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Switzerland: Trends & Developments

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Trends and Developments

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The wheels continue to turn quickly

Despite crypto winter being predominant in the first half of 2022, Switzerland's crypto scene has still been very busy in the past year and many new businesses have been established and a vast variety of crypto projects have been launched. Recent turmoils in the crypto scene with Terra/Luna, FTX, Three Arrows Capital, BlockFi, Celsius Networks, Voyager Digital, BUSD/Paxos, USDC-pegging, etc, as well as the shocking banking sector's developments with the bankruptcies of the US Silicon Valley Bank (SVB) and US Signature Bank as well as the emergency take-over of Credit Suisse by UBS, etc, seem not having had huge negative impact on the Swiss crypto space. To the contrary, the more solid business models seem to become stronger, the gray area of business seems to shrink to the benefit of regulated projects on the one hand and fully-decentralised models on the other side. 2023 will certainly intensify the competition between (centrally) regulated players and DeFi, but maybe regulators will become successful in closing the gap by finally seriously developing new regulatory concepts fitting to and be reasonable for DeFi.

In Switzerland, the new laws on distributed ledger technologies (DLT) are in force for over a eighteen months now and the Swiss crypto scene as well as the Swiss regulator FINMA have had plenty of opportunities to put the legislators' provisions on DLT into practice. However, it has proven rather challenging to receive general information and guidance on FINMA's practice regarding the new DLT laws. Most information from the FINMA is provided bilaterally when filing

for a license application (eg, fintech license or DLT trading facility license) or when submitting a so-called "non-action letter" to get confirmation from the FINMA that a certain project is not subject to a FINMA license. This makes it even more crucial to work together with experienced and knowledgeable advisors having day-to-day exposure to the crypto ecosystem, the regulator and the tax authorities. Finally, we expect to see in 2023 the first DLT-trading facility license and the first fintech license for pooled crypto assets.

Stablecoins

Despite the collapse of the stablecoin on the Terra/Luna blockchain last year, the BUSD/Paxos-issues with the US SEC and the recent short time de-pegging of USDC from the USD in light of the SVB and signature bank bankruptcies, stablecoins have been on the rise in Switzerland. In addition to several private market initiatives, there is also a new project of the Swiss Banking Association (SBA) for a common stablecoin of the Swiss banks. Finally, also the Swiss National Bank (SNB) experiments with crypto-baked digital currencies (CBDC), in particular also as a settlement method for digital exchanges or banks.

For stablecoins, FINMA follows the rules based on the stablecoin supplement to the ICO Guidelines, which takes the same approach as blockchain-based tokens by mainly focusing on the economic function and the purpose of a token (substance over form). Depending on the case, FINMA will follow the 'same risks, same rules' principle and the relevant features of each case. Since stablecoins can be variable, the requirements under supervisory law may differ depend-

ing on which assets (eg, currencies, commodities, securities and real estate) the stablecoin is backed by or pegged to and the legal rights of its holders. Regulations of banking, fund management, financial infrastructure, money laundering and securities trading can all become relevant.

Changes to Anti-Money Laundering Regulations

On 2 November 2022, FINMA published its revised anti-money laundering ordinance (AMLO-FINMA). Amongst other changes, a new provision affects certain business activities with virtual currencies particularly. As of now, financial intermediaries must identify the contracting party when crypto-related transactions exceed the threshold of 1,000 Swiss Francs, either as a single transaction or as seemingly connected transactions. This is unless such transactions represent money or value transfers and are conducted within the course of an ongoing contractual relationship with the financial intermediary. The provision aims at detecting so-called “smurfing” transactions. A new provision, which entered into force on 1 January 2023, intensifies the duty to monitor transactions for certain financial intermediaries significantly: When accepting payments in cash or other anonymous means of payments for the purchase or sale of virtual currencies, financial intermediaries must implement suitable technical precautions to prevent any transactions from exceeding the threshold of 1,000 Swiss Francs within a period of 30 days.

This new provision targets mainly crypto-ATM-providers as well as virtual asset service providers (VASPs) providing (money) exchange services. As crypto currencies do not qualify as cash according to the anti-money laundering ordinance (AMLO), the FINMA added “or other anonymous means of payments” and explained in their explanatory report that all cryptocurren-

cies shall be in scope of that, ie, not only privacy coins such as Monera, Dash or Zcash. It goes without saying that implementing such technical precautions comes with high costs and efforts. To implement preventing measures may not even be technically possible. It is therefore expected that not all financial intermediaries affected by this new provision will be able to continue their business in the same way.

Another change in the AMLO-FINMA is related to DLT trading facilities, as the scope of application of AMLO-FINMA will be extended to DLT trading facilities.

Developments regarding (DLT) Trading Facilities

The Swiss National Bank (SNB) has set criteria for admitting DLT trading facilities to the Swiss Interbank Clearing (SIC) payment system. Although it is the SNB that grants access to SIC, DLT trading facilities need to get a FINMA license first. With press release of 4 March 2022, the SNB said it will consider applications that “make a significant contribution to the fulfilment of the SNB’s statutory tasks” and do not pose any major risks where doing so. One of the SNB’s statutory tasks is to facilitate and secure the operation of cashless payment systems. Further criteria are the operation as a securities settlement system and the settlement of payments in Swiss Francs via SIC.

While the crypto world is still shaking from the recent disruption which the collapse of one of the biggest crypto exchanges has brought, our focus is on how this event, unfolding into one of the biggest crisis in the financial market since 2008, may affect existing and future crypto-related project and businesses in Switzerland.

As of today, FINMA has not issued a single license for a DLT trading facility. In light of recent events and in connection with anticipated and long overdue clarifications and guidelines on the qualification of crypto assets as securities from regulators worldwide, in particular from the United States Securities and Exchange Commission (SEC), an increase in applications for DLT trading facilities seems likely. In particular, the high level of legal certainty for crypto-regulations and taxation in Switzerland, the broadly established crypto ecosystem and crypto-infrastructure within Switzerland, a crypto-experienced public sector as well as a high reputed and leading financial place and regulator provide a very solid ground for setting up and operating fully regulated setups in and from Switzerland.

Tokenised Financial Instruments

The DLT laws introduced the possibility to issue and transfer ledger-based securities (*Registerwertrechte*) exclusively by a technical transfer on a blockchain or distributed ledger, which will be recognised as legally valid even without the physical transfer of a document or paper (required for certificated securities (*Aktienzertifikat*)); and/or a written assignment (required for simple uncertificated securities (*einfache Wertrechte*)); or a booking implemented by a central securities depository (required for book-entry securities (*Bucheffekten*)).

All rights that can be certificated in securities up to now can also be structured as ledger-based securities, ie, in principle, all contractual rights including, in particular, receivables as well as shares in corporations. Therefore, tokenisation has become a lot easier since the introduction of the DLT laws in February 2021.

Hence, in the last months the interest in tokenising ordinary financial instruments has

risen strongly as it enables direct trading on the blockchain (almost) in real-time and without the involvement of the banking system: all that is required is a mobile phone with access to a wallet. However, the biggest interest is not with the issuers of the financial instruments themselves as of yet, but on the secondary market with third-parties re-issuing (“re-packaging”) existing financial instruments on the blockchain. Therefore, they often use what is known in Switzerland as structured products, where they issue new debt instruments tracking the ordinary financial instrument and issue them in the form of ledger-based securities in accordance with Swiss law. Such products can also be issued with special purpose vehicles in other jurisdictions and Swiss law can be chosen as applicable law for tokenising the product interests to be issued. Since inflation, many projects are looking out to bringing fixed-income products on the blockchain, for which such above-described structured products could be a solution.

A big breakthrough of directly issued tokenised instruments is expected in the coming years when fully regulated financial market infrastructures for tokenised instruments will be established on a broader basis; also, the new Swiss DLT trading platform license will play its part in this new world.

Digital Wealth Management

Digital wealth management has been encouraged for several years. In particular, the client onboarding and KYC-processes have been further automated and digitised thanks to continued updates of the Swiss regulator FINMA’s regulations on video- and online-identification, which made client onboarding economically more attractive. Further, the rise in popularity and the enlargement of the product offerings in exchange traded funds (ETFs) increased vari-

ous algorithmic management offerings based on standardised ETF products, not only in classic management mandates with minimum investment amount requirements getting smaller and smaller, but also in the sector of voluntary Swiss pension plans (so-called pillar 3).

Further, there are more and more sophisticated models with providers of trading signals to established financial institutions. As such, trading signal providers do not need any financial market license in most cases; this is because they do not know the specific end-client portfolios but deliver their signals on general expectations of its client regarding the market development of a specific security. Finally, social trading is still in vogue as there are views in the market that such activity is unregulated because despite the traders being followed by the users, the traders only trade based on their own criteria but do not know and do not want to know the interests and preferences of the users copying their trading behavior.

Combining Web 3.0, Fiat- and Cryptocurrencies Within One License

In 2021, the legislator wanted to provide a level of protection for investors in crypto-based assets that qualify as virtual currencies held in collective custody (ie, in pooled custody wallets) similar to the banking regulation, and therefore made them subject to the FinTech license. In contrast to the conventional FinTech license for public deposits, the license for crypto-based assets held in collective custody does not have a CHF 100 million limit, but the catalogue of exceptions is explicitly restricted to settlement accounts, accounts of state-supervised companies, and institutional investors with professional treasury operations.

This FinTech license recently gained the interest of several projects as it allows – similar to

the higher banking license in Switzerland – the combination of fiat- and cryptocurrency custody business within one license. Some projects even take this advantage a step further to introduce web 3.0 banking characteristics where the client can use her/his account balance either as fiat or as the respective stablecoin on the blockchain, ie, she/he can use his balance in the shop nearby, in the metaverse for buying an NFT-based purse or to make an instant payment to the wallet of a friend.

Swiss Association as Legal Wrapper for DAOs

With Decentralised Autonomous Organisations (DAOs), the community exercises control over a software protocol by participating in on-chain voting with governance tokens, eg, use of funds or change of the protocol's functionalities. The governance of the organisation is described in the smart contract of the protocol, guaranteeing that the organisation behaves as described. Whilst the DAO is neither a fixed term in Swiss law nor does it have a defined structure, its effects may well be recognised thereunder. Therefore, it must be analyzed in detail based on specific characteristics on a case-by-case basis. In many cases, especially when an asset is raised from several users to finance the DAO and its activities and if these users have voting rights, a DAO often qualifies as a collective investment scheme. Further, in many other cases, a DAO would at least be qualified as a simple partnership according to the CO since it is a catch-all provision, with unlimited liability of its members and tax consequences. Many web3 projects therefore choose to link the DAO to the legal entity form of the Swiss association so that the Swiss association provides a legal wrapper for the DAO, limiting the personal liability of its members. The Swiss association is a very flexible entity type which can be tailored to the spe-

cific needs of a project and which has no interest or shares that are controllable. Further, liability is limited to the Association's own funds and the Association has full legal personality and can therefore also enter into agreements.

On 1 January 2023 new rules have entered into force for associations that are required to register in the commercial register, including the requirement to have a person with signing authority in Switzerland and to keep an internal list of its members, including their names and addresses. Associations in Switzerland are required to register in the commercial register if the association operates a business conducted in a commercial manner for its purpose, is subject to auditing or mainly collects or distributes assets abroad, directly or indirectly, intended for charitable religious, cultural, educational or social purposes.

Implications by new European Union Regulation

On 5 October 2022, the European Council published the agreed text of the European Union regulation on markets in crypto assets (MiCA). The text is now subject to formal approval by the European Parliament and will then be translated into each of the official languages of the EU and published in the Official Journal of the EU. MiCA will enter into force 20 days after that publication, presumably in 2023. Some provisions of MiCA will apply 12 months after MiCA enters into force, all others will enter into force 18 months after.

Switzerland as a non-EU country will still be affected by MiCA as most crypto-related business have ties to EU jurisdictions. Hence, Swiss companies who offer their products or services to EU countries will need to assess carefully whether their business activities are subject to MiCA or – with regards to crypto assets consti-

tuting financial instrument, such as securities, the EU Directive on markets in financial instruments (MiFID II). Since MiCA aims at covering the range of crypto assets in the broadest way possible, it is likely that MiCA will have an impact, despite being out of scope of Swiss financial market regulation. This is especially the case for pure utility tokens.

For some tokens, enhanced rules apply under MiCA. For example, the issuance of a crypto-asset designed to maintain a stable value, ie, stablecoin, by reference to a single currency, is considered an “e-money token” under MiCA. As a basic rule, the issuance of an e-money token requires a physical presence within EU/EEA and a license as a bank or e-money institute. In addition, a so-called “crypto asset whitepaper” must be published.

Hence, Swiss crypto companies are well-advised to clarify rather sooner than later whether MiCA is affecting their business model. In particular, it has to be assessed which crypto-asset services can be provided cross-border-wise from Switzerland into the EU and for which tokens issued from Switzerland a crypto-asset whitepaper can be notified into the EU and then passported within the EU.

Tax reporting of Crypto Assets

Switzerland has an already well-established taxation practice regarding crypto assets. However, on an international level, the automatic exchange of information (AEOI) released by the Organisation for Economic Co-operation and Development (OECD) does not cover crypto assets. Therefore, the OECD had published in March 2022 the draft Crypto-Asset Reporting Framework (CARF) for consultation with interested parties.

In particular, the Swiss Bankers Association (SBA) has submitted detailed comments on the OECD's proposal on the CARF. In Switzerland, it is expressively welcomed to create a level playing field for all types of service providers and to extend tax transparency to crypto assets. The CARF is meant to close gaps where Common Reporting Standard (CRS) does not apply. However, there has been a certain degree of irritation on the fact, that CARF is not adopting the long-established system of the AEOI but instead introduces a whole new regime of its own, despite serving the same purpose as AEOI. As opposed to securities assets with AEOI, CARF's starting point will be tokenised assets. Further, whereas the AEOI focuses on balances, the CARF is transaction-based and requires not always easy valuations of crypto assets in a FIAT-currency. At least the initially rather many cases of necessary double-reportings under AEOI and CARF have been reduced in the final version of the CARF. It remains to be seen, how the specific implementation measures/guidelines will look like.

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of law affecting commerce today, with a focus on the hi-tech, innovative and regulated sectors. The regulatory, fintech and DLT practice group is one of the leading teams in Switzerland and provides a fully integrated approach together with the firm's other experts, such as in data protection, corporate law, intellectual property, litigation or tax.

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