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FINMA Guidelines on initial coin offerings

To date, Switzerland has no specific regulation on initial coin offerings (ICOs) or virtual currencies. Nor is there any relevant case law or consistent legal doctrine on the matter. Yet, increased clarity on the applicable rules is crucial in light of a dynamic market and a high level of demand.In its Guidelines published earlier this year the Swiss Financial Market Supervisory Authority (FINMA) indicates how it intends to apply the existing financial market legislation to enquiries on the part of ICO organisers. Moreover, the text defines the information FINMA requires to address such enquiries as well as the principles on which it will base its decisions.

FINMA's approach: case-by-case assessments and a token classification

According to FINMA, each case needs to be decided on its individual merits. As already noted in FINMA Guidance 04/2017, the financial market regulation potentially impacts ICOs in several areas. However, these rules are not applicable to all projects. Depending on the specific design of the ICOs, they may not always be subject to regulatory requirements. In other words, circumstances must be assessed on a case-by-case basis.When evaluating ICOs, FINMA will above all consider the economic function and purpose of the blockchain-based units (i.e., tokens) issued by the ICO organiser. In this regard, the key criteria are (a) the underlying purpose of the tokens and (b) whether they are already tradeable or transferable. While there exists no generally recognised terminology for the classification of tokens, FINMA has established three types of tokens:• **Payment token**s are synonymous with cryptocurrencies. They give rise to no claims on their issuer. Payment tokens are intended to be used now, or in the future, as a means of payment for acquiring goods and services or as a means of money or value transfer. • **Asset tokens** represent assets such as debt, equity or other claim on the issuer (for instance, participations in companies, or earnings streams, or an entitlement to dividends or interest payments). In terms of their economic function, the tokens are analogous to equities, bonds or derivatives. Tokens that enable physical assets to be traded on the blockchain also fall into this category. • **Utility tokens** are intended to provide digital access to an application or service by means of a blockchain-based infrastructure at the point of issue.With regard to the three categories, FINMA notes that the function – and hence the classification – may change over time. In addition, it points to the possibility of hybrid tokens given that the classifications are not mutually exclusive.

Importance of anti-money laundering and securities regulation

According to FINMA's analysis, money laundering and securities regulation are the most relevant to ICOs. By contrast, the Banking Act, which governs deposit-taking, or the Collective Investment Schemes Act, which governs investment fund products, are generally not applicable.The Anti-Money Laundering Act (AMLA) aims at protecting the financial system against the risks of money laundering and the financing of terrorism. It goes without saying that money laundering risks are particularly high in a decentralised blockchain-based system, where assets can be transferred anonymously and without any regulated intermediaries. The AMLA imposes a range of obligations on financial intermediaries, for instance, to establish the identity of beneficial owners. Anyone who provides payment services or who issues or manages a means of payment is a financial intermediary subject to the AMLA.Switzerland's securities regulation draws on a range of texts, in particular the Financial Market Infrastructure Act (FMIA), the Stock Exchange Act (SESTA), the Stock Exchange Ordinance (SESTO) and the Code of Obligations (CO). The rules aim at ensuring that (a) market participants can base their decisions about investments on a reliable minimum set of information, and (b) trading be fair, reliable and offer efficient price formation.Based upon the two aforementioned criteria (i.e., function and transferability) and in light of the applicable laws, FINMA will

treat ICO enquiries as follows:• **Payment ICOs**: For ICOs where the token is intended to represent a means of payment and can already be transferred, FINMA will require compliance with anti-money laundering regulations, but will not treat such tokens as securities. • **Asset ICOs**: FINMA considers asset tokens as securities, which means that there are securities law requirements for trading in such tokens, as well as civil law requirements under the CO (e.g. prospectus requirements). • **Utility ICOs**: These tokens do not qualify as securities if their only purpose is to provide digital access rights to an application or service and if the utility token can already be used in this way at the point of issue. However, if a utility token constitutes, exclusively or partially, an investment in economic terms, FINMA will treat such tokens as securities (i.e., in the same way as asset tokens).

The implications of the applicability of the securities law

In cases where the securities law is applicable to ICOs, there are noteworthy implications for both the ICO organisers (A) and the intermediaries (B).*A. Consequences for ICO organisers*• Self-issuance of securities is not regulated under the FMIA or the SESTA. The same applies to the public offering of securities to third parties without intermediaries. • However, the creation and issuance of derivative products as defined by the FMIA to the public on the primary market is regulated (Art. 3 para. 3 SESTO). • The issuing of equities or bonds can result in prospectus requirements under the Swiss Code of Obligations, which are currently not subject to supervisory law. • However, according to the Financial Services Act (FinSA), that is expected to enter into force in January 2020, prospectus requirements will become part of supervisory law (Art. 35 FinSA).*B. Consequences for intermediaries:*• Underwriting and offering tokens constituting securities of third parties (e.g. an ICO organiser) publicly on the primary market, if conducted in a professional capacity, is a licensed activity (Art. 3 para. 2 SESTO). • Client dealers, i.e., securities dealers who, in a professional capacity, trade in securities in their own name for the account of clients and maintain accounts for these clients themselves or with third parties for the settlement of transactions or hold securities of these clients in safe custody themselves or with third parties in their own name (Art. 3 para. 5 SESTO), are also subject to FINMA licensing requirements. • Specific licensing requirements apply for trading venues (stock exchanges or multilateral trading venues, Art. 26 seqq. FMIA) and organised trading facilities (Art. 42 seqq. FMIA).

Outlook

The Guidelines constitute an important contribution to sustainably establishing blockchain technology in Switzerland. FINMA supports the federal government’s Blockchain/ICO Working Group in which it is participating. After further consolidation of the supervisory practice, it may in future decide to publish its interpretation in the form of a circular.Julien DIF, Switzerland