Cryptocurrencies and their Regulation in Switzerland

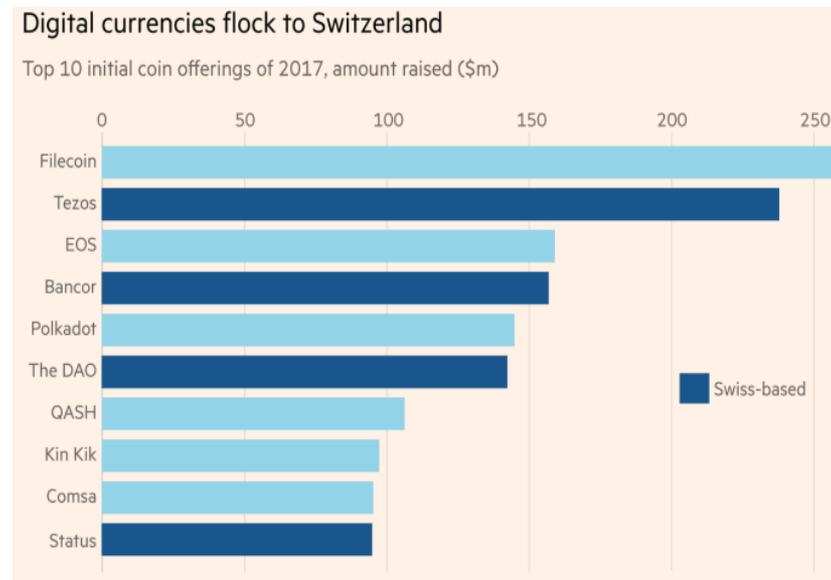## Zurich Behavioral Economics Network
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Today, let's look at:

➢ The Swiss Cryptocurrency Boom 2014 – 2017

➢ What is a Cryptocurrency?

➢ Regulatory Problems (as per the BIS)

➢ Regulatory Issues (as per Swiss governmental authorities) 1 - 5

➢ Legal Issues

➢ Practical Issues

➢ The Botton Line

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The Swiss Cryptocurrency Boom 2014 – 2017

- 2008: Satoshi Nakamoto created bitcoin.
- 3 October 2013: Bitcoin Association Switzerland; 2014 BTC-ATM in café Schoffel:
- Federal Council (Government) of Switzerland: Report on virtual currencies of **25 June 2014: "no need for regulatory activity"**
- Summer 2015: Etherum launched; Summer 2017: ICO boom
- FT, 25 January 2018: "Switzerland embraces cryptocurrency culture"
- 16 February 2018: **Finma-ICO Guidelines**
- September 2018: **Swiss Bankers' Association Guidelines**

Digital currencies flock to Switzerland

Top 10 initial coin offerings of 2017, amount raised ($m)

	0	50	100	150	200	250
Filecoin						
Tezos						
EOS						
Bancor						
Polkadot						
The DAO						
QASH						
Kin Kik						
Comsa						
Status						

■ Swiss-based

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What is a Cryptocurrency? (Definition)

Finma ICO Guidelines: «Payment tokens (synonymous with cryptocurrencies) are tokens which are intended to be used, now or in the future, as a means of payment for acquiring goods or services or as a means of money or value transfer. Cryptocurrencies give rise to no claims on their issuer.»

-> Swiss law: (i) no security, (ii) no claim/right.
But: issuing is subject to AML («means of payment»).

Issuer: can be a specific person (e.g. Ripple: Ripple Labs) or an algorithm

-> comparable to Monopoly money:
valuable, as long as you are in the game.

Q. What was the DAO? common decentralized investor platform for startup funding – SEC: DAO token is a security…

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Regulatory Problems (as per the BIS)

Bank for International Settlements (BIS) Annual Report 17 June 2018:

- «The tried, trusted and resilient way to provide confidence in money in modern times is the independent central bank.»

Operational Problems:

- **Scalability:** not possible (energy/computing power/storage)
- **Stability of value:** no central bank stabilizes volume; even pegged currencies (e.g. 1DAI=1$) are volatile. 1600 – 4000 Currencies.
- **Trust in finality of payments:** (i) only when ledger is updated; only if no one controls more than 50%. E.g. 2013: BTC-fork was rolled-back by miners.

Regulatory Problems: AML (example: 2013 drop in BTC value when Silk Road was closed down); fraudulent ICOs, theft from exchanges; stability of financial system

Suggested Approach: (i) Globally co-ordinated regulations, (ii) interoper-ability with financial entities; (iii) regulate service providers

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Regulatory Issues (as per Swiss govt.)

- **Means of Payment: not a problem: WIR, Farinet etc. (different e.g. in RU: payment must be made in RUB. E.g. in China: forbidden)**

- **License required?**

- **Issuing? Prospectus? Marketing?**

- **Exchange: Regulated?**

- **AML?**

- **Taxation? Bookkeeping?**

- **«Gewähr» of Banks / Security Traders?**

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Regulatory Issues 1

License?

For the ICO:

The issuing of tokens does usually not require any
license, except:

- if the token qualifies as derivative instrument (->securities trader license)
- Possibly if the token-issuing is a financial product, e.g. insurance, or has a debt capital character (banking license); or if the funds raised in the ICO are managed by a third party (Investment Fund)

Underwriting for others:

Underwriting and offering tokens constituting securities of third parties: securities traders license (SESTO 3)

➢ Issuing Cryptocurrencies is not a activity requiring a license

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Regulatory Issues 2

Issuing/Prospectus/Marketing? (in Switzerland at least)

Prospectus: CO 652a/1156: minimal requirements: Commercial Registry information, capital, annual accounts; if bonds: interest/repayment terms, collateral. [future Financial Services Act 37]
BUT: **Prospectus not required for cryptocurrencies** and utility tokens.

Definition Security: Financial Market Infrastructure Act: standardized certificated or uncertificated securities, derivatives and intermediated securities suitable for mass standardized trading, i.e. publicly offered for sale or placed with more than 20 counterparties (FMIA 2).
Finma: **Pre-sale of rights to future tokens: claims are securities ("Wertrechte" – CO 973c)**.

USA: Howey Test: registration if (i) investment of money; (ii) in common enterprise; (iii) with expectation of profit; (iv) through efforts of promoter

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Regulatory Issues 3

Exchanges / Crypto Brokers:

If trading platform only for Cryptocurrencies:
If neither securities nor other **financial instruments** within the meaning of Article 42 FinfraG in conjunction with Article 3 of FIDLEG (text of 15 June 2018, final vote in Parliament: equity securities, debt securities, units in collective investment schemes, structured products, derivatives, deposits with a risk or price-dependent redemption value or interest, and bonds) are traded:

The operator does not require a licence as a bank, securities dealer or trading centre.

BUT: AML rules apply.

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Regulatory Issues 4

KYC/AML:

- Anyone issuing a **means of payment** (cryptocurrency)
  is a financial intermediary (AMLA 2), if the
  tokens can be transferred technically on a blockchain -> membership of SRO and
  KYC (unless funds are accepted through a financial intermediary)
- **Pre-financing/pre-sale**: rights qualify as security -> not subject to AML
- (Utility token: AML does only not apply if main reason is to provide access to a
  non-financial application of blockchain technology). Security token: not subject to
  AML)
- Any **exchange** from one cryptocurrency to another is also subject to AML rules
  (different in EU).
- **Services** to transfer tokens are subject to AML, if the service provider maintains
  the private key of the custody wallet.
- Swiss Bankers' Association Guidelines: (i) no anonymous currencies; (ii) up to CHF
  3'000: copy identity document sufficient; above: full AML KYC

Regulatory Issues 5

Taxes:

as a rule (potential exception utility token), no VAT.
Token issuance not subject to income tax (in case of utility
tokens, due to corresponding provisions), but in case of security tokens potentially to
stamp duty (1%).

Social Security:

Social Security payments for contributors rewarded in tokens?

Accounting of Cryptocurrencies:

	Assets	Liabilities
CO:	intangible assets or securities	none
Swiss GAP FER:	securities/inventory(?)	none
IFRS:	intangible assets/inventory(?)	none
		(Utility/Sec. Token: debt or security)

Legal Issues

And another one: Transfer of the tokens under civil law?

Problem: Under Swiss law, claims can only be transferred in writing [with signature] (CO 164); (bearer) securities can be transferred by traditio.
Caveat: Problem does not apply to cryptocurrencies (no claims)

Suggestions for Solutions:
- **Security**: a «document», not necessarily in writing. Electronic document possible? No court decisions…
- **Book-entry right**: if registered in book of issuer (CO 973c; Finma: can be done digitally on a blockchain). But: para. 4: transfer must be in writing.
- **Transfer of entire contract?** No form prescribed…
- **Intermediated Security?** Transfer by instruction, no formal requirements. But: must be registered with a custodian (Verwahrstelle), which must be a bank, securities trader etc. (FISA 4).

  ➢ **Big Problem, but not for cryptocurrencies**

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Practical Issues

Finma's Approach:

- Banks: For the time being reluctant to support crypto projects; Finma wants to have crypto-related activities in the Organizational Regulations

- Several Crypto Brokers in Switzerland, but Crypto Exchanges only starting

- VQF has a focus on ICOs and related companies; Crypto Valley Association intends to set up its own focused SRO

- Finma initiated nearly 20 investigations against ICOs, liquidated ICO companies (no blockchain)

- February 2018: ICO Guidelines: Finma is willing to review prior to any sale (incl. pre-sale!) and to give clearance

- Bankers' Association Guidelines: specify AML requirements

Botton Line:

Regulation of Cryptocurrencies in Switzerland:

➢ Problem for Banks: "Gewähr"

➢ Subject to AML rules; in spite of Finma and SBA: not fully clear

o No license to issue; no restrictions on means of payments

o No prospectus required for issuing

o No issuance tax; accounting: work in progress

o Transfer possible under civil law (no "claim")

o February 2018: ICO Guidelines: Finma is willing to review prior to any sale (incl. pre-sale!) and to give clearance

➢ **favourable regulatory environment,**
high AML standards,
cautious banks

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