Kellerhals Carrard

FINMA ICO guidelines – Initial Review by Kellerhals Carrard

The wave of Initial Coin Offerings (ICOs) started two years ago and has made Switzerland a hotspot in this respect globally. The Swiss Financial Market Supervisory Authority FINMA published its ICO guidelines on 16.2.2018 to enhance legal security and reduce ambiguity (LINK). The KC LAB team of Kellerhals Carrard undertook a preliminary analysis and welcomes the ICO guidelines in principle, but has the following observations and reservations to add:

- The FINMA assumes the categorisation of payment tokens, utility tokens and asset tokens, which has evolved out of the practice. The terms are explained to facilitate understanding yet room for interpretation remains (e.g. we would favour a specification of the utility token definition to include ancillary purposes without being re-qualified as FMIA-security). That being said, note that one token may also fall in several of these categories depending on its elaboration.

- The guidelines differentiate between these different tokens with regard to the application of the financial markets' regulations (namely the legal acts on stock exchanges, banks, collective investment schemes and money laundering). All things considered the FINMA proceeds cautiously and forgoes rigorous or unexpected interference. The comprehensive survey, which is put at disposition already helps companies determine subjugation questions and be clear on these matters in advance.

- According to section 3.2.3 of the guidelines, in the case of pre-financing (where investors only have claim to a future token or to a token that will be exchanged into further tokens later) and pre-sale phases of an ICO, value rights may result out of tokens and these rights shall be treated as FMIA-securities (Effekten). Pre-sale is not prohibited as such but should be implemented correctly.

- In the guidelines FINMA reminds us that book-entry of self-issued uncertificated securities (Wertrechte) is essentially unregulated, even if they are standardized and suitable for mass trading and therefore qualify as FMIA-securities (Effekten). However, underwriting and offering tokens constituting securities of third parties publicly on the primary market constitute a licensed activity (if conducted in a professional manner).

- Section 3.2.2 of the guidelines with respect to utility tokens is – depending on interpretation – in the best case unclear or rather in the most cases leads to a qualification as FMIA-securities. In practice ICOs with utility tokens are often used as a kind of crowd funding and therefore also have a financing component (e.g. financing of a platform or of a software), meaning that they may not yet be used in relation to the service. Furthermore, they are accordingly tradeable – which construes the purpose of the ICO. In both cases pursuant to a restrictive interpretation of the FINMA guidelines the utility tokens could be qualified as FMIA-securities. We would favour a specification in the definition (see above) to balance information requirements with the need of the blockchain industry to continue to use utility tokens for R&D financing.

- According to section 3.6 of the guidelines, utility tokens are only exempted from the application of the AMLA if the prerequisites of accessoriness (art. 2 par. 2 let. a no. 3 AMLO) are given. The transfer of financial assets must appear to be an ancillary service, which is integrated in a contractual relationship, which is not attributed to the financial sector. In other words, the distribution of tokens must primarily be carried out to give access to domain non-financial application of blockchain technology.

- The distribution of token-based shares or bonds can also result in prospectus requirements under the Swiss Code of Obligations. With respect to an offer made abroad the laws and regulations of the respective foreign countries must be observed, whereby many require prospectuses or even registration with a surveillance authority. On this point particular caution is advisable, since the violation of regulations in this field is tied to significant liability and penal risks. Ultimately art. 156 of PILA requires that the prospectus not only refer to the law of the country of the issuer but also to the law of every country where distribution occurs, hence in all countries where tokens are offered.

Bottom line: The FINMA does not diverge from its approach of treatment of particular cases. The guidelines are not more nor less than what their name conveys. They underline the importance of clarifying which legal regulations apply exactly and case-specifically before the implementation of an ICO. In many cases this also includes collecting a "no action letter" from the FINMA before the ICO is implemented.

It is a step forward for the industry; however, there is room for improvement (be it for FINMA or the lawmakers) to strengthen and further rather than to impede the blockchain technology.

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