

Supplement to the guidelines

for enquiries regarding the regulatory framework for initial coin offerings (ICOs)

Published 11 September 2019

1 Background

Since mid-2018 an increasing number of ICOs and other tokenisation projects based on distributed ledger or blockchain technology, have been based around the creation of tokens known as 'stable coins'. This supplement to the ICO guidelines for enquiries regarding the regulatory framework for initial coin offerings (ICOs)¹, which continue to apply unaltered, provides information for interested market participants about how FINMA treats the most common types of such projects under Swiss financial market regulation.

The value of 'stable coins' is frequently linked to an underlying asset (e.g. such as fiat currency). The usual objective of such projects is to minimise the price volatility typical of currently available payment tokens. This, in turn, should increase market acceptance, in particular for payment purposes. The goal is to increase price stability compared with payment tokens such as Bitcoin or Ether. However, "stable" is primarily a marketing term. Nevertheless, due to its international prevalence the term 'stable coin' is used here.

The concrete design of 'stable coins' can vary greatly in legal, technical, functional and economic terms. Therefore, no fully generic classification is possible. The following classification only applies under Swiss financial market regulation and would not necessarily be valid in other jurisdictions. Additionally, the information required by FINMA to process corresponding enquiries from market participants is outlined below.

¹ Available at: <https://www.finma.ch/en/news/2018/02/20180216-mm-ico-wegleitung/>

2 Indicative classification under supervisory law

2.1 General principle

'Stable coins' are currently not governed by any specific regulations, either globally or in Switzerland. Swiss financial market regulation is principle-based and technology-neutral. In order to protect creditors, depositors and investors and to ensure the proper functioning of the financial markets, it regulates deposit-taking, the management, safekeeping and distribution of collective investment schemes as well as the operation of financial market infrastructures and other activities of financial intermediaries.

FINMA's treatment of 'stable coins' under supervisory law follows its existing approach for blockchain-based tokens: the focus is on the economic function and purpose of a token ('*substance over form*') and follows the tried and tested principle of '*same risks, same rules*', while taking into account the specific features of each project. FINMA has found that projects to create 'stable coins' often give rise to potential licensing requirements under the Banking Act (BA; SR 952.0) or the Collective Investment Schemes Act (CISA; SR 951.31). In addition, due to their frequently intended purpose as a means of payment, the Anti-Money Laundering Act (AMLA; SR 955.0) is almost always applicable. If a payment system of significant importance is launched in connection with the creation of a 'stable coin', a licensing requirement under the Financial Market Infrastructure Act (FMIA; SR 958.1) as a payment system is probable.

2.2 Categories

From a legal point of view, many but not all 'stable coins' confer a contractual claim against the issuer on the underlying assets (so-called redemption claim) or confer direct ownership rights. Depending on the specific purpose and characteristics of 'stable coins', different financial market laws can apply. The following remarks regarding the possible categories are purely for indicative purposes. The specific assessment of each individual case (including related advertising claims) remains decisive.

2.2.1 Linked to currencies

Where the token is linked to a specific fiat currency with a fixed redemption claim (e.g. 1 token = CHF 1), classification as a deposit under banking law is indicated. Where there is a redemption claim dependent on price developments, e.g. as a result of the token being linked to a basket of currencies, the distinction between a deposit under banking law and a collective investment scheme can become relevant. In this context it is important 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). For the latter categorisation to apply, 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 the issuer of the 'stable coin'.

Existing exemptions from the requirement for a bank license also apply to 'stable coin' projects, for example the exemption of taking deposits only from banks, other prudentially supervised institutions or institutional investors with professional treasury operations (Art. 5 para. 2 BO).

A 'stable coin' that does not foresee an explicit redemption claim for the token holder but instead is based on an alternative stabilisation mechanism, can nevertheless trigger licensing requirements under other financial market regulations (alongside AMLA requirements), in particular under the FMIA if operation of a payment system of significant importance is foreseen.

2.2.2 Linked to commodities

Where a token is linked to commodities, the exact nature of the claim on the assets as well as the type of commodity (in particular whether "bank precious metals" or other commodities are involved) are of particular significance.

If a 'stable coin' merely evidences an ownership right of the token holder, it generally does not qualify as a security. This presupposes that (i) an ownership right and not merely a contractual claim to the underlying commodities exists, (ii) the transfer of the token results in the transfer of the respective ownership right and (iii) the commodities are not deposited pursuant to art. 481 Code of Obligations (CO; SR 220). Questions of validity under property law lie outside financial market law and regulation and remain the responsibility of the parties involved.

Where there is merely a contractual claim against the issuer on "bank precious metals", qualification as a deposit under banking law is probable due to the similarity to bank precious metal accounts. Where there is a contractual claim on other commodities, the token will generally qualify as a security and possibly as a derivative – insofar as it is linked to a financial market activity. 'Stable coins' with contractual claims on underlying assets can therefore also give rise to a licensing requirement as a derivatives house in accordance with art. 3 para. 3 of the Stock Exchange Ordinance (SESTO; SR 954.11). Where a link to a basket of commodities (including "bank precious metals") with a price-dependent redemption claim exists, a collective investment scheme is probable.

2.2.3 Linked to real estate

Where a link to individual properties or to a real estate portfolio and a redemption claim of the token holder exists, the normal third-party management of the real estate portfolio is in itself an indication of a collective investment scheme. In view of the legal hurdles involved in real estate transfers, a price-based redemption claim often exists, which also suggests a licensing requirement as a collective investment scheme.

2.2.4 Linked to securities

A token that is linked to an individual security by way of a contractual right for delivery to the token holder would normally also constitute a security. Whereas a self-issuance does not generally trigger licensing requirements under the Stock Exchange Act (SESTA; SR 954.1), the acquisition and primary market offering of corresponding 'stable coins' can constitute an activity as a securities issuing company (Art. 3 para. 2 SESTO). Upon entering into force, the prospectus requirements imposed by the new Financial Services Act (FinSA; 950.1) must also be met including in cases of self-issuance. Where a link to a basket of securities with a contractual claim by the token holder on a share of the basket exists, a licensing requirement as a collective investment scheme is probable.

2.3 Dubious stabilisation mechanisms

From time to time FINMA is asked to assess 'stable coin' projects that claim to invest the proceeds from an ICO in certain assets, apparently seeking to achieve a stabilisation or even an increase in value, even though no plausible mechanism for such stabilising effects is apparent. Investors are here frequently promised an investment opportunity. Such advertising claims are often dubious in nature. When such projects are conducted in or from Switzerland, it is probable that FINMA will take enforcement measures.

3 Information for investors

'Stable coins' are not necessarily subject to reduced price volatility nor are they per se safe investments. The risks for investors are always dependent on the specific product and the exact structure. In addition, legal uncertainty remains regarding the transferability and enforceability under civil law of claims linked to tokens. It cannot be excluded that an issuance of 'stable coins' is fraudulent – like any other type of token issuance.

Appendix 1: Supplementary minimum requirements for enquiries concerning 'stable coins'

Value stabilisation and claim of the token holder	
How does the intended value stabilisation mechanism operate (please provide details of technical and legal aspects)?	
Where the token is linked to a basket of assets: How is the individual token holder's share of the value calculated?	
Does the token holder acquire an explicit claim on the underlying assets?	
If yes, what is the legal nature of the token holder's claim (please include contractual terms and documents)?	
If yes, how does the redemption or return mechanism for the token operate?	
Underlying assets	
Are the assets only held in custody or are they also invested? By whom are the underlying assets managed or held? If invested, what types of financial instruments are they invested in?	
Who has which legal rights over and access to the underlying assets and in what way?	
Who bears the risks, profits or losses and expenses resulting from the management of the underlying assets?	

Appendix 2: Categories of 'stable coins'

Categories	Indicative supervisory classification (in addition to anti-money laundering legislation ²)
1. Linked to <i>fiat currency / cryptocurrency</i> with fixed redemption claim	Deposit under banking law ^{3/4}
2. Linked to <i>basket of fiat currencies / cryptocurrencies</i> 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^{3/4} – for the account of the token holder: collective investment scheme
3. Linked to <i>commodity</i> (incl. "bank precious metals") with contractual claim	Bank precious metals: deposit under banking law ^{3/4} Commodity: security and possibly derivative ⁵
4. Linked to <i>basket of commodities</i> (incl. "bank precious metals") with redemption claim dependant on price development	Collective investment scheme
5. Linked to <i>commodities</i> (incl. "bank precious metals") with ownership rights	No prudential licensing requirement
6. Linked to <i>real estate</i> with redemption claim dependent on price development	Collective investment scheme
7. Linked to <i>specific security</i> with contractual claim	Security and possibly derivative ⁵
8. Linked to <i>basket of securities</i> with redemption claim dependent on price development	Collective investment scheme

² Due to their usual intended purpose as a means of payment, the AMLA is almost always applicable.

³ See para. 2.2.1 for the importance of the legal structure of the claim.

⁴ Existing exemptions from bank licensing requirements, for example for deposit taking only from banks and other supervised companies or from institutional investors with professional treasury operations, apply (Art. 5 para. 2 BO). If a payment system of significance is launched, licensing requirements pursuant to the FMIA with additional requirements for risk-increasing services may apply (Art. 10 FMIA).

⁵ No prudential supervision for self-issuance unless activity as a derivative house is involved.