New guidance of the Swiss financial market regulator (FINMA) on Initial Coin Offerings (ICO)

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Following enforcement actions against unauthorized providers of the fake cryptocurrency "E-Coin" in September 2017 and the publication of regulatory guidance 04/2017 of September 29, 2017, today, February 16, 2018, the Swiss Financial Market Supervisory Authority FINMA published some further guidance on ICOs. FINMA explains how it will apply financial market legislation in connection with enquiries from ICO projects and provides a list of the information FINMA requires to process such enquiries.

Key takeaways:

- FINMA announces a categorization of tokens into payment tokens, utility tokens and asset tokens.

- Depending on the category (different) financial market laws and regulation apply. However, FINMA again confirms its principle based and technology neutral approach and highlights the need to carefully assess the compliance of an ICO with today's applicable Swiss (financial market) laws on a case by case basis (see our Legal Update of September 2017).

- FINMA states that it may issue some more guidance in a more formal regulatory circular if it sees the need for it, but still, no ICO or blockchain specific legislation or regulation is to be expected in Switzerland in the short term.

- However, FINMA announced to be part of a respective blockchain/ICO working group announced by the Swiss government (see our Legal Update of January 2018).

- In view of the large number of ongoing ICO projects, the new guidance provides for helpful insights on the procedure and required information based on which FINMA generally assesses the regulatory implications and compliance of a specific ICO project.

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- FINMA restates that a number of (undisclosed) ICOs are under review by FINMA and again warns from legal risks involved in organizing or participating in an ICO.

- Besides (financial market) regulatory questions, other important Swiss corporate, contract or tax law aspects as well as foreign laws may need careful analysis before launching an ICO.

1. Categories and insights on legal assessment

With the new guidelines, FINMA intends to create more clarity for market participants. This is to be seen against the background that, on the one hand, there is no ICO-specific regulation in Switzerland and no relevant case law or consistent legal doctrine providing for clear guidance and, on the other hand, the application of financial market law and regulation to ICOs has to be analyzed on a case-by-case basis (see also FINMA Guidance 04/2017).

a. Categories of Tokens

In view of such case-by-case analysis, the new guidelines state that FINMA focuses on the economic features of the tokens. Key factors are the tokens' underlying purpose and the token's tradability resp. transferability starting as of the crowd sale. And while there is currently no generally recognized classification of tokens, FINMA differentiates between three categories for its analysis:

- Payment tokens (cryptocurrencies): These tokens have no further features or links to other development projects. Provided their acceptance, payment tokens become a means of payment over a period of time.

- Utility tokens: Utility tokens aim at providing digital access to an application or service.

- Asset tokens: These tokens represent assets (participations in physical assets, businesses, earnings, dividend rights, interest payments, etc.). The economic features of an asset token are the same as the economic features of equities, bonds or derivatives.

Needless to say that depending on the economic features, hybrid tokens – combining the above categories – are possible.

b. Application of Financial Market Law and Regulation

As to the application of financial market law and regulation to ICOs, FINMA finds that anti-money laundering (AML) and securities regulation are the most relevant in practice, but other regulation (banking regulation, regulation on collective investment schemes, etc.) may be applicable as well.

On the basis of the above-mentioned categories FINMA will apply AML- and securities regulation as follows:

- ICO of payment tokens: FINMA will require compliance with anti-money laundering regulations, if the payment tokens are transferrable at the time of issuance. FINMA will not, however, treat payment tokens as securities.

- ICO of utility tokens: Pure utility tokens that can be used as of the time of issuance, will not be treated as securities. However, if the utility token also functions as an investment, FINMA will treat it as a security.

- ICO of asset tokens: FINMA treats asset tokens as securities.

c. Legal implications

Application of the AML-regulation triggers several due diligence requirements (e.g., identification of beneficial owner, obligation to join a self-regulatory organisation (SRO) or accepting direct FINMA supervision). The requirements can also be met by accepting the funds through a financial intermediary who is subject to Swiss AML-regulation and who exercises the due diligence requirements on behalf of the issuer.

If a token is treated as a security, the relevant regulation applies (for example to trading) and the public issuance of shares and bonds in the form of tokens requires compliance with the relevant prospectus requirements.

Of course, if also other regulations apply, these may cause for additional requirements, such as the need to obtain a licence from FINMA.

2. Process and requirements in order to have FINMA assess an ICO project

As the assessment of an ICO project depends on the features and rights associated with a token and its issuance as well as the availability of a secondary market to trade such token, FINMA published a helpful annex in order to extract the relevant aspects of an ICO in order to have the project properly assessed from a regulatory perspective (see page 8-10 in the published guidance).

The questions and criteria of such annex do not come as a surprise as the list is similar to the information requirements as per the questionnaires which FINMA has sent in the second half of 2017 to organizers of a large number of Swiss ICOs which occurred without FINMA's involvement in order to enquiry whether these projects occurred in compliance with Swiss financial market regulatory laws.

3. Other relevant Swiss and foreign law aspects

It is important to note that the published guidance (and its annex describing relevant information and criteria) does not cover all relevant legal aspects of an ICO project. In particular, Swiss tax and corporate law aspects may be of significant relevance on how to structure an ICO project. Also, foreign non-Swiss (regulatory and other) laws are likely to apply in case the ICO investor is domiciled abroad, even in case of ICOs in, or offered out of, Switzerland (see also our Legal Update of September 2017).

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