technology going forward and at the same time putting the transactions on a robust legal basis, the Swiss Parliament adopted on 25 September 2020 an act to improve the current legal framework for DLT (the **DLT Act**).

The DLT Act amends – without regulating or endorsing any particular technology – various existing laws in order to remove legal obstacles that hampered the development of a functioning market for Tokens that are a digital representation of financial instruments. The most important innovations of the DLT Act are the introduction of

- i. "DLT rights" as new type of right designed for digital assets (the **DLT Rights**, see section 2 below);
- ii. a right to set-aside Crypto-Assets held by a custodian for clients (see section 3 below); and
- iii. A new license category for trading venues for DLT Rights and foreign securities that are transferred on a distributed ledger (see section 4 below).

The Federal Council announced that the DLT Act will presumably enter into force on 1 August 2021 together with the implementing secondary legislation by way of amendment of the relevant ordinances. These amendments to the ordinances are currently under consultation until the 2 February 2021.

2 DLT Rights

2.1 Eligible Rights

DLT Rights may become the digital equivalent of certificated securities or uncertificated securities by **linking** a right to a **registration on a distributed ledger** instead of a certificated security instrument or a registration in an uncertificated securities register. DLT Rights may not be exercised or transferred outside of the relevant distributed ledger. As regards the scope of DLT Rights, any rights that could be issued as certificated or uncertificated securities may be issued as DLT Rights. Therefore, they may be used to represent:

- i. **fungible** contractual **claims** (e.g. debt obligations);
- ii. **non-fungible** contractual **claims** (e.g. claims arising from license agreement);

- iii. **membership rights** that can be issued as certificated or uncertificated securities (e.g. shares in stock corporations); and
- iv. **rights in rem** that can be issued as certificated or uncertificated securities (e.g. mortgage certificates).

However, cryptocurrencies or the possession or factual control of assets could not be issued as DLT Rights.

2.2 Issuance of DLT Rights

According to the DLT Act, the issuance of DLT Rights requires (i) the **registration** of a right on a distributed ledger on the basis of an agreement between the issuer and the first holder stipulating the registration of the relevant rights on a distributed ledger and (ii) the **undertaking** that such rights may only be transferred and exercised on the relevant distributed ledger. In addition, it is advisable that the parties specify explicitly their intention in the terms of the DLT Rights to create DLT Rights and that Swiss law shall be the applicable law. Without such choice of law, the Swiss Private International Law Act as amended by the DLT Act stipulates that the laws of the place of incorporation or residence of the issuer, subject to special rules for rights *in rem*, apply.

Moreover, the DLT Act specifies that the distributed ledger must ensure that (i) exclusively the holders of the DLT Rights (and not the debtor) can dispose of the DLT Rights, (ii) its integrity is protected by appropriate technical and organizational measures against unauthorized access and changes, (iii) its terms of operations and the terms of the relevant DLT Rights and the registration agreement are recorded on or accessible through the distributed ledger, and (iv) the register entries are visible to the public. However, the DLT Act does not define any technical requirements, e.g. regarding the minimum number of participants in the ledger or the applied consensus mechanism.

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2.3 Transfer and "ownership"

Once created, DLT Rights can only be **transferred in accordance with the rules of the relevant distributed ledger**. This process will usually require that the Tokens constituting DLT Rights are transferred from the public key of the transferor to the public key of the transferee and that the persons who are entitled to dispose of the DLT Rights have the relevant private key (either held directly or indirectly by a wallet provider). It is no longer relevant how the relevant rights represented in the DLT Right would be transferred without the digital representation in a DLT Right, as it would currently be the case. The DLT Act

will provide for a rule on the **finality** of such transfers even if the transferor falls into insolvency. Holders of DLT Rights will also benefit from *bona fide* protection rights similar to holders of paper-form security certificates in case they have acquired DLT Rights from an unauthorized seller.

Furthermore, the DLT Act will also specify how **security interests** can be created in respect of DLT Rights by way of a pledge or a title transfer security.

2.4 Use as underlying of book-entry securities

By amending the Swiss Federal Act on Intermediated Securities (**FISA**) the DLT Act allows the creation of book-entry securities with DLT Rights as the underlying assets. To create such **book-entry securities**, the DLT Rights must be (i) transferred to a custodian that may act in such capacity under the FISA (e.g. a bank, securities firm or central securities depository), and (ii) credited to one or more securities account(s) by such custodian. The DLT Rights themselves must be immobilized in the sense that they are kept in custody by the custodian and cannot be transferred on the distributed ledger anymore. Once DLT Rights are held as book-entry securities under the FISA, they may only be transferred as book-entry securities in accordance with the rules of the FISA.

The MiCA Regulation apply also to cross-border issuances of Swiss issuers.

2.5 Qualification of DLT Rights as securities

While the DLT Act **extends the current definition of securities** set-out in the Financial Market Infrastructure Act to **DLT Rights**, DLT Rights qualify as securities under Swiss law if they are standardized and suitable for mass trading (**DLT Securities**). These conditions are met if DLT Rights are issued with identical terms to at least 20 investors. DLT Rights qualifying as securities must comply with the general requirements applying to securities under Swiss financial markets regulation.

In practice, most DLT Rights that are not individually-structured will qualify as securities, except if they fall within the category of utility tokens as defined by FINMA.

3 Setting-aside rights of Crypto Assets in a bankruptcy case

Where Crypto-Assets (including DLT Rights and Tokens issued in any other form, e.g. cryptocurrencies or utility tokens) are held in custody by a bank or any other entity with registered offices in Switzerland, such Crypto-Assets may be **set-aside** in its insolvency if the Crypto-Assets are either held (i) on a **segregated**

basis (e.g. on individual public addresses for each client) or (ii) on an **omnibus client account** (e.g. on a shared public address for more than one client) on the condition that the proportional share of each client can be ascertained.

Where Crypto-Assets are held on a segregated basis, the provider of such custody services would not hold client deposits and such service provider would not be subject to a bank licensing requirement. However, under the draft ordinances relating to the DLT Act, holding payment tokens via omnibus client accounts would bring the service provider into the scope of a **bank license requirement as a "bank light"**.

4 Trading platform for DLT Securities

The DLT Act introduces a new license category for trading platforms, where DLT Securities are traded. The legislator thereby departs from its principle of a technology-neutral regulation in order to remove the barriers which currently do not allow the set-up of **trading venues for trading DLT Securities** in Switzerland (at least for as long as such DLT Securities are not structured as book-entry securities). So far trading venues may not integrate post-trading activities into the trading platform. Separate central counterparties and central securities depositories are required for the clearing and settlement of transactions. As regards transactions on distributed ledgers, such post-trading activities are typically executed simultaneously with a transaction through registration of the relevant transaction on the distributed ledger without the involvement of additional intermediaries handling the clearing or settlement. Also, such trading venues would not be permitted to provide a direct access to retail clients at present.

The DLT Act will amend the Swiss Financial Market Infrastructure Act by introducing **DLT trading systems** as platforms providing for multilateral trading of DLT Rights or other foreign law governed rights that are represented on a distributed ledger qualifying as DLT Securities (on the basis of non-discretionary rules and which meet at least one of the following requirements:

- i. the trading system allows the trading by unregulated entities or individuals as participants;
- ii. the operator of the trading system deposits centrally DLT Securities on the basis of uniform rules; or
- iii. the operator of the trading system performs the post-trading activities with DLT Securities (e.g. clearing and settlement) on the basis of uniform rules and procedures.

Moreover, the DLT Act will allow a firm regulated as a securities firm or as a bank to operate an organized trading facility (**OTF**) for the trading of DLT Rights. To be licensed as a securities firm, the firm will not have to reach a minimum threshold with its own account trading activity.

5 Proposal for European MiCA Regulation

The European Commission published on 24 September 2020 a legislative proposal for an EU Regulation on Markets in Crypto-Assets (**MiCA Regulation**). This proposed MiCA Regulation would introduce a comprehensive regulatory framework

regarding the issuance of Crypto-Assets and certain services provided in respect of Crypto-Assets. Crypto-Assets with similar features as e-money would become subject to regulatory requirements that are similar as those currently applicable in the EU under the E-money regulation. To the extent that the Crypto-Assets do not have the features of e-money, but reference underlying assets, they would be classified as "asset-referenced tokens". Except for certain exemptions by reference to a maximum issuance amount and the status of the investors as professional clients, such instruments may only be issued by issuers incorporated and authorised for such activity in the EU. Other Crypto-Assets would become subject to certain minimum disclosure requirements, including e.g. certain requirements regarding the white paper.

The obligations of the proposal **apply also to cross-border issuances of Swiss issuers** into the EU and,

therefore, if implemented as proposed, will become relevant also for Swiss issuers of DLT Rights and other Tokens.

6 Outlook

The introduction of DLT Rights in Swiss law with the DLT Act will remove the most relevant obstacles for the development of a **functioning primary and secondary market in digital assets** in Swiss law and create a sound legal basis for issuing and trading rights represented in Tokens. The new rules will establish settlement finality for transfers on a distributed ledger for Tokens representing rights. However, for cross-border issuances, the impact of the new legislation may be limited in the future by new legislation that is currently underway in other relevant markets such as the proposed MiCA Regulation in the EU.



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