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State Secretariat for Economic Affairs SECO
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Attn. Mr. Frank Wettstein
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Geneva, 20 September 2018
9989.335 / BENHA

Re: Consultation on the work of the Working Group Blockchain / ICO

Dear Mr. Wettstein,
Ladies and Gentlemen,

Reference is made to the consultation that the Federal Department of Finance initiated on 31 August 2018 on the subject referred to above.

Our association thanks you for giving it the opportunity to take position on the various issues raised in this context.

For the sake of convenience, the questions raised in the consultation paper are reproduced below with the numbering used in that document. We have inserted our answers after each of the corresponding questions.

2.1. "How do you assess the potential of DLT/blockchain technology for the financial industry?"

The potential of DLT/blockchain technology for the financial industry is in our view difficult to exaggerate. The DLT – and more particularly blockchain technology – has the potential of simplifying the manner in which financial markets operate and thereby to reduce businesses' financing costs. The DLT can also give smaller companies access to new forms of financing by democratizing access to financial markets, which for the time being is essentially reserved to large companies.

More specifically:

- *Simplification of the functioning of financial markets*. By transferring the record of the ownership of financial assets from the records of custodians to decentralized ledgers, the DLT can make certain forms of capital market infrastructures redundant for certain forms of transactions, while guaranteeing a comparable level of reliability and security at a fraction of the cost.

- *Lowering of financing costs for businesses*. Currently, market infrastructures require a high level of security and supervision, and are consequently extremely costly. Their costs are ultimately borne by the companies that rely on them to finance their activities. This raises the overall costs of doing business, inhibits entrepreneurship and innovation, and consequently works as a drag on the economy as a whole.

  The DLT has the potential to significantly change this state of affairs, by limiting the need to rely on "trusted third parties" (in particular custodians) to establish ownership of financial assets, and by relying instead on decentralized ledgers for that purpose.

- *Creation of alternative sources of financing for businesses*. Currently, because the costs associated with raising capital or debt from the public are high, access to capital markets is *de facto* reserved to large companies. SMEs and start-ups must rely on other types of financing to operate, such as banking loans or venture capital. For start-ups, which have typically no revenue, traditional banking financing is generally not available. This leaves venture capital as the only available source of financing. Venture capital financing is however costly and uncertain.

  The DLT can change this situation. By making it easier to raise capital from the public, it can democratize access to capital markets and create new financing

opportunities for businesses, thereby favouring entrepreneurship and innovation. DLT-induced forms of financing could also work as a catalyst for other types of capital raising. For example, venture capital firms may find it easier to invest in smaller businesses if they can rely on the fact that a liquid secondary market for their investment can easily be organized when they decide to exit the company.

2.2 "During which time horizon will this potential materialize according to your view?"

The technology for raising capital or debt through the DLT is currently available.

The main factor that currently prevents market participants from using the technology on a large scale is the lack of legal certainty and standards. This is however an issue that is bound to be addressed in the short term – the timeframe being months and not years. Incidentally, this is the reason why our association was established. Our association's purpose is to facilitate the use of the DLT in the field of capital markets, by adopting standards and documenting good practices at the regulatory, accounting and technical levels.

In this respect, a key element is that adjusting the Swiss legal framework to better capture the specificities of the DLT should not create the perception that using the DLT is not possible under existing laws and that legislative changes are necessary for that purpose. The timeframe for legislative changes is incompatible with the pace of technical and market evolutions in this field. Any notion that the use of the DLT in financial markets raises issues under existing Swiss laws would likely result in the activity in this sector being transferred to other jurisdictions. Such an outcome would represent an own goal of historical proportion for Switzerland.

In this respect, we would like to point out that the legal analysis advertised by the "Blockchain Task Force" in April 2018, to which the consultation document refers, is in our view unduly restrictive, and does not represent a consensus view of the Swiss legal community. We attach to this letter a copy of a legal opinion issued by Prof. Dr. Hans Caspar von der Crone from the University of Zurich, which makes it clear that the tokenization of securities is both possible and relatively easy to carry out under current Swiss civil and company law.

2.3 Are there legal revisions that could support facilitating business relationships between Fintech firms and banks?

In our view, beyond certain technical adjustments that are discussed in our response to question 5.2.2 below, the facilitation of business relationships between fintech firms and issuers of digital tokens, on the one hand, and banks, on the other hand, involves a streamlining of the due diligence procedures that are being applied to prevent money laundering. This, however, primarily requires the development of common standards in this respect. Legislative changes are not necessary to achieve this goal. Such legislative changes would likely be unhelpful, as they would freeze regulatory standards in this respect, almost certainly be quickly outdated, and inevitably fail to follow the pace of technological evolutions and market practices.

3. CIVIL LAW

3.1 Civil Law Classification and Transfer of Tokens

3.1.1. "Which types of rights should be tradable and transferable on a blockchain?"

Digital tokens have the same economic function as physical certificates (*papiers-valeurs / Wertpapiere*, within the meaning of Articles 965 *et seq.* of the Swiss Code of Obligations ("**CO**")). Like *Wertpapiere*, their purpose is to establish ownership of the rights that they incorporate. *Wertpapiere* achieve this by associating a right with a physical document. Tokens achieve this by associating a right with a cryptographically secured digital code. The logic underlying the two techniques is similar. Only the technology used is different.

Thus, the scope of the rights capable of being transferred on a blockchain should – as a matter of civil law – be identical to the scope of the rights capable of being incorporated in *Wertpapiere.* The only requirement in this respect should be that the relevant right or claim be transferable.

3.1.2 "Which (further) barriers exist in practice with regard to the transfer of rights?"

Some scholars have expressed the view that Article 973*c* para. 4 of the Swiss Code of Obligations may raise issues for the tokenization of securities under Swiss law.

This analysis is however incorrect.

As evidenced by the legal opinion of Prof. Dr. Hans Caspar von der Crone already mentioned above, the requirement of a written assignment in reality only applies when the

debtor of the rights that are to be transferred (*i.e.* here the issuer of tokenized securities) is not involved in the transfer. That is not the case when an issuer wraps (or incorporates) the securities that it issues into tokens and allows them to be transferred on a blockchain. The issuer is in such a case involved in the transfer, which as a result does not require any written assignment to be valid.

Of course, Article 973*c* para. 4 CO could be made clearer in this respect. A proposal to clarify this provision should however not be construed as an assessment that transfers of uncertificated securities (incorporated in tokens) are invalid absent a written assignment. The current legal situation in this respect is similar to the one that existed until the Federal Act on Intermediated Securities ("**FISA**") became effective in 2010. Until then, the transfer of uncertificated securities was subject to the regime applicable to the assignment of claims (*i.e.* Article 164 *et seq.* CO). Article 165 para. 1 CO also required a written assignment in this context. It was however never claimed that all transfers of uncertificated securities – in particular those carried out on stock exchanges – were invalid. In practice, issuers of registered shares addressed the issue by providing in their articles of association (or in the terms of the financial instruments that they issued) that an assignment would only be effective if it was notified to the company.

Should it be nonetheless decided to clarify Article 973*c* para. 4 CO in this respect, we would submit that the text proposed by the "Blockchain Taskforce" in its report of April 2018 is needlessly complex and restrictive. In particular, the proposal to make the "tokenization" of uncertificated securities conditional upon an "independent expert" having opined that the blockchain used in the tokenization process guarantees a "*Funktionssichereit*" and that the terms of the issue or the issuer's constitutive documents are being complied with[1] is both unnecessary and unclear. It is in particular unclear who the "independent expert" would be, what independence criteria would be applied, and according to what standards the "*Funktionssichereit*" of the blockchain would be assessed. If the reason for changing the law is to create legal certainty and predictability, the revised legal text should clarify the legal requirements, not create further uncertainties.

In our view, ensuring the "*Funktionssichereit*" of the blockchain used for the tokenization of securities and obtaining the necessary technical confirmation to assess the point is part of the fiduciary duties of the board of directors (Article 717 para. 1 CO). Failure to act diligently in this respect would be a cause of director liability toward token holders (Article 754 *et seq.* CO). A special provision is unnecessary to achieve this result.

[1] BLOCKCHAIN TASKFORCE, "Positionspapier zur rechtlichen Einordnung von ICOs", Bern/Zug, April 2018, page 13.

In our view, if a clarification of Article 973*c* para. 4 CO was deemed useful (despite the fact that this provision does not currently prevent the tokenization of securities), a potential drafting could be the following:

> *"Le transfert des droits-valeurs exige une cession écrite, à moins que les statuts de l'émetteur ou que les conditions de l'émission n'en disposent autrement. Leur nantissement est soumis aux règles relatives à l'engagement des créances."*

The reference to the terms of the issuer's articles of association or those of the issue, as proposed above, reflects the language used in Article 7 FISA. It also reflects the general principle of freedom of contracts, which allows debtors and creditors to agree on the manner in which claims or contracts between them can be transferred to third parties. The clarification would consequently be consistent with the general structure of FISA and general Swiss civil law.

3.1.3 "Are risks apparent that would arise in connection with the facilitation of the transfer of rights on a blockchain that would potentially also have to be addressed by legislative measures?"

As a first remark, it should be noted that the DLT is bound to *significantly reduce* the risks generally associated with the transfer of securities, not to increase them. The transfer of certificated securities (*i.e.* of securities incorporated in physical certificates) can raise the question of the legitimate ownership of the relevant instrument, in particular under circumstances in which the relevant certificates were lost, stolen, forged, issued without authority, or cancelled and re-issued by the issuer.

Likewise, the transfer of uncertificated securities (*i.e. Wertrechte*) can raise issues when an uninterrupted chain of assignments cannot be established (which is frequent), when there are suspicions of double assignment, or when the validity of an assignment within the chain is put into question.

Uncertainties about the ownership of securities do not only create risks for their acquirers (whose ownership may subsequently be challenged). It is also a risk for the issuer of the relevant securities, who, as a debtor of the relevant dividends, interest payments or other amounts payable in connection with the securities, incurs the risk of making payments to the wrong person, and as a result, having to pay twice.

The incorporation of financial instruments into digital tokens through the DLT makes it possible to determine their ownership with certainty, and eliminates the risk of double assignment and forgeries. It consequently excludes risks of subsequent challenge to the ownership (for the acquirer) or of double payment (for the issuer). The DLT is therefore primarily a factor of *reduction* of risks in the financial markets. The risks that are associated with the use of the DLT in the financial markets, and which are outlined below, must be analysed in this perspective.

(A) Money laundering risk

The tokenization of securities is often associated with the risk of money laundering. This risk indeed exists, since the issuance and trading of securities or other financial instruments by means of the DLT generally involves persons who are identified by electronic codes only (*i.e.*, their wallet or public address).

However, the claim that the DLT is inherently more vulnerable to illicit activities than traditional fundraising methods is incorrect. In many cases, the reverse is true. Because it establishes a direct link between issuers and investors – without the intervention of intermediaries – the DLT makes it possible for issuers to identify their investors much

more precisely – and with much more granularity – than is currently the case in traditional financial markets.

As an example, Swiss listed companies currently only have very partial information on the identity of their shareholders. It is not uncommon for listed companies to have 30% or more of their shares held "in dispo", *i.e.* by persons who have not requested their registration in the company's share register. In the context of the revision of Swiss company law that is currently being discussed before the Swiss Parliament, the Federal Council deliberately decided not to change this state of affairs.

For what regards unlisted companies, the Federal Council has recently proposed to prohibit the use of bearer shares, out of fear that such instruments could be used to facilitate money laundering or terrorist financing. However, the same could in reality be said of the use of certificated registered shares (*i.e.* registered shares incorporated in *Wertpapiere*), since these instruments can often be endorsed in blank and transferred without the issuer's knowledge or any publicity as regards the identity of the parties. For unlisted companies, a duty to identify the beneficial owner of shares only exists with respect to stakes that represent 25% or more of the share capital or voting rights (Article 697*j* CO). This limit is high. It implies that investors are currently in a position to invest significant sums in Swiss companies through nominees (below 25% of the issuer's share capital or voting rights) without having to disclose their identity.

Issuers of tokenized shares, by contrast, can take advantage of the DLT to have a much more detailed picture of their shareholder base. As the legal opinion of Prof. Dr. Hans Caspar von der Crone referred to above shows, an issuer can – for example – make the exercise of *any* shareholder right subject to the relevant token holder having been identified to its satisfaction.

In conclusion on this point, it is in our view incorrect to assume that tokenized financial instruments are inherently more prone to money laundering than traditional methods of financing. On the contrary, the technology has the potential of creating much stricter requirements in this respect. Tokenized securities cannot be compared to bearer shares.

Before imposing far-reaching due diligence requirements that are likely to prevent the DLT from reaching its full potential in the financial sector, lawmakers and regulatory authorities should first assess whether the market is adequately addressing the issue. Governmental intervention should be the *ultima ratio*. As an example, our association is currently working with its banking members on creating standards and trying to develop best practices for the use of the DLT in the financial markets. There is no reason to doubt *a priori* that such initiatives will fail to deliver satisfactory results.

The real risk in this respect is that some issuers fail to take the steps that are necessary to identify their shareholders. This risk, we believe, is however not necessarily critical. Without due diligence on their investors, issuers will generally not be in a position to open bank accounts with regulated institutions or be in a position to raise capital from institutional investors such as venture capital firms. They will as a result be shut out of the mainstream business community.

We believe that this creates a strong incentive for issuers to self-regulate, which should be significant enough to make governmental intervention unnecessary in this respect. The legal opinion of Prof. Dr. Hans Caspar von der Crone shows that current Swiss law provides adequate instruments to reach this goal.

Should legislative intervention be nonetheless deemed advisable, we could think of two ways to address the issue:

(i) *Require issuers that are offering securities to the public to provide detailed information about the manner in which they are identifying shareholders in the offering prospectuses required under the new Federal Act on Financial Services ("**FinSA**")*. This would make it possible to identify the issuers that are failing to take adequate steps, and would create an incentive for them to tackle the issue. This requirement could be introduced in FinSA's implementing regulations, *i.e.* without a revision of the law being required.

(ii) *Create a mandatory notification duty to the issuers of tokenized securities, similar to the one that Article 697i CO currently contemplates for bearer shares*. The regime would not prevent the transfer of the legal ownership of the relevant securities through the blockchain. It would however prevent – by operation of law, rather than on the basis of the issuer's articles or the terms of the issuance – the exercise of the rights associated with the relevant securities (tokens) until its new owner has identified itself to the satisfaction of the issuer, through a regime similar to that of Article 697*m* CO. For the reasons outlined above, we consider however such an extreme measure to be disproportionate and unwarranted for the time being.

(B) Risk of fraud

The suspicion that currently surrounds ICOs and the disrepute in which these transactions have fallen is mainly due to two factors: the lack of clarity about the nature of the rights that are being incorporated in the relevant tokens, on the one side, and to the poor quality of many "white papers" that are being produced to market these instruments, on the other side.

In our view, the proper way to address the risk of fraud in the ICO market is through disclosure and transparency, on the one hand, and through an effective liability and enforcement regime, on the other hand. In an open economy like Switzerland's, the purpose of financial regulations should be to make sure that investors are put in a position to make informed decisions about the investments they are making and the risks they are taking. The purpose of financial regulations should not be to protect investors against themselves by prohibiting certain types of investments on the grounds that they may generate losses.

Considering the new prospectus regime that the Federal Parliament created last June when it adopted FinSA, we do not believe additional legislative steps to be required to protect ICO investors for the moment. FinSA makes it clear that the public offering of securities triggers a duty to publish an offering prospectus[2]. The prospectus must be approved by a regulatory authority prior to publication[3]. Any person who participated in the preparation or publication of the document is personally liable toward investors for the damage that they incurred as a result of inaccurate, misleading or incomplete statements therein. In addition, intentional omission to publish a prospectus when required, as well as intentional material misstatements or omissions in a prospectus are criminal offences.

In the future, tokens distributed in the context of ICOs will likely increasingly be "security tokens" (*i.e.* incorporate securities). The "white papers" used to market these instruments will as a result increasingly be subject to the prospectus requirements referred to above. This, in our view, coupled with adequate enforcement measures, should be sufficient to adequately protect investors and the functioning of Switzerland's financial markets.

(C) Extension of the scope of the statutory regime applicable to listed companies that have offered their securities to the public

Another point to address in the medium term to adapt Swiss law to the generalization of tokenized financial instruments will be the scope of the rules regarding listed companies.

Currently, unlike other jurisdictions such as the U.S., Swiss law defines the scope of most of its rules on public companies by reference to the concept of *listing*, rather than by reference to the concept of *public offering*. This is in particular the case for disclosure of large shareholdings, voluntary and mandatory public takeover offers and "*Vinkulierung*". This is also true – to some extent – for the rules on market abuse (although in that case the scope is defined by reference to the concept of "admission to trading on a trading

2 Article 35 para. 1 FSA.
3 Article 51 FSA.

platform", rather than by a reference to listing). FinSA will change this situation (Articles 35 *et seq.*), but for prospectus requirements only.

This may compromise the situation of investors in tokenized securities in practice, and also the functioning of the Swiss financial markets generally. The regimes referred to above are based on the assumption that public companies are generally also listed. This is currently correct in most cases, although not necessarily. Many Swiss companies currently have publicly traded securities, without however having them listed on a stock exchange. This is in particular the case of companies having securities traded on platforms such as BEKB's OTC-X[4] or Bondpartners' HelveticA[5]. The trend toward trading securities outside of traditional securities exchanges is bound to continue. Since January 2018, the Financial Market Infrastructures Act ("**FMIA**") has made it possible for brokers to operate organized trading facilities ("**OTFs**") without having to be licensed as a securities exchange or a multilateral trading facility ("**MTF**")[6].

This development is particularly important for tokenized securities. Tokenized securities will typically be offered to the public and publicly traded. If they are issued by SMEs or start-ups, they are however unlikely to be listed on a stock exchange. This creates a risk for investors and the market, due in particular to the inapplicability of the rules regarding disclosure of large shareholdings and takeovers. Extending the scope of these rules to circumstances in which shares are publicly traded (and not only listed) would in our view be desirable in the medium term. To avoid uncertainties as to whether particular securities must be deemed to be "publicly traded" or not in this context, **we would suggest to create the possibility for non-listed issuers to voluntary "opt-in" to the regimes regarding disclosure of large shareholdings and takeovers, by adopting specific provisions to that effect in their articles of association**. Such a regime would mirror the regime set forth in Article 125 para. 3 and 4 FMIA, which makes it possible for issuers to "opt out" of the mandatory offer regime of Articles 135 and 163 FMIA.

(D) Loss or theft of private keys

As mentioned above, tokens must in our view be understood as a modern-day equivalent of physical certificates (*papiers-valeur*, *Wertpapiere*), which were used before the digital age. 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.

4 https://www.otc-x.ch/otcx/otcx.
5 https://www.bpl-bondpartners.ch/cours/
6 Articles 42 *et seq.* FMIA.

The rules regarding *Wertpapiere* contain special provisions that make it possible to break the link between the physical certificate and the underlying right under particular circumstances, namely in case of loss or theft[7]. These processes involve a public call to the holders of the relevant certificate, and a subsequent cancellation of the instrument absent a reaction within a specified period of time.

Like physical certificates, private keys that make it possible to evidence control over tokens (and, through such control, ownership of the relevant tokens) can be lost or stolen. Currently, Swiss law does not specify how tokenized rights can be separated from the tokens to which they have been associated. The terms of the instrument incorporated in the tokens can specify the manner in which tokens will be cancelled and re-issued. However, a general statutory regime similar to the one contemplated by Articles 971 *et seq.* and 981 *et seq.* CO, defining explicitly the circumstances under which the tokens incorporating rights governed by Swiss law can be cancelled, would contribute to the predictability and certainty of transactions.

3.1.4 "Is there a need for statutory minimum requirements regarding the design of a blockchain? How would these look like?"

In our view, any statutory or regulatory definitions of what constitutes a "good" from "bad" blockchain to support financial instruments would be misguided and counterproductive. This would be tantamount to introducing statutory requirements on the quality of the paper on which certificates must be printed and on the quality of the ink that must be used to that effect. A definition or abstract standards would almost certainly be quickly outdated, and inevitably fail to follow the pace of technological evolutions in this field.

The legislative framework should in our view be technologically neutral. From a legislative or regulatory perspective, it is in our view better to rely on the fiduciary duties (for what regards civil law) and general regulatory "fit and proper" requirements (for financial intermediaries and their corporate bodies) to ensure that the tokenization process is being carried out in a responsible manner, rather than to try to impose particular technological solutions through legislation.

3.2 Treatment of Tokens in Insolvency Proceedings

3.2.1 "How is the custody of tokens by third parties organized in practice from a technical and legal perspective?"

To our knowledge, two regimes are currently being applied in practice:

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[7] Articles 971 *et seq.* and 981 *et seq.* CO.

(a) Under the first regime, the custodian holds the private keys to the wallets on which tokens are credited, which are stored either on its own IT systems or on the IT systems of a third party mandated by the custodian. In such a case, the custodian must be able to store and manage the private keys and the blockchain addresses to which the keys relate, and to broadcast transaction messages to the relevant blockchain networks. There are variations of this first regime, which are sometimes referred to as "custodian wallet provider"[8] services. The custodian can have:

- *exclusive control* over the private keys;
- *joint or shared control* over the private keys (meaning that the custodian can only use the private keys to generate transactions together with the client); or
- *alternative control* over the private keys (meaning that each of the client and the custodian can access the private key).

(b) Under the second regime, the custodian neither controls, nor has access to the private keys, but solely acts as an intermediary entrusting a third party custodian wallet provider which itself holds and controls the private keys (*i.e.* acts as a sort of "sub-custodian").

Certain wallet providers are not holding, storing or having access to their clients' private keys. Such non-custodian wallet providers in our view must not be characterized as "custodians", as the services that they provide do not involve any element of custody or control over third party assets. We refer in this respect to our response to question 4.2.2 below.

3.2.2 "Are risks apparent that would arise in connection with a segregation approach for cryptographic tokens that would also have to be addressed by legislative measures?"

We believe that the regime described in our response to question 3.2.1 above raises mainly two questions.

The first is of practical nature. It relates to the manner in which custodians are storing private keys, and the manner in which liquidators or other third parties may access these

[8] A "custodian wallet provider" is generally referred to as an entity that provides services to safeguard private cryptographic keys on behalf of their customers, to hold, store and transfer virtual currencies or tokens. For the reasons outlined in our answer to question 5.2.7 below, the term is however a misnomer, as "custodian wallet providers" are in reality not "custodians" within the meaning of the Swiss financial regulations.

private keys if the relevant custodian becomes bankrupt or is otherwise put into administration.

The second is of legal nature. It relates to the manner in which tokens must be treated in the event of a bankruptcy of the custodian.

(A) Storage of private keys

There is in our view no reason to treat digital assets differently than other assets in the event of a bankruptcy of their holders, except when the digital nature of the asset raises a particular difficulty. For what regards digital tokens, one particular issue may be that the administrator or liquidator of the bankruptcy may be – as a practical matter – unable to access the private keys that are required to dispose of the tokens.

In our view, the adequate storage of private keys should be deemed part of the fiduciary duties and conduct of business requirements of any firm that accepts digital assets in custody. The method of storage used should make it possible for authorized third parties such as a FINMA-appointed administrator or liquidator to access the keys and transfer the digital assets to which they are linked. We would expect compliance with these requirements to be part of the periodical regulatory audits to which FINMA-regulated firms are subject. This, however, does not require specific changes to current financial market laws. These kind of requirements can be adequately treated in ordinances or guidelines.

(B) Treatment of digital assets in a bankruptcy

Another question is the extent to which digital assets can be segregated for the benefit of their owners in the bankruptcy of the custodian, or whether the owner only has a monetary claim against the custodian for payment of the value of the relevant digital assets.

The legal situation is in our view clear for what regards tokens that incorporate securities, financial instruments or claims for the delivery of goods or services against the issuer (*i.e.* for security and utility tokens under the FINMA's terminology). These instruments are "deposited assets" within the meaning of Articles 16 and 37*d* of the Federal Act on Banks and Savings Institutions (the "**BA**") if the underlying right satisfies the requirements of these provisions. The fact that the relevant rights were tokenized (*i.e.* wrapped into tokens) does not change their nature.

The situation is potentially less clear for cryptocurrencies ("payment tokens" under FINMA's terminology). These tokens do not generally incorporate any rights or claims, and it is consequently unclear whether they must be treated as "deposited assets" (and consequently segregated in the bankruptcy of the custodian), or as cash deposits, which must be repaid together with the other debts of the custodian.

In our view, cryptocurrencies must be treated as "deposited assets" and segregated from the other assets of the custodian in the event of a bankruptcy pursuant to Articles 16 and 37*d* BA. This is consistent with the manner in which cryptocurrencies are treated under corporate law (contribution of cryptocurrencies for the payment of newly issued shares are treated as contributions in kind, and not in cash). Also, treating cryptocurrencies as cash deposits would trigger the application of the deposit insurance scheme of Articles 37*h et seq.* BA. Given the CHF 6 billion cap that applies to that scheme, this would have a knock-on effect on the holders of "regular" cash accounts at the bank.

Likewise, in the second regime outlined in our answer to question 3.2.1 above, the claim of the custodian against the sub-custodian that holds the private keys should be eligible for distraction in the bankruptcy of the custodian pursuant to Article 16 Nr. 3 BA.

Because the regime applicable to cryptocurrencies in the bankruptcy of a custodian is not entirely clear under the current legislation, a clarification in either the BA or the Ordinance on Banks and Savings Institutions ("**BO**") would – even if not technically necessary – be nonetheless useful.

4. COMBATTING MONEY LAUNDERING AND TERRORIST FINANCING

4.1 Preliminary Remarks

4.2.1 Should decentralized trading platforms that have no power of disposal over third party assets be covered by the Anti-Money Laundering Act similar to trading platforms with power of disposal over third party assets and thereby become subject to due diligence duties?

We believe that it would be unwise for a jurisdiction of the size of Switzerland to try to regulate decentralized trading platforms in a vacuum, without coordination with its neighbours and the other main financial centres. Absent such coordination, Switzerland will always be at a disadvantage. A more stringent regime than its neighbours will create competitive distortions and drive the trading platforms' activities out of Switzerland. A more permissive approach may compromise Switzerland's efforts to have its financial regulations recognized by other countries (*e.g.* by EU members), and may as a result compromise Swiss firms' access to foreign markets.

Currently, decentralized trading platforms that only make it possible to exchange digital assets (without any conversion of such assets into fiat currencies) remain out of the scope of the EU's fifth anti-money laundering directive of May 2018. Taking a different approach on this topic in Switzerland would be difficult to justify at the moment. In our view, the correct approach in this respect is for Switzerland to follow closely the manner in which the EU's anti-money laundering directive will evolve in the future and replicate the regime that will be applied by the EU member States.

4.2.2 Should non-custodian wallet providers be covered by the Anti-Money Laundering Act and thereby become subject to due diligence duties?

Non-custodian wallet providers ("**NCWP**") are not acting in any of the capacities contemplated in Article 2 para. 1 or 2 of the Federal Act on Combating Money Laundering and Terrorist Financing ("**AMLA**"), and are not providing any of the services contemplated in Article 2 para. 3 AMLA. NCWPs are clearly out of the AMLA's scope.

There does not seem to be any justification for expanding the scope of the AMLA to capture these service providers either. The services provided by NCWPs do not involve any custody element.

NCWPs do not keep a record of their clients' trades, balances or private keys. They only provide an interface that makes it possible for users to interact with the blockchain and "read" the information stored on that (decentralized) support. The information displayed

on the application that provides the wallet reflects data on the blockchain, not on the NCWP's systems. Considering the technical nature of the service provided, imposing extensive AML obligations on NCWPs seems unjustified.

Also, attempts to do so would be essentially pointless, since NCWPs are generally not in a position to enforce the obligations that the AMLA imposes on financial intermediaries. In particular, because NCWPs do not keep any of their clients' assets in custody or keep any accounts for their clients, they are not in a position to "freeze" their clients' assets pursuant to Article 10 AMLA.

4.2.3 "Are transparency obligations similar to those in Art. 697*i* CO required for legal entities (*e.g.* notably foundations) that issue tokens? In the affirmative, in which form?"

As mentioned above in our response to question 3.1.3, such a solution would in our view be unwarranted and disproportionate for the time being.

5. FURTHER FINANCIAL MARKET REGULATION

5.2.1 A sandbox can be described as a regulatory carve-out that allows testing of novel business models within defined thresholds (e.g. CHF-amount, period of time, etc.). Today, a sandbox exists already in banking law for which clearly defined thresholds apply, and it is not the industry itself deciding over the application of the sandbox Are further sandboxes justified for blockchain-specific applications? In the affirmative, which of today's legal requirements have a curbing effect on innovative capacity specifically in the blockchain area that could be addressed with additional sandboxes? Which objective thresholds would be suitable in practice for such additional sandboxes?

The usefulness of the "sandbox" concept is in our view uncertain. A regulatory regime dedicated to the "testing of novel business models" raises practical difficulties, the main one being how to transition the relevant firm from the "sandbox" to the "regular" regulatory regime when the "testing" phase comes to an end. Another element is that, for the reasons outlined in our answer to question 5.2.2 below, the practical implications of a "sandbox" regime, and consequently its usefulness, are often difficult to assess in advance.

In our view, the right course of action consists in defining reasonable materiality thresholds and sufficiently flexible requirements *for all firms*, so that the regulatory requirements can be adjusted in a reasonable way to reflect the size, complexity and business model of the relevant firms.

With respect to digital assets and tokenized securities, the key element is to create (i) adequate transparency about what will be characterized as public deposits for regulatory purposes, (ii) the distinction between payment and security tokens (*e.g.* for asset-backed instruments such as deposit receipts for precious metals or other tradable assets), as well as (iii) flexibility in the definition of the AML due diligence standards to take into account the particular nature of digital assets.

5.2.2 Are the recently introduced, respectively the soon to be introduced, Fintech reforms in banking law (i.e. innovation space [sandbox], Fintech license, and refinements for settlement accounts) sufficient for blockchain-based applications or would further revisions (e.g. an increase of the threshold for the innovation space) be reasonable; in the affirmative, which revisions and why?

As mentioned in our answer to question 5.2.1 above, the key element in our view is not so much the creation of new regimes of exception, but rather pragmatism and reasonableness in the application of existing criteria.

Regimes of exception, when they are created, should not only focus on the status of the exempted entity, but also on its interactions with third parties. For example, with respect to the fintech exemption introduced in July 2017 (for companies that accept deposits of CHF 1 million or less pursuant to Article 6 para. 3 and 4 BO), the business relationships of the exempted fintech companies with banks were in our view not sufficiently taken into consideration. Exempted fintech companies are not necessarily financial intermediaries subject to the AMLA. When fintech companies that are not subject to AMLA want to open a bank account, they must provide the relevant bank with detailed information about the beneficial owners of the funds to be deposited (*i.e.* provide the "Form A" contemplated in Article 27 *et seq.* CDB 16, since they do not benefit from the exemption contemplated in Article 33 CDB 16). The obligation to provide such a Forms A (including, possibly, hundreds or thousands of names and other details on the beneficial owners of the funds) is a burden that is often commercially unbearable for the banks. This may explain why many banks are still reluctant to accept exempted fintech companies as clients. Without a bank account, however, these companies remain shut out of the mainstream business community.

This example shows that isolated carve-outs and exemptions are generally insufficient to address the regulatory issues that start-ups and smaller businesses are facing in the financial sector. More comprehensive measures are required to make it genuinely easier for innovative financial firms to do business in Switzerland. Requirements such as the delivery of Forms A are unhelpful in this context, and should be removed.

5.2.3 Today, tokens may qualify as securities or derivatives pursuant to Financial Market Infrastructure law, depending on the design of the respective token. Is it sufficiently clear, when a token is considered to be a security or a derivative (if not, why)? How could legal certainty and planning certainty be enhanced?

The uncertainties that currently exist about the scope of the various requirements regarding the trading in derivatives (and in particular, the exemptions contemplated in Article 94 para. 3 and 4 FMIA) are unrelated to the question of whether the relevant products are tokenized or not.

As mentioned above, the fact that a financial instrument is tokenized does not change the nature of the underlying instrument. The tokenization is only a process to facilitate the transfer of (non-standardized) financial instruments, (standardized) securities, or (standardized or non-standardized) derivatives or structured products.

5.2.4 "Which specific requirements in financial market infrastructure law, that are linked to the classification of tokens as a security or a derivative (*e.g.* regulations on secondary trading, market conduct requirements in the derivatives area) are not suited or problematic for blockchain-based assets and why? How could these requirements be adapted?"

Please refer to our answer to question 3.1.3 above.

5.2.5 "Today, the regulations of stock exchanges and multilateral trading facilities (MTF) are linked to the definition of securities and limit the scope of potential participants on such trading platforms. Are today's regulations of stock exchanges and MTFs suited for blockchain-based assets or is there a need for revision? For instance, should regulations for MTFs be made more flexible (e.g. scope of potential participants) or is there a need for a new license type (e.g. MTF for blockchain-based assets)? In the affirmative, does the direct access of retail clients to MTFs require specific measures to ensure market integrity, investor protection, market transparency, or orderly trading?"

Please refer to our answers to questions 3.1.3 and 4.2.1 above.

5.2.6 "Is the licensing requirement for securities settlement systems (Art. 61 FMIA) a market entry barrier for the operation of crypto trading platforms? Should a *de minimis* threshold be introduced?"

No. Firms that provide wallets or token exchanges are not central securities depositories within the meaning of Article 61 para. 1 FMIA, or securities settlement systems within the

meaning of Article 61 para. 3 FMIA. This is because transactions in tokenized securities are carried out through the blockchain, which – by definition – is administered in a decentralized manner and is consequently not "operated" by any single person.

The services provided by wallet providers do not generally involve any custody element (see our answer to question 4.2.2 above). "Custodian" wallet providers in reality either hold the private key of their clients (in which case the custody relates to the private key, not to the tokens to which they refer, which are recorded in the blockchain) or are using their own private keys (in which case they are acting as nominees rather than as custodians). In either case, there is no "central" deposit, since the transfer of securities are not "based on uniform rules and procedures" within the meaning of Article 61 para. 3 FMIA.

Token exchanges are typically platforms on which tokens can be purchased or sold. They consequently provide services related to the execution of trades, not their clearing or settlement.

5.2.7 "In the area of collective investment scheme laws, are there challenges that are specific to blockchain-based business models? In the affirmative, what are these challenges (e.g. custody bank requirements)? Which amendments would be suited to address such challenges?"

In our analysis, wallet providers (including "custodian wallet providers", as defined in our answer to question 3.2.1 above) are technically not "custodians" for the purpose of the Swiss regulations. This is because control over private keys does technically speaking not involve control over the associated tokens, which are recorded on the blockchain. This, however, should not prevent collective investment schemes from investing in tokenized assets when this is in the interest of investors and consistent with their investment policies.

In our view, FINMA should be given the authority to grant general or specific exemptions from the requirements of Article 72 *et seq.* of the Federal Act on Collective Investment Schemes ("**CISA**") in connection with transactions in digital assets. We note that similar exemption regimes already exist in other contexts for certain types of funds such as SICAVs (Article 44*a* para. 2 CISA) or alternative investment schemes (Article 71 para. 5 CISA).

5.2.8. "Is there an interest to allow replicating collective investment schemes, parts thereof, collective investment schemes units, or fund assets on a blockchain? Which amendments would be required to that end?"

As for other forms of financial assets, the tokenization of fund units is likely to reduce transaction costs over time by reducing the custody and sub-custody costs. For the same reasons, funds will over time likely be willing to invest in tokenized financial instruments. As mentioned in our answer to question 5.2.7 above, sufficient flexibility should be built into the Swiss regulations on collective investment schemes to make this possible.

5.2.9 "From today's perspective and with respect to blockchain-based applications, do you expect significant issues with the implementation of potentially relevant market conduct rules pursuant to FinSA (Art. 7-20 FinSA)? For instance with respect to the appropriateness and suitability checks and documentation obligations."

No. The obligations contemplated by these provisions reflect general fiduciary duties that providers of financial services owe to their clients. These duties must be applied in an appropriate manner to reflect the particular nature of digital assets. The manner in which of Articles 7 to 20 FinSA is sufficiently general to provide the necessary flexibility in this respect.

5.2.10 "What is the respective assessment regarding prospectus requirements pursuant to Art. 35 et seq. FinSA?"

We believe the prospectus requirements contemplated in Article 35 *et seq*. FinSA will provide an overdue contribution to the transparency of the ICO market. As mentioned in our answer to question 3.1.3 above, from a policy perspective, it is in our view preferable to regulate that market through disclosure and transparency requirements, rather than through prohibitions and business conduct requirements.

5.2.11 "From today's perspective, in the area of FinIA, do you see specific challenges for blockchain-based business models? In the affirmative, which are these?"

No. However, as mentioned in our answer to question 3.1.3 above, some amendments to FMIA (namely Articles 120 and 125) as well as in the CO would in our view be advisable.

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association.

As indicated above, we enclose for your information a copy of the legal opinion of Prof. Dr. Hans Caspar von der Crone dated 7 September 2018. This opinion was commissioned by our association, and has considerable proprietary value for our organization. We therefore request that this document be treated confidentially within the SECO and not be published or shared with third parties. We have otherwise no objection to the publication or disclosure of this letter.

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

Capital Markets and Technology Association

s/Jacques Iffland *s/Morgan Lavanchy*

Jacques Iffland
Chairman

Morgan Lavanchy
Member of the Committee

Encl.: Legal opinion of Prof. Dr. Hans Caspar von der Crone dated 7 September 2018 (confidential treatment requested)