

Briefing September 2019

Swiss Financial Market Supervisory Authority Publishes New Guidelines for Stable Coins

Against the backdrop of the growing number of projects for so-called "stable coins" since mid-2018, the Swiss Financial Market Supervisory Authority ("**FINMA**") published new guidelines on 11 September 2019 explaining the regulatory qualification of tokens that are linked to underlying assets such as fiat currency, commodities or securities with the goal to minimise fluctuations in their market value. The new guidelines supplement FINMA's ICO guidelines of 16 February 2018, which continue to apply. While the stable coin guidelines are general in nature, their publication coincides with the recent announcement by the Swiss based Libra Association to launch a payment token that is backed by a basket of fiat currencies, a project that has attracted worldwide attention by governments and regulators.

Background

On 11 September 2019, FINMA published guidelines with a focus on "stable coins" (the "**Stable Coin Guidelines**") as a supplement to its February 2018 guidelines for enquiries regarding the regulatory framework for initial coin offerings (the "**ICO Guidelines**"). The Stable Coin Guidelines confirm FINMA's principle-based and technology-neutral approach to financial market regulation and provide a high-level overview of the regulatory qualification of stable coins under Swiss financial market laws, in particular with respect to the Swiss Banking Act, Collective Investment Schemes Act, Anti-Money Laundering Act and Financial Market Infrastructure Act. FINMA distinguishes between four categories of stable coins by reference to the underlying assets (see further below).

Supplemental Rules for Stable Coins

Since the release of FINMA's ICO Guidelines in February 2018, FINMA has observed an increasing number of projects for tokens that are linked to underlying assets such as a basket of currencies or commodities. For the purposes of the Stable Coin Guidelines, FINMA refers to such tokens as "stable coins", although it considers that this is primarily a marketing term. The aim of linking tokens to underlying assets is to prevent speculative swings which are typical for "traditional" payment tokens such as Bitcoin or Ether and, ultimately, to help establish cryptocurrencies as a stable, low-volatility means of payment. Against this background and given that there are no specific rules for stable coins under Swiss law, the Stable Coin Guidelines outline FINMA's approach for the application of the legal and regulatory framework to such coins.

¹ <https://www.finma.ch/en/~media/finma/dokumente/dokumentencenter/myfinma/1bewilligung/fintech/wegleitung-stable-coins.pdf?la=en>

FINMA does not consider stable coins to be a new type of token. It emphasises that the categorisation set out in the ICO Guidelines remains applicable although it is rather unlikely that utility tokens will be backed by underlying assets. Since stable coins are in most cases intended to serve as a means of payment or value transfer, they often qualify as a form of payment token even if the holder may redeem the token for the underlying assets with the issuer (which would otherwise indicate an asset token). Stable coins which are used as a means of payment fall within the scope of Swiss anti-money laundering (AML) regulation.

The Stable Coin Guidelines also focus on Swiss fund regulation, which was previously only addressed in a generic way in FINMA's ICO Guidelines. Where a stable coin is deemed a unit in a collective investment scheme (see below), it may also qualify as an asset token.

Same Risks, Same Rules

In the Stable Coin Guidelines, FINMA follows its well established approach of focusing on the economic function and the purpose of a token ("*substance over form*") and applying the existing regulatory framework in a technology-neutral manner according to the principle "*same risks, same rules*" while continuing to evaluate projects on a case-by-case basis (even taking into account advertising claims relating to a particular coin). This means, for example, that a stable coin exposing its holders to risks that are similar to those found in a banking relationship may trigger a banking licence requirement for the issuer pursuant to the Swiss Banking Act, while a stable coin with similarities to a fund unit may be subject to licensing obligations under the Swiss Collective Investment Schemes Act.

Categorisation of Stable Coins based on their Underlying

Stable coins may take many different forms depending on their legal, technical, functional and economic design. Nevertheless, the new Stable Coin Guidelines

establish four main types of stable coins based on the type of underlying.

The issuer of a stable coin **backed by currencies** may require a licence as a bank if the holder of the coin has a right of redemption at a fixed price against the issuer (e.g. 1 coin equaling 1 CHF) because in such a set-up, the issuer may be deemed to have accepted deposits from the public (an activity reserved to banks if performed on a commercial basis). By contrast, if the coinholder has the right to redeem the stable coin only at the current value of an underlying currency basket (*i.e.* at net asset value), the coin may qualify as a unit in a collective investment scheme rather than as a deposit. To distinguish between a deposit and a unit in a collective investment scheme, FINMA looks at the question as to who will bear the risks related to the management of the underlying assets (such as profits or losses from interest, market fluctuations of the underlying assets, or counterparty and operational risks). If it is the coinholder that bears those risks, then the coin is likely to qualify as a unit in a collective investment scheme. Otherwise, if it is the issuer that bears such risks, it may constitute a deposit from the public.

The licensing requirements for an issuer of stable coins **backed by commodities** depend on the type of underlying commodity and whether the coinholder has a contractual claim only or acquires a right in *rem* in the underlying commodity. FINMA considers that issuers of the latter type of coin are not subject to financial market regulations. The qualification of a coin representing a contractual claim against the issuer, on the other hand, depends on the type of underlying commodity. Depending on the design of such stable coins, their issuer may require a banking or securities dealer licence. The coin itself may constitute a security and potentially also qualify as a derivative or as a unit in a collective investment scheme.

Redeemable stable coins which are **backed by real estate** will in most cases fall within the scope of the Swiss Collective Investment Schemes Act and require a licence thereunder (unless a statutory exemption applies) since the underlying real estate will usually be managed by the issuer on behalf of

the coinholders and the latter do not have a right in *rem* in the real estate.

A stable coin that is **backed by a single security** and that provides for a (contractual) right of the coinholder in the underlying security likely qualifies as a security itself. By contrast, if the underlying assets are composed of **several securities**, the respective stable coin constitutes in most cases a unit in a collective investment scheme.

Further, in the Stable Coin Guidelines, FINMA warns market participants of fraudulent projects relating to stable coins which claim to rely on a stabilisation mechanism that in fact does not exist.

New Prospectus Requirements under the Financial Services Act

Although the prospectus requirements in respect of stable coins are not discussed in detail in the Stable Coin Guidelines, it is worth noting that with the new Swiss Financial Services Act (expected to enter into force as of 1 January 2020), the prospectus requirements for all tokens (including stable coins) that qualify as securities will undergo substantial changes. Whereas under the current rules, the issuer would only be required to prepare a prospectus if the token represents shares, bonds or units of collective investment schemes, the rules under the new Swiss Financial Services Act require the preparation and approval by a Review Board (*Prüfstelle*) of a prospec-

tus for the public offering of all tokens (including stable coins) qualifying as securities unless an exemption applies. Furthermore, for certain tokens qualifying as financial instruments which are offered to retail clients, a key information document must be prepared.

Conclusion

The stabilisation mechanism adds an additional layer of complexity to the regulatory treatment of stable coins vs. other types of tokens. While the Stable Coin Guidelines set out the framework on which FINMA bases its assessment of stable coins, FINMA reiterates at the same time that a case-by-case analysis will be required depending on the specific features of a stable coin. Consequently, issuers of stable coins will have to make a careful assessment of the impact of the stabilisation mechanism on their regulatory status and the regulatory qualification of the coins they plan to issue. Requesting a ruling from FINMA based on a detailed description of the stabilisation mechanism and the underlying assets will in our view continue to be good practice for most projects.

Moreover, issuers of stable coins and other tokens in general have to assess the implications of the anticipated entry into force of the Financial Services Act on 1 January 2020 for their projects, in particular with respect to prospectus requirements and the obligation to prepare a key information document for certain tokens.

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