

Briefing February 2018

Swiss Financial Regulator FINMA Releases Regulatory Guidelines for Initial Coin Offerings (ICO)

With Switzerland continuing to be among the dominant jurisdictions for establishing and developing blockchain-driven businesses, many of which are financed by way of ICOs, the Swiss Financial Market Supervisory Authority FINMA on 16 February 2018 published a guidance paper setting forth in broad strokes its intentions for future regulatory practice in this area. FINMA also clarified its expectations with respect to the requirements for no-action letter requests or more generally regarding enquiries concerning the application of Swiss financial market laws in the context of specific ICO projects.

The “FINMA Guidelines for Enquiries Regarding the Regulatory Framework for Initial Coin Offerings (ICOs)” published on 16 February 2018 (FINMA ICO Guidelines¹) follow FINMA’s initial high-level guidance paper on the regulatory treatment of initial coin offerings published in September 2017 (FINMA Guidance 04/2017). The FINMA ICO Guidelines aim to inform prospective and existing market participants as to how FINMA intends to respond to enquiries regarding the Swiss legal and regulatory framework for ICOs. The Guidelines also summarise the principles FINMA applies to assess individual projects under the various Swiss financial market laws, in particular anti-money laundering and securities regulation.

FINMA Continues to Evaluate Projects on a Case-by-Case Basis

The FINMA ICO Guidelines reiterate the point made in previous guidance: FINMA will consider proposed ICO projects on a case-by-case basis. The Guidelines provide a general framework. However, FINMA does not consider it feasible, given the dynamics of the market, to stipulate generally applicable, hard-and-fast rules. FINMA also emphasises that it will assess ICO projects based on a substance over form view taking into account the underlying economic purpose. Based on these key statements, it will in our view continue to be good practice to present Swiss ICO projects to FINMA for no-action confirmation or

¹ Available on the FINMA website under <https://www.finma.ch/en/~media/finma/dokumente/dokumentencenter/myfinma/1bewilligung/fintech/wegleitung-ico.pdf>

confirmation of the applicable regulation. FINMA seeks however to streamline this process and the FINMA ICO Guidelines include in their annex a questionnaire outlining the key factual elements FINMA requires to assess a regulatory enquiry in connection with a planned ICO. Enquiries can be submitted to FINMA in a Swiss official language (German, French or Italian) or, notably, in English.

Categories of Tokens

Recognising that there is no established categorisation of blockchain tokens/coins in the market, the FINMA ICO Guidelines outline a basic system with three main categories of economic token functionalities, which can be combined to form hybrid models:

- **Payment tokens** (*Zahlungs-Token*): Tokens which are factually used or intended by the issuer to be used as a means of payment for goods or services or as a means for the transfer of money or value. In FINMA's categorisation, payment tokens are not coupled with any claim against the issuer. FINMA considers this category to be synonymous with the term "cryptocurrencies" in their pure form (such as Bitcoin).
- **Utility tokens** (*Nutzungs-Token*): Tokens intended to provide access to a digital application or service which is rendered using a blockchain.
- **Asset tokens** (*Anlage-Token*): Tokens representing a specific asset or claim, in particular a debt claim against the issuer or an equity position/ corporate membership right in the issuer. By way of example, asset tokens may – economically – represent a share, bond or derivative instrument, entailing a promise by the issuer to share a proportional part of future profits or other fund flows with the tokenholders. Tokens intended to enable physical assets to be traded on the blockchain also fall into this category.

Further to this basic categorisation, the FINMA ICO Guidelines distinguish between tokens immediately issued in the context of the ICO fundraising on an

existing blockchain and the mere promise to investors

of a future token issuance and allocation where such tokens or the underlying blockchain are still in development (referred to as "pre-financing"). Furthermore, FINMA refers to a "pre-sale" as an initial distribution of tokens entitling investors to acquire different tokens at a later point in time.

Tokens and Securities Regulation

So far, there was no clear position under Swiss law as to what types of tokens would qualify as securities, with many practitioners leaning towards the view that a security token must be coupled with some form of right or claim against the issuer.

The FINMA ICO Guidelines refer to the investor and market protection purposes of Swiss securities regulation and note that FINMA is bound by the definition of securities in the Financial Market Infrastructure Act (FMIA). The definition includes certificated securities (*Wertpapiere*) or uncertificated securities (*Wertrechte*) as well as derivatives and intermediated securities that are standardised and suitable for mass trading, requiring that they be publicly offered in a standardised structure and denomination or are placed with more than 20 clients (except if they are created specifically for individual counterparties). FINMA further states that the securities register (*Wertrechtbuch*) required for the creation of uncertificated securities can be kept in digital form on a blockchain.

On this basis, FINMA qualifies the individual token categories as follows:

- **Payment tokens:** FINMA does not consider payment tokens to qualify as securities (consistent with its practice regarding Bitcoin and Ether). However, FINMA notes that this view might have to be revised if mandated by future legislative action or case law.
- **Utility tokens:** As long as their function is limited to providing a right of access to a digital

application or service and the token is actually usable in this sense at the point in time of issuance, utility tokens are not seen as capital market instruments and consequently not as securities. However, if the economic purpose of the token is an investment, at least partially, FINMA will treat utility tokens as securities.

- **Asset tokens:** FINMA considers asset tokens to be securities, specifically if they represent an (uncertificated) security or a derivative. FINMA further notes that claims in the context of pre-financings and pre-sales can qualify as securities. In each case, the prerequisite for a security qualification is that the tokens are standardised and suitable for mass trading.

The FINMA ICO Guidelines do not specifically address asset tokens referring to specific physical assets in the context of securities regulation. In our experience, these types of tokens have so far not been treated as securities, but this remains to be clarified given the categorisation now established by FINMA. It is also noteworthy, even though FINMA generally does not consider utility tokens to be securities, that it may qualify them as such if it believes them to include an investment function. This caveat appears to align FINMA's position on utility tokens to some extent with recent communications by the US SEC in respect of the Munchee Inc. ICO project.

If a token is qualified as a security, the issuer will need to prepare a prospectus pursuant to the Swiss Code of Obligations, if the tokens represent shares or bonds. Furthermore, if the tokens represent derivatives, the issuer may be subject to a licence requirement as a securities dealer.

In addition, although the FINMA ICO Guidelines do not address this point directly, the securities qualification will affect the regulatory requirements for players in the secondary market, e.g. trading or exchange platforms.

Tokens and AML Regulation

Anti-money laundering (AML) regulation remains a focus area for FINMA, in particular in connection with new technologies enabling the storage and transfer of values. In the context of ICOs, the FINMA ICO Guidelines state that token issuers may qualify as so-called financial intermediaries subject to Swiss AML regulation if, in particular, they provide payment services or issue payment instruments.

On this basis, FINMA qualifies the individual token categories as follows:

- **Payment tokens:** FINMA considers ICOs of payment tokens to qualify as the issuance of payment instruments triggering AML-obligations as soon as the tokens can be transferred by technical means on the blockchain infrastructure (this may be upon issuance or at a later point in time).
- **Utility tokens:** ICOs of utility tokens may qualify as issuance of payment instruments in a similar manner as is the case for payment tokens. However, the FINMA ICO Guidelines note that AML regulation may not apply in the individual case if the token is mainly intended to provide access to a blockchain infrastructure for purposes outside of the financial sector (based on an exemption from AML regulation for value transfers as an accessory service).
- **Asset tokens:** ICOs of asset tokens are not considered an issuance of payment instruments by FINMA and are therefore, in principle, not subject to AML regulation.

As a general matter, financial intermediaries are required to join a recognised Swiss self-regulatory organisation (SRO) for AML purposes or submit to direct AML-supervision by FINMA. However, according to the FINMA ICO Guidelines, it is sufficient in the context of an ICO that the committed funds are

collected by a Swiss regulated financial intermediary. If this is the case, the token issuer itself does not need to submit to AML regulation.

Banking and Fund Regulation

The FINMA ICO Guidelines only briefly touch on the topic of banking regulation in the context of ICOs. In particular, according to the Guidelines, the issuance of tokens is not typically associated with a repayment obligation of the issuer, in which case the latter is, consequently, not seen as accepting deposits from the public in the meaning of the Swiss Banking Act. Debt obligations or repurchase commitments of the issuer towards the tokenholders must be assessed in each individual case, with e.g. standardised bond obligations not qualifying as deposits from the public based on a specific exemption.

Swiss collective investment schemes (fund) regulation is not substantively addressed in the FINMA ICO Guidelines. However, it should be noted that the rules on collective investment schemes may apply if an ICO serves to raise funds to be pooled and managed on behalf of the tokenholders.

Summary and Outlook

While many aspects of financial market regulation in the context of the blockchain remain open at this point, the FINMA ICO Guidelines provide a clearer picture for persons intending to launch an ICO-financed project in the future. The document also expresses FINMA's commitment to respond to well-documented and reasoned enquiries by interested parties as to the regulatory treatment of their planned tokens. FINMA indicates in the Guidelines that it may publish further guidance on ICOs in the more formal format of a circular in the future once it has settled into a consistent practice. Separately, one has to bear in mind that requirements based on foreign laws may have to be met by the issuer or

other involved parties in an ICO project depending on the relevant target markets.

The media release accompanying the FINMA ICO Guidelines² stresses that FINMA recognises the innovative potential of blockchain technology and is generally supportive of ICO projects conducted in a lawful manner by legitimate innovators. However, FINMA also draws the attention of investors to the risks associated with providing financing to early stage projects through an ICO and the volatility of blockchain tokens in general.

Separately from FINMA's efforts in the context of blockchain, the Swiss Federal Council currently examines whether regulatory measures with regard to Fintech are necessary. In this context, the Federal Department of Finance (FDF) together with the State Secretariat for International Financial Matters and FINMA have been tasked to work on further defining the legal qualification of cryptocurrencies and regulatory requirements for ICOs.

To accelerate the process, the FDF launched a blockchain/ICO task force (in which Bär & Karrer is represented) to identify the areas to be addressed in future legislative and regulatory projects. The task force will further debate risks and opportunities for Switzerland in this sector.

Separately, professional organisations representing the interests of the blockchain industry are driving self-regulatory initiatives. In particular, the Zug-based Crypto Valley Association recently presented a policy framework including a Code of Conduct for Decentralized Ecosystems outlining best practice guidance for ICOs by its members. In particular, the code emphasises transparency and the requirement to present the business model, token functionality and use of proceeds in a clear and comprehensible format.

² Available on the FINMA website under <https://www.finma.ch/en/~media/finma/dokumente/dokumentencenter/8news/medienmitteilungen/20180216-mm-ico-wegleitung.pdf>

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