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Swiss Regulators Set Precedent with Groundbreaking ICO Guidelines

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On February 16, 2018, the Swiss Financial Market Supervisory Authority (FINMA) released a set of guidelines (the Guidelines) that sets out how it will handle inquiries from organizers of initial coin offerings (ICOs). Building on the principles outlined in FINMA's guidance released in September, 2017, the Guidelines separate tokens into three categories: (i) payment tokens; (ii) utility tokens; and (iii) asset tokens, all as further described below. Tokens classified into a category will be subject to varying laws and regulations, and as such, FINMA will be taking a holistic approach, on a case by case basis, when assessing the characteristics of a proposed ICO and the associated token. FINMA's landmark guidance represents a monumental development in the cryptocurrency space.

Token Classification

FINMA is the first national regulator to establish a token classification system, electing to focus on the functionality and transferability of a token when separating token structures. Under Swiss law, tokens are categorized into the following three classes:

1. **Payment Token:** Payment tokens refer to cryptocurrencies that are solely used now, or in the future, as a means of payment for goods or services, or as a means of money or value transfer (like Bitcoin).
2. **Utility Token:** Utility tokens refer to tokens that are meant to provide digital access to an application or service through a blockchain-based infrastructure.
3. **Asset Tokens:** Asset tokens represent assets such as a debt or equity claim on the issuer, and are analogous to equities, bonds or derivatives. As well, tokens intended to represent physical assets on the blockchain will be categorized as asset tokens.

Beyond the three classes noted above, FINMA advised that many existing and future tokens may likely be hybrids of two or more classes. Depending on how FINMA classifies the token associated with an ICO – which is initially based on the descriptive information of a token provided by the ICO organizers to FINMA[1] – the token may be subject to securities laws, anti-money laundering rules and other laws and regulations.

Tokens Subject to Securities Regulations

According to the Guidelines, the Financial Market Infrastructure Act (FMIA) defines securities as:

[….] standardised certificated or uncertificated securities, derivatives and intermediated securities (Art. 2 let. B FMIA), which are suitable for mass standardised trading, i.e. they are publicly offered for sale in the same structure and denomination or are placed with more than 20 clients, insofar as they have not been created especially for individual counterparties (Art. 2 para. 1 FMIA).[2]

If FINMA classifies a token as a security based on this definition, token issuers should expect to be subject to the requirements for security issuers outlined in the Code of Obligations (CO) – which includes regulations outlining prospectus requirements, the Stock Exchange Act (SESTA) and Stock Exchange Ordinance (SESTO), among others. Relying on the definitions of the FINMA token categories, FINMA states that a pure payment token would not be treated as a security, and as such would not be subject to securities regulations. Similarly, FINMA does not consider a utility token to be a security where the *sole* purpose of the token is to confer digital access rights, subject to the requirement that the token is able to be used for its described purpose at the time of issue. Accordingly, if FINMA determines that a token has any investment rationale when it is issued, FINMA will treat such token as a security. Finally, all tokens categorized as asset tokens will be treated as securities.

Despite a token nominally fitting the description of either a payment or utility token, FINMA will also consider the manner and timing in which an issuer raises capital through its token issuance to determine if the token is a security. More specifically, if there is a pre-financing or a pre-sale of a utility or payment token, FINMA will view that token as a security. Similar to simple agreements for future tokens (SAFTs) – which in Canada and the United States may be viewed as securities and are meant to be issued to accredited investors before coins are ever created and distributed – these are simply methods to raise capital through blockchain technology. While this may cause headaches for issuers that have already conducted ICOs with pre-sale options, it is encouraging to see the beginning of an alignment in approach (formal or informal) towards this type of financing across national borders.

When reviewing the properties and functions of a token using the FINMA token categories, it is important to keep in mind that FINMA will be classifying a token based on what the ***perceived intent*** of the token is. The Guidelines note that “ICOs raise a variety of legal issues for which there is no relevant case law and no consistent legal doctrine.”[3] While the cryptocurrency sector continues to develop and more tokens walk the line of being a security, token issuers and investors should be prepared to deal with substantial growing pains as regulations develop and mature, and case law is established. Following an underlying theme of the sector, it is important to recognize that while the Guidelines are a significant and positive step for the cryptocurrency industry, token issuers and investors must still proceed with caution.

Tokens Subject to Anti-Money Laundering Regulations

FINMA will require anti-money laundering (AML) compliance based on a token’s categorization. More specifically, the Anti-Money Laundering Act (AMLA) applies to any person or entity that “provides payment services or who issues or manages a means of payment,”[4] as such person or entity would be considered to

be a financial intermediary subject to the AMLA. Payment tokens are most clearly captured by this definition as their sole purpose is to facilitate the payment for goods or services. Utility tokens, however, will not be subject to the AMLA provided that the intention behind issuing the token is to provide access to a non-financial application on the blockchain. As noted above, FINMA's interpretation of "intent" will be at the center of discussion as the courts begin to interact with the industry on a more frequent basis. With the proliferation of decentralized exchanges that do not require issuer initiatives to list a token, a distinction will need to be made for tokens that can be used as a form of payment despite a lack of intent on the part of the issuer to enable this feature.

Regardless of which category a token may fall under, AMLA compliance will be required for any token that facilitates the transfer of tokens if the service provider maintains control of their clients' private keys, or if an entity facilitates the exchange of a cryptocurrency for fiat or a different cryptocurrency.

Key Takeaways

By dividing tokens into three broad categories, FINMA has provided the foundation for other regulatory bodies to build on, or at least a framework to consider. As case law and policy approaches develop, and ambiguities in this model are addressed, it will be important for regulators to implement regulations that can similarly evolve without unnecessary friction. It is interesting to note (and perhaps unsurprising) that FINMA focused on securities law and AML regulations, and did not address the significant tax concerns surrounding cryptocurrencies. If other countries decide to follow FINMA's three token category model, it will be interesting to see how they address issues concerning tokens that closely resemble securities, as well as what tax implications may be associated with being classified into one token category verses another. While the Guidelines represent a significant stepping stone on the path to mainstream adoption of cryptocurrencies, both investors and issuers must continue to proceed with caution for the foreseeable future as regulations and case law continue to evolve.

We Can Help

For more information about how Cassels Brock can assist with your business, please contact Michael Weizel, David Gardos or another member of our firm's cross-disciplinary Emerging Companies or Securities Groups.

The authors of this article are not Swiss lawyers and are not providing legal opinions on Swiss law, nor are they providing legal opinions on how the Guidelines may impact the interpretation of ICOs by regulators in Canada. Any person considering launching an ICO in Switzerland is encouraged to contact Swiss counsel.

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[1] See the minimum information requirements for ICO enquiries in the appendix to the Guidelines here.

[2] *Ibid*, p. 4.
[3] *Ibid*, p. 2.
[4] *Ibid*, p. 6.

This publication is a general summary of the law. It does not replace legal advice tailored to your specific circumstances.