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Panel 10: Cryptocurrencies – A virtual reality?

Co-Chairs:
Carlos Mauricio Mirandola, Vortx DTVM, São Paulo
Manoj Pundit, Borden Ladner Gervais LLP, Toronto

Panelists :
Andrea Huber, Loyens & Loeff Switzerland LLC, Zurich
James Bergin, Federal Reserve Bank of New York, New York

PART SWITZERLAND

I. Update and trends – general state of FinTech innovation in Switzerland

The digitalization of the financial services sector is one of the most exciting developments in the past years, and Switzerland has a leading role in many of these respects. Globally, every tenth FinTech start-up company was founded in Switzerland. Switzerland has progressed into a leading global FinTech hub, in particular in the area of blockchain and cryptocurrencies because of its stable political, legal, economic, social and technological environment.

Back in February 2017, the Swiss Federal Council held a FinTech consultation proposing three measures to promote innovation in the financial sector and to remove barriers to market entry for FinTech companies including a "sandbox" exemption, a settlement accounts exemption and a FinTech license ("banking license light"). The amended Swiss Federal Banking Ordinance (*BO*) has been entered into force on 1 August 2017 introducing the "sandbox" exemption and the extended timeframe for settlement accounts.

On 21 June 2018, the Swiss Federal Department of Finance initiated a consultation regarding a newly created FinTech license which will enable companies that are not banks to accept public deposits up to an aggregate amount of CHF 100 million. The new legislation may already enter into force on 1 January 2019.

1. “Sandbox” Exemption

As a first measure, a “sandbox” exemption has been introduced as of 1 August 2017 that allows to engage in certain activities which under the previous regulation would have triggered a banking license.

Under the “sandbox” exemption, public deposits can be accepted without a banking license, provided that liabilities towards clients and investors never exceed the threshold of CHF 1 million in aggregate, irrespective of the number of public deposits and the deposits accepted are neither invested nor interest-bearing. These client deposits must be liquid and available at any time. This exemption is not only available to FinTechs but also to any other type of business.

In addition, clients must be informed individually and not later than at the time of the contractual commitment (*Verpflichtungsgeschäft*) that there is neither a prudential supervision nor a deposit insurance. A disclaimer in the general terms and conditions is not sufficient, however, information the client via a website is permitted if the lack of prudential supervision and deposit insurance is showed separately to the client. Such information must be displayed in text and in a form which is reproducible. Also, explicit acknowledgement of the client is required.

Should the company exceed the threshold of CHF 1 million, it must notify the Swiss Financial Market Supervisory Authority (FINMA) within 10 days and an application for a banking license must be filed within 30 days. The company does not need to reduce or return the amount exceeding CHF 1 million if the license application is filed within such timeframe.

2. Extended Timeframe for Settlement Accounts

Secondly, according to the amendment of the BO as per 1 August 2017, the settlement accounts exemption has been extended from 7 days to 60 days. It has been specifically created to facilitate the operation of business models with the purpose of transmitting funds (e.g. money transmitting, crowdfunding or payment collection). Securities dealers, however, are not affected by the settlement period and, therefore, are not limited in their activities. Further, cryptocurrency dealers do not benefit from the exemption, provided that their activity is comparable to the one of a foreign currency dealer. Lastly, credit balances on client accounts of precious metal dealers fall under the exemption if a precious metal dealer is in physical possession of the precious metal credit of its client and such client is entitled to a preferential claim in case of the precious metal dealer’s bankruptcy. Precious metal dealers are not limited in their activities by the 60 day-period.

Certain amendments to the Consumer Credit Act have been passed by the Swiss Parliament on 15 June 2018 affecting the crowdlending business. In particular, a crowdlending intermediary will be

required to review the credit standing of the consumers (art. 27a of the revised Consumer Credit Act) and will have to report loans granted to the consumer credit information office (art. 25 of the revised Consumer Credit Act).

3. New FinTech License

A third measure – a FinTech license under art. 1b of the Swiss Federal Banking Act (BA) – was discussed by the Swiss Parliament in connection with the introduction of the Financial Services Act (FIDLEG) and the Financial Institutions Act (FINIG) which were passed on 15 June 2018 and are expected to enter into force on 1 January 2020. This new type of "banking license light" will be available – if certain requirements are met – not only to FinTech firms but also to any other company not engaging in commercial banking and not accepting public deposits of more than CHF 100 million in total. The deposits accepted can neither be invested nor bear interest.

a. General Provisions

Pursuant to art. 1b para. 1 of the BA, anyone active in the financial sector, accepting deposits from the public up to CHF 100 million in a commercial capacity and neither investing these deposits nor paying any interest will benefit from the new FinTech license with simplified requirements. Anyone within the scope of art. 1b of the BA must inform its clients in a clear and comprehensive manner about the risks related with the business model, the services and technologies used and that deposits accepted under the FinTech license will not be covered by a deposit insurance. As these points are crucial for clients, the information duty cannot be fulfilled via disclaimer in the general terms and conditions and clients must be informed individually and at the latest at the time of contractual commitment (*Verpflichtungsgeschäft*). Group companies shall be deemed affiliated companies if they are perceived as economic units or if they are obliged to support each other. The threshold of CHF 100 million will generally apply to the entire group.

b. Organizational Requirements

An application for a FinTech license shall provide the same information and documents on the persons either entrusted with its administration and management or in their capacity as holders of qualifying equity interests as currently applicable for banks in art. 8 BO. Form of legal entity pursuant to art. 1b of the BA can either be a stock corporation (*Aktiengesellschaft*), a partnership limited by shares (*Kommanditaktiengesellschaft*) or a limited liability company (*Gesellschaft mit beschränkter Haftung*). The company must have its registered office and its core business in Switzerland. As for banks, the company must describe in detail its business areas in its articles of association or organizational regulations. The description must remain objective and exactly define the geographical scope of the activities. Business area and geographical scope shall correspond to the company's

financial capacities as well as to its board and management organization. Any subsequent changes in the articles of association or organizational regulations require prior FINMA approval.

Factually, the company shall be managed from Switzerland. The management team members must have their place of residence at a location which is suitable for the proper management of the business operations. Like for banks or asset managers of collective investment schemes if the company's purpose or volume of business call for a special governing body to enable adequate guidance, supervision and control, the respective body must consist of at least three members. Moreover, at least one third of the board members must be independent from the management team, taking into consideration that FinTech companies often are start-up companies. Further, qualified shareholders of the licensed company with a stake of 10% or higher do not need to be independent from the management team. This certainly makes sense for start-up constellations but constitutes an unequal treatment of asset managers of collective investment schemes – notably a lower type of license in the FINIG licensing cascade – where at least two thirds of the board members cannot engage in operative activities and at least on third of the board members needs to be independent from the qualified shareholders.

Pursuant to art. 1b BA, the respective persons must ensure compliance with legal and regulatory requirements and establish an effective risk management framework as well as an internal control system must be ensured. The functions supervising compliance and risk management must be segregated from the profit-oriented business, but under certain circumstances, the FINMA can grant easement from such requirement if the gross proceeds are lower than CHF 1.5 million and the business model only has limited risks. Supervision of compliance and risk management can be outsourced to third parties if certain requirements are met. Instruction and supervision of third parties must be provided by the license holder pursuant to art. 1b of the BA.

Public deposits must be kept in Switzerland separate from own funds of the company. A separation per client, however, will not be required by law. The funds must be liquid at any time, and no investment or payment of interest will be permitted. Further, specific rules for conflicts of interests will apply. This new provision takes into consideration that certain FinTech business models may not offer financial services within the scope of the FIDLEG so that additional rules will apply in this respect.

c. Capital Requirements

Capital and audit requirements are substantially reduced compared to the fully-fledged banking license. The minimum capital pursuant to art. 1b BA shall amount to 5% of the public deposits received in the sense of art. 5 BO but at least CHF 300,000. It must be fully paid-in, kept at any time and cannot be borrowed or invested. The capital shall solely be used for the purpose of the company. Taking into consideration specific risk aspects, FINMA can implement stricter requirements in certain cases. The Capital Adequacy Ordinance for banks will not apply to license holders pursuant to art. 1b

BA. With respect to accounting and audit standards, the general standards of the Swiss Code of Obligations will apply and not the standards of the BA.

d. Conclusion

The implementation of the FinTech license will boost innovation and significantly lower the market entry hurdles for FinTechs accepting public deposits. To enable the establishment of a level playing field, however, regulatory practice for comparable financial institutions subject to prudential revision such as asset managers should also be reviewed by FINMA.

II. Current status of ICO regulation in Switzerland

On 16 February 2018, FINMA published ICO guidelines as Switzerland has seen a rapidly growing number of planned or executed initial coin offerings (ICOs) in Switzerland, in particular in the Canton of Zug (so-called cryptovalley). Swiss financial law and regulation are not applicable to all ICOs, so each ICO must be reviewed and analyzed on a case-by-case basis. In particular, the following laws may apply:

- **Banking Act:** Accepting public deposits in the context of an ICO may trigger the requirement for a banking license.
- **Stock Exchange Act:** Depending on the qualification of the tokens, a securities dealer license may be required in case the tokens are treated as securities.
- **Collective Investment Schemes Act:** Compliance with the Collective Investment Scheme Act may be required if the assets collected in the course of the ICO are pooled and managed by a third party in view of a return of profit.
- **Prospectus requirements:** If tokens are designed as equity or debt instruments or if they are going to be distributed to the broad public, it needs to be analyzed whether a prospectus will be required. The FIDLEG is currently expected to enter into force on 1 January 2020 which will amend the current prospectus regime.
- **Anti-Money Laundering Act:** If the token qualifies as a payment instrument or if one virtual cryptocurrency is exchanged against another virtual cryptocurrency, the Anti-Money Laundering Act may apply mainly for brokers and platforms (for further details, see section III. Below).
- **Cross-Border Compliance:** Depending of the structure of the ICO, the domicile of the company and the target markets, further cross-border regulations may apply.

For the qualification of the tokens, see section IV. below.

In the meantime, a few Swiss tax authorities have issued official guidance on how cryptocurrencies should be treated when it comes to personal income. For both income and wealth-tax purposes, any

type of cryptocurrency must be declared in the personal income tax declaration. It is also noteworthy that the mining of bitcoins is deemed to be a self-employed activity, and thus requires the payment of both income taxes and social security contributions.

In principle, the proceeds from an ICO are regarded as taxable income for the purposes of corporate income tax. Stakeholders would thus be well advised to address corporate income tax aspect in advance. Further, depending on the specific features of the token, the ICO may be exempt from, or out of scope for, Swiss VAT, or it may be regarded as a supply of services that are subject to Swiss VAT.

III. Anti-money laundering issues

The objective of the Anti-Money Laundering Act (AMLA) is to protect the financial system from money laundering and the financing of terrorism. Pursuant to art. 2 para. 3 lit. b of the AMLA, anyone who provides payment services or issues or manages any means of payment, is considered to be a financial intermediary. Means of payment include transfer of assets by a third party in the context of a payment system, regardless of whether the payment system can only be accessed by a limited number of users. Two-party relationships (issuer of the means of payment and user of the payment system are identical), however, are not subject to the AMLA.

The exchange of a cryptocurrency for fiat money, for example, or the offer to transfer tokens if the service provider maintains the private key, are subject to the AMLA.

AMLA due diligence and reporting requirements include, among others:

- Not accepting assets originating from criminal activities;
- Establishing the identity of the client and the beneficial owner(s) of the assets;
- Clarifying the economic background of suspicious business relationships;
- Clarifying and recording relationships and transactions involving increased risks;
- Complying with organizational measures;
- Filing a report with the Money Laundering Office Switzerland (MROS) in case of suspicious activities.

In connection with the new FinTech license described above, it has become necessary to revise the FINMA Anti-Money Laundering Ordinance (AMLO-FINMA) as these institutions will be subject to the AMLA. The partial revision of the AMLO-FINMA sets out the duties of due diligence for future FinTech license holders. Since these entities are expected to be small institutions, less stringent organizational requirements than those applicable to banks are proposed below certain thresholds. This applies in particular to the requirement that banks set up an independent competence center for money-laundering issues entrusted with control tasks.

In principle, the same duties of due diligence under anti-money laundering legislation as for directly subordinated financial intermediaries (DSFIs) will apply in view of their similar size. In contrast to DSFIs, however, entities under art. 1b of the BA accept deposits from the public and thus engage in higher-risk business, so not all of the relief granted to DSFIs will be applicable to them.

IV. Cryptocurrency trading – regulatory issues

There is no established legal doctrine in Switzerland regarding the qualification of tokens. The FINMA, however, differentiates between (i) payment tokens, (ii) utility tokens and (iii) asset tokens, based on the underlying economic function of the token.

a. Payment tokens

A payment token (synonymous with cryptocurrency) is intended to serve as a mean of payment, means of money or value transfer and is a digital unit of value. Cryptocurrencies give rise to no claim on their issuer. There is a number of views as to whether tokens which give rise to no claims on their issuer constitute securities or not. Given that payment tokens are designed to serve as means of payment and are not analogous in their function to traditional securities, FINMA will payment tokens not treat as securities. However, if payment tokens were to be classified as securities by new case law or legislation, FINMA expects to revise its practice.

b. Utility tokens

Utility tokens provide digitally access to an application or service by means of a blockchain-based infrastructure at the point of issue. To qualify as an utility token according to the FINMA guidance, on the one hand, the sole purpose of the token is to confer digital access rights to an application or service (i.e. no investment function) and a token can actually be used in this way at the point of issue. Utility tokens typically do not qualify as securities.

c. Asset tokens

Asset tokens represent assets such as debt, equity or other claim on the issuer, e.g. a share in future company earnings or capital flows. In terms of their economic function, these tokens are analogous to equities, bonds or derivatives. Tokens which enable physical assets to be traded on the blockchain also fall into this category.

FINMA treats asset tokens as securities. Asset tokens constitute securities within the meaning of art. 2 lit. b of the Financial Market Infrastructure Act (FMIA) if they represent an uncertificated security and the tokens are standardized and suitable for mass standardized trading. Further, an asset token qualifies as a security if it represents a derivative (i.e. the value of the conferred claim depends on an underlying asset) and the token is standardized and suitable for mass standardized trading. In the case of the pre-financing and pre-sale phases of an ICO which confer claims to acquire tokens in the

future, these claims will also be treated as securities if they are standardized and suitable for mass standardized trading.

d. Legal implications in case of securities

Under the Stock Exchange Act (SESTA), book-entry of self-issued uncertificated securities in question is generally unregulated, even if the uncertificated securities in question qualify as securities within the meaning of the FMIA. The same applies to the public offering of securities to third parties. The creation and issuance of derivative products as defined by the FMIA to the public on the primary market is regulated under art. 3 para. 3 on the Stock Exchange Ordinance (SESTO). If conducted in a professional capacity, underwriting and offering of tokens constituting securities of third parties publicly on the primary market is a licensed activity under art. 3 para. 2 SESTO.

In addition, the issuing of tokens with similar features as equities or bonds may trigger the prospectus requirement under the Swiss Code of Obligations. Under the FIDLEG, which is expected to enter into force on 1 January 2020, prospectus requirements will become part of the supervisory law.

The following implications result for ICO organizers:

- Self-issuance of securities is neither regulated under FMIA nor SESTA. The same applies in case of a public offering of securities to third parties without intermediaries;
- Creation and issuance of derivative products under FMIA to the public on the primary market is subject to regulation (art. 3 para. 3 SESTO);
- Issuance of equities or bonds can result in an obligation for an prospectus under the Swiss Code of Obligations.

For intermediaries, the following implications need to be taken into consideration:

- Underwriting and offering of tokens constituting securities of third parties publicly on the primary market, if conducted in a professional capacity, is subject to FINMA license (art. 3 para. 2 SESTO);
- Securities dealers who, in a professional capacity, trade securities in their own name for the account of clients and maintain accounts for these clients or with third parties for the settlement of transactions or hold securities of these clients in custody themselves or with third parties in their own name are also subject to FINMA license (art. 3 para. 5 SESTO);
- For trading venues and organized trading facilities, specific licensing requirements apply (art. 26 et seq. FMIA and art. 42 et seq. FMIA).

Annex – Timeline ICO

Timeline ICO

LOYENS & LOEFF