

ICOs vs STOs vs IEOs?

Digital assets are increasingly taking over the regulated world of finance

The forms in which digital assets are issued are continuously developing, which makes them an increasingly strong competitor to traditional forms of financing. Recently, EOS and tataru collected around USD 4.2 bn and USD 575 m, respectively, through an ICO; tZERO and nexo collected around USD 134 m and USD 52.5 m, respectively, through an STO; and bitfinex and tron game global took in USD 1 bn and USD 80 m, respectively, through an IEO.¹ While the IPO has become the standard in the traditional financial world, the world of digital assets is moving with increasing speed – from ICO to STO to IEO. **By Dr Reto Luthiger, Dr Wolfgang Müller and Dr Alexander Vogel**



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Initial coin offerings (ICOs) were the first form of token issuance by way of distributed ledger technology (DLT), which includes the blockchain. ICOs were very popular, particularly in 2017, and enabled issuers to issue all types of tokens directly through their own websites. The rather strongly regulated asset tokens stood less in focus than the less regulated payment tokens or the unregulated utility tokens. ICOs were very prone to fraud because the DLT world was still in its infancy, regulations were just being established and the business model was often not fully developed.

The ICO bubble burst around the end of 2017, and security token offerings (STOs) became more popular, i.e. the offering of asset tokens (tokens backed by securities),

which are often issued directly on the website of the issuer. The restrictions on asset tokens show that investment is the primary purpose of STOs, in all known forms of equity and debt. As a rule, STOs are considered to be regulated token offerings because the issuance of asset tokens usually requires the publication of an offer prospectus and often the review of such prospectus by a governmental authority (from 1 January 2020, also in Switzerland due to the Financial Services Act, FinSA), and involves the performance of a certain know-your-customer (KYC) check on the investors.

The initial exchange offering (IEO) became popular in 2019. Here, all types of tokens are placed on the primary market through an “intermediary” trading platform (exchange) with a kind of listing, and are traded on the secondary market after-

wards. As opposed to ICOs and STOs, IEOs involves not only an issuer and an investor but also a trading platform.

Today, KYC processes are (de facto) compulsory for all ICOs, STOs and IEOs, as issuers cannot open a bank account in a jurisdiction with a respectable reputation otherwise.

Asset tokens under Swiss law

According to the guidelines of the Swiss Financial Market Supervisory Authority (FINMA) on ICOs, which are also well known internationally, all tokens that represent assets are categorised as asset tokens. Such tokens can represent, for example, a contractual obligation to the issuer or a membership right under company law, for example in the form of a share in future company profits or cash flows. Therefore, depending on the



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1) www.tokens-economy.com



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particular economic function, tokens mainly represent shares, bond interests or derivative financial instruments. The category of asset tokens can also include tokens that have the purpose of making physical assets tradable on the blockchain.

From the perspective of civil law, the tokenisation, meaning the electronic recording of rights into a registry distributed electronically (distributed ledger), can be understood analogous to the traditional process of certification of securities: rights are issued in a special form – such as uncertificated securities, intermediated securities, certificated securities or (asset) tokens – and therefore subject to special regulations, which, in particular, define the modalities of their transfer. In the first half of 2019, the Swiss Federal Council submitted for approval the preliminary draft act to strengthen DLT with the goal of creating legal safety. The draft recommended, among other things, to distinguish the uncertificated securities as per Article 973c of the Swiss Code of Obligations (**OR**) as “uncertificated securities without the properties of a security” from the new “uncertificated securities with the properties of a secu-

urity” or so-called “DLT uncertificated securities”.

Asset tokens with standardized characteristics suitable to be traded on a large scale, which have the same structure and denomination and are offered to the public or placed with more than 20 customers, are considered to be securities under Swiss law and, therefore, all provisions typically applicable to securities apply.

Issuing of asset tokens on the primary market

The issuance of asset tokens is, in principle, subject to the prospectus obligation if such tokens are publicly offered as shares, bonds, collective investment schemes or structured products, as defined under the currently applicable legislation. Under the new FinSA with effect as from 1 January 2020, the issuance of asset tokens will always require an offer prospectus if securities are offered to the public. Additionally, the FinSA will introduce a prospectus review obligation. Depending on the specific situation, additional regulatory requirements may have to be observed when issuing collective investment schemes and structured products.

Should intermediaries be involved in the placing of securities or derivatives, they may be subject to the securities dealers' regulation, either as an issuing house or a derivative firm.

Trading of asset tokens on the secondary market

According to the new FinSA, the public offer to acquire securities on the secondary market is also subject to the prospectus publishing and review requirements. Additional applicable regulation requirements must be observed when distributing collective investment schemes and structured products under the current applicable legislation or according to the new FinSA. Trading securities for third parties generally requires a licence as securities dealer (known as securities firms under the new Financial Institutions Act (**FinIA**) in effect as from 1 January 2020). The activities as a trading platform in connection with asset tokens, i.e. the matching of purchase and sale offers, generally requires a licence as a stock exchange, multilateral or organised trading facility. The activity as a central depository also requires a licence.

Outlook

The market for digital assets, from ICOs to STOs to IEOs, has strongly developed and, with its increased focus on asset tokens, is rapidly penetrating the regulated world of financing possibilities as is known from the traditional handling of securities. From a fiscal perspective, the Swiss marketplace is affected by the strong disadvantage created by the withholding tax. From the viewpoint of costs, STOs and IEOs remain, despite regulations, generally more favourable than IPOs because they involve fewer intermediaries. Recently, FINMA granted the first two full bank licences to two DLT-focused financial service providers, SEBA Crypto AG and Sygnum AG. Over the following months, FINMA is expected to issue further authorisations to banks, securities dealers and also trading facilities with a special focus on DLT/blockchain, which should open the door for institutional investors to the market of digital assets on a larger scale. ■