capital markets and technology association.

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Geneva, 28 June 2019

Re: Consultation on the adaptation of federal law to developments in distributed ledger technology (the "DLT Act")

Ladies and Gentlemen,

Reference is made to the consultation that the Federal Department of Finance initiated on 22 March 2019 on the subject referred to above.

The purpose of the Capital Markets and Technology Association is to promote the development of new technologies in the field of capital markets. One of our association's main objectives is to facilitate the issuance and trading of securities using the distributed ledger technology. The proposed DLT Act is therefore of particular relevance to our association and we thank you for giving us the opportunity to express our views on this topic.

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1. Summary

Our association generally welcomes the proposed amendments to Swiss law, which clarify the legal regime applicable to digital assets and the distributed ledger technology (or "**DLT**") in general and increases both the security of transactions and the predictability of Swiss legislation in this respect.

– **Our association generally welcomes the manner in which the proposed legislation contemplates treating digital assets as a matter of civil law**. In particular, it is in our view correct to address the situations in which securities are associated with digital tokens by reference to the rules applicable to certificated securities (*droit des papiers-valeurs / Wertpapierrecht*). Our comments on the civil law provisions of the proposed DLT Act relate to questions of detail, which are explained further in Section 2 below.

– In our view, **the main flaw of the draft DLT Act relates to the proposed treatment of digital assets in the bankruptcy of custodians**. Under the draft DLT Act, holders of tokenized securities would only be allowed to claim ownership of their securities in the bankruptcy of a custodian if the relevant securities had at all times been recorded on an individual (i.e. segregated) distributed ledger address. Such a regime is inappropriate, as it denies an adequate level of protection to depositors when digital assets are held on a pooled (*i.e.* non-segregated) distributed ledger address of the custodian at any point in time, which will generally be the case in practice[1]. Also, the proposed regime, if implemented, would unduly worsen depositor protection[2], risk putting an end to the development of the DLT in capital markets through unjustified capital adequacy requirements[3], create security risks[4] and is generally based on misconceptions regarding how distributed ledgers function[5].

– We welcome the creation of a new type of trading platform, but the provisions that relate to the **new DLT-based trading venue should be simplified** to avoid creating unmanageable complexity.

1 See Section 3.5 below.
2 See Section 3.2 below
3 See Section 3.3 below.
4 See Section 3.4 below.
5 See Section 3.6 below.

– Independently from the above, **the draft legislation fails to make certain adjustments that would be advisable in order to adequately protect investors and the Swiss financial markets as a whole**. Because they are bound to be traded on OTC markets (at least in the foreseeable future), tokenized securities will be out of the scope of some of the key regulations that apply to listed companies, such as the **rules on disclosure of large shareholdings or public takeovers**. Making it possible for issuers to voluntarily subject themselves to these rules (in the form of an **"opt in"**) would in our view be desirable. Such a regime would mirror the regime set forth in Article 125 paras. 3 and 4 of the Financial Market Infrastructure Act, which makes it possible for issuers to "opt out" of the Swiss mandatory offer regime under certain circumstances. Our association would also welcome changes to the Swiss **anti-money laundering framework**, in particular with respect to the online identification of clients.

2. Comments on the proposed civil law regime

As mentioned above, we generally agree with the manner in which the draft legislation contemplates addressing the tokenization of securities from a civil law perspective. Tokens are the modern-day equivalent of physical certificates, which were used before the digital age to evidence the ownership of securities. Like such certificates, tokens indivisibly associate a right with an object. In the case of tokens, that object is an entry in an electronic decentralised ledger rather than a piece of paper. We note that the regime contemplated in the draft amendments to the Swiss Code of Obligations (**"SCO"**) is based on principles that are similar to those outlined in the "blueprint for the tokenization of shares" that our association published in October 2018.

With respect to the specific changes contemplated in the SCO, we would note the following:

– **Proposed new Article 622 para. 1 SCO**. The draft legislation provides that shares of Swiss corporations are in principle issued in certificated form, and that the articles of association of the company can contemplate an issuance in uncertificated form (*i.e.* in the form of uncertificated or tokenized securities) or in the form of intermediated securities.

  This regime contradicts Article 973*c* SCO. This provision makes it possible to issue uncertificated securities not only if the articles of association of the issuer contemplate such a regime, but also if the terms of the issue so permit or with the consent of the holders. To be consistent, Article 622 para. 1 SCO should contemplate the same exceptions to the principle according to which shares must, by default, be issued in certificated form.

– **Proposed new Article 973*d* SCO**. The second paragraph of this provision defines the conditions that a distributed ledger must satisfy to be capable of supporting tokenized securities under the new law. The third paragraph gives authority to the Federal Council to impose minimum requirements for the use of particular distributed ledgers.

Giving a governmental authority the power to determine the circumstances pursuant to which a particular distributed ledger can be used for the tokenization of securities is in our view inappropriate. Whether a distributed ledger can responsibly be used for tokenization purposes is ultimately a technical matter and the responsibility of the governing bodies of the entities who choose to tokenize securities. In this respect, the aim of governing bodies should be to increase legal certainty and ensure technology-neutral regulation[6]. Giving authority to a governmental authority in this respect is likely to be detrimental for two reasons.

First, a governmental authority will likely be at pains to follow technological developments in a timely manner, especially in a fast-moving technological area such as the DLT. There is a risk that issuers could be prevented from using useful new technologies, not because the relevant technologies are inadequate, but only because the authorities have been unable to keep track of the latest technological developments in a timely manner.

Second, a governmental authority's intervention creates the risk of political interference in what should be a purely technical debate.

In our view, paragraph 3 of the proposed Article 973*d* SCO should be removed altogether. The choice of technically adequate distributed ledgers should be the responsibility of the issuers, and the consequences of choosing a defective technology should be a matter of liability for the responsible persons within the relevant organizations. In other words, in the interest of the security of transactions and of the regular functioning of the financial markets, the consequences of creating tokenized securities on distributed ledgers that fail to satisfy the requirements of Article 973*d* para. 2 SCO should be to engage the personal liability of the persons responsible for making the decision, rather than make the transactions carried out on the relevant tokenized securities invalid.

6 As FINMA noted itself at the time of the release of its guidelines on ICOs, *"Swiss legislation on financial markets is principle-based; one such principle is technology neutrality*" (https://www.finma.ch/en/news/2017/09/20170929-mm-ico/).

– **Proposed new Article 973*e* SCO**. Paragraph 6 of this provision provides that, if the rights of a good faith acquirer of certificated securities conflict with those of a good faith acquirer of tokenised securities, the rights of the owner of the certificated securities should prevail. There is no rationale for such a preference. In case of such conflict, the preference should be given to the person who acquired the relevant securities first. As the Federal Department of Finance points out in its report[7], securities will often be issued in certificated form before they are tokenized. In practice, the holder of certificated securities should thus generally have preference over the holder of tokenized securities. However, it is also conceivable that a company issues certificates for securities that it had already tokenized previously. In such a case, there is no reason not to protect the rights of the tokenized securities' owners.

– **Proposed new Article 973*h* SCO.** The second paragraph of this provision makes any issuer of tokenized securities liable for the prejudice that may result from a malfunctioning of the distributed ledger or smart contract used for the tokenization process "*unless* [the issuer] *demonstrates that it acted with an appropriate level of diligence*". This requirement is excessively vague. As currently drafted, the provision could be construed as making issuers liable for technical issues that are ultimately beyond their control. This could have an inhibiting effect on issuers, and needlessly divert them from carrying out economically meaningful and desirable tokenization transactions. To avoid such an outcome, it should be clarified that the issuer of tokenized securities will not be deemed to have acted negligently (and will consequently not be held liable) if the distributed ledger and the smart contract used for the tokenization process are consistent with recognized market standards[8]. This "safe harbour" provision should be drafted broadly enough to make it possible for the relevant "recognized market standards" to be developed by either governmental authorities or non-governmental organizations.

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7 Federal Department of Finance, "*Loi fédérale sur l'adaptation du droit fédéral aux développements de la technologie des registres électroniques distribués – Rapport explicatif relatif au projet mis en consultation*", Berne, 22 March 2019 ("**Explanatory report**"), page 34.

8 "*.. à moins qu'il ne prouve qu'il a agi* avec *toute la diligence requise ou conformément à des standards reconnus*" / "*… sofern er nicht nachweist, dass er mit der erforderlichen Sorgfalt gehandelt oder die anerkannten Standards eingehalten hat*".

3. Comments on the proposed amendments to bankruptcy laws

As mentioned above, the most significant defect of the proposed new legislation relates to the manner in which it contemplates treating digital assets in the bankruptcy of custodians. The issues raised by the proposed legislation are in essence the following.

3.1 Solution proposed by the draft DLT Act

The bankruptcy of a custodian is a significant risk for depositors. To protect depositors, Swiss law contains mechanisms to ensure that deposited assets:

– do not fall into the bankruptcy estate of the custodian at all, as provided *e.g.* by Articles 16 and 37*d* of the Federal Act on Banks and Savings Institutions (the "**Banking Act**");

– can be retrieved from the bankruptcy estate of the custodian, as provided *e.g.* by Article 242*a* of the Federal Act on Debt Collection Proceedings and Bankruptcy (the "**Bankruptcy Act**").

The level of protection afforded by law depends on the legal nature of the deposited assets. Depositors of movable objects and securities generally benefit from the full protection afforded by law, while cash depositors are generally treated as creditors of the bankrupt custodian.

The draft DLT Act however contemplates a different mechanism. The proposed new Article 242*a* of the Bankruptcy Act and the amendments to Articles 16 and 37*d* of the Banking Act do not provide that digital assets can be segregated and/or recovered from the bankruptcy estate of a custodian under all circumstances. Rather, such a right is only contemplated under the condition that the relevant digital assets can "*be allocated to the relevant third party at all times in the* [distributed] *ledger*", *i.e.* are not pooled with digital assets belonging to other clients or to the custodian itself.

As is clear from the German version of the draft DLT Act, the amended Articles 16 and 37*d* of the Banking Act would apply to *all* digital assets (referred to as "*kryptobasierter Vermögenswerte*"), including digital assets that represent securities[9]. Although it uses slightly different language, Article 242*a* of the Bankruptcy Act should have a similar scope[10].

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[9] Explanatory report (German version), p. 16: "*Kryptobasierte Vermögenswerte – worunter einerseits kryptobasierte Zahlungsmittel (oder. Zahlungs-Token) und andererseits die neu geschaffenen DLT-Wertrechte zu verstehen sind*". The French version of the report is somewhat ambiguous.

[10] See Section 3.7 in this respect.

As will be further explained below, this approach has no justification from a depositor protection point of view, creates security risks and operational difficulties, and is generally based on a misconception of the distributed ledger technology.

3.2 The proposal would worsen depositor protection in bankruptcy

It is hard to see what policy argument could be used to *lower* the protection afforded to depositors compared to the current regime. Yet this is what the proposed modifications of bankruptcy laws would do.

Today, all securities are segregated from the bankruptcy estate of banks and securities dealers. The fact that those securities are represented by individual or global certificates, are intermediated securities or are tokenized is irrelevant. Such an approach achieves a good level of protection and is easily understood by depositors. If the deposited assets are securities (*e.g.* shares of a listed company), then they are segregated in the event of bankruptcy.

The proposed new provisions would change this and tie the treatment of securities in bankruptcy to the way a specific technology is used to keep them in custody. Under the proposal, there would therefore be securities that are not segregated in the event of bankruptcy of custodians. This would significantly worsen the position of depositors while at the same time making it much harder for them to understand the risks they are exposed to. Depositors would indeed need to ask their custodians about their custody model and obtain assurances that the relevant digital assets can be allocated to them "*at all times*" in the relevant distributed ledger.

The current approach of the Swiss legislation, which sees all securities deposited with professional custodians segregated in the event of bankruptcy, is predictable and offers a good level of protection to depositors. There is no reason whatsoever to depart from this regime to offer a lower protection for depositors.

3.3 Moving securities on-balance sheet is the end of the DLT in financial markets

For digital assets to be viable in the long run, they need to be marketable to a broad base of investors, including those that are not particularly tech-savvy and institutional investors such as pension funds and insurance companies. Although it would be possible for these investors to maintain their own custody solution for the digital assets they hold, they are unlikely to do so. For institutional investors, dealing with a professional, reputable custodian is both a risk mitigation measure and a way to remain focused on the actual investment decisions. The proposed DLT Act is, in this respect, a direct threat to the future of the DLT in financial markets.

The proposed revised Articles 16 and 37*d* of the Banking Act would indeed lead digital assets not held on individual addresses (including tokenized securities held for the account of clients) to be on-balance sheet assets for the banks that hold them. The on-balance sheet treatment will in turn trigger capital adequacy requirements for the banks holding the digital assets.

If these changes to the Banking Act were implemented, they would dramatically increase the costs of offering services in the area of digital assets. Banks are unlikely to take the trouble of setting up new services in the DLT area only to be imposed punishing capital adequacy measures that do not exist for non-tokenized assets. For reference, capital adequacy requirements already in place for cryptocurrencies impose a flat 800% risk weight of cryptocurrencies held by banks and they have already proved to limit investments from banks in the DLT. Having similar requirements for all digital assets would be disastrous.

If the revised Articles 16 and 37*d* Banking Act are adopted, we consider that the base scenario will be one where banks simply refrain from providing DLT-related services. Without banks to serve as a conduit for institutional investors and private investors that are not particularly tech-savvy, digital assets are unlikely to be adopted by a base of institutional investors large enough to serve as a new way to fund start-ups and SMEs. Such an outcome would be the exact opposite of the stated aim of the DLT Act.

3.4 Pushing custodians towards individual addresses creates significant security risks

There are several ways to structure the custody of digital assets. To simplify, these can be summarized as follows:

(1) The custodian generates public / private distributed ledger key pairs for each client (or account) holding digital assets. The custodian retains sole control of the private key[11], but to each distributed ledger address[12] (an "individual address") correspond digital assets of a single client.

(2) The custodian generates public / private distributed ledger key pairs with which digital assets belonging to several clients are associated. Here as well, the custodian retains sole control of the private key, but the digital assets of several clients may correspond to the same distributed ledger address (a "pooled address").

[11] Although other forms of custody involving joint control with clients exist, they are less practicable due to the operational complexity they entail.
[12] Itself a hash of the public key.

Any operation involving the use of a private key is sensitive, as it may expose the private key to third parties with malicious intent. For this reason, it is generally safer to store the private keys in "cold storage" conditions. Cold storage implies that the private keys are stored on devices not connected to the Internet (and in some cases on devices which have never been connected to the Internet). Cold storage is safer, as the risk of intrusion and viruses is significantly lower. It comes at a cost, though: in practice, performing operations using private keys stored in such conditions takes considerable time (*e.g.* up to 48 hours).

At the other end of the spectrum, private keys can be recorded on "hot wallets", *i.e.* software or devices used to perform operations involving public / private key pairs that are (or are installed on devices) connected to the Internet. Although they are less safe, these public / private key pairs can be used at shorter notice.

To manage their clients' needs for swift execution and safety, custodians tend to leave a portion of the digital assets held in custody in hot wallets with the rest in cold storage. Forcing custodians to adopt individual addresses would prevent them from adopting these vital security measures. Unless a specific client holds a significant quantity of the same digital assets, it is not practicable to keep a part of a single client's assets in a dedicated cold storage address. Custodians would therefore store a significant amount (and potentially the vast majority) of digital assets they hold for clients on hot wallets, thus creating higher security risks.

Furthermore, managing a large number of addresses is not trivial. Public / private key pairs are not similar to ISIN numbers that are requested from a central authority. They are generated – or, perhaps more precisely they are *discovered* – through the use of a "seed" phrase. The seed is a hash of a text input (e.g. "Hello world"). There is a single public / private key pair corresponding to this input, and it can be found by any person who knows of and uses the seed phrase. Generating seed phrases is therefore critical to ensure that private keys are not compromised. The more public / private key pairs are generated, the more a pattern may start to emerge in seed generation, thereby increasing operational risks. Such a pattern may indeed lead third party with malicious intents to predict the seeds used by a custodian, and thus to discover the public / key pairs of such custodian, which would result in the loss or theft of the relevant digital assets.

3.5 Pooling digital assets is often an operational necessity

As a practical matter, settling all transactions in digital assets "on-chain", i.e. in a manner that is clearly visible on the distributed ledger, is often not possible or desirable. For example, no distributed ledger natively offers delivery-versus-payment (DvP). To achieve DvP in digital assets transactions, some form of pooling is therefore necessary. This is especially true when the transaction is performed on a trading platform, as the parties do not know each other.

It would also be highly inefficient to perform "on-chain" transfers for trades entered into between two clients of the same company. This would generate fees (on public distributed ledgers such as Ethereum, all transactions are subject to fees) and may also take considerable time if the digital assets are stored in cold storage conditions. Further, the settlement of all trades on-chain would clog the network of the most popular DLTs, such as Ethereum, as those are already facing scalability issues and would not be able to handle the uptick in transaction volume.

Under such circumstances, denying the legitimate acquirer of the relevant securities any segregation and recovery right because the digital assets were not recorded on individual addresses would be unjustified and unduly harsh. For "traditional" (intermediated) securities, the (internal) record of a transaction on the securities account of the acquirer suffices to entitle the acquirer to a segregation and recovery of the relevant asset in the custodian's bankruptcy. There is no reason to treat DLT-based securities any differently.

3.6 The idea that individual addresses ensure a better publicity is irrelevant and based on a misconception

Changes to the Banking Act proposed in the draft DLT Act seem to be based on the assumptions that individual addresses (i) allow the identification of depositors based on the distributed ledger and (ii) ensure some level of publicity regarding the fact that the digital assets belong to a client, and are not held for own account by the relevant custodian.

– First, the distributed ledger itself will almost always be insufficient to identify to whom the digital assets belong, even if individual addresses are used. The basic idea behind distributed ledgers using private / public key cryptography is that transactions are validated if the transaction message that relates to them has been generated using a valid private / public key pair. The identity of the holder of the private key does not need to be recorded in the distributed ledger and is irrelevant to validate transactions, which also explains why keeping private keys safe is so critical. The same is true for the identity of the client of the private key holder: it plays no role in the transaction validation process and will almost never be recorded on the distributed ledger.

  For these reasons, a combination of the distributed ledger and of the internal records of the relevant custodian will be necessary to identify the client to whom the digital assets belong. The added protection afforded by using individual addresses thus seems very low. In any event, it does not justify the significant worsening of the depositor protection that a differentiation between the custody models of digital assets would create. It also bears mentioning that using internal records of custodians to identify their clients' holdings is the default model for the

custody of (not DLT-based) securities. For example, pursuant to Article 17 of the Federal Act on Intermediated Securities, the liquidator of a bankrupt custodian must exclude from the custodian's estate all intermediated securities recorded on the securities account maintained (internally) by the custodian.

– Second, the idea that individual addresses ensure some level of publicity is based on a misconception and the draft DLT Act appears to conflate distributed ledgers and *public blockchains*, such as the Ethereum blockchain. A distributed ledger may well be distributed but it is not necessarily *public*, *i.e.* third parties – including depositors – are not necessarily able to view what is recorded on the distributed ledger. A distributed ledger kept by a consortium of banks, for example, would not necessarily be accessible to the banks' end clients.

– Third, the necessity to individualize deposits is only relevant for cash deposits, whereby if cash is deposited in "*sealed envelope*" or in a similar manner, ownership of the deposited cash does not pass to the custodian. The idea underlying this construct is that, to remain the property of the depositor, cash deposits must be clearly identified as being individualized and separated from the rest of the cash held by the custodian. Securities are and should remain treated differently. They are held in the name of the custodian for the account of the custodian's clients, but are distracted in the event of bankruptcy. There is no reason to create an exception for securities recorded using the DLT.

3.7 Article 242*a* of the Bankruptcy Act and Articles 16 and 37*d* of the Banking Act should cover all types of digital assets

According to the German and Italian versions of Article 242*a* of the Bankruptcy Act, segregation in the event of bankruptcy would apply to cryptocurrencies and tokenized securities ("*DLT-Wertrechte*"). This language is however too restrictive and is not consistent with the proposed amendments of the Banking Act (Articles 16 and 37*d*), which refer to a more encompassing concept of "crypto-assets". This latter approach should be applied for Article 242*a* of the Bankruptcy Act as well.

3.8 FINMA's practice only applies to cryptocurrencies

The Explanatory report justifies changes to bankruptcy laws and the need for individual addresses to allow the segregation of digital assets as corresponding to FINMA's current practice[13]. This, however, is not accurate, as FINMA's practice only applies to *cryptocurrencies* and FINMA has not stated that it would also apply to digital assets

[13] Explanatory report, p. 38.

representing securities. The proposal found in the DLT Act consequently goes (far) beyond the existing regulatory practice.

Besides, FINMA's practice regarding the on-balance sheet treatment of cryptocurrencies constitutes a very weak basis on which to build changes to bankruptcy laws, as it is unpublished, highly controversial and by no means the reflection of a consensus or an established international standard.

Rather than crystalize FINMA's practice, the DLT Act should be the occasion to depart from it. The idea that digital assets not held on individual addresses are not segregated in a bankruptcy indeed risks putting a strain on the depository protection scheme (*Garantie des dépôts / Einlagensicherung*)[14]. This scheme is meant to protect depositors in the event of a bankruptcy of their custodian. The depositor protection scheme provides a limited privilege to depositors compared to other creditors in the event of a bankruptcy of their custodian. Assets that are capable of being segregated and recovered pursuant to Article 16 of the Banking Act are excluded from the scheme. Conversely, client assets that cannot be segregated from bankruptcy, *e.g.* cash denominated in Fiat currencies, are bound to fall into that scheme.

Thus, prohibiting the recovery of digital assets in the event of a bankruptcy of a custodian (for example because the relevant assets were not recorded "at all times" on an individual distributed ledger address dedicated to the client) would result in putting the relevant assets in the scope of the depositor protection scheme. The Banking Act limits the overall size of the depositor protection scheme to CHF 6 billion[15]. Thus, integrating digital assets in that scheme would automatically reduce the maximum level of protection given to holders of other forms of assets.

3.9 Depositor protection can be improved without compromising the future of the DLT

The regime contemplated in the draft legislation does not need to be formulated in the way it currently is. In particular, contrary to what is suggested in the report of the Federal Department of Finance on the draft DLT Act[16], the proposed regime is not necessary to avoid a situation in which owners of digital assets are given more rights than holders of traditional assets in the bankruptcy of their custodian. If anything, the proposed changes would place holders of digital assets at a significant disadvantage compared to holders of traditional financial assets.

To address the issues referred to above, all digital assets should be recognized as movable assets (*Objets/Sachen*) for the purpose of the Bankruptcy Act and as "deposited

14 Article 37*h* et seq. of the Banking Act.
15 Article 37*h* para. 3 lit. b of the Banking Act.
16 Explanatory report (footnote 5), page 38.

movable assets and securities" (*choses mobilières et titres déposés par les clients/bewegliche Sachen und Effekten der Depotkunden*) for the purposes of Articles 16 and 37*d* of the Banking Act, regardless of the manner in which their custody is organized. Such a solution would:

- increase depositor protection without compromising the security of digital assets;
- not punish banks for investing in a new technology that could help finance critical sectors of the Swiss economy;
- ensure that the deposit protection scheme is not overburdened by claims relating to digital assets; and
- provide a clear and legible legal framework that investors could easily navigate without having to perform due diligence exercises on their custodians.

To achieve this, we suggest amending the proposed text of paragraph 1bis of Article 16 of the Banking Act:

Article 16

"Are deemed deposited assets for the purpose of Article 37d:

1bis crypto-assets held for the account of clients and over which the bank has a power of disposition, provided such digital assets can ~~at all times~~ be allocated to the relevant clients in the books of the bank;"

"Sont réputées valeurs déposées selon l'art. 37d:

1bis les cryptoactifs dont la banque a le pouvoir de disposer pour le compte des clients déposants et dont l'appartenance aux clients déposants peut être déterminée ~~en tout temps~~ dans le registre ou dans les livres de la banque;"

"Als Depotwerte im Sinne von Artikel 37d des Gesetzes gelten:

1.^{bis} kryptobasierte Vermögenswerte über die die Bank die Verfügungsmacht für die Depotkunden innehat und die den Depotkunden ~~jederzeit~~ im Register oder in den Büchern der Bank individuell zugeordnet werden können;"

A similar adjustment should be made to the proposed Article 242*a* para. 2 of the Bankruptcy Act:

> ***Article 242a***
>
> *"Crypto-assets held for the account of third parties and over which the bankrupt debtor has a power of disposition can be recovered, provided such digital assets are ~~at all times~~ individually allocated to the relevant third parties either by the register or by the books of the bankrupt debtor".*
>
> *"La revendication est fondée lorsque le failli a le pouvoir de disposer pour le compte du tiers des ~~cryptomonnaies et des droits-valeurs d'un registre distribué~~ cryptoactifs et qu'ils sont ~~en tout temps~~ attribués individuellement à ce tiers dans le registre ou dans les livres du failli."*
>
> *"Der Anspruch ist begründet, wenn der Gemeinschuldner die Verfügungsmacht über die kryptobasierten Werte ~~Zahlungsmittel und die DLT-Wertrechte~~ für den Dritten innehat und diese dem Dritten ~~jederzeit~~ entweder im Register oder in den Büchern des Gemeinschuldners individuell zugeordnet sind."*

We note here that, generally, the terminology used in the German version of the draft legislation is inconsistently reflected in the French version. The German version uses the concept of "*kryptobasierten Zahlungsmittel*" to designate payment tokens, "*DLT-Wertrechte*" to designate tokenized securities, and "*kryptobasierte Vermögenswerte*" to designate deposited digital assets. By contrast, the French version indistinctly uses the term "*cryptoactifs*" to designate both cryptocurrencies and tokenized securities. To be consistent, the German concept of "*kryptobasierten Zahlungsmittel*" should rather be translated by "*cryptomonnaies*" or "*moyens de paiement cryptographiques*".

4. New license for DLT Trading Facilities

The draft DLT law foresees the creation of a new type of DLT-based trading venues (the "**DLT Trading Facilities**"), which would provide a mix of trade and post-trade services. While we generally welcome the proposed concept, the current proposal unnecessarily paves the way for more complexity, which would discourage market participants from applying for the license. Generally, DLT Trading Facilities should not be treated with more defiance than other regulated venues such as stock exchanges and multilateral trading facilities (MTFs). All those venues are subject to licensing requirements and placed under the supervision of FINMA. This, alone, should relieve most of the concerns raised in the Explanatory report.

We have set out below our comments on the relevant proposed provisions of FMIA.

– **Proposed new Article 73*c* FMIA.**

The third paragraph of this provision would allow the Federal Council to define additional rules regarding the admission, the obligations and the exclusion of participants to DLT Trading Facilities. A corresponding provision does not exist for stock exchanges and the rules of DLT Trading Facilities will in any event be subject to FINMA's approval[17]. Also, imposing transparency obligations for participants would be excessive, knowing that some of them will be individuals. For these reasons, the third paragraph of Article 73*c* FMIA should be deleted.

– **Proposed new Article 73*d* FMIA.**

Paragraph 3(a) of this provision gives authority to the Federal Council to impose minimum requirements on the distributed ledgers. In line with our comments on the proposed Article 973*d* SCO[18], this should be deleted.

Paragraph 3(b) of Article 73*d* FMIA would also give authority to the Federal Council to identify digital assets that cannot be admitted to trading on DLT Trading Facilities. According to the Explanatory report[19], this would be justified to protect the financial system and market participants against money laundering and terrorist financing. Contrary to the impression that the draft DLT Act gives in this respect, the use of financial assets for money laundering and terrorist financing purposes is not specific to the DLT. If there are assets that should not be traded due to concerns that they are used for illicit purposes, they should not only be excluded from DLT Trading Venues but from *all types of regulated venues*, regardless of the technology they use. In any event, as the regulations of regulated trading facilities are all approved by FINMA, it would be possible to simply ask operators of those trading facilities to describe the assets they admit to trading with sufficient precision to exclude the types that are suspected of covering illicit activities. Furthermore, as financial market infrastructures, the DLT Trading Venues are subject to proper conduct requirements[20]. Knowingly admitting to trading assets whose purpose is to facilitate illicit transactions would clearly not comply with those requirements.

17 See Article 27 para. 4 FMIA.
18 See Section 2 above.
19 Explanatory report, p. 52.
20 Article 9 FMIA.

– **Proposed new Article 73e FMIA.**

We do not think that authority should be given to the Federal Council to set "additional obligations" for operators of platforms who admit unregulated participants, as foreseen in the first paragraph of this provision. At a minimum, clear guidance should be given in the law as to what these additional obligations would be (e.g. obligation to inform participants as to the risks of the instruments admitted to trading on the platform). Again, this is anyway a point that could be addressed in the review of the rules of the DLT Trading Facilities and may be seen as relating to proper conduct requirements.

The second and third paragraphs provide that the Federal Council can set requirements for DLT Trading Facilities that provide post-trade services. While it may indeed be advisable to set in more details the conditions at which those services can be provided, more guidance should appear in the act as opposed to an ordinance.

5. Further amendments

5.1 Omission of adequate regulations for publicly-traded, unlisted, securities

As of today, no Swiss stock exchange offers the listing of tokenized securities.

Tokenized securities, as a result, can currently only be admitted to trading on trading venues that are not stock exchanges. The resulting regime is suboptimal, since many of the rules designated to protect investors and the functioning of the capital markets as a whole (*i.e.* the rules on disclosure of large shareholdings, public takeovers, on-going disclosure requirements or market abuse) only apply to companies that have equity securities listed on a stock exchange.

The issue reflected above is not directly linked to the rise of the DLT technology or to the tokenization process. It is a consequence of the fact that, until recently, Swiss law has assumed that public companies (*i.e.* companies that have offered their securities to the public, rather than to a limited circle of persons) would be listed on stock exchanges. This assumption may have reflected the reality in the past. It however no longer holds true today. Securities are increasingly traded on venues that are not stock exchanges. The Financial Market Infrastructure Act of 2015 has evidenced this trend, as it now explicitly contemplates several types of trading platforms for securities in addition to traditional stock exchanges.

To guarantee an adequate level of investor protection and a correct functioning of the Swiss financial markets, it would be necessary that the scope of key financial regulations – in particular the rules on disclosure of large shareholdings and takeovers) be extended to issuers that have offered securities to the public and are allowing such securities to be traded on trading platforms other than stock exchanges. Because trading platforms can admit securities to trading without the consent of the relevant issuer, the application of the regulations referred to above cannot only depend on an admission to trading on a platform. The application of the relevant rules must reflect a decision of the issuer. One way to achieve this would be to create a regime of "opting in", through which an issuer could decide to voluntarily subject itself to the rules on disclosure of large shareholdings and on takeovers. Because the implementation of these rules is within the jurisdiction of stock exchanges, such "opting in" should be made subject to the relevant issuer recognizing the jurisdiction of the bodies of the relevant stock exchange, and also to the issuer agreeing to participate in the running costs of these bodies. Such a solution would require a statutory basis, which could take the form of an addition to Articles 120 and 125 of the Financial Market Infrastructure Act.

In this respect, we would suggest adding a paragraph 1bis to Article 120 of the Financial Market Infrastructure Act, which could read as follows:

Article 120

"1bis A company having its registered office in Switzerland and whose equity securities are not listed in Switzerland can decide that the provisions of this Chapter 3 will apply to it by adopting a provision to that effect in its articles of association and by submitting a request to that effect to a Swiss stock exchange. For the purpose of this Chapter 3 only, the company having satisfied these requirements shall be deemed to have its equity securities listed on the Swiss stock exchange to which it shall have submitted its request. Swiss stock exchanges shall adopt regulations specifying the fees that they can impose on companies having submitted to them the request contemplated in this paragraph. They shall keep a list of such companies and make this list available to the public."

"1bis Une Société ayant son siège en Suisse et dont les titres de participation ne sont pas cotés en Suisse peut décider que les dispositions de ce chapitre 3 lui seront applicables en adoptant une disposition à cet effet dans ses statuts et en en faisant la demande auprès d'une bourse suisse. Pour les besoins de ce chapitre 3 exclusivement, la société ayant satisfait à ces exigences sera réputée avoir ses titres de participation cotés à la bourse suisse à laquelle elle aura présenté sa demande. Les bourses suisses définissent dans un règlement les émoluments qu'elles peuvent percevoir auprès des sociétés qui leur ont fait la demande prévue par cet alinéa. Elles tiennent une liste de ces sociétés et la mettent à disposition du public."

"1bis Eine Gesellschaft mit Sitz in der Schweiz, deren Beteiligungspapiere nicht in der Schweiz kotiert sind, kann beschliessen, dass die Bestimmungen dieses Kapitels 3

auf sie anwendbar sind, indem sie eine entsprechende Bestimmung in ihre Statuten aufnimmt und ein entsprechendes Gesuch an eine Schweizer Börse stellt. Hat die Gesellschaft diese Anforderungen erfüllt, gelten die Beteiligungspapiere, lediglich für den Zweck dieses Kapitels 3, als an der Schweizer Börse, bei der die Gesellschaft ihr Gesuch eingereicht hat, als kotiert. Die Schweizer Börsen erlassen Vorschriften über die Regelung der Gebühren, die sie den Gesellschaften, welche ihnen das in diesem Absatz vorgesehene Gesuch eingereicht haben, auferlegen können. Sie führen eine Liste dieser Gesellschaften und machen diese Liste der Öffentlichkeit zugänglich."

A similar paragraph should be inserted in Article 125 of the Financial Market Infrastructure Act for what regards the rules on public takeovers. In addition, paragraph 4 of Article 135 of the same act could be amended as well to read:

Article 135

"4 FINMA lays down provisions on the obligation to submit an offer and the determination of the minimum price when the company is subject to the provisions of this chapter pursuant to Art. 125 para. 1bis. The Takeover Board is empowered to make proposals."

"4 La FINMA édicte des dispositions sur l'obligation de présenter une offre et la détermination du prix minimum lorsque la société est soumise aux dispositions du présent chapitre en vertu de l'art. 125 al. 1bis. La commission est habilitée à présenter des propositions."

"4 Die FINMA regelt die Angebotspflicht und die Festlegung des Mindestpreises, wenn die Gesellschaft den Bestimmungen dieses Kapitels gemäss Art. 125 Abs. 1bis unterliegt. Die Übernahmekommission ist befugt, Vorschläge zu unterbreiten."

This would allow FINMA the flexibility to adapt Article 135 paragraph 2 of the Financial Market Infrastructure Act to a situation where the relevant securities are not traded on a Swiss stock exchange. The solution to be found here could be similar to that applied for illiquid (listed) securities, where the review body of the offer must proceed to a valuation of the company to determine the minimum price.

5.2 Clarification of anti-money laundering framework

The draft DLT Act also provides that DLT Trading Platforms will be subject to the Anti-Money Laundering Act ("**AMLA**"). We understand this need and welcome it. The current legislative process should however be the occasion to update the anti-money laundering framework to modern technology.

By and large, the AMLA still assumes that the default model of financial intermediaries is one where they physically meet their clients. At a time where banks operated a wide network of branches and independent asset managers had a deeply personal connection

to their clients, this was probably true. Today, however, this is no longer true. A study by software company Crealogix found that 80% of respondents conduct everyday banking transactions online and close to 21% only conduct banking transactions online[21]. These trends are especially relevant in innovative areas such as the DLT, where operating a brick and mortar business no longer makes sense. To give digital assets a better chance to succeed, the anti-money laundering and terrorist financing (or "**AML**") framework that surround them should thus also be modernized.

(A) Online identification

One area where improvement is needed is the online identification of clients. FINMA Circular 2016/17, which regulates both video identification and online identification, is currently too restrictive and inflexible. It is also (already) dated. The circular's insistence on the use of identification documents (IDs) equipped with a machine readable zone (MRZ)[22] illustrates this point. Indeed, large parts of the world population do not have identity documents that contain an MRZ, e.g.:

- there are no longer identity cards in the United Kingdom. British citizens who do not wish to travel and do not have a passport use their driving license (which do not contain an MRZ and few optical features) to establish their identity, as permitted by local regulation[23];
- Italian identity cards are widely used for identification in Italy, yet do not have optical security features and do not have an MRZ[24]. Italian citizens who do not have a passport cannot use this document to be identified under the AMLA;
- the French identity card can serve as a valid travel document, especially in Europe, but does not have optical security features; and
- the last version of the Australian passport has very few optical security elements (only UV elements and watermarks that cannot be verified through a video identification or through the online identification procedure)[25]. According to the letter of FINMA Circular 2016/17, this document would be insufficient to open an AMLA-relevant relationship online.

21 https://crealogix.com/ch/en/news/swiss-banking-customer-survey-open-banking-is-the-new-competitive-factor-for-banks/.
22 FINMA Circular 2016/17, at 15.
23 See https://www.consilium.europa.eu/prado/en/GBR-FO-09002/index.html.
24 See https://www.consilium.europa.eu/prado/en/ITA-BO-03001/index.html.
25 See https://www.consilium.europa.eu/prado/en/AUS-AO-05001/index.html.

The documents referred to above are not only very common, they are also very commonly accepted in countries other than Switzerland as valid proof of identity to pass AML verifications. While it is true that persons holding those documents could open an account by sending letters and obtaining authenticated copies of their IDs, the added hurdles mean that they generally take their business elsewhere.

It should also be noted that the requirements of FINMA Circular 2016/07 are technically outdated. MRZs were meant to allow automated checks of IDs as well as to check the name of the potential client against lists of persons who are politically exposed persons or are subject to sanctions. Today, these checks are performed automatically but without having to use MRZs. It is also possible to falsify an MRZ, as it can be generated based on the information contained on a particular ID.

The topic of online identification of new clients is fast becoming a critical one for the financial industry, in particular service providers who offer DLT-based services and attract an international clientele. It is therefore urgent to act by amending the AMLA to allow more flexibility in identifying clients through online means. The guiding principles of these changes to AMLA should be that (i) financial intermediaries can use technology that is currently available to fulfil their obligations, and (ii) in doing so, they should seek to obtain reasonably high comfort as to the identity of their clients.

(B) Treatment of issuers of means of payment

The Explanatory report proposes to amend Article 4 of the Anti-Money Laundering Ordinance ("**AMLO**") to provide that the issuance of payment tokens as part of an "initial coin offering" should be assimilated to the professional issuance of payment means. The adoption of the DLT Act should be the occasion of bringing further changes to the AMLO in this respect. In particular, FINMA's practice according to which issuers of payment tokens can delegate AML functions to financial intermediaries and avoid registration with a self-regulatory organization (or "**SRO**") should be formalized in the AMLO and should be extended to all financial intermediation activities.

The focus of the AMLA and the AMLO should be that AML checks are performed under the responsibility of a financial intermediary registered with an SRO. The fact that this part is outsourced should not raise difficulties. We believe that this would be a boost to FinTech firms that launch innovative products but lack the organizational capabilities to perform AML checks themselves.

5.3 Clean-up of the "securities" definition

The definition of securities is currently found in Article 2(b) FMIA and will soon be moved to Article 3(b) of the Financial Services Act ("**FinSA**"). In several respects, the formal definition of securities under Swiss law is confusing. It refers at times to how securities are represented (by mentioning paper certificates and intermediated securities, for example) and to what they represent (by referring to derivatives).

The proposed DLT Act does not contain a suggestion to amend the definition of securities but, in our view, such a change is necessary. From the narrow perspective of DLT-based financial instruments, the definition of securities should at a minimum carry the idea that uncertificated or tokenized securities can be securities. More generally, the definition should shift from a focus on *how* securities are represented to *what* they represent. In practice, the shift has already occurred. In its guidance on initial coin offerings, FINMA noted that tokens that have "*an investment purpose*" must be treated as securities. FINMA did not condition such qualification on the tokens being represented by instruments mentioned under Article 2(b) FMIA.

We believe that the issue outlined above could be easily addressed in the context of FinSA, which contains a specific definition of "financial instruments". Securities could be defined as a subset of this category, *i.e.* as *standardised* financial instruments.

This would result in Article 3(b) FinSA being rephrased as follows:

> ***Article 2***
>
> *…*
>
> *"b. securities: standardised financial instruments, which are suitable for mass trading"*
>
> *"b. valeurs mobilières: instruments financiers standardisés et susceptibles d'être diffusés en grand nombre sur le marché"*
>
> *"b. Effekten: vereinheitlichte und zum massenweisen Handel geeignete Finanzinstrumente"*

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capital markets
and technology
association.

We hope the above is helpful, and remain at your disposal for any clarification that you may wish.

Sincerely yours,

Capital Markets and Technology Association

s/ Jacques Iffland *s/ Thomas A.Frick*

Dr. Jacques Iffland
Chair of the Executive Committee

Dr. Thomas A.Frick
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