Consultation on the work of the Working Group Blockchain / ICO

1. Background

The Swiss Federal Department of Finance (FDF) informed on 18 January 2018 that it has established a working group on Blockchain/ICO, including with the involvement of, *inter alia*, the Federal Office of Justice (FoJ) and the Swiss Financial Market Supervisory Authority (FINMA), to review the legal framework in particular for financial sector-specific applications based on blockchain technology. The analysis includes also – but is by no means limited to – Initial Coin Offerings (ICOs). The work aims at increasing legal certainty, enabling innovation, and safeguarding the integrity of the financial center. Clarifying the regulatory framework – both, with respect to civil law as well as financial regulation issues – shall contribute to maintaining Switzerland's position as an attractive location for blockchain/ICOs, with high standards in the area of market conduct. The working group will prepare a report to the Federal Council by the end of 2018 and identify potential need, as well as options, for action. Based on these results, the Federal Council will decide upon launching revisions to the legal framework.

The working group comprises members of the State Secretariat for International Finance, the Federal Office of Justice, FINMA, the Swiss National Bank, the State Secretariat for Economic Affairs (SECO), the Federal Office of Police, as well as the Swiss Federal Customs Administration. Over the past months, various members of the working group already had exchanges with companies, law firms, and experts on ongoing *Distributed Ledger Technology (DLT)* projects and on legal challenges. Likewise, in its considerations, the working group has taken into account the position paper of the private sector initiative "Blockchain Task Force", which paper was published in April 2018. With the present consultation, the industry is invited to comment on the direction of possible recommendations and provide further remarks where needed.

This consultation paper does not contain detailed background and analyses, but rather aims directly at possible recommendations and issues in the following areas:

- General Matters
- Civil Law
- Combatting Money Laundering and Terrorist Financing
- Further Financial Market Regulation

Interested parties are invited to submit written feedbacks by 20 September 2018 by e-mail to fin@sif.admin.ch

2. General Matters

Possible Scenarios

The working group itself does not take a position on the likelihood of a broad adoption of DLT/blockchain technology. The working group considers it important, that the legal framework provides sufficient flexibility and legal certainty for all realistic scenarios (broad, selective, and limited adoption of DLT/blockchain technology in the financial sector).

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

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

Bank accounts for Fintech firms

Access to bank accounts: The Fintech industry regularly highlights that firms with Fintech business models (namely those related to blockchain/ICOs) face difficulties in entering into business relationships with Swiss banks. As this is not directly an issue pertaining to the legal framework, a separate working of the Swiss Bankers Association has addressed this matter. It is, however, conceivable that revisions to the legal framework could also help, respectively operate as a confidence-building measure, in this matter.

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

3. Civil Law

3.1. Civil Law Classification and Transfer of Tokens

To classify tokens from a civil law perspective one has to analyze the legal relationships that form the basis for the issuance and trading of tokens. A token as such represents simply an entry in a decentralized register and thereby does not have legal effects. Legal obligations are created only between persons who use tokens and afford legal relevance to their token-related actions. Correspondingly, the classification of tokens depends heavily on the specific case at hand.

When issuing and using tokens, often the intention is to link assets or rights with an entry in a decentralized register. The report to be published by the end of 2018 will discuss which assets and rights are suitable to be linked with an entry in a decentralized register and which legal requirements under current law apply. Special attention will be paid to barriers to transferring assets and rights under current law. The working group has – in-

line with various publications on this topic – identified the written form requirement for the transfer of simple claims (Art. 165(1) CO) and uncertificated securities (Art. 973c(4) CO) as a potential barrier. In certain cases further – specific – statutory requirements relating to the representation and transfer of rights may be relevant also, e.g. in the area of company law.

Tokens representing rights are intended by their users to fulfill a function that is similar to, and currently traditionally assumed by, negotiable securities. The intention is that such tokens are attached to and facilitate trading with such rights. Legal scholarship discusses different approaches to align the trading of rights on the blockchain with the current legal framework. However, these approaches are not yet tested in practice and subject to legal uncertainty.

Therefore, the working group intends recommending an amendment and further development of the securities laws to facilitate trading of rights on a blockchain. As the entry in a decentralized register that is accessible to interested parties allows the creation of disclosure similar to the possession of a negotiable security, *prima facie,* it would appear justified to confer similar legal effects also to such an entry. Thereby, well-tried general principles of securities laws should be maintained as much as possible. A digital representation and transfer would thus only be feasible for such rights that can be documented also in a negotiable security and are freely transferable.

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

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

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?

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

3.2 Treatment of Tokens in Insolvency Proceedings

In bankruptcy, the insolvent debtor‘s assets are collected and realized. Regularly in such proceedings, amongst others, there is also the issue of which assets form part of the debtor’s estate, namely in cases where assets that economically belong to the debtor are located with third parties as well as cases in which the debtor holds the power of disposal over assets and such assets are claimed by a third-party.[1]

[1] Similar issues can arise also in the context of a seizure of assets.

With regard to the segregation of data based on Article 242 Swiss Federal Act on Debt Enforcement and Bankruptcy (SchKG), there is legal uncertainty today. This uncertainty affects also the treatment of access keys and similar data in connection with crypto currencies and other tokens. The corresponding issues were identified also in the parliamentary initiative 17.410 Dobler ("Data are the most valuable good of private firms. Regulating the restitution of data in the insolvency of providers"). The Legal Affairs Committee of the National Council adopted unanimously the initiative on 3 May 2018 and thereby recognized the need for action. The need for legislative action is shared also by the working group.

The working group is evaluating a segregation approach for cryptographic tokens, which are in the possession of the insolvent debtor but economically belong to a third party. However, a bankruptcy proceeding may (indirectly) also affect data without an objective financial value. Therefore, the working group considers creating a procedure to enforce also the return of such data.

To enforce the return of data would require that the third party can show a statutory or contractual claim on the data or tokens respectively. The third party would need to have a qualifying right to the data or tokens respectively that allows an unequivocal allocation of the entitlement. Such a claim may not go beyond comparable property law-based claims. Also, in situations where it is not possible to unequivocally allocate data to the respective claimant (similar to mixing chattels in property law), only a contractual right of return would continue to apply. The working group further considers also a regulation on cost allocation such that the cost for the transfer of data would have to be assumed by the person entitled to the data.

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

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?

4. Combatting Money Laundering and Terrorist Financing

4.1. Preliminary Remarks

The Swiss Federal Act on Combating Money Laundering and Terrorist Financing (AMLA) is technology-neutral and therefore already covers many of the activities in the crypto area. For instance, based on established practice, custodian-wallet providers, trading platforms that have access to clients' private keys, respectively those that hold power of disposal over the assets, currency exchanges, and issuers of payments tokens are subject to the Anti-Money Laundering Act. Hence, the working group takes the view that a fundamental revision of the

Anti-Money Laundering Act is not indicated. However, with a view to addressing potential risks, the question arises whether certain activities in the crypto area, which today in principle do not fall under the Anti-Money Laundering legislation, should become subject to the regulations on combatting money laundering and terrorist financing through targeted revisions. For instance, today, certain activities are not covered by the Anti-Money Laundering Act, e.g. non-custodian wallet providers and decentralized trading platforms that do not hold private keys, respectively have no power of disposal over the assets.

4.2 Questions

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?

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

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

5. Further Financial Market Regulation

5.1. Preliminary Remarks

Blockchain-based applications may particularly touch upon banking law (e.g. license requirement as bank), financial market infrastructure law (e.g. regulations on securities and derivatives trading; regulation of trading platforms), collective investment scheme law, as well as to the future Financial Services Act (e.g. prospectus requirements for ICOs) and Financial Institutions Act (e.g. license requirement as securities dealer). In the banking realm, only recently a number of reforms have been introduced with a view to Fintech business models (innovation space [Sandbox] and extension of the exemption for settlement accounts), respectively are about to be introduced (Fintech license). In other areas (e.g. financial market infrastructure law), representatives of the crypto industry proposed in particular a regulatory carve-out (pursuant to which only prospectus requirements and anti-money laundering regulations would apply, and financial market infrastructure regulation would not apply). To date, the industry did not, or only selectively, provide a detailed discussion of which requirements in financial market regulation lead to specific challenges in the areas of blockchain/ICO. Against this background, the working group currently sees no fundamental barriers in financial market law that affect blockchain-based applications specifically. In contrast, the working group considers that there is certain need for action in financial market infrastructure law, e.g. regarding requirements for financial market infrastructures.

5.2 Questions

General

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?

Banking Law

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?

Financial Market Infrastructure Law

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?

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?

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?

5.2.6 Is the licensing requirement for securities settlement systems (Art. 61 FMIA[2]) a market entry barrier for the operation of crypto trading platforms? Should a *de-minimis* threshold be introduced?

Collective Investment Schemes Law

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?

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?

Financial Services and Financial Institutions Laws

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[3])? For instance with respect to the appropriateness and suitability checks and documentation obligations.

5.2.10 What is the respective assessment regarding prospectus requirements pursuant to Art. 35 et seq. FinSA[3]?

5.2.11 From today's perspective, in the area of FinIA[4], do you see specific challenges for blockchain-based business models? In the affirmative, which are these?

[2] Financial Market Infrastructure Act (Finanzmarktinfrastrukturgesetz, FinfraG).
[3] Financial Services Act (Finanzdienstleistungsgesetz, FIDLEG).
[4] Financial Institutions Act (Finanzinstitutsgesetz, FINIG).