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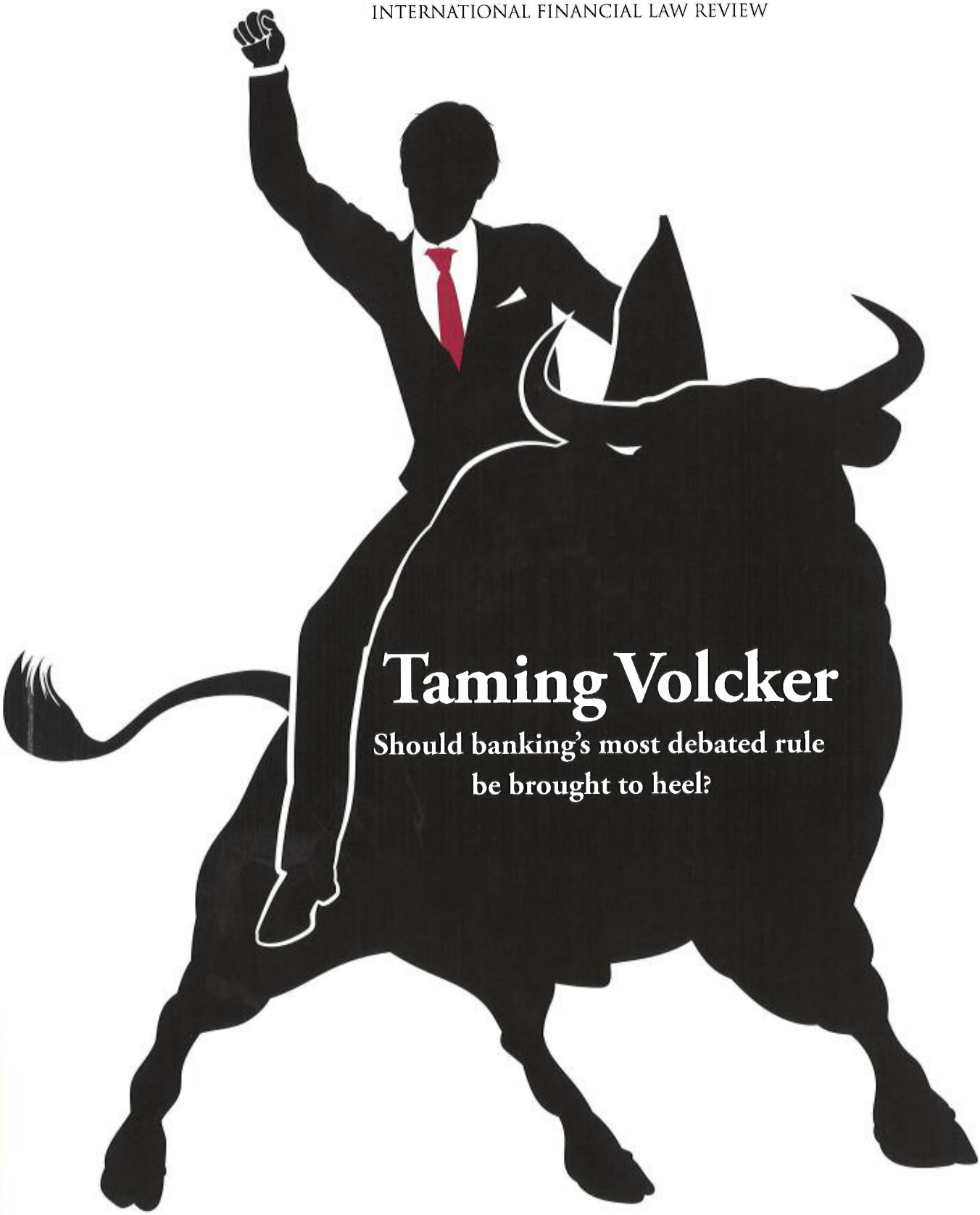

Taming Volcker

Should banking's most debated rule be brought to heel?

US litigation: latest on Lehman

How the EU creditor hierarchy is changing

Electronic stock ledgers & DLT

Fintech special focus: Asia & EU highlights

FINTECH SPECIAL FOCUS
SWITZERLAND

Prudent legislating, Swiss-style

Daniel Flühmann, Eric Stupp, Peter Hsu and Rashid Bahar of Bär & Karrer look at the steps taken by Swiss regulators to lay down a framework for the fintech sector

The Swiss fintech and crypto landscape has evolved significantly over the past years, leading up to a recent boost in regulatory developments with further changes on the horizon.

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Status quo and the upcoming agenda on fintech

Swiss financial regulation is characteristically principle-based rather than rule-based, allowing it to cope with a good measure of innovation without the need for constant changes to the legal framework. Nevertheless, the Swiss Financial Market Supervisory Authority (Finma) undertook significant efforts to support the emerging fintech sector and to clarify regulatory uncertainties, starting in late 2016. In particular, Finma amended some of its regulatory circulars to be technology-neutral, with a view to facilitating fintech business models without foregoing its regulatory objectives. Thus, it lifted the formal requirement for asset management contracts to be agreed in writing and enabled video and online identification processes to satisfy client onboarding requirements stemming from Swiss anti-money laundering (AML) regulation. Finma also launched a dedicated fintech desk to address requests in the areas of fintech and cryptocurrencies.

Further to the measures taken by Finma, certain regulatory easements targeting – but not limited in scope to – fintech operators were enacted in 2017 by the Swiss Federal Council (the Swiss federal government). Specifically, the Federal Banking Ordinance (BO) was amended with effect as of August 1 2017 to broaden the space within which a fintech business can operate without triggering a requirement to obtain a full banking licence. This was mainly achieved by allowing the holding of third party monies in interest-free settlement accounts for a longer period of time (60 days instead of the previous seven) without such funds qualifying as (bank-type) deposits from the public. In addition, a regulatory sandbox regime was introduced, allowing the acceptance of client deposits in an amount of up to CHF1 million

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(approximately $1.04 million) without a banking licence.

That said, important items of the Swiss fintech agenda will only enter into force at a later stage, given that they require amendments to federal statutory laws. In particular, these include the envisaged new fintech licence type (sometimes referred to as a banking licence light) as well as certain amendments to the consumer credit regime in Switzerland with a view to crowdfunding (see further below). It is expected that such amendments to statutory laws will become effective in January 2020.

Initial coin offerings

Separately from its focus on fintech, Finma has become more active in the area of blockchain-driven business models and initial coin offerings (ICOs), since 2017.

On the one hand, Finma was swift to take enforcement action as the hype around cryptocurrencies was building. It closed down certain non-compliant digital coin providers and initiated investigative proceedings regarding several ICOs.

On the other hand, Finma expressed support for blockchain technology and, in particular, issued guidelines on the regulatory treatment of ICOs in February 2018. The guidelines supplement an earlier, more general guidance paper and summarise the principles Finma applies in assessing ICO projects and, more generally, blockchain tokens, under various Swiss financial market laws. In particular, Finma's focus in the area of ICOs lies on assuring compliance with securities offering, trading and exchange rules as well as AML regulation.

Finma was swift to take enforcement action as the hype around cryptocurrencies was building

As a general principle, Finma reviews ICO projects presented to it on case-by-case basis. To facilitate this process and to guide interested parties, it defined three main categories of tokens based on their economic functionality: (1) payment tokens, (2) utility tokens and (3) asset tokens. Finma uses these token categories to assess requests regarding the regulatory qualification of tokens and token offerings using a regulatory matrix. In particular, tokens may qualify as securities (this is in particular the case for asset tokens and utility tokens lacking a fully developed technical functionality) or as payment instruments in the meaning of AML regulation (as with payment tokens and utility tokens where the payment aspect is not merely of an accessory nature).

The so-called three buckets concept used in Finma's ICO guidelines intentionally leaves room for hybrid token models. Finma even indicated in a recent roundtable event that it expects tokens to change their regulatory classification over the course of their lifetime. For instance, a utility token might qualify as a security at the point in time of the ICO, but potentially no longer once the development of the platform enabling the actual utility of the token is completed and the platform becomes operative. Finma so far left it open how it intends to address this particularity going forward.

In our view, the Finma ICO guidelines have a remarkable impact on pending and future ICOs. In particular, it appears the archetype of a utility token, ie a token that neither qualifies as a security subject to securities laws nor as a payment instrument subject to mandatory AML regulation, will have a very narrow field of application. Rather, Finma's classification is such that many tokens will qualify as securities. Token sales are also more likely to become subject to mandatory AML/KYC duties (though voluntary KYC processes have been put in place for many ICOs already in the past for various reasons including the exclusion of investors from jurisdictions with a less than welcoming regulatory environment).

Under Swiss law, the shift towards a security qualification of tokens means that issuers may need to prepare a prospectus if the tokens represent shares or bonds. Moreover, tokens that are considered securities at their

place of issuance are, as a factual matter, more likely to qualify as securities also in other jurisdictions in which they are offered, potentially triggering filing or registration duties for public offerings in a number of places. As a further consequence, the secondary market in tokens will be impacted, with brokers, underwriters and exchange platforms facing more stringent regulatory requirements if they offer or trade in securities.

A new regulatory licence type will be introduced to address the perceived needs of fintech businesses

While many will see this trend towards a professionalisation of the ICO and secondary token markets as a drawback, there can be little doubt that at least a moderately regulated environment will be beneficial for sustainable development of blockchain-based financing and token-operated business models in the long term.

Against this background, Finma expressed its willingness to examine well-documented ICO projects (the annex to the ICO guidelines specifies the documentation requirements) and to provide a view on the regulatory qualification and associated duties. It will therefore in many cases remain good practice to obtain regulatory clearance for a particular ICO structure or business model before the launch (Finma does not review projects that have been launched prior to its involvement, but may initiate enforcement proceedings if it has a concern that they do not comply with financial markets laws and regulations). Finma also intends to further develop the regulatory practice in the blockchain space and it may in the future issue a more detailed circular on the topic.

Blockchain task force

On a more fundamental level, the Swiss Federal Department of Finance (FDF) launched a blockchain task force (in which our law firm is also represented) to further analyse the current legal and regulatory framework around blockchain tokens and to identify the areas to be addressed in future legislative and regulatory projects.

The blockchain task force is not only focused on matters of financial regulation, but also discusses civil law aspects. In particular, one of the topics of the position paper the task force is expected to publish in late April 2018 revolves around the transfer of uncertificated securities (*Wertrechte*) and other rights represented in a token under Swiss civil law. Furthermore, the position paper will address the treatment of tokens under AML, securities and banking regulation.

Fintech licence

As mentioned above, significant developments in fintech regulation will unfold in the near future. In particular, a new regulatory licence type will be introduced to address the perceived needs of fintech businesses (though, in the spirit of technology-neutral regulation, the licence will also be available to businesses without a fintech angle).

The new licence type will bridge the gap resulting from the fact that, as a general principle, only regulated banks in Switzerland are allowed to accept deposits from the public on a professional basis, although many developing fintech businesses, such as crowdfunding platforms, by design need to accept and hold on deposit substantial client funds without actually engaging in typical commercial banking. Such businesses have a very different risk profile from a bank but are at present relegated to either operating under the exemptions from the definition of deposits from the public (eg the abovementioned settlement account exemption) or settling for a full banking licence. However, most fintechs would not go down the second route given the demanding standards which have to be fulfilled in order to obtain and maintain a Swiss banking or securities dealer licence.

In response to this dilemma, to lower the market entry barrier, the Swiss Federal Council proposed in late 2016 to introduce a new licence type for fintech innovators with significantly less onerous regulatory requirements than those applying to a traditional banking licence. The creation of

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this new licence type requires an amendment of the Swiss Banking Act by Parliament. Taking into account the current pace of the dispute resolution process between the two chambers of Swiss Parliament (the law-making project has been piggybacked onto a larger proposal for revision of Swiss financial services and financial institutions laws), the new rule is expected to enter into force in January 2020.

Pursuant to the draft of the relevant new provisions, the holder of a fintech licence will be allowed to accept deposits from the public in amounts up to a total of CHF100 million, subject to the competence of Finma to approve a higher maximum amount if adequate safeguards for the protection of customers are in place.

Although the Banking Act will apply by analogy to fintech licence holders, the requirements for obtaining and maintaining the licence, in particular organisational, capital and audit requirements, are expected to be significantly reduced when compared with a banking licence on account of the different risk profile of fintech operators. The deposits will also not be protected by the Swiss depositor protection scheme, a fact that the licence holders will need to inform their clients about.

As a counterpart for the less onerous regulatory requirements, a fintech licence holder will not be allowed to pay interest on or re-invest the deposits, effectively excluding the conduct of typical commercial banking business. It remains to be seen how the new licence type will be received in the market once introduced (in preparation, in 2017 Finma launched a voluntary survey to gauge interest and gather information on potential activities that might be conducted under the new licence). The success will in our view be highly dependent on the final implementation of the rule, the handling of the application process for the new licence by Finma and the practical ongoing compliance burden on the licence holders.

This process has been undertaken so far in a prudent and considered manner without any apparent tendency for regulatory overkill

Consumer protection in crowdlending

Crowdlending as an alternative source of funding has shown rapid growth rates in Switzerland. However, consumer credit regulation has not evolved at the same rate, leading to potentially inferior consumer protection, mainly due to the lack of reporting duties to central credit information depositories in crowdlending scenarios. This gap is created by the fact that non-professional lenders acting on a crowdlending platform are typically exempt from duties under the Consumer Credit Act. Furthermore, the platforms themselves only have limited duties based on their status as an intermediary. As a consequence, traditional consumer credit providers (or other crowdlending platforms or lenders) may not have the full picture of a potential borrower's existing credit exposure when assessing his or her creditworthiness.

This information asymmetry is intended to be addressed by a revision of the Consumer Credit Act, which will subject crowdlending intermediaries (ie platforms) to certain reporting duties and further obligations in connection with the review of the creditworthiness of the borrowers. This shift of responsibility from the lenders to the intermediary should close the gap outlined above. The changes are expected to enter into force concurrently with the fintech licence project.

Legislating in moderation

The Swiss law-making bodies and Finma, as the main financial regulator, have taken up the challenge of addressing the increasingly rapid developments in the areas of fintech and cryptocurrencies. In our view, this process has been undertaken so far in a prudent and considered manner without any apparent tendency for regulatory overkill. As a result, the climate in Switzerland for financial innovators remains favourable, as evidenced by the ever-increasing number of start-up companies and experienced players in Switzerland alike becoming active in these areas.