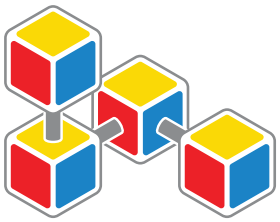

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COALITION OF AUTOMATED LEGAL APPLICATIONS

REGULATORY FRAMEWORK FOR TOKEN SALES

An Overview of Relevant Laws and Regulations in Different Jurisdictions

Primavera de Filippi, Benedikt Schuppli, Constance Choi, Carla Reyes, Nikita Divissenko, Xavier Lavayssière, Francesco Dagnino, Marcus C. Funke, Frank Bierwirth, Thomas Müller, Max von Cube, Axel Schiemann, Jiong Sheng, Gianna Abegg, Nathan Kaiser, and Jackie Yang

Coalition of Automated Legal Applications

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Contents

Switzerland

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Switzerland has become an undisputed hub for ICOs, making up over $600 million of the total ICO funding of $3 billion obtained in 2017.

Switzerland has become an undisputed hub for ICOs, making up over $600 million of the total ICO funding of $3 billion obtained in 2017.[311] Other sources put the number even higher, up to $1 billion raised by ICO in Switzerland.[312] We can ascribe this story of success to many factors, such as Switzerland's role as a global financial center as well as Switzerland's financial market supervisory authority (FINMA).

However, the most prominent reason for Switzerland's ascension as a crypto hub may relate more to the Ethereum Foundation's establishment there in 2014. Ethereum has become a role model for a number of crypto-endeavors in terms of its jurisdiction of choice and its legal structure.

Nevertheless, FINMA has proven its principles-based regulatory approach, its neutrality toward technologies in use, by clearly stating that ICOs are a legitimate way of financing commercial and noncommercial enterprises. Simultaneously, the Swiss regulator clearly communicated that ICOs are potentially subject to several financial market laws. Below is an overview over the Swiss regulatory framework governing token sales, the regulator's statements regarding ICOs, a summary of two ICOs conducted from Switzerland, and our critical thoughts and a comparative analysis.

Regulatory framework

In this overview, we focus on securities law, the law on collective investment schemes, and money regulations (including payment services as part of banking regulations and AML regulations).[313]

Securities law

Securities

In this overview, we focus on securities law, the law on collective investment schemes, and money regulations.

Securities in Switzerland are regulated in a number of acts, including the Federal Act on Securities and Stock Exchanges (SESTA) as well as the corresponding ordinance (SESTO). Furthermore, the Federal Act on Financial Market Infrastructures (FMIA) as well as the corresponding ordinance (FMIO) cover other functions of securities regulations, including the definition of securities, provisions regarding the secondary market, and criminal law provisions concerning insider trading and market abuse in relation to securities.[314]

Under Swiss law, *securities* are defined as standardized certificated and uncertificated securities, derivatives, and intermediated securities that are publicly offered for sale in the same structure and denomination or are placed with more than 20 clients, provided that they have not been created especially for individual counterparties.[315]

Uncertified or certified securities are based on a common legal basis and issued under identical terms. According to Swiss law, uncertified securities are created with the entry in a physical or an electronic book and continue to exist only in accordance with such an entry. Swiss law does not require a specific form of the book; basically, any natural person or legal entity may create such book and, on this basis, issue uncertified securities.

Any transfer of the uncertified securities need not be registered in the book. However, the law requires written form for such a transfer. Various legal scholars have argued that this formal requirement serves only for documentation. As a consequence, a transfer of uncertified securities on the blockchain would comply with this requirement, because the transfer would be properly recorded on the blockchain. Certified securities are issued by a physical deed. This report will not consider certificated securities.

According to the Federal Act on Intermediated Securities (FISA), intermediated securities are personal and corporate rights of a fungible nature against an issuer that are credited to a securities account and may be disposed of by the account holder in accordance with FISA provisions.[316]

Because the creation of intermediated securities requires the involvement of a regulated financial institution, tokens will hardly ever qualify as intermediated securities.

Intermediated securities are created, among other things, by a custodian that registers the uncertificated securities in its main register and credits the respective rights to one or more securities accounts.[317]

The custodian needs to be a licensed bank, a licensed securities dealer, or a licensed asset manager for collective investment funds. The main register for intermediated securities may exist in electronic, dematerialized form. A distributed ledger may serve as the main register for intermediated securities.[318] Tokens, which represent equity or debts rights and were initially issued as uncertificated securities, may be represented and transferred on the blockchain, once they have been recorded in the main register of a custodian and subsequently credited to a securities account, thereby becoming intermediated securities.[319]

Because the creation of intermediated securities requires the involvement of a regulated financial institution, tokens will hardly ever qualify as intermediated securities.

Derivatives are the remaining subcategory of securities. Under FMIA, derivatives are defined as financial contracts, the value of which depends on one or more underlying assets, and which are not spot transactions.[320] Underlying assets include—but are not limited to—shares, bonds, commodities, and precious metals as well as reference values such as currencies, interest rates, and indices.[321] As a rule, if certain parameters are definable in a flexible manner, then the standardization and suitability will not be sufficient for purposes of mass trading.[322]

Derivatives exist in the form of bilateral contracts or as intermediated or uncertificated securities.[323] As mentioned, a derivative will be deemed to exist only if it is not a spot transaction.[324] Spot transactions, as outlined in FMIO, are transactions that are settled either immediately or, following expiry of the deferred settlement deadline, within two business days.[325]

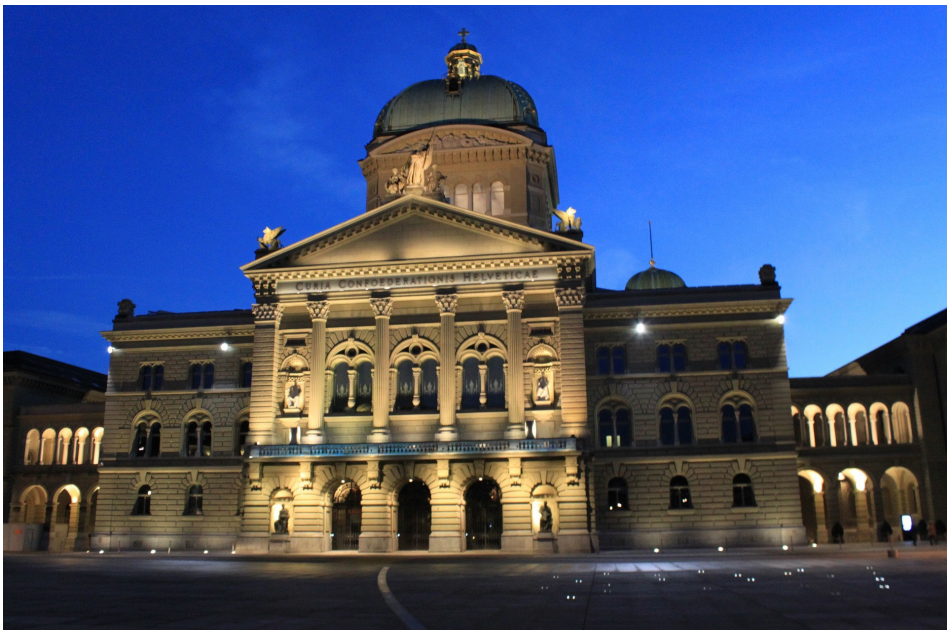
Collective investment schemes

According to Article 7 of the Collective Investment Schemes Act, collective investment schemes are assets raised from investors for the purpose of collective investment and managed for the account of such investors. To fall within the definition, the investment requirements of the investors must be met on an equal basis.

Financial instruments

Swiss law provides only for the category of "financial instruments" as a regulated category of financial products peripherally, with little or no effect on the current regulatory landscape.

In current law, Swiss law provides only for the category of "financial instruments" as a regulated category of financial products peripherally, with little or no effect on the current regulatory landscape.[326] However, the current law does not provide for a definition of *financial instruments*. The FMIA uses the term in relation to trading facilities only. The Financial Services Act (FinSA), likely to be set into force per 2020, defines financial instruments in accordance with MiFID II Appendix I.[327] According to the draft FinSA, *financial instruments* include equity and debt rights, interests in collective investment schemes, structured products, derivatives, and certain structured deposits.[328] As FinSA will presumably not be enacted until 2020, we will not analyze financial instruments further in this section.



Bundeshaus-253006 by Viola (violetta), 2012, used under CC0 1.0.

Tokens as securities or collective investment schemes

ICOs are currently not governed by any specific regulation in Switzerland.

ICOs are currently not governed by any specific regulation in Switzerland. The issuance of equity and debt rights on the primary market, the trading of securities on the secondary market, and deposit-taking are regulated by existing laws that protect creditors, depositors, and investors, and that ensure the proper functioning of financial markets. Swiss legislation on financial markets is principles-based; one such principle is technology neutrality.[329]

On 16 February 2018, FINMA issued comprehensive guidelines regarding the applicability of Swiss financial market laws to token sales. These guidelines did not impose new rules or regulation on ICOs and the qualification of tokens; rather, they confirmed the application of existing rules on ICOs.[330]

FINMA identifies three token categories in its guidelines:

- *Payment tokens* (cryptocurrencies) are tokens "intended to be used, now or in the future, as a means of payment for acquiring goods or services or as a means of money or value transfer. Cryptocurrencies give rise to no claims on their issuer."
- *Utility tokens* are those "intended to provide access digitally to an application or service by means of a blockchain based infrastructure."
- *Asset tokens* "represent assets such as a debt or equity claim on the issuer. Asset tokens promise, for example, a share in future company earnings or future capital flows. In terms of their economic function, therefore, these tokens are analogous to equities, bonds or derivatives. Tokens which enable physical assets to be traded on the blockchain also fall into this category."[331]

These categories reiterate more or less the nomenclature developed by legal scholars and practitioners. Unfortunately, the distinguishing criteria among the three categories remain somewhat vague. The definition of a payment token is very broad; it embraces all use cases where goods and services can be acquired by means of a token and where the debtor is not the issuer.

Utility tokens, on the other hand, are intended to provide access to an application or service. Utility tokens may also be a means of payment in consideration for a service, that is, for the functionality of the application. Hence, according to FINMA's definition, each utility token used for accessing an application—where the counterparty is not the issuer—may at the same time be a payment token.

Since genuine blockchain-enabled applications are decentralized networks, this double dip will be accomplished in many scenarios. Rather than stating in the guidelines that "cryptocurrencies give rise to no claim on their issuer," it should read, "the function of

cryptocurrencies is exhausted in their existence as a digital resource; they do not entail any claim on their issuer or another counterparty."

On the other hand, the definition of an asset token representing a debt or equity claim on the issuer is remarkably clear. Unfortunately, the definition is beefed-up by inclusion of the category of tokens that "enable physical assets to be traded on the blockchain." This latter category has nothing to do with a claim against the issuer and should not fall within the same category—it is unnecessary.

If a token merely enables a (tokenized) physical asset to be traded on a decentralized market place, it should be qualified as a utility and not as an asset token.

If an asset (e.g., precious metal or any other commodity) is tokenized by an issuer and can be redeemed by a token holder, then the token represents a claim against the issuer (or the holder of the respective assets) and is therefore an asset token. However, if a token merely enables a (tokenized) physical asset to be traded on a decentralized market place, it should be qualified as a utility and not as an asset token.

Consequently, some uncertainty remains regarding the qualification of utility tokens as securities. FINMA states in its guidelines that utility tokens shall "not be treated as securities, provided that their sole purpose is to confer digital access rights to an application or service and that the utility token can actually be used in this way at the point of issue." If the utility token entailed an investment purpose component, then FINMA would treat such a token as a security.

In our view, FINMA's approach that a utility token, which "additionally or only has an investment purpose at the point of issue," will qualify as a security lacks legal basis. FINMA seems inspired by the notion of a security under US securities regulations (i.e., the Howey test), but the financing of a project—with the expectation that the token will gain value once the blockchain network is launched—does not in itself qualify it as a security under Swiss law.

In addition, FINMA's approach has some awkward consequences on the secondary token market. Strictly applying the guideline, an exchange of utility tokens bearing an investment element in a professional capacity would require a securities dealer license. However, as soon as the utility token became fully functional, it would cease to be a security.

In our view, qualifying all utility tokens as securities would undermine the token categorization of the guidelines.

In most instances, a utility token is issued before the platform has reached full functionality. In many cases, the funds raised in the ICO will go (at least partially) toward development costs of the platform. In our view, qualifying all utility tokens as securities would undermine the token categorization of the guidelines.

Given the above, structuring a utility token may cause the most headaches around the potential application of the Swiss anti-money laundering regulation and securities law. The guidelines lack a criterion of clear demarcation between utility tokens and the other two token categories. An ICO organizer is, despite of the guidelines, left with either complying with both the securities and anti-money laundering regulation or discussing the token with FINMA prior to the ICO.

Finally, in its guidelines, FINMA has confirmed that the regulation on collective investment scheme would be relevant in an ICO, should the funds accepted in the context of the ICO be managed by third parties. This requirement may be triggered in the event the token holders have no right to decide on the investment policies but will receive a participation of the earning of the ICO entity. In the event the ICO entity is not an operational company but an investment vehicle only, the ICO and the rights of the token holders must be structured very carefully, not to be captured by the regulation of the collective investment schemes.

Regulatory consequences

Generally, a Swiss entity collecting funds for a third party while issuing securities triggers a licensing requirement as a securities dealer, acting specifically as an issuing house.[332] This is the case when the activity in question is conducted on a professional basis and the company is primarily active in the financial industry.[333]

A Swiss entity collecting funds for a third party while issuing securities triggers a licensing requirement as a securities dealer, acting specifically as an issuing house.

The same licensing requirement applies to situations where an entity is issuing tokens that qualify as derivatives on a professional basis, and the entity is active primarily in the financial industry. Furthermore, if the assets raised from investors during an ICO are used for the purpose of collective investments, and if such assets are managed for the account of such investors, and if the investors' investment requirements are met on an equal basis, then the provisions of the collective investment scheme legislation need to be considered (see above).

However, collecting funds for one's own account without a platform or issuing house acting as an intermediary (and without issuing derivatives in the fashion described above) is unregulated from a regulatory law perspective in cases where repayment is not obliged, payment instruments have not been issued, and no secondary market is maintained by the issuer or a third party.[334] This is even the case for tokens that qualify as securities under Swiss law.

Apart from licensing requirements, the public issuance of a token that qualifies as either a debt or an equity security requires a prospectus, as does the placement of units in collective investment schemes.[335] Furthermore, the issuance of certain derivatives—structured products—requires a simplified prospectus; and these structured products have to be issued, guaranteed, or secured by a regulated bank or securities dealer if they are not exclusively underwritten by qualified investors.[336] This report does not deal with the scholarly dispute over whether the public issuance of a derivative, which does not qualify as a structured product, requires a prospectus. Generally, it is advisable for issuers of security tokens to draw up a prospectus.[337]

Until now, Swiss securities law does not require the filing of a prospectus for debt or equity securities with any governmental or supervisory authority, as is common practice in many other jurisdictions (e.g., the European Prospectus Directive).[338] Such obligation regarding the primary market currently exists only in

regard to the collective investment scheme regulation, in which fund managers must submit the obligatory prospectus to FINMA.[339] As such, the prospectus for equity and debt securities in Switzerland is a matter of private law, rather than regulatory law. Therefore, FINMA does not exert any supervision over debt or equity securities prospectuses.

Nevertheless, these provisions will be subject to change with the enactment of FinSA. Under FinSA, a prospectus will be required to be filed with a FINMA-authorized inspection body for securities that are publicly offered.[340]

Money regulations

Banking regulations/payment services

Under Swiss law, accepting deposits from the public qualifies as a banking activity that requires a license, unless one of the exemptions in the Banking Ordinance is applicable.[341]

Four important exemptions from the said application of the Swiss Banking Act are noteworthy.

First, payments from investors based on a prospectus subject to Swiss law do not qualify as deposit under the Swiss Banking Act. Even though the disclosure requirements of a Swiss prospectus are currently rather low, the white papers used in ICOs do generally not cope with the legal requirements for a Swiss prospectus. However, it would take limited effort to amend a white paper in order to meet the prospectus requirements.

Second, payments to a charitable foundation would generally not be deemed as deposit. We believe that Swiss foundations engaging in an ICO do not have a charitable purpose and may therefore not benefit from this exception.

Third, accepting deposits from an unlimited number of third parties below the aggregate value of CHF one million would not trigger banking license requirements (regulatory sandbox).

Fourth, the acceptance of (virtual or fiat) money not exceeding a value of CHF 3,000 by a payment system for future services or goods fall out of scope of the term deposit (provided that no interest is being paid to the investor).[342] Even though the last two exceptions may be relied upon in an ICO, they would limit the acceptable ticket sizes and scale. Midsize and large investments would be excluded.[343]

Under Swiss law, accepting deposits from the public qualifies as a banking activity that requires a license, unless one of the exemptions in the Banking Ordinance is applicable.

FINMA stated that ICOs as a means to collect funds for one's own account in cases where, among others, repayment is not obliged and payment instruments have not been issued, do not fall within the scope of Swiss banking regulation.

In its guidelines, FINMA stated that the issuance of tokens would not generally be associated with claims for repayment on the ICO company, and such tokens would therefore not fall within the definition of a deposit. To this extent, token issuers would not be required to obtain a banking license. If, however, the tokens represent liabilities with debt character (e.g., promises to return capital with a guaranteed return) and the issuance of the tokens is not documented by a prospectus subject to Swiss law, then the funds raised may be treated as deposits and the ICO company would be subject to Swiss banking regulation (unless one of the aforementioned exceptions applied).[344]

Swiss AML regulations

The Swiss AML/CFT framework primarily consists of the following two separate pieces of legislation: the Anti-Money Laundering Act (AMLA) and the Criminal Code (CC).

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The AMLA requires financial intermediaries to comply with the following statutory obligations: general duties of due diligence, including verification of the identity of the customer, establishment of the identity of the beneficial owner, and duty to keep records and to enact organizational measures.[345]

A person is subject to Swiss AML provisions if such person qualifies as a financial intermediary as defined in Article 2 of AMLA. Financial intermediaries include banks and securities dealers.[346]

Furthermore, financial intermediaries are also considered all natural and legal persons who accept, retain, or help transfer assets belonging to others on a professional basis. Examples of such activities include the offering of payment services, the issuance and management of means of payment and trading with money, foreign exchange, raw materials, securities, and precious metals.[347]

The use of virtual currencies as a means of payment for the acquisition or sale of goods and services does not constitute financial intermediation.

The trading in cryptographic tokens on a professional basis, and the operation of trading platforms where monies or cryptographic tokens from users of the platform are transferred to other users of the platform and the operator acts on a professional basis, fall under the AMLA.[348]

Regarding the applicability of the AMLA on activities in relation relating to cryptographic tokens, FINMA stated in its guidelines that the issuance of payment tokens would constitute the issuing of a means of payment, provided that the tokens may be transferred from one holder to another holder on a blockchain infrastructure. Anyone who provides payment services or who issues or manages a means of payment is deemed a financial intermediary subject to Swiss AML regulation.[349]

Regarding the application of the said AML requirements to ICO organizers, the guidelines foresee an important easement. According to FINMA, the ICO organizer would comply with the regulation if it accepted the funds via a third party service provider affiliated with a self-regulating organization (SRO) or subject to FINMA supervision. However, the ICO organizer would not have to affiliate with an SRO or be licensed directly by FINMA itself.

FINMA confirmed that payment tokens do not qualify as securities under Swiss law.

This analysis of FINMA is, albeit welcome, quite a liberal interpretation of the AMLA, which requires all financial intermediaries to affiliate with an SRO or be licensed by FINMA (whereas all other duties may be outsourced to a service provider).

No additional financial market regulation applies to payment tokens. FINMA confirmed that such tokens do not qualify as securities under Swiss law. Therefore, no prospectus requirements apply to the creation and issuance of payment tokens.

In 2015, FINMA confirmed that classical cryptocurrencies such as bitcoin and ether should be deemed virtual currency.[350] Virtual currency must be treated like any other currency in regard to AML provisions:

> *[Accordingly,] the exchange of fiat money, bitcoin, ether into a newly issued token with a value itself in the course of an ICO would be qualified as currency exchange, which is regulated in the AMLO-FINMA. Any Swiss entity offering currency exchange has to comply with the Swiss AML rules in the event such entity is acting on a professional basis. In the course of any ICO, the required threshold to act on professional basis is being reached if the value of the accepted bitcoins or ethers in exchange of the issuance of new tokens exceeds CHF 2 million.[351]*
>
> *In such event, the Swiss entity issuing new virtual currency tokens has either to join a self-regulatory organization for AML purposes or submit itself to the respective supervision of FINMA. Any investor (whether foreign or Swiss) investing more than an equivalent of CHF 5,000 in the ICO is subject to the required know your customer due diligence of the Swiss entity conducting the offering.[352]*

According to FINMA, a virtual currency is a digital representation of a value that is tradable on the Internet and takes on the function of money without being considered legal tender.

Others have argued that the issuance of an "intrinsic" token qualifies only as currency exchange if it is an actual virtual currency.[353] According to FINMA, a virtual currency is a digital representation of a value that is tradable on the Internet and takes on the function of money without being considered legal tender. Virtual currencies can be used as a means of payment for goods and services.[354] For a token issued during an ICO, usually no secondary market exists yet. Thus, the token is restricted in its tradability. Therefore, such a token potentially does not qualify as virtual currency, and the issuance cannot qualify as a currency exchange. This may even be the case for "intrinsic" tokens or "utility" tokens, provided that they do not qualify as a means of payment.

Furthermore, at the time when the issued token may be listed on a secondary market and made tradable, the issuer itself may not be involved in creating the secondary market. Rather, independent and separate entities (e.g., crypto exchanges) will maintain and take care of the respective secondary market. That's why being subject to the AMLA via conducting a currency exchange will more likely affect the exchange rather than the original issuer (as long as the token is not being used within an electronic payment system maintained by the issuer, and the issuer is not involved in the creation of the secondary market). However, in light of the applicability of AMLA and the respective ordinances, how FINMA will treat the issuance of such tokens is unclear.

FINMA emphasizes that the exchange of a cryptocurrency into fiat money or another cryptocurrency would be subject to AML regulation.

FINMA, on the other hand, emphasizes that the exchange of a cryptocurrency into fiat money or another cryptocurrency would be subject to AML regulation. The same would apply to entities providing token transfer services, if such service providers held the private key (e.g., a custody wallet provider). Intermediaries on the secondary market do not fall under the FMIA and do not require a securities dealer license.

Regulatory statements/Decisions

FINMA ICO guidelines (16 Feb. 2018)

On 16 February 2018, FINMA published its long-awaited guidelines on ICOs. FINMA picked up on some of the considerations made in its previous guidance (04/2017, below) but also make some novel interpretations.

Its main contributions are the introduction of a nomenclature to distinguish among token types, that is, payment tokens, utility tokens, asset tokens, and hybrid forms.

The guidelines marked a change in direction: FINMA took a tougher stance on the treatment of ICOs. FINMA subsumed any token that confers a right to the tokenholder under the definition of an uncertificated security. As uncertificated securities, the issuance and the exchange of the respective tokens come under the purview of FINMA as securities within the meaning of FMIA in connection with FMIO, in case they are issued in a standardized fashion and are suitable for mass-trading. As such, both the primary market issuance by a third party and the secondary market exchange may become regulated activities.[355]

FINMA recognizes the innovative potential of distributed ledger/ blockchain technology.

FINMA guidance on ICO regulations (29 Sept. 2017)

Background

In FINMA Guidance 04/2017 on the regulatory treatment of ICOs, FINMA recognizes the innovative potential of distributed ledger/ blockchain technology.[356] It welcomes and supports all efforts to develop and implement blockchain solutions in the Swiss financial

center. Recently there has been a marked increase in ICOs, either conducted in or offered from Switzerland. ICOs are a digital form of raising funds from the public. They exclusively take place using distributed ledger or blockchain technology. "Token sale" or a "token-generating event" are other terms used.

Under the usual procedure for ICOs, financial backers will transfer a certain amount of cryptocurrency to a blockchain-generated address supplied by those organizing the ICO campaign. In return, financial backers receive blockchain-based coins or other tokens connected with a specific project or company run by the ICO organizers. How ICOs are structured from technical, functional, and business standpoints varies markedly from offering to offering. There is no catch-all definition.

Regulation

ICOs are currently not governed by any specific regulation, either globally or in Switzerland. Equity and debt capital-raising, deposit-taking, and the activities of financial intermediaries are controlled by existing laws that protect creditors, depositors, and investors, and which ensure that financial markets function properly.

ICOs are currently not governed by any specific regulation, either globally or in Switzerland.

Swiss legislation on financial markets is principles-based; one such principle is technology neutrality. Consequently, collecting funds for one's own account without a platform or issuing house acting as an intermediary is unregulated from a supervisory standpoint in cases where repayment is not obliged, payment instruments have not been issued, and no secondary market exists. However, due to the underlying purpose and specific characteristics of ICOs, various links to current regulatory law may exist depending on the structure of the services provided. This concerns the following areas in particular:

- Provisions on combating money laundering and terrorist financing: the AMLA applies where the creation of a token by an ICO vendor involves issuing a payment instrument. If this is the case, other supervisory issues may be effective for third parties, especially for professional cryptobrokers or trading platforms that carry out exchange transactions or transfers with tokens (secondary trading with tokens).

- Banking law provisions: accepting public deposits, in which an obligation toward participants arises for the ICO operator because of the ICO, generally necessitates a banking license.

- Provisions on securities trading: a licensing requirement to operate as a securities dealer may exist in which the tokens issued qualify as securities (e.g., derivatives).

- Provisions set out in collective investment schemes legislation: potential links to collective investment schemes legislation may arise where the assets collected as part of the ICO are managed externally.

Because of the close proximity in some areas of ICOs and token-generating events with transactions in conventional financial markets, the scope of application of at least one of the financial market laws may encompass certain types of ICOs as well as ICO activities that aim to circumvent those provisions. Given the wide variety in structure of ICO models, FINMA can carry out a conclusive regulatory assessment only in specific cases. Currently, FINMA is assessing several such cases. Where financial market legislation has been breached or circumvented, enforcement proceedings will be initiated.

FINMA has closed down the unauthorized providers of the fake cryptocurrency "E-Coin."

FINMA does not carry out legal assessments of ICOs beyond the area of financial market legislation (e.g., the Swiss Code of Obligations and/or tax law).

FINMA closes down fake cryptocurrency E-Coin (19 Sept. 2017)

FINMA has closed down the unauthorized providers of the fake cryptocurrency "E-Coin."[357] The developers of E-Coin had accepted some million Swiss francs in public deposits without holding the required banking license. FINMA has also launched bankruptcy proceedings against the legal entities involved.

For over a year since 2016, the Quid Pro Quo Association had been issuing so-called E-Coins, a fake cryptocurrency developed by the association itself. Working together with Digital Trading AG and Marcelco Group AG, the association gave interested parties access to an online platform on which E-Coins could be traded and transferred. Via this platform, these three legal entities accepted funds amounting to at least four million Swiss francs from several hundred users and operated virtual accounts for them in both legal tender and E-Coins. This activity is similar to the deposit-taking business of a bank and is illegal unless the company in question holds the relevant financial market license.

FINMA liquidates the companies

FINMA found that the three legal entities had seriously breached supervisory law by failing to obtain the required authorization.

FINMA has taken action to protect creditors by launching enforcement proceedings against those involved. In its proceedings, FINMA found that the three legal entities had seriously breached supervisory law by failing to obtain the required authorization. As is usual in serious cases of unauthorized activity, FINMA has liquidated the association and the two companies. Since the three legal entities are insolvent, FINMA has also launched bankruptcy liquidation proceedings against them. FINMA has been able to seize and block assets to the value of approximately two million Swiss francs. The final amount of liquidation proceeds will not be known until bankruptcy liquidation proceedings have been concluded and all relevant liabilities have been identified.

Not an actual cryptocurrency

Unlike real cryptocurrencies, which are stored on distributed networks and use blockchain technology, E-Coins were completely

under the providers' control and stored locally on their servers. The providers had suggested that E-Coins would be 80 percent backed by tangible assets, but the actual percentage was significantly lower. Moreover, substantial tranches of E-Coins were issued without sufficient asset backing, leading to a progressive dilution of the E-Coin system to the detriment of investors.

FINMA welcomes innovation, but when innovative business models are misused for unauthorized activities, FINMA intervenes.

FINMA warning about unscrupulous cryptocurrency providers

FINMA welcomes innovation, but when innovative business models are misused for unauthorized activities, FINMA intervenes. FINMA has evidence of attempts by unauthorized parties to persuade former E-Coin users to invest in two new, presumably fake, cryptocurrencies. FINMA has also placed the following companies on its warning list due to suspicious activity in the same field:

- Suisse Finance GmbH in Liquidation
- Euro Solution GmbH
- Animax United LP

In addition, FINMA is conducting 11 investigations into other presumably unauthorized business models relating to such coins. As with any other investment opportunity, market participants should carefully weigh up the risks before they invest in instruments of this kind. FINMA publishes advice on its website suggesting ways in which market participants can protect themselves.

Examples of ICOs

Ethereum Foundation/ether

The Ethereum blockchain and the eponymous cryptoasset ether (which is proprietary to the Ethereum blockchain) barely needs an introduction: it is consistently ranked as the second or third cryptoasset after bitcoin, with a staggering market capitalization of $126 billion.[358] Ethereum is a decentralized platform on which smart contracts can be written and deployed to execute decentralized applications.

The Ethereum blockchain has become the unrivaled underlying network on top of which cryptographic tokens are issued.

In summer of 2014, the Switzerland-based Ethereum Foundation conducted a token sale in which approximately $18.4 million was raised in exchange for 60 million ether.[359]

Ever since, the Ethereum blockchain has become the unrivaled underlying network on top of which cryptographic tokens are issued. Among tokens that were not issued as part of their own proprietary blockchain but on top of an existing blockchain, 18 of the top 20 by market capitalization were issued on the Ethereum blockchain.[360]

Under Swiss law, ether neither represents a participation and a claim in or against the issuer, nor does it derive its value from an underlying base value. Ether is a value in itself. Ether can therefore

also not take the form of uncertificated or intermediated securities. As such, ether is not a security and the trading in ether is not subject to regulation except for AML provisions and the Banking Act, in cases which deposits from the public are taken and no exemption can be relied upon.[361]

Tezos Foundation/Tezzies (XTZ)

In July 2017, the Tezos Foundation conducted an ICO selling 607 million Tezzies (XTZ) in exchange for $232 million worth of cryptographic assets, mainly ether and bitcoin.

Tezos is a blockchain-based, Dapps platform project. Within the Tezos blockchain, formal verification of smart contracts shall be facilitated. Furthermore, an on-chain governance mechanism shall be implemented.

Arthur and Kathleen Breitman cofounded Dynamic Ledger Solutions in 2015 to support the development and promotion of the platform, owning all the intellectual property of the project. To launch an ICO and handle the funds, they established a Swiss foundation known as the Tezos Foundation.

In July 2017, the Tezos Foundation conducted an ICO selling 607 million Tezzies (XTZ) in exchange for $232 million worth of cryptographic assets, mainly ether and bitcoin. Tezzies gave various rights to participate in the upcoming Tezos network. XTZ's value would derive from the usefulness of the network—that is, the demand to use the network based on scarcity of access to the network.[362]

XTZ is a value in itself. XTZ neither represents a participation and a claim in or against the issuer, nor does it derive its value from an

Figure 13: Ether (ETH) token price and trading volume

Source: CoinMarketCap.com, Ethereum (ETH) chart, 5 Aug. 2015–8 April 2018.

underlying base value. XTZ can therefore also not take the form of uncertificated or intermediated securities. As such, XTZ is not a security and trading in XTZ is not subject to regulation except for AML provisions and the Banking Act, in cases which deposits from the public are taken and no exemption as described hereinabove can be relied upon.[363]

Critical thoughts and comparative analysis

Switzerland's Crypto Valley has been a leading force in making Switzerland a global hub for token sales.

Switzerland's Crypto Valley, a loosely organized cluster of blockchain start-ups, law firms, and government initiatives sprawled around the city of Zug, connected but not congruent with the eponymous Crypto Valley Association, has been a leading force in making Switzerland a global hub for token sales.

The Zug model, which includes setting up a Swiss foundation to distribute and issue the tokens while using the raised funds to ensure a proper development of the blockchain platforms or applications, has become the go-to model for many token sales conducted in Switzerland. Credit must certainly be given to the Ethereum Foundation established in Zug, which attracted a number of start-ups and companies already active in the development of distributed ledger technologies and helped Switzerland to become a crypto hub.

The foundation model chosen for the Ethereum blockchain ensures stable governance of the structure. But it neither provides nor benefits from the tax treatment of the fundraising by an ICO nor results in any regulatory easement. Payments from token holders to the issuing foundation or company is generally treated as income for accounting purposes at the level of the ICO promoter. This treatment would trigger corporate income taxes because Swiss tax law generally follows accounting law.

The company should, however, be allowed to record provisions in the same amount as the received funds, neutralizing the income from issuing the tokens. We see at least two conceivable justifications for such provisions. Therefore, we see a trend toward the issuance of income-sharing or royalty-sharing tokens by Swiss stock corporations or Swiss limited liability companies.

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On the other hand, and different from such corporate structures, foundations may exist for decades and consistently provide funding for the development or maintenance of the envisioned platforms. the corresponding white paper. Therefore, these foundations can potentially exist for decades if not centuries, and consistently provide funding for the development or maintenance of the envisioned platforms.

That's why innovators continue to select the foundation structure for open-source projects such as the Ethereum Foundation's Ethereum blockchain or Web3 Foundation's Polkadot protocol. These kinds of initiatives would have a hard time raising money on the traditional capital markets, as they promote nonproprietary, open-source technology and have built (or aim to build) decentralized, nonproprietary networks.

We shall see whether the foundation model prevails as the go-to ICO model, as it has been co-opted by numerous initiatives for which the attributes "open source" and "nonproprietary" seem to be of lesser importance.

The hype and buzz around Switzerland as the go-to jurisdiction has slightly abated since FINMA has seemed to take a tougher stance on these novel forms of fundraising, disillusioning many entrepreneurs. Receiving a no-action letter from FINMA takes a long time and, thus, slows down often unrealistic timelines for conducting an ICOs. Firms are deciding to conduct ICOs in Liechtenstein or Malta instead.

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Nevertheless, the Swiss government has reaffirmed its overall positive approach to innovation in the field of distributed ledger technology. The ministers of finance and education have initiated a blockchain taskforce to fortify Switzerland's standing as a worldwide leader in the field.[364]

Furthermore, financing of start-ups through ICOs has recently exceeded financing through venture capital in Switzerland. It has also opened such investments to a large number of non-institutional investors. Despite some initial teething troubles, we believe that blockchain technology will play an important role in venture capital and probably in other kinds of corporate financing.

Gibraltar

Benedikt Schuppli

Gibraltar, a British overseas territory nestled on the southern coast of Spain, across from Morocco, is an offshore jurisdiction with more registered companies than households.[365] Lately, Gibraltar has used its momentum around blockchain technologies to position itself as a crypto-friendly jurisdiction, leading many issuers of ICOs to consider conducting their token sale there, rather than setting up in other, less flexible European jurisdictions.

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With the Digital Ledger Technology (DLT) Regulatory Framework, Gibraltar has become the first jurisdiction to propose and outline a distinct legislative framework dealing explicitly and exclusively with blockchain technology in relation to financial services regulation. Below we assess the DLT Regulatory Framework. Furthermore, we analyze regulator statements and undertake a comparative analysis of Gibraltar's approach to ICOs with that of other jurisdictions.[366]

Regulatory framework

The government of Gibraltar and the Gibraltar Financial Services Commission (GFSC) are currently working on implementing a legal and regulatory framework that will be aligned to the DLT Regulatory Framework for the sale, promotion, or distribution of tokens. As this