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FinTech Developments

FINMA publishes Guidelines for initial coin offerings (ICOs)

The Swiss Financial Market Supervisory Authority (FINMA) published Guidelines for enquiries regarding the regulatory framework for initial coin offerings (ICOs). In the Guidelines, FINMA informs how it deals with the supervisory and regulatory framework for ICOs under Swiss law. The Guidelines provide specific information to assess the regulatory framework for ICOs.

1. Key Issues

Already in its Guidance 04/2017 published on 29 September 2017, FINMA highlighted areas in which ICOs may be covered by financial market regulations, but without providing much guidance on how the issues will be assessed. In its new Guidelines published on 16 February 2018, FINMA clarifies the principles on which it will base its response to specific enquiries and provides a checklist of information to be provided if negative clearance is requested from FINMA.

2. Substantial Contents

- A key message given by the Guidelines is that **FINMA continues to be ready to review ICOs** and to give negative clearance, as far as regulatory aspects are concerned. When reviewing a project, FINMA will consider, among others, not only the investor categories an ICO targets, compliance with AML regulations, and the functionalities of the token generated including the rights it confers to the investor, but also the technologies used (distributed ledger technologies, open source etc.), the technical standards (such as the Ethereum ERC20) and the wallets and technical standards to transfer tokens.
- FINMA distinguishes **three token categories**: (1) Payment tokens (i.e. cryptocurrencies), which are intended to be used as a means of payment and do not grant any claims against the issuer of the token; (2) utility tokens, which grant access to an application or service, and (3) asset tokens, which represent assets such as a debt or equity claim against the issuer, or which enable physical assets to be traded on the blockchain. If a token combines functions of more than one of these categories, it is considered a hybrid token and has to comply with the requirements of all categories concerned.
- To **assess whether tokens qualify as securities** under Swiss law, FINMA applies the general definition of the Swiss Financial Market Infrastructure Act. As securities qualify standardized uncertificated securities (i.e. rights which are issued or established in large numbers, are based on a common legal basis such as issuance conditions and are generically identical), derivatives and intermediated securities, which are suitable for mass standardized trading, i.e. publicly offered for sale in the same structure and denomination or are placed with more than 20 clients, insofar as they have not been created especially for individual counterparties. For uncertificated securities, there is an obligation to keep book on the details of the number, the denomination and the creditors, but FINMA confirms that this obligation can be complied with on a blockchain. For the time being, FINMA will not consider payment tokens to be securities; utility tokens will only be considered securities if they have an investment purpose at the point of issue. Asset tokens will be

considered as securities.

FINMA confirms that the creation of uncertificated securities and their public offering are not regulated, unless they qualify as derivative products. However, underwriting and offering (in a professional capacity) security tokens of third parties publicly on the primary market is a licensed activity. Furthermore, the issuing of tokens that are similar to bonds or shares may trigger prospectus requirements under the Swiss Code of Obligations.

- FINMA confirms that the issuing of tokens will not qualify as deposits, i.e. does not require a **banking license**, unless the tokens grant claims with debt capital character against the issuer. Collective Investment Schemes regulations only apply if the funds received in an ICO are managed by third parties.
- Issuing payment tokens will trigger the **anti-money laundering act (AML) provisions** to apply, if the tokens can be transferred technically on a blockchain infrastructure. Issuing utility tokens will not trigger such application, as long as their main reason is the providing of access to a non-financial application of the blockchain technology. Asset tokens are not deemed a means of payment under the AMLA. FINMA clarifies that the application of the AMLA will not only be triggered by an exchange of a cryptocurrency against a fiat currency but also by an exchange against a different cryptocurrency.
- For the **pre-sale** phase prior to an ICO, FINMA distinguishes a pre-financing, in which investors are only promised future tokens, from a pre-sale, in which investors receive tokens which entitle them to receive different tokens at the time of the ICO. The rights granted in the pre-sale phase are considered as securities by FINMA if they are standardized and suitable for mass standardized trading. If so, they are not subject to AML regulations.

3. Preliminary Assessment

The new FINMA Guidelines provide a helpful clarification of FINMA's position on a number of issues. Furthermore, FINMA clearly states that it will continue to be ready to review ICO projects submitted. However, this does not apply to ICOs that already took place, which will only be reviewed in the context of investigations into potentially unlicensed activities and may, therefore, lead to fines imposed and the liquidation of the entities involved. Hence, it is highly recommendable to submit any ICO project to FINMA early, once the project has developed to a level that the relevant information can be provided in the submission.

The checklist for the information FINMA wishes to receive in a submission clearly shows that FINMA will not only review the legal structure, but also the technical features of a planned ICO. A careful project management is required to enable all relevant information to be available in time.

Other than the Code of Conduct issued by the Crypto Valley Association on 8 January 2018, the scope of the FINMA Guidelines is limited to Swiss regulatory issues. In particular, the Guidelines do not require the ICO to be subject to pre- and post ICO audits and do not stipulate the comprehensive transparency requirements the Code of Conduct proposes. The Guidelines also do not address any of the civil, criminal or tax law issues that may become relevant in an ICO but rather state that the market participants themselves remain responsible for compliance with such rules. Therefore, a comprehensive and thorough legal, regulatory and risk review of any ICO project remains indispensable.

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