

Classification of stablecoins under Swiss law: FINMA publishes amended guidelines

11 October 2019 | Contributed by [Meyerlustenberger Lachenal](#)

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Introduction

The Swiss Financial Market Supervisory Authority (FINMA) has published a supplement to its Guidelines on Initial Coin Offerings (ICO) which outlines how it plans to apply provisions of Swiss supervisory law to projects involving so-called 'stablecoins'. The supplement's publication was prompted by a steady increase in the number of stablecoin projects submitted to FINMA since 2018, including a submission from the Geneva-based Libra Association for an assessment of its Libra project under Swiss supervisory law.

Classification of stablecoins under Swiss law

Among projects based on blockchain technology, there has been an observable increase in the number of projects to create stablecoins in the last 24 months. 'Stablecoins' are blockchain-based digital currencies that aim to have a stable value (ie, cryptocurrencies that aim to minimise the volatility of their price relative to a particular asset or basket of supposedly 'stable' assets). This stability is intended to foster market acceptance – particularly for payment purposes – to avoid the kinds of high fluctuation in value experienced in payment tokens such as bitcoin and ether.

Stablecoins achieve price stability through various methods, including:

- currency pegging against a fiat currency or commodity;
- collateralisation against other cryptocurrencies or fiat currencies; or
- algorithmic coin supply management.

Like the FINMA guidelines, this article focuses on three kinds of stablecoin:

- fiat-backed stablecoins;
- physical-asset-backed stablecoins; and
- digital-asset-backed stablecoins.

Such asset-backed stablecoins can be pegged to a cryptocurrency, fiat money or to exchange-traded commodities (eg, precious metals or industrial metals), real estate or securities. In a supplement to its ICO Guidelines, FINMA provided further direction on how it will assess such stablecoins under Swiss supervisory law, following the principle of 'same risks, same rules' and its approach of a principle-based and technology-neutral assessment, thus focusing on the economic function and purpose of a token based on its specific features (ie, substance over form).

The concrete design of stablecoins can vary greatly from legal, technical, functional and economic standpoints. Therefore, a detailed case-by-case analysis is required, based predominately on:

- the asset class the stablecoin is pegged to;
- the way in which fluctuations of such assets are treated by the stablecoin's issuer; and
- the legal relationship between the stablecoin's issuer and holder (especially the characterisation of a redemption claim, if any).

The latter element will be particularly decisive for determining whether the stablecoin project will fall within the scope of the Banking Act's or the Collective Investment Schemes Act's (CISA's) licensing requirements. In addition, due to their usual aim to be a means of payment, the Anti-money Laundering Act (AMLA) must be considered in most projects.

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Where a stablecoin project generates a payment system of significant importance, such as that expected in the Libra project, a licence as a payment system pursuant to the Financial Market Infrastructure Act (FMIA) must also be considered. A payment system is of 'significant importance' if it is necessary for the proper functioning of the financial market or the protection of financial market participants and if it is not operated by a bank.

Indicative classification under supervisory law

FINMA looks at the characteristics and specific purpose of a stablecoin in order to determine the potentially applicable financial market laws. In particular, it is legally decisive if a stablecoin confers a contractual claim against the issuer on the underlying assets (a so-called 'redemption claim') or confers direct ownership rights. In view of this approach, FINMA has developed the following indicative categories of stablecoin but also stresses the necessity of a case-by-case assessment.

Stablecoins linked to currencies

A redemption or repayment claim of a token holder against an issuer will likely be a deposit under banking regulations if it is a fixed amount (eg, 1 token = Sfr1) or a collective investment scheme if the amount depends on the underlying cryptocurrencies' price developments. Therefore, it is decisive whether the underlying assets are managed for the account and risk of the token holder (indicative of a collective investment scheme) or for the account and risk of the issuer (indicative of a deposit under banking law). In other words, all opportunities and risks from the management of the underlying assets, be they in the form of profits or losses, from interest, fluctuations in the value of financial instruments, counterparty or operational risks, must be borne by a stablecoin issuer.

Existing exemptions from the requirement for a bank licence under the Banking Ordinance also apply to stablecoins, including:

- the settlement account exemption;
- bonds or similar rights with a prospectus-like document; and
- taking deposits only from banks and other prudentially supervised institutions or institutional investors with professional treasury operations.

Stablecoin structures with no explicit redemption or repayment claim for token holders, which are based on an alternative stabilisation mechanism, can trigger licensing requirements in addition to anti-money laundering and counter-terrorist financing requirements – particularly under the FMIA if the operation of a payment system of significant importance is foreseen.

Stablecoins linked to commodities

When linking a stablecoin project to commodities, FINMA sees two significant elements: the exact nature of the claim on the assets (eg, contractual or ownership rights) and the type of commodity (in particular, bank precious metals or other commodities).

Stablecoin projects merely conferring ownership rights to token holders do not generally qualify as a security, and require that:

- an ownership right and not merely a contractual claim to the underlying commodities exists;
- the transfer of the token results in the transfer of the respective ownership right; and
- the commodities are not deposited pursuant to Article 481 of the Code of Obligations.

FINMA acknowledges that civil law issues are the sole responsibility of the project and therefore it does not comment on them.

With regard to pure contractual claims against an issuer on bank precious metals, FINMA sees a similarity to bank precious metal accounts, which will probably trigger Swiss banking regulations. For other commodities, a contractual claim would probably qualify the stablecoin as security and possibly as a derivative if it were linked to a financial market activity (see below).

Where a stablecoin is linked to a basket of commodities – including bank precious metals and/or other commodities – with a price-dependent redemption claim, a collective investment scheme is probable.

Stablecoins linked to real estate

According to FINMA, with regard to token holders' redemption rights and individual properties or real estate portfolios, normal third-party management of a real estate portfolio is in itself an indication of a collective investment scheme. FINMA also holds that a price-based redemption claim often exists in real estate transfers in view of the legal hurdles involved, which often trigger Swiss collective investment scheme regulations.

Stablecoins linked to securities

Stablecoins where token holders have a contractual right to the delivery of an individual security also usually constitute a security. Therefore, issuing activities can

- trigger prospectus regulations under the new Financial Services Act, which enters into force on 1 January 2020; or
- require a licence as a securities house according to the Swiss Stock Exchange and Securities Trading Act and the new Financial Institutions Act from 1 January 2020.

Additional licensing and registration requirements and duties of conduct may apply for specific secondary market activities – in particular, FMIA's licensing requirements apply where a trading platform is operated.

Licensing requirements as a collective investment scheme are likely where a link to a basket of securities with a contractual claim by the token holder on a share of the basket exists.

Projects with no plausible stabilisation mechanisms

Stablecoin projects that claim to invest the proceeds obtained from investors (through an ICO or otherwise), achieve a stabilisation or even an increase in value without a plausible mechanism for such stabilising effects are considered by FINMA to promise an investment opportunity and therefore risk being subject to FINMA's enforcement measures.

Category	Indicative supervisory classification (in addition to anti-money laundering legislation)
Linked to fiat currency/cryptocurrency with fixed redemption claim.	Deposit under banking law.
Linked to basket of fiat currencies and cryptocurrencies with redemption claim dependent on price development.	Management of the currency basket and risk bearing: <ul style="list-style-type: none"> • for the account of the issuer: deposit under banking law; and • for the account of the token holder: collective investment scheme.
Linked to commodity (including bank precious metals) with contractual claim.	Bank precious metals: deposit under banking law. Commodity: security and possibly derivative.
Linked to basket of commodities (including bank precious metals) with redemption claim dependant on price development.	Collective investment scheme.
Linked to commodities (including bank precious metals) with ownership rights.	No prudential licensing requirement.
Linked to real estate with redemption claim dependent on price development.	Collective investment scheme.
Linked to specific security with contractual claim.	Security and possibly derivative.
Linked to basket of securities with redemption claim dependent on price development.	Collective investment scheme.

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