Chambers AND PARTNERS

CHAMBERS GLOBAL PRACTICE GUIDES

Blockchain 2024

Definitive global law guides offering comparative analysis from top-ranked lawyers

Contributing Editors
Marina Reason, Kelesi Blundell and Patricia Horton
Herbert Smith Freehills

Trends and Developments

Contributed by:
Olivier Favre, Caroline Clemetson, Tarek Houdrouge and Roland Wild
Schellenberg Wittmer Ltd

Schellenberg Wittmer Ltd is a leading Swiss business law firm, with more than 150 lawyers in Zurich and Geneva, and an office in Singapore. It handles all clients' legal needs – transactions, advisory and disputes. The offices in Zurich and Geneva cover the whole of Switzerland, while the office in Singapore is a gateway to and from the Asia-Pacific region. Schellenberg Wittmer provides a comprehensive range of legal services to a worldwide client base of domestic and international companies and entrepreneurs, including also a range of clients in the fintech and blockchain space. Its regional desks were set up to develop the firm's existing cross-border business initiatives, centralise case work across these regions, and underpin Schellenberg Wittmer's commitment to providing top-tier, full business law services to clients on a global level.

Authors

Olivier Favre is a partner in the banking and finance group at Schellenberg Wittmer in Zurich, and co-head of the firm's blockchain technologies and fintech industry group. He specialises in transactional and advisory work, and is particularly recognised in the market for his expertise in derivatives, structured finance and financial regulatory matters. He also advises clients on insurance and reinsurance regulation. Olivier approaches fintech matters from a regulatory and transactional angle. His clients include regulated financial institutions, issuers, insurance companies, new fintech ventures and industry associations.

Caroline Clemetson is a partner in the banking and finance group of Schellenberg Wittmer in Zurich and Geneva. She specialises in financial services and financial regulation, asset management, collective investment schemes and other investment products, the distribution of financial products, derivatives, trade finance and pension funds, as well as fintech, insurance and insurance brokerage regulation. Caroline also has extensive experience in corporate and transactional matters, as well as in-house experience, having worked at FINMA immediately prior to joining Schellenberg Wittmer. She is a member of the firm's management committee.

Contributed by: Olivier Favre, Caroline Clemetson, Tarek Houdrouge and Roland Wild, **Schellenberg Wittmer Ltd**

Tarek Houdrouge is co-head of Schellenberg Wittmer's banking and finance group, and a partner in the corporate and commercial group in Geneva. His main areas of expertise are banking and finance, transactions and corporate law. He advises banks and financial institutions on all regulatory matters, cross-border activities, lending transactions, the distribution of financial products, and fintech and cryptocurrency.

Roland Wild is a partner in Schellenberg Wittmer's taxation group in Zurich. He specialises in corporate tax and has a strong focus on the financial industry. He advises and represents banks, asset managers, fund managers and institutional investors on all tax matters and is providing both advisory and litigation services. He also regularly provides support for the relocation of crypto foundations and companies and their founders to Switzerland or the so-called Crypto Valley.

Schellenberg Wittmer Ltd

Löwenstrasse 19
PO Box 2201
8021 Zurich
Switzerland

Tel: +41 44 215 5252
Fax: +41 44 215 5200
Email: zurich@swlegal.ch
Web: www.swlegal.ch

Schellenberg Wittmer

Blockchain in Switzerland: An Overview

Swiss digital assets regulation

Switzerland was an early adopter of blockchain technology and continues to have an active community of blockchain and crypto-asset ventures. This development was facilitated by favourable regulation and the pragmatic approach of the Swiss Financial Market Supervisory Authority (FINMA).

A key milestone was the token classification by FINMA that has applied since 2018 and distinguishes the following types of tokens.

- Payment tokens or cryptocurrencies are digital assets intended only as a means of payment without giving rise to any claims against the issuer or third parties.
- Utility tokens are digital assets constituting rights to access or use a digital application or service, provided that such application or service is already operational at the time of the token sale.
- Asset tokens are digital assets representing an asset (eg, a debt or equity claim against the issuer or a third party) or a right in an underlying asset.

While this token classification has not changed since it was first introduced, the Swiss legal framework had to be improved in order to facilitate the issuance of "asset tokens" and to provide for better protection of clients using the services of wallet providers and trading platforms for digital assets. For these purposes, the Federal Act on the Amendment of Federal Laws to take into account developments in Distributed Ledger Technology of 25 September 2020 (the "DLT Act") was adopted. As the name suggests, the DLT Act is not a separate legal framework for digital assets, but rather an amendment of existing acts in order to expand the scope of the relevant rules, to the extent necessary, to make them workable for the issuance of digital assets.

The DLT Act, inter alia, introduced:

- "DLT Rights" as a new category of assets that may be created with registration on a distributed ledger and that are available for securities issued on a blockchain;
- "DLT MTFs" as a new licence category for trading venues where such DLT Rights can be traded and the expansion of the regulation of organised trading facilities (OTFs) to also allow trading activities in digital assets; and
- legal certainty regarding how digital assets can be set aside in the insolvency of a wallet provider where such assets are held.

The DLT Act has been fully in force since August 2021. It aims to establish a framework that can work in a "technology-neutral" way without having to regulate any particular technology. The Swiss regulator continues to adhere otherwise to a "same business, same risks, same rules" approach by applying the same legal and regulatory framework to business activities as it applies generally to the issuance and trading of digital assets.

As regards services provided in the field of decentralised finance (DeFi – eg, staking, yield farming or decentralised exchanges), Swiss regulation does not provide for separate rules as yet.

Anti-money laundering (AML) rules

In the context of initial coin offerings (ICOs) and tokens, the following relevant financial intermediation activities are subject to the Swiss AML regulation under the Swiss Anti-Money Laundering Act (AMLA) and the Anti-Money Laundering Ordinance (AMLO):

- the issuance of means of payment that cannot be used exclusively with the issuer;
- the provision of services related to payment transactions in the form of money and asset transmission services; and
- money exchange services.

A financial intermediary in the sense of the AMLA must be affiliated with an authorised AML self-regulatory organisation (SRO). Furthermore, a financial intermediary has to comply with the obligations defined in the AMLA, including (without limitation) identification and know-your-customer (KYC) obligations relating to the contracting party and its beneficial owner, and has to file reports with the Money Laundering Reporting Office in cases of suspected money laundering or terrorism financing.

In the FINMA Guidance 02/2019 on payments on the blockchain dated 26 August 2019, FINMA also specified that financial intermediaries supervised by FINMA must comply with the travel rule for blockchain transactions. This also applies to other financial intermediaries for AML purposes, as a result of their SRO affiliation. Under this travel rule, the relevant Swiss financial intermediary has to transmit the same information as required for wire transfers in fiat money or, alternatively, has to:

- identify the transferee in accordance with the Swiss AML rules as if the transferee was a client of the Swiss financial intermediary; and
- verify the transferee's power to dispose of the wallet address used by it through appropriate technical measures as defined by the relevant Swiss financial intermediary.

Issuance of DLT Rights as a digital security

Under Swiss law, payment tokens and utility tokens that do not represent any claims against an issuer or third parties can be validly created and transferred in accordance with the terms of the respective distributed ledger. A transfer can therefore be validly made by executing a transaction between two wallets.

The DLT Act introduced the possibility to issue digital assets representing enforceable rights under Swiss law as governing law in the form of DLT Rights. This is a new type of asset that is issued by way of registration on the blockchain and, as a result of such registration, may only be transferred and exercised on such blockchain. For these purposes, the distributed ledger must meet all of the following requirements.

- It must create a link between the DLT Rights and the distributed ledger in the sense that the holders of the DLT Rights (but not the debtor) must have the power to dispose of the DLT Rights.
- It must protect the integrity of the DLT Rights by utilising appropriate technical and organisational measures against unauthorised access and changes. Such measures include cryptographic validation procedures for access to, and the transfer of, DLT Rights. However, the DLT Act does not require a minimum number of participants in the ledger and does not provide rules as to the consensus mechanism (proof of work, proof of stake, etc).
- Its terms of operation, the terms of the DLT Rights and the terms governing the registration must be recorded on, or be accessible through, the distributed ledger.
- The entries relating to the DLT Rights in the distributed ledger must be public.

Any rights that could be issued as certificated or uncertificated securities may be issued as DLT Rights, including bonds or membership rights

such as shares in stock corporations. However, cryptocurrencies may not be issued as DLT Rights.

Such DLT Rights constitute securities for the purposes of Swiss securities regulation on the basis that they are issued in fungible form to at least 20 holders.

Once created, DLT Rights follow the principle of blockchain finality and can only be transferred by a transfer of the relevant tokens on the relevant blockchain. Moreover, the DLT Act provides that holders of the DLT Rights on the relevant blockchain benefit from a bona fide protection of their rights similar to the protection of the owner of a certificated security.

However, it is possible to issue DLT Rights as "intermediated securities", to the extent that they are immobilised with a custodian and the custodian credits the entitlements in the DLT Rights in its custody accounts. In such event, the DLT Rights are transferred in the same way as other "intermediated securities".

Tokenised shares or bonds as use cases of DLT Rights

The DLT Act allows for the issuance of "tokenised" shares or bonds by Swiss companies. To the extent that such shares or bonds are issued as DLT Rights, they may be transferred on the blockchain according to the terms of the registration agreement. Such shares or bonds no longer have to be classified as "normal" uncertificated securities that may only be transferred with a written assignment, as was the case prior to the entry into force of the DLT Act.

Regarding the issuance of shares, all Swiss corporate law requirements regarding the issuance of shares still have to be complied with prior to the tokenisation of shares – the passing of a shareholders' meeting resolution, amendment of the Articles, registration of the capital increase with the Commercial Register, payment of the contributions, etc – and the possibility to issue shares as DLT Rights must be stated in the Articles. In this respect, the technology for the issuance of the tokenised shares (smart contract) has to be duly selected by the company to allow compliance with the requirements of Swiss corporate law, including transfer restrictions (restricted registered shares), for example.

If the distributed ledger on the blockchain (ie, the register of uncertificated securities introduced by the DLT Act) complies with the requirements of the Swiss Code of Obligations regarding the establishment of the share register and a list of beneficial owners, it would be possible to state that on a distributed ledger and have only one register in place. However, this should be considered only if the distributed ledger is not fully public, in order to avoid disclosing confidential information. The Swiss Capital Markets and Technology Association (CMTA) provides some guidance on template documentation that may be used in this respect (see CMTA Standards).

Regarding the issuance of bonds, it is possible to issue debt instruments as DLT Rights, provided that the issuance of the instruments and the title to such instruments results from the registration of the bonds on the blockchain-based register. It may be possible to keep a register of bondholders, which is separate from the blockchain-based registration of the bonds. However, the prevailing register that determines who has title to the bonds will have to be the blockchain-based register in order to allow the classification of the bonds as DLT Rights. Please note that it would be possible to issue the bonds on the basis of a "split governing law clause" as Swiss

law governed DLT Rights, while the terms and conditions are not governed by Swiss law.

The issuance of tokenised shares or bonds as DLT Rights will take effect upon the registration on the distributed ledger. The registration agreement between the company and the first holder, whereby the DLT Rights may only be transferred and exercised via the tokenised shares or bonds on the distributed ledger, may be included in the terms and conditions, the Articles, a prospectus, a subscription form or any similar document.

This new process could allow smaller companies to raise funds at an earlier stage – and at lower costs than the usual procedures – through new technologies as a result of the increased visibility and the possibility of attracting a larger number of investors directly. Given that DLT Rights are held on a distributed ledger, there is no longer the need to involve custodians, except where the shares shall be held as "intermediated securities".

To the extent that any such tokenised shares or bonds shall be issued on the basis of a private placement exemption without any prospectus, the blockchain-based register that is used for any such offer would have to be a "permissioned blockchain" that allows the offer to be limited in line with the relevant selling restriction (eg, limitation to professional investors).

Asset management and collective investment schemes in the crypto space

Many Swiss actors have structured and launched collective investment schemes in the crypto space in recent years. For different reasons, such collective investment schemes were domiciled in foreign (ie, non-Swiss) jurisdictions in the beginning, but FINMA has now approved Swiss-domiciled funds investing in crypto-assets, making it also possible in Switzerland. Such collective investment schemes (Swiss or foreign) are managed by Swiss-regulated asset managers that manage the funds in Switzerland and are regulated by FINMA, or will need to be regulated by FINMA as a simple asset manager where they fall within the transitional period of the new regulatory regime for asset managers in Switzerland, provided that they manage funds investing in crypto-assets but do not reach the de minimis assets under management (AuM) of at least CHF100 million in order to be regulated as a fund manager.

Basically, such foreign collective investment schemes can only be offered to qualified investors in Switzerland as they do not meet the equivalence needed in order to be approved by FINMA for distribution to retail investors. Swiss approved funds are also for qualified investors.

The question of the feasibility of a Swiss-domiciled fund investing in crypto-assets was raised a few years ago. From a Swiss regulatory perspective, the first point that needed to be addressed was whether crypto-assets can be considered eligible assets for a Swiss fund. The regulatory regime in terms of assets is quite flexible in Switzerland, depending on the type of fund created and the capabilities of the actors involved in such assets. In order to have a Swiss-regulated fund, a fund management company needs to be in place for the administration of the fund; a custodian bank that is authorised by FINMA as a custodian bank for funds is also necessary.

The analysis carried out for Swiss funds has shown that a Swiss-regulated fund can be created and approved by FINMA as a Swiss fund of the type "other fund for alternative investments" with particular risks, as crypto-assets are to be considered as an eligible asset for such fund,

according to the Swiss Collective Investment Schemes Act.

Another matter that needs to be addressed is the custody of the assets with a Swiss custodian bank. In this sense, a Swiss custodian bank for funds needs to have explicit approval from FINMA in order to maintain such assets in custody. A Swiss fund investing in crypto-assets can be a regulated fund in Switzerland if it satisfies all the above conditions.

The newly introduced non-authorised and supervised Swiss fund, the so-called Limited Qualified Investor Fund or L-QIF, considers the above-mentioned assets as eligible. The same conditions as for a regulated fund would apply with more flexibility as to the risk diversification. However, the know-how in terms of assets of the fund management company and the investment manager of collectives assets is crucial. The expectations and conditions in terms of custody are the same as for regulated funds. Risk disclosures for those type of assets are crucial and must be implemented in the fund documentation.

Regulation of trading venues

A Swiss trading venue for asset tokens or for utility tokens qualifying as securities would need to be licensed by FINMA as a stock exchange or as a multilateral trading facility (MTF); alternatively, if the trading activity qualifies as the operation of an organised trading facility (OTF), the operator would require a licence as a bank or securities firm with approval from FINMA to operate an OTF.

A new licence category for "DLT Trading Facilities" became available with the full entry into force of the DLT Act in August 2021. This covers a multilateral trading venue where DLT Rights and similar tokens represented on a blockchain may be traded according to non-discretionary rules. Such DLT Trading Facilities must provide for one of the following:

- trading is allowed by unregulated participants;
- the operator of the trading system centrally deposits the eligible tokens on the basis of uniform rules; or
- the operator of the trading system performs the post-trading activities in relation to the eligible tokens on the basis of uniform rules and procedures.

The DLT Act does not provide authorisation requirements for foreign DLT Trading Facilities that admit Swiss direct participants. In this respect, the new regulation is more liberal than the current regulation of MTFs, as foreign MTFs do require FINMA authorisation before admitting Swiss direct participants.

So far, no Swiss trading venue has been licensed as a DLT Trading Facility under the DLT Act. However, FINMA has granted licences to securities firms that operate OTFs that may trade DLT Rights on their trading system.

Wallet service providers

A provider of storage services for digital assets qualifies as a financial intermediary if it has the power to dispose of the private keys of the stored tokens (custodian wallets). As such, the service provider is subject to AML rules.

With the DLT Act, it became possible to segregate digital assets held in custodian wallets in the insolvency of the wallet provider, regardless of whether they are issued as DLT Rights or constitute other digital assets (eg, cryptocurrencies).

This allows the offering of custodian wallets without a banking licence, provided that the digital assets are held for clients on a segregated basis. However, to the extent that client assets are pooled and held on omnibus client accounts, a fintech licence is required. Such licence would, in addition to holding client wallets as omnibus accounts, also allow to accept deposits of up to CHF100 million (excluding deposits by clients that are subject to prudential supervision and excluding institutional clients with treasury operations).

Staking services

FINMA recently provided guidance on the regulation of staking services. Staking as such is not subject to regulation in Switzerland. However, providing staking as a service has regulatory consequences.

For custodians that are not licensed as a bank or fintech licensee, the provision of staking services is limited to direct staking (where the custodian either operates itself the validator node or outsources the technical operation thereof to a third party, provided that the custodian maintains at all times the withdrawal keys to return the staked crypto-assets of its clients) and requires that staked cryptocurrencies/payment tokens are held on an individually segregated basis for each client.

Where the custodian is licensed as a bank or fintech licensee, it must meet certain safe harbour rules to ensure that the services provider does not trigger regulatory capital requirements for deposits, in particular:

- the client must provide instructions regarding the type and amount of crypto-assets to be staked;
- appropriate measures have been taken to ensure that the crypto-assets transferred for staking to a particular staking address and, after unstaking, to a particular payout address, can be unambiguously attributed to the client;
- the client is transparently and clearly informed of all risks (including slashing, lock-up periods and insolvency risks);
- appropriate steps are taken to mitigate the operational risks of operating a validator node (including business continuity management) to avoid slashing and other penalties; and
- a Digital Asset Resolution Package (DARP) allowing FINMA to effect the segregation and delivery of the crypto-assets in an insolvency event of the custodian is prepared to ensure appropriate risk management.

It should also be noted that staking rewards are generally subject to income tax in Switzerland.

Crypto-asset brokers

If tokens qualify as securities under Swiss law (ie, asset tokens that are issued as securities in the sense of Swiss law), they are subject to Swiss securities regulation. Under the Financial Institutions Act (FinIA), a licence as a securities firm is required in order to carry out any brokerage activities on behalf of clients (other than banks, securities firms and other supervised institutional clients) regarding such tokens and any market-making activities regarding such tokens. A licence requirement is triggered in each case if these activities are executed on a professional basis.

Brokerage activities could be subject to a banking licence if the service provider accepts fiat currencies or tokens on own accounts, respectively public keys, in connection with such services. However, the service provider could rely

on a "settlement account exemption" if client funds are held on settlement accounts used to settle client transactions, provided that no interest is paid on the funds and, except for accounts with securities firms, the settlement occurs within 60 days at the latest.

Regardless of any licensing requirements, a provider of brokerage services for cryptocurrencies qualifies as a financial intermediary for AML purposes and, as such, is subject to the AML rules.

Developments in taxation regarding asset tokens

Asset tokens are divided into three subcategories by the Federal Tax Administration (FTA):

- debt tokens;
- asset tokens with a contractual basis; and
- tokens with participatory rights.

Debt tokens

Debt tokens qualify as bonds for tax purposes as they represent an obligation of the issuer to repay all or a substantial part of the investment and, where applicable, to make an interest payment.

The funds received do not constitute taxable income for the issuer as they are recognised as liabilities. Corresponding interest payments are business expenses and are therefore tax-deductible but generally subject to withholding tax (WHT).

The issuance of debt tokens is exempt from securities transfer tax (STT), while secondary market transactions involving a Swiss or Liechtenstein securities dealer (as defined in the Swiss Stamp Tax Act) are subject to STT.

Asset tokens with a contractual basis

In the case of asset tokens with a contractual basis, the investor is entitled to a cash payment which is measured according to a certain profit ratio or liquidation result or a proportional share of a reference value of the issuer – eg, earnings before interest and tax (EBIT), licence income or sales.

Funds raised through the issuance of asset tokens with a contractual basis qualify as taxable income, whereas payments to investors generally qualify as tax-deductible expenses. However, a tax-deductibility requires that (i) the investors are known, (ii) the issuer's shareholders do not hold more than 50% of the issued tokens, and (iii) that payments to the token holders do not exceed 50% of EBIT. If one of these conditions is not met, the FTA assumes a taxable hidden profit distribution, which is subject to corporate income tax as well as WHT.

The issuance of asset tokens with a contractual basis is not subject to issuance stamp tax and, in general, does not constitute a contribution subject to issuance stamp tax either. As long as these tokens do not refer to taxable securities as defined by the Swiss Stamp Tax Act, they are not subject to STT.

Tokens with participatory rights

In the case of tokens with participatory rights, the legal relationship between the issuer and the investor is of a corporate nature and the investors' participatory rights are stipulated in the respective company's statutes.

Funds raised through the issuance of such tokens do not constitute taxable income, in so far as they qualify as capital contributions (including surplus and à-fonds-perdu payments).

Payments to holders of tokens with participatory rights qualify as dividends and are therefore subject to WHT.

The issuance of tokens with participatory rights is subject to issuance stamp tax and, in general, does not constitute a contribution subject to issuance stamp tax either. As long as these tokens do not refer to taxable securities as defined by the Swiss Stamp Tax Act, they are not subject to STT.

CHAMBERS GLOBAL PRACTICE GUIDES

Chambers Global Practice Guides bring you up-to-date, expert legal commentary on the main practice areas from around the globe. Focusing on the practical legal issues affecting businesses, the guides enable readers to compare legislation and procedure and read trend forecasts from legal experts from across key jurisdictions.

To find out more information about how we select contributors, email Katie.Burrington@chambers.com