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Oliver Widmer, Urs Kloeti and Niku Gholamalizadeh
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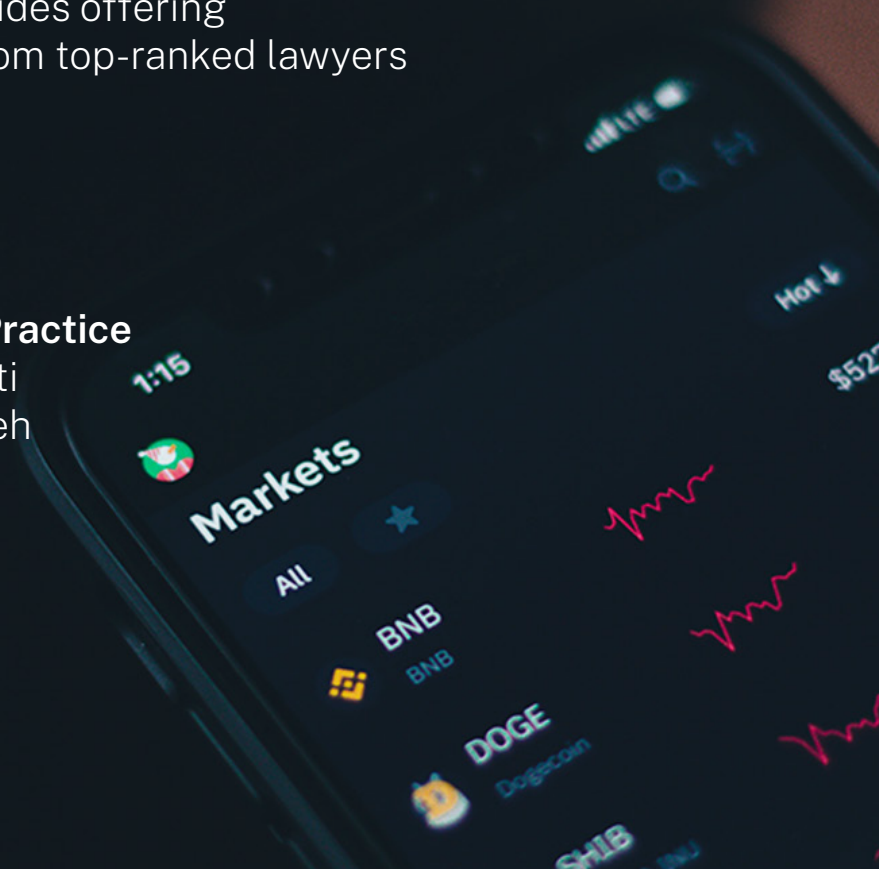

SWITZERLAND

Law and Practice

Contributed by:
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Pestalozzi

Contents

Pestalozzi is a multicultural full-service Swiss business law firm that has focused on high-end work for domestic and international clients since 1911. Its lawyers are strong and empathic personalities, known for their truly independent approach to advising and representing their clients. The firm guides and supports its clients in their strategic business decisions, anticipates their future challenges and helps them solve their critical issues. Being fully integrated, Pestalozzi encounters no internal limits in shaping the most competent and efficient teams for clients' needs. With more than 100 professionals in Zurich and Geneva, the firm is at home in Switzerland's two main commercial hubs, and has developed a wealth of experience in its key industries of banking, life sciences, commodity trading and insurance. While being locally embedded, Pestalozzi has also developed sought-after expertise in dealing with multi-jurisdictional transactions and disputes.

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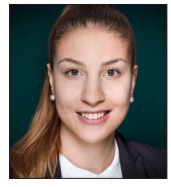

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1. Blockchain Market and Business Model Overview

1.1 Evolution of the Blockchain Market

Over the last year, the global blockchain ecosystem has been facing challenging times due to instabilities on the global financial markets. Inflation and the failure of major market participants such as FTX, Luna and Celsius have led to reduced valuations of risky asset classes, including crypto-assets. According to the latest CV VC Top 50 Report 2022, the top 50 blockchain and cryptocurrency companies in Switzerland and Liechtenstein were valued at USD185 billion on 31 December 2022, which is a substantial decrease since the end of 2021. Despite the challenging market environment, the Swiss Crypto Valley remains resilient, and leading companies as well as start-ups continue to develop and optimise technologies adopting omnipresent topics such as sustainability. While the worldwide regulatory framework is evolving following several scandals in recent years, the Swiss Crypto Valley is recognised for its pragmatic approach and dynamic regulation, and hence continues to be a globally preferred jurisdiction.

With over 500 companies, Zug continues to be the epicentre of the Crypto Valley, which was home to more than 1,000 blockchain-focused companies in 2022. Despite the decreasing market capitalisation, the number of employees working directly in crypto and blockchain companies remains stable, at around 6,000 employees. Thousands more work for and with these companies remotely across the globe. Other important technological hubs are Zurich, Geneva, Ticino, Vaud, Lucerne and Berne.

As of 31 December 2022, the market participants that are subject to supervision by the Swiss Financial Supervisory Authority (FINMA) included five fintech companies. These institutions hold a fintech licence, which allows them to accept public deposits of up to CHF100 million or crypto-based assets (provided that these are not invested and no interest is paid on them).

1.2 Business Models

The use cases of blockchain in Switzerland include cryptocurrency exchange platforms, tokenisation platforms, custodial and non-custodial wallet services, hot and cold storage solutions, supply chain and trade finance solutions, and decentralised finance (DeFi) applications.

For example, in relation to trading in securities and the clearing and settlement of securities operations, the SIX Digital Exchange (SDX – the world's first fully regulated financial market infrastructure digital asset exchange) provides fully integrated issuance, trading, settlement and custody infrastructure for digital assets. SDX focuses on a business-to-business model and operates as regulated financial market infrastructure, including functioning as an exchange and a centralised securities depository. SDX became a member of the Enterprise Ethereum Alliance in April 2021.

With respect to the upgrade of Ethereum to the decentralised blockchain-based computing platform, the transition announced by developers Tim Beiko and James Hancock known as "The Merge" from proof of work (PoW) algorithms towards a proof of stake (PoS) model was completed in 2022. The PoW conversion reduced Ethereum's energy consumption by an estimated 99.95% and has been a first step towards more sustainability.

Over the last 12 months, there has been increased demand for the licensing of business models. The main drivers for such increased demand are that institutional investors want to invest in blockchain products and ask for prudential supervision combined with a shift from offshore to onshore jurisdictions.

1.3 Decentralised Finance Environment

In 2022 and for the first months in 2023, FINMA had an increased number of DeFi-related enquiries compared to 2021. DeFi has so far emerged particularly in the form of DeFi applications that facilitate financial market services, such as the trading of tokens and lending business. DeFi is largely based on peer-to-peer models. Any service in the financial market that can be realised as a computer program can, in principle, also be implemented as a DeFi application. Unlike traditional financial market services, there are no individually identifiable or controlling operators for genuine DeFi applications.

When processing enquiries, FINMA distinguishes projects without identifiable operators from those that describe themselves as DeFi but are actually organised and controlled centrally and are therefore similar to traditional financial market intermediaries; such projects fall within the scope of financial market law. The specific enquiries to FINMA concerned trading platforms via which tokenised securities or cryptocurrencies can be traded. When responding to such enquiries, FINMA utilises the following approaches:

- FINMA applies the existing rules to DeFi applications, thereby abstracting from the use of specific technologies or procedures (principle of technology neutrality);
- if a DeFi application offers the same service and poses the same risks as intermediaries in the traditional financial market, FINMA also applies the same rules (same risks, same rules); and
- if, from an economic perspective, a DeFi application offers an activity that would require licensing under financial market law, FINMA also assumes a licensing requirement in the case of new types of technical or legal implementation (substance over form).

Furthermore, due to the new types of institutional and systemic risks that may arise from such business activities, FINMA determines the particular regulatory requirements on a case-by-case basis, depending on the specific structure and scope of the DeFi products and services offered, considering the following criteria:

- reflection of the DeFi-related business activities in the institution's risk control framework and organisational rules;
- the impact of the DeFi project, particularly addressing risk management, conflicts of interest, money laundering risks, suitability issues and a monitoring concept; and
- regulatory analysis of the DeFi application in foreign markets (if applicable).

FINMA applies its risk-based approach when dealing with requests from institutions. Furthermore, the Swiss regulator continues to have a technology-neutral position that also applies to DeFi products and services, and thus allows market participants to operate in the DeFi ecosystem as long as they comply with Swiss financial market regulation.

1.4 Non-fungible Tokens

More and more start-up companies are engaging in the development of NFTs and marketplaces in Switzerland, especially in the Crypto Valley. FINMA has received an increased number of requests regarding NFT products and their qualification under the Swiss financial market regulation laws. FINMA categorises NFTs based primarily on their economic function and the underlying assets and/or claims they represent. The analysis of whether NFTs constitute securities pursuant to Swiss financial market laws is key. Despite the tokens being called "non-fungible", FINMA analyses whether a specific NFT is fungible from a commercial perspective on a case-by-case basis, depending on the structure, the contractual framework and the functionality related to such NFT. If such fungible NFT is used for investment or capital-raising purposes, qualification as a security is likely.

Luxury watch brands, premium whisky sellers, sports teams and well-known consumer companies are leveraging Swiss NFT know-how to interact with consumers, boost sales or protect their products from counterfeiters. Several Swiss NFT projects have set out to prove that the technology can have a lasting impact beyond the spectacular headlines. Even an institution as conservative as the Swiss post office got in on the act by issuing NFT postage stamps in 2021 (crypto-stamp.post.ch/en).

NFTs worth hundreds of millions of dollars are traded every week on platforms like OpenSea, Rarible and Nifty.

2. Regulation in General

2.1 Regulatory Overview

In Switzerland, the existing laws are applied in a technology-neutral way. In order to avoid having legal gaps, the Federal Law on the Adaptation to Developments in Distributed Ledger Technology and the accompanying ordinance (DLT Bill) entered into force in 2021.

The DLT Bill entails specific amendments to the following ten existing federal laws:

- the Swiss Code of Obligations;
- the Federal Intermediated Securities Act;
- the Federal Act on International Private Law;
- the Federal Debt Enforcement and Bankruptcy Act;
- the Federal Banking Act;
- the Federal Financial Institutions Act;
- the Federal Financial Market Infrastructure Act;
- the Federal Financial Services Act;
- the Federal Anti-Money Laundering Act (AMLA); and
- the Federal Act on the Swiss National Bank.

One of the key amendments of the DLT Bill was the introduction of a licence for DLT trading facilities. Licensing as a DLT trading facility allows for the multilateral trading of DLT securities. The financial market infrastructure for DLT securities can admit other companies and persons to trading, as well as financial intermediaries.

In addition to the DLT trading licence, the DLT Bill improved the framework conditions for companies using blockchain in Switzerland through the introduction of book-entry securities on a blockchain. Moreover, legal certainty has been increased in insolvency law by explicitly regulating the segregation of crypto-based assets in the event of bankruptcy.

Finally, the DLT Bill also addressed identified risks in the area of money laundering and terrorist financing.

This means that neither blockchain technology nor cryptocurrencies are governed by any sector-specific laws or regulation. Therefore, existing laws and regulations apply to the new blockchain technology and, respectively, blockchain-based business models. The new rules will not disrupt the application of the current regime, under which several statutes must be taken into consideration.

Consequently, before a blockchain-based business model is implemented or digital assets are marketed, the project owner should be aware that several statutes may apply in Switzerland (in addition to foreign laws). For example, an initial coin offering (ICO) and/or the envisaged business model may trigger licensing requirements pursuant to one or more Swiss financial market regulations (such as the Banking Act, the Collective Investment Schemes Act, the Financial Services Act, the Financial Institutions Act, the Financial Market Infrastructures Act and/or AMLA).

Initially, FINMA clarified that the existing laws remain applicable to blockchain-based companies or cryptocurrency-related business models, subject to any changes in law or amendments to existing statutes. Going forward, market participants using blockchain technology or cryptocurrency may be subject to one or more laws, as the new rules will only partially amend the existing statutes.

2.2 International Standards

Swiss anti-money laundering regulations have implemented the recommendations of the Financial Action Task Force (FATF), particularly with respect to cryptocurrencies or virtual currencies and following the FATF's adoption of the guidance on the application of the risk-based approach to virtual assets and virtual asset service providers (VASPs).

In Switzerland, the AMLA applies to all activities of financial intermediaries related to crypto-assets. When Swiss financial intermediaries hold cryptocurrencies for others or assist in their transfer, they are subject to the same obligations as when fiat money such as the Swiss franc is involved.

FINMA has also issued guidance on payments on blockchain (FINMA Guidance 02/2019), to clarify and inform market participants about the regulatory requirements related to the FATF's "travel rule", with which financial intermediaries need to comply.

In order to implement a FATF recommendation for dealing with VASPs, Switzerland also amended the Anti-Money Laundering Ordinance (AMLO-FINMA) in 2021 and reduced the

threshold for customer identification in cryptocurrency exchange transactions from CHF5,000 to CHF1,000. On 1 January 2023, the partially revised AMLO-FINMA entered into force in order to take into account the latest revisions to the AMLA and the Federal Council's Anti-Money Laundering Ordinance. Amongst other things, the revision specified the application of the threshold for transactions with virtual currencies. In view of the risks and recent instances of abuse, the threshold of CHF1,000 applies for linked transactions within 30 days (and not per day). In the context of exchange transactions of virtual currencies for cash or other anonymous means of payment, technical measures are mandatory to avoid the threshold being exceeded by such linked transactions. Furthermore, due to the fact that DLT trading facilities are also open to private clients, the scope of application of the AMLO-FINMA is amended to the extent that it also applies to trading facilities for DLT securities.

Therefore, Switzerland as a whole goes beyond the international standard of the FATF.

Apart from FATF recommendations and as regards blockchain-based payment systems or stablecoins, FINMA has also made it clear that the regulatory requirements for such payment systems are based on international standards, such as the Principles for Financial Market Infrastructures (PFMI).

2.3 Regulatory Bodies

FINMA is the regulatory body most relevant to businesses or individuals using blockchain technology or operating fintech companies in Switzerland. As supervisor and regulator, FINMA is responsible for protecting investors and creditors. It also ensures that the Swiss financial market functions properly and may therefore publish guidelines, information for individuals or public warnings. In the field of blockchain and fintech, FINMA can be approached for a pre-assessment concerning tokens or business models. Applying a risk-based approach when dealing with institution's requests, FINMA is able to adopt its practice immediately in order to take increased market risks into account.

2.4 Self-Regulatory Organisations

In Switzerland, there are several self-regulatory organisations (SROs) that may supervise blockchain-based businesses. In many cases, blockchain-based businesses that qualify as financial intermediaries need a licence from FINMA to operate as a financial institution (eg, a securities firm), as a bank (eg, fintech licence) or as financial market infrastructure (eg, payment system), which includes FINMA supervision with respect to anti-money laundering conduct rules.

Blockchain-based companies may also qualify as financial intermediaries but not require any financial market licence for their business activities. In particular, this applies to blockchain-based businesses that provide payment transaction services – ie, carry out electronic transfers for third parties or issue or manage means of payment, such as (digital) credit cards. In such cases, financial intermediaries must nevertheless be affiliated with an SRO. Where the blockchain-based company does not hold a FINMA licence, FINMA may only supervise blockchain-based businesses indirectly via the SRO.

The most prominent example of a crypto service provider that operates without a FINMA licence in Switzerland is Bitcoin Suisse AG. In 2021, following Bitcoin Suisse AG's submission of an application for a banking licence, FINMA came to the preliminary conclusion that, based on the current organisation structure, Bitcoin Suisse AG

is presumably not eligible for a banking licence, following which Bitcoin Suisse AG withdraw its licence application. FINMA did not determine any unauthorised activities by Bitcoin Suisse AG, as deposits with and corresponding obligations by Bitcoin Suisse AG are guaranteed by a Swiss bank. Thus, the company continues to provide crypto-related financial services such as prime brokerage, trading, custody and lending without a FINMA licence but subject to supervision by an SRO.

The SRO is responsible for monitoring its members' compliance with Swiss anti-money laundering regulation encompassing, inter alia, AMLA and the SRO's rules and regulations.

Apart from these supervisory bodies, various trade groups and associations have mushroomed in the Swiss blockchain ecosystem – eg, the Bitcoin Association Switzerland, the Swiss Blockchain Federation, the Capital Market Technology Association (CMTA) and the Crypto Valley Association. These associations have no supervisory power but can participate in legal consultation processes and/or may set best practice standards on a non-binding basis. Examples of such standards include the Digital Assets Custody Standard and the AML Standards for Digital Assets (each published by CMTA).

2.5 Judicial Decisions and Litigation

To date, there is no Swiss court decision explicitly interpreting or determining the applicability of Swiss laws to the use of blockchain or cryptocurrencies.

The Swiss regulator has clarified that the existing laws (eg, the Swiss financial market laws) are applicable to new technologies as well. In this context, the initiation of enforcement and bankruptcy proceedings vis-à-vis envion AG are noteworthy. The Swiss Cantonal Court of Zug dissolved envion AG based on Article 731b, paragraph 1, number 3 (Defects in the organisation of the company) of the Swiss Code of Obligations, and ordered its liquidation in a decision of 14 November 2018.

The bankruptcy proceedings of envion AG were conducted as ordinary bankruptcy proceedings controlled by the Bankruptcy Office of Zug (in accordance with the Swiss Debt Enforcement and Bankruptcy Act). Accordingly, the creditors were informed with a "call to creditors", which prompted more than 6,000 creditors to register their claims through an internet portal. The creditors submitted more than 57 million tokens to the bankruptcy administration. In broad terms, this procedure shows that the Swiss courts and authorities apply the existing principles of Swiss civil, litigation and bankruptcy law to blockchain-based or cryptocurrency business.

2.6 Enforcement Actions

In 2022, FINMA carried out 183 investigations relating to the unauthorised acceptance of public deposits, including by fintech business models, and a total of 206 investigations. This number includes investigations into unauthorised financial intermediaries, lack of SRO affiliations and unauthorised fintech business models (separate data on fintech was not provided by FINMA). FINMA's enforcement activities may, in particular, result in criminal reports to law enforcement agencies, activity bans, withdrawals of licences, the opening of bankruptcy proceedings or the publication of orders against institutions.

FINMA is willing to consistently take action against financial service providers in the fintech area that violate or circumvent supervisory laws, such as the banking, securities or anti-money laundering regulations.

The Dohrnii Foundation Case

In May 2023, FINMA concluded enforcement proceedings against the Dohrnii Foundation and its founder and former managing director personally. The Dohrnii Foundation and its founder launched an ICO in spring 2021 for a previously newly created token, the DHN Token, which was initially aimed at providing access to a learning platform as well as a marketplace where users should have bought cryptoservices and products from other users with the DHN Token. Based on this designated purpose, the DHN Token was intended to classify as a utility token, which would not be subject to regulatory and licensing requirements.

FINMA applied its approach established in the ICO Guidelines concerning the classification of tokens, and concluded that the DHN Token could not be used for the purpose ascribed to it and that, "as a pre-functional token, it served as an investment in advance". Due to the actual commercial function of the DHN Token, FINMA qualified the DHN Token as a hybrid token containing characteristics of all three possible token categories: utility tokens, asset tokens and payment tokens.

Correspondingly, FINMA decided that the issue of such DHN Token breached the following Swiss financial market law provisions.

- The Dohrnii Foundation unlawfully operated as a securities firm without the required FINMA licence, pursuant to the Swiss Financial Institutions Act, when selling the DHN tokens.
- The founder of the Dohrnii Foundation accepted funds totalling around CHF1.5 million from more than 20 investors, which were to be invested in the crypto sector and repaid with returns. This constituted unlawful banking activities without the required FINMA licence, pursuant to the Swiss Banking Act.
- The Dohrnii Foundation issued a token intended to be used as a means of payment on the Dohrnii platform (payment token). Hence, the Dohrnii Foundation acted as a financial intermediary without complying with the respective regulatory obligations established in the Swiss AMLA.
- In addition, the founder did not comply with the cease-and-desist order during the investigation, but continued his activities. Moreover, both the Dohrnii Foundation and the founder partially failed to comply with their duty to provide information to FINMA during the investigation.

The Dohrnii Foundation case clearly evidences FINMA's substance-over-form approach and confirms that, when reviewing tokens, FINMA does not primarily rely on the formal structure, but rather analyses the commercial function of tokens.

2.7 Regulatory Sandbox

Swiss blockchain-based businesses that may qualify as banks can make use of the banking sandbox.

In order to benefit from the sandbox exception, the following requirements must be fulfilled:

- the acceptance of deposits must not exceed the maximum amount of CHF1 million (even if such deposits are made by more than 20 depositors), provided that such deposits are not invested by the Swiss company and do not bear interest; and
- depositors must be informed (in writing) in advance that the Swiss company is not subject to FINMA supervision and that the

deposits are not covered by the deposit protection scheme.

If these criteria are fulfilled, the deposit-taking activity will not be deemed to be "on a professional basis". There is not yet any other regulatory sandbox in Switzerland.

Despite not being a "sandbox" by definition, it is worth mentioning that Swiss licensing requirements are, in principle, applicable to activities that are carried out "on a professional basis". The criteria of activities being carried out on a professional basis are defined separately for banks and particular financial institutions, including institution specific exemptions. In most cases, activities are deemed to be carried out on a professional basis if pre-defined thresholds are achieved/exceeded – eg, regarding the amount of assets under management, the number of clients or the total gross earnings per year. Activities below such thresholds can be carried out without a FINMA licence (unless otherwise provided by law). Such activities below the licensing thresholds do not excuse institutions from the obligation to affiliate with an SRO if the activities fall into the scope of AMLA (see **2.4 Self-Regulatory Organisations**).

2.8 Tax Regime

As of May 2023 neither a digital service tax nor any other specific tax legislation applicable to blockchain-based business models or the use of cryptocurrencies has been or is expected to be introduced in Switzerland.

Adapting Tax Law

A June 2020 report on a possible need to adapt tax law to developments in the technology of distributed electronic registers (DLT/blockchain) made the following recommendations to the Federal Council.

- The current VAT law provides the necessary framework to also record facts based on distributed electronic registers; the current tax law has also proven itself for income, profit, wealth and capital taxes, so there is no apparent need for legislative action in this area.
- In terms of withholding tax, it could be argued that the strong ability of equity and participation tokens to circulate and be traded on the capital market, as well as their hedging purpose, should lead to the levying of withholding tax on their proceeds. An extension of the object of the withholding tax to the proceeds of investment tokens would therefore be justified from a tax system perspective. However, due to the negative effects on the attractiveness of Switzerland as a business location, it is recommended that the levying of withholding tax according to the debtor principle or according to the paying agent principle should not be extended to the earnings of all investment tokens.
- Technological developments and the ongoing revision of securities law are expected to have an impact on securities trading and thus also on the turnover tax. Due to the uncertainties regarding the type and scope of the future use of DLT trading systems, it is recommended – also in the interest of maintaining Switzerland's attractiveness as a business location – to refrain from making any legislative adjustments regarding the turnover tax at this time.

In view of the above, existing tax laws apply to crypto business models and blockchain-based services. For example, transactions with crypto-assets will usually be beyond the scope of Swiss transfer taxes. If, however, an asset-backed token qualifies as a "bond-like" instrument as defined in Swiss tax practice, the trading of

such an asset token can trigger Swiss securities transfer tax if a Swiss securities dealer (as defined in Swiss tax law) is involved as a party or intermediary in the transaction.

Tax Classification

The Swiss Federal Tax Administration issued a working paper for the first time on 27 August 2019 (updated on 14 December 2021) regarding the treatment of cryptocurrencies and other coins or tokens based on blockchain technology for Swiss income, withholding and stamp tax purposes, clarifying the most important tax uncertainties. For the specific tax treatment, this working paper distinguishes between native/payment tokens, asset(-backed) tokens and utility tokens. While this Swiss tax classification is based on the same principles as the classification for Swiss financial market regulation purposes as outlined in **3.2 Categorisation**, the Swiss tax authorities conduct their own analysis and classification, which is not necessarily in line with that of FINMA. The working paper also clarifies that tokens are generally considered as assets that are subject to net wealth taxes imposed by the Swiss cantons and municipalities. Some cantonal tax authorities have also issued guidelines clarifying the tax treatment of crypto-assets based on the general tax legislation.

VAT

While the use of payment tokens is treated in the same manner as the use of fiat currency, the transfer of asset tokens and utility tokens is generally considered as a supply for VAT purposes. Trading with payment tokens or asset tokens is generally exempt from VAT. By contrast, the transfer of utility tokens is considered a taxable supply for VAT purposes, resulting in Swiss VAT if the place of supply is in Switzerland and no specific exemption applies.

The same principles apply for ICOs: the VAT treatment of an issuance of crypto-assets depends on the characterisation thereof:

- the issuance of payment tokens is not considered a supply;
- the issuance of asset tokens is generally an exempt supply; and
- the issuance of utility tokens is considered a taxable supply if no specific exemption applies.

The proceeds from the sale of crypto-assets generally constitute income for the issuer, unless the asset sold is a debt instrument.

Tax Consequences

In sum, the possible tax consequences for the parties involved in cryptocurrency transactions must be analysed on a case-by-case basis under current federal and cantonal tax laws (and existing guidelines). Because the existing Swiss tax laws are applicable to crypto business models and blockchain-based services, the most significant uncertainty in terms of tax law remains the qualification of the token. Once the token has been assigned to a specific token category, the tax law impact may be determined based on the established laws and practice for this type of asset. It is generally possible to confirm the Swiss tax treatment in a binding advance tax ruling. For ICOs and other significant transactions, arranging a tax ruling is best practice.

2.9 Other Government Initiatives

On 2 February 2022, the Federal Council adopted its report on digital finance, in which the opportunities and risks of digitalised financial markets are highlighted and specific fields of action are defined. In its report, the Federal Council defines 12 areas of action, where specific measures shall be implemented by the Fed-

eral Department of Finance. The areas of action address the need for not only legal/regulatory adjustments, but also innovation support and market development measures, and include topics such as open finance, green fintech, AI and DLT. The measures include the review of the current legal and supervisory framework considering new players on the market, including analysis of existing licence categories and examination of alternative regulation options such as self-regulation and private certification. Furthermore, the potential for innovation in the use of AI is one of the topics that may lead to a need for action in the regulatory/legal framework in order to mitigate the risk of abuse.

3. Cryptocurrencies and Other Digital Assets

3.1 Ownership

In the context of cryptocurrencies and blockchain, digital assets can be divided into two types of cryptocurrency (or token) from a Swiss civil law perspective.

- The first is cryptocurrencies (such as Bitcoin) that primarily represent a value within the blockchain context, the value of which is limited to applications on the blockchain. Such tokens cannot be characterised as property (rights in rem), securities or uncertificated securities, or rights, so there is no specific requirement for the valid transfer of such tokens (or claims to such tokens) from a civil law perspective. In other words, the transfer may occur without any formal requirements by making the de facto power of disposal (or access) available to the transferee or any third party.
- The second type is tokens that are intended to represent (tradable) rights existing outside the blockchain and fulfil the purposes of securities that can be transferred via the blockchain, for which formal requirements must be fulfilled (so-called ledger-based securities). A ledger-based security is a right that is registered in a securities ledger in accordance with an (registration) agreement between the parties. To create and transfer ledger-based securities, the securities ledger must meet the following requirements:
  (a) it must give the creditors, but not the debtors, power of disposal over their rights by means of technical procedures;
  (b) its integrity must be protected from unauthorised modifications by appropriate technical and organisational measures;
  (c) the content of the rights, the functioning of the ledger and the registration agreement must be recorded in the ledger or in accompanying data linked thereto; and
  (d) creditors may view the information and ledger entries concerning them and check the integrity of the content of the ledger concerning them, without the assistance of third parties.

Unlike the transfer of uncertificated securities, the transfer of ledger-based security does not require a written deed of assignment. For example, a purchase agreement (legal basis) and the actual transfer of the ledger-based security via the entry into the distributed ledger are sufficient for a valid transfer of ownership. Both fungible tokens and NFTs can be issued as ledger-based securities (or rights).

The DLT Bill does not explicitly answer the general question as to when the transfer of such securities (digital assets) is final; the answer will depend on the underlying technology and the (registration) agreement between the parties.

However, if the creditor of a ledger-based security becomes bankrupt, for example, after it disposed of a ledger-based security, the DLT Bill provides that such disposal will be legally binding and effective towards third parties if it became irrevocable according to the distributed ledger's rules (or any other trading system) and it has actually been entered into the ledger within 24 hours.

3.2 Categorisation

In broad terms, digital assets (such as payment tokens, utility tokens and security tokens) are classified as intangible assets that can be the object of contractual agreements. The prevalent categorisation of digital assets initially stems from FINMA and distinguishes between three types of tokens:

- payment tokens;
- utility tokens; and
- asset tokens.

This token categorisation and the treatment of tokens by FINMA are rather straightforward from the perspective of the Swiss financial market laws. FINMA's focus is on the economic function and purpose of a token (substance over form), and follows the principle of "same risks, same rules", while taking into account the specific features of each project.

Payment Tokens

These are synonymous with cryptocurrencies, such as Bitcoin, and are intended to be used, now or in the future, as a means of payment for acquiring goods or services, or as a form of money or value transfer. Cryptocurrencies give rise to no claims on their issuer, so FINMA will not treat payment tokens as securities. However, if payment tokens were to be classified as securities through new case law or legislation, FINMA would accordingly revise its practice.

Utility Tokens

These are tokens that are intended to provide access digitally to an application or service by means of a blockchain-based infrastructure. FINMA will not treat utility tokens as securities if their sole purpose is to confer digital access rights to an application or service, and if the utility token can actually be used in this way at the point of issue. In such cases, FINMA is of the view that the underlying function is to grant access rights, and the connection with capital markets – which is a typical feature of securities – is missing. However, if utility tokens have an investment purpose at the point of issue, either additionally or solely, FINMA will treat such tokens as securities in the same way as asset tokens.

Asset Tokens

These represent debt or equity claims on the issuer. For example, asset tokens promise a share in the future company earnings or future capital flows. In terms of their economic function, therefore, these tokens are analogous to equities, bonds or derivatives. Tokens that enable physical assets (such as commodities or real estate) to be traded on the blockchain would also fall into this category, so FINMA will treat asset tokens as securities if they represent an uncertificated security and the tokens are standardised and suitable for mass standardised trading.

3.3 Stablecoins

Stablecoins are currently not governed by any specific regulation in Switzerland. FINMA's treatment of any stablecoins under supervisory laws follows its existing approach for blockchain-based tokens.

Thus, stablecoins backed by deposits of fiat currency or by "algorithmic" stabilisation mechanisms are neither payment tokens nor security tokens, per se. In any case, stablecoin projects often give rise to potential licensing requirements.

For example, a stablecoin backed by deposits of fiat currency with a fixed redemption right of the token holder may be subject to the Swiss banking regulation. If that stablecoin project would also qualify as a payment system, it may additionally be subject to the Financial Market Infrastructure Act, provided that the payment system reaches the threshold of "significant importance" to the Swiss economy. Should the stabilisation mechanism depend not on the issuance and redemption of tokens and the sale or purchase of a currency but, alternatively, on the price development of a basket of currencies or commodities, which is managed by the system's operator, there is the risk that the stablecoin and the issuer will be subject to the Collective Investment Schemes Act.

Finally, FINMA has found that AMLA is "almost always" applicable to stablecoins and the issuer, as the payment feature usually appears to be a pivotal element. Applying this approach to stablecoins linked to currencies, commodities, real estate or securities, for example, will prompt any issuer or sponsor of stablecoin projects to preassess the project from a supervisory perspective, particularly with respect to Swiss banking regulation, financial market infrastructure regulation, securities and funds regulation and anti-money laundering regulation.

3.4 Use of Digital Assets

In Switzerland, payments for goods and services made with cryptocurrencies are basically allowed, and there are no specific cryptocurrency-related limits. For such payments, the general principles of Swiss civil laws apply, notably contract law. Therefore, the limitations that do apply are to be found in the Swiss Code of Obligations, for example, which sets out the material and formal requirements for the valid entry into and performance of agreements such as purchase agreements, service agreements and employment agreements.

3.5 Non-fungible Tokens

No specific regulation applies to the creation, marketing or sale of NFTs, which, unlike fungible tokens, are not interchangeable. NTFs are usually non-divisible in nature and are thus amenable to blockchain projects related, for example, to the digitisation of unique objects (such as pieces of art, luxury goods and real estate), digital identity and digital certifications.

Apart from their uniqueness, NFTs are comparable to other tokens. The categorisation by FINMA into payment tokens, utility tokens and asset tokens is therefore also applicable to NFTs until further notice. The categorisation is also decisive for tax purposes – ie, there are no tax laws specifically applicable to NFTs. Depending on the token category to which the NFTs are assigned, sales of NFTs may be subject to VAT or other taxes.

Due to its lack of standardisation and suitability for mass trading, an NFT should not qualify as an asset token in principle. It can also be assumed that NFTs are not issued for the purpose of being used as a means of payment between third parties. Therefore, NFTs should also not qualify as payment tokens, and the issuance and trading of NFTs should not be subject to Swiss money laundering regulations.

However, it cannot be excluded that the new phenomenon of so-called fractionalised NFTs (F-NFTs) may qualify as asset tokens if ERC-20 tokens are issued "in the same structure and denomination".

Since the design of smart contracts can vary widely, case-by-case consideration is unavoidable. However, until FINMA (or the courts) develops clear guidelines, the uncertainty remains considerable and the direct exchange with authorities is correspondingly valuable.

In a recent statement, the Swiss Federal Council declared that it was closely monitoring the latest blockchain developments on NFTs, as there is not yet any international consensus on the regulatory treatment thereof.

From a Swiss financial market supervisory perspective, it can thus not be excluded that the issuance and/or transfer of such tokens will be subject to some degree of financial market regulation. In broad terms, the general principles of law and existing statutes will apply – regarding, for example, data protection, intellectual property, and creditor and investor protection.

4. Exchanges, Markets and Wallet Providers

4.1 Types of Markets

Digital assets can be traded or exchanged peer-to-peer in the blockchain network or by using cryptobanks, cryptobrokers, crypto-exchanges or crypto trading platforms.

The Swiss secondary market for trading digital assets currently consists of these market participants (or stakeholders). Furthermore, there is a market for exchange-traded products (ETPs), which are physically backed whereby settlement is in the underlying asset, rather than in a cash equivalent. In addition to traditional underlying assets such as equity securities or currencies, digital currencies are also admissible as underlying assets on the Swiss Stock Exchange SIX or the BX Swiss. Like gold ETPs, investors are entitled to the underlying cryptocurrency.

Since November 2018, when Amun AG listed the world's first ETP based on cryptocurrencies with the Swiss Stock Exchange, the number of ETPs referring to digital currencies as underlying assets as well as ETP providers and issuers has been growing. ETPs often include features of structured products, which are subject to the regulatory requirements of the Federal Financial Services Act. Structured products may be offered in or from Switzerland to retail clients if they are issued, guaranteed or secured in an equivalent manner by prudentially supervised institutions. FINMA ensures that such requirements are met in the context of admission to trading on a trading venue.

Moreover, financial market infrastructure entities based on DLT technologies have commenced operations since September 2021, with the SIX Digital Exchange AG acting as a central securities depository and associated company SDX Trading AG acting as a stock exchange.

4.2 On-Ramps and Off-Ramps

Usually, persons exchange fiat currencies for cryptocurrencies (and vice versa) or cryptocurrencies for cryptocurrencies at crypto-exchanges, cryptobanks and cryptobrokers, or crypto trading platforms. Before such persons can use the exchange or trading services of the respective platform's operator, they must register and undergo an anti-money laundering/know your customer (AML/KYC) check. Once the onboard-

ing procedure is completed, they may use an account or wallet provided by the platform's operator.

The exchange or "secondary trading" of cryptocurrencies at cryptobanks and cryptobrokers or crypto-exchanges occurs as follows:

- the platform's operator purchases or sells the cryptocurrencies from or to the persons as a principal; or
- it purchases or sells the cryptocurrencies as an agent of the customer.

By contrast, the exchange or "secondary trading" of cryptocurrencies on a trading platform is usually based on a multiparty relationship – ie, crypto trading platforms automatically match the purchase or sale orders of their clients and credit or debit the respective amounts. While the accounts offered by the platform are involved at centralised cryptocurrency trading platforms, at decentralised cryptocurrency trading platforms trades are settled directly by using the customer's blockchain address.

The use of centralised cryptocurrency trading platforms is currently more common in Switzerland. As crypto-exchanges, cryptobanks, cryptobrokers and centralised crypto trading platforms qualify as financial intermediaries, they are required to apply the AML identification and monitoring rules upon the commencement of the client relationship and during the execution of money transmission transactions. As financial intermediaries, they must be directly supervised by FINMA or be affiliated with an SRO.

4.3 KYC/AML/Sanctions

Financial Intermediaries

AMLA states that financial intermediaries are persons who, on a professional basis, accept or hold onto deposit assets belonging to others or assist in the investment or transfer of such assets. They include persons who provide services related to payment transactions, in particular by carrying out electronic transfers on behalf of other persons, or who issue or manage means of payment such as credit cards, travellers' cheques or virtual currencies, or who accept such virtual currencies.

In principle, persons transferring digital assets such as payment tokens may qualify as financial intermediaries and, as such, are subject to both the simplified and the enhanced due diligence duties. For example, a cryptobroker must identify the customers with which it is dealing and determine the beneficial owner of the assets.

Furthermore, if legal entities are customers of a cryptobroker, the broker must determine the controlling persons of those legal entities and be provided with certain corporate documents and powers of attorney. Under certain circumstances, the cryptobroker must also clarify the economic background and the purpose of a crypto transaction or a business relationship (eg, if the transaction or the business relationship appears unusual or to be very risky).

Sanctions

Goods, services and assets subject to Swiss sanctions are defined individually in each particular case. The State Secretariat for International Finance (SIF) has stated with respect to digital assets that the Swiss sanctions regime is technology-neutral and applicable to both traditional uncertificated securities and crypto-assets. Furthermore, SIF has clarified that virtual currencies also fall into the definition of the term "means of payment", referring to the Swiss Anti-Money Laundering Ordinance.

Within the latest sanctions imposed by the Swiss government by means of the Ordinance on measures in connection with the situation in Ukraine of 4 March 2022 (Ukraine Ordinance), particular attention was given to digital assets as they are deemed to play an important role in the evasion of sanction laws. In particular, cryptocurrency could be used to enable restricted payment transactions. Against this background, the Ukraine Ordinance explicitly includes crypto-based funds in the definition of funds/monies. In addition, the provision of services in connection with cryptowallets, crypto-accounts or the custody of crypto-based assets is explicitly forbidden.

4.4 Regulation of Markets

As mentioned in **3. Cryptocurrencies and Other Digital Assets**, the existing laws apply to markets for digital assets. The implementation of digital asset projects often gives rise to potential licensing requirements under financial market supervisory laws. In this respect, FINMA is the competent regulator or supervisor to monitor compliance with Swiss financial market regulation. In addition, if there is suspected illegal conduct with respect to other areas of regulation (such as antitrust laws, tax laws, criminal laws or unfair competition), other authorities may become involved (eg, federal or cantonal prosecutors, administrative authorities or courts).

4.5 Re-hypothecation of Assets

In Switzerland, there is no specific blockchain regulation applicable to the re-hypothecation of crypto-assets.

4.6 Wallet Providers

In Switzerland, there is no specific blockchain or cryptocurrency regulation that is applicable to wallet provision. In practice, cryptobanks, cryptobrokers, crypto-exchanges and crypto trading platforms offer custodian services, as well as cryptocustodians. In particular, cryptocustodians (such as XAPO) are specialised companies that offer hot and/or cold storage of digital assets for their clients.

Hot or cold storage solutions for private cryptographic keys must be assessed on a case-by-case basis from a Swiss banking regulation perspective. As a matter of principle, if clients' assets are commingled or the service provider has the sole power of disposal over the clients' assets, there is an imminent risk for the service provider that the services will be regulated under the Swiss Banking Act.

5. Capital Markets and Fundraising

5.1 Initial Coin Offerings

In Switzerland, there is no regulation specific to ICOs; as mentioned in **3. Cryptocurrencies and Other Digital Assets**, the existing laws apply to this kind of fundraising. FINMA will apply financial market laws if the issuance of tokens and/or the commercial activity qualify as payment tokens or asset (security) tokens, or as regulated business activity (such as banking activity, securities dealing activity or financial intermediation).

As a matter of principle, FINMA will apply the principles of "substance over form" and "same risks, same rules". For example, FINMA will first categorise the ICOs and if, for example, an ICO qualifies as a securities token offering, FINMA will analyse whether the securities offering complies with the Swiss Financial Services Act, the Swiss Collective Investment Schemes Act and/or the Swiss Financial Market Infrastructure Act (whichever is applicable). FINMA will then analyse the commercial activity and assess whether it is centralised or decentralised. For example,

if the token issuer operates, on a commercial basis, a centralised trading platform through which the token holders may trade or exchange their tokens, FINMA may qualify the issuer as a securities firm or a trading facility subject to the Swiss Financial Institutions Act or the Swiss Financial Market Infrastructure Act (whichever is applicable).

5.2 Initial Exchange Offerings

In Switzerland, there is no specific blockchain or cryptocurrency regulation applicable to initial exchange offerings. The same principles apply as mentioned in **3. Cryptocurrencies and Other Digital Assets** and **5.1 Initial Coin Offerings**.

5.3 Other Token Launch Mechanisms

The regulation of the Swiss financial markets is technology-neutral and based on principles.

In Switzerland, crypto-assets distributed by airdrop are treated no differently from other types of offering mechanisms. In certain cases, anti-money laundering provisions may apply. Provided that the airdrop is done without any activity by the receiving party, the receiving party has made no investment decision, so no prospectus requirement applies.

In December 2021, Airdrop.com announced that it was set to launch its platform for digital token distribution. In February 2022, one of the most well-known Bitcoin exchanges, BitMEX, issued its own token, which became available for free in an airdrop.

5.4 Investment Funds

In Switzerland, there is no specific blockchain or cryptocurrency regulation applicable to crypto-investment funds or collective investment schemes that invest in digital assets.

FINMA applies the existing Swiss Collective Investment Schemes Act and the respective ordinances to crypto-investment funds. Such funds would qualify as alternative investment funds subject to certain investment rules.

5.5 Broker-Dealers and Other Financial Intermediaries

In Switzerland, there is no specific blockchain or cryptocurrency regulation applicable to broker-dealers or other financial intermediaries that deal in digital assets. As a matter of principle, FINMA applies existing financial market regulation on a case-by-case basis to assess whether a licence is required.

6. Smart Contracts

6.1 Enforceability

In Switzerland, there are no laws, regulations or binding judicial decisions addressing the legal enforceability of smart contracts. Swiss legal doctrine largely agrees that a smart contract is not a contract in the sense of the Swiss Code of Obligations.

Due to the automated character of a smart contract, the application of civil law principles concerning the formation and execution of traditional contracts to smart contracts raises questions. According to the prevailing doctrine, a computer system lacks the legal personality required to enter into a contract. There might also be legal uncertainty due to the pseudonymity of the users or participants in blockchain networks, and even their legal capacity to initiate transactions that are then automatically executed by the smart contract could be questioned. The legal validity of arrangements related to smart contracts is not, however, prima facie excluded.

6.2 Developer Liability

As existing legal principles apply to blockchain technology, the legal risk of developers being held responsible for losses, as injuring party or tortfeasor based on contractual or tort law (eg, liability for programming errors, technical program effects or any technical flaws), cannot be excluded.

Furthermore, pursuant to the DLT Bill, the obligor under a ledger-based security is liable for damage to the acquirer arising out of information that is inaccurate, misleading or in breach of statutory requirements, unless the obligor can prove that they acted with due diligence. Consequently, if an obligor were to use a specific blockchain technology in order to issue tokens, it might be held liable if that technology had flaws and caused losses to the token holders.

7. Lending, Custody and Secured Transactions

7.1 Decentralised Finance Platforms

The operation of DeFi platforms is not prohibited in Switzerland. Swiss law does not provide for specific blockchain or cryptocurrency regulation applicable to DeFi platforms. As mentioned in **3. Cryptocurrencies and Other Digital Assets** and **5. Capital Markets and Fundraising**, FINMA applies the existing financial market regulation on a case-by-case basis to assess whether a licence is required for the platform's operation. As a matter of principle, there is the risk that cryptocurrency lending activities will be subject to Swiss banking regulations.

7.2 Security

Generally, a lender can take collateral for a loan in the form of a pledge or a transfer of "ownership" of claims by entering into a separate security agreement. Claims can be either pledged or assigned for security purposes.

In terms of digital assets, the DLT Bill sets out that a collateral (eg, lien) can also be established without transferring the ledger-based security if the collateral is visible in the ledger and, at the same time, it is guaranteed that only the security taker can dispose of the ledger-based security in the event of default.

7.3 Custody

Under Swiss law, investors or token holders can deposit their digital assets with third parties and provide collaterals via custodians (as discussed in **7.2 Security**). A custodian may qualify as a financial intermediary and be subject to Swiss financial market regulation, notably Swiss anti-money laundering regulation; hence, a custodian will be required to affiliate with an SRO. Should that custodian take deposits, it may also be required to obtain a licence as a fintech company or bank in Switzerland.

8. Data Privacy and Protection

8.1 Data Privacy

The exercise of data subjects' rights is particularly demanding and subject to the general principles of Swiss civil law, notably the Federal Act on Data Protection, according to which data subjects have a legal right to information, rectification, revocation and deletion. The right to information entitles data subjects to request information from the data controller on whether data relating to them is being processed. The other rights of data subjects are essentially aimed at correcting false, incomplete and/or redundant data. Since public blockchains do not have a central control body and there is consequently no central person responsible for

data protection, the enforcement of these rights (including the "right to be forgotten") is de facto impossible.

Therefore, a blockchain should be designed in a way to comply with Swiss laws and regulation. For example, if the person concerned consents to data processing before using a blockchain or blockchain-related product, the specific processing of that individual's data within the scope of such application and to the extent of that consent is not unlawful. Furthermore, "chameleon hash functions" may enable data on a blockchain to be deleted under certain conditions, or the storage of data off-chain, while limiting the on-chain data to hash values may be a permissible privacy design under Swiss privacy laws.

8.2 Data Protection

In principle, when personal data is processed, the Federal Act on Data Protection applies. Accordingly, and firstly, personal data is all information relating to an identified or identifiable person.

A person is identified when information clearly establishes the identity of that individual. The person is identifiable if their identity can be inferred on the basis of additional information. The existence of personal data must be assessed on a case-by-case basis and in consideration of the specific circumstances.

Therefore, it cannot be excluded that data stored on blockchains, or blockchain-related products or services, can be regarded as personal data if there is actual or legal access to additional information that enables the person concerned to be identified. Secondly, the processing of data means any operation with personal data, regardless of the means and procedures applied, in particular the collection, storage, use, modification, disclosure, archiving or destruction of personal data. Data processing in that sense occurs when a node is added to a blockchain, and the block is duplicated and saved again. Processors of this data are all participants in the system (namely the initiator of a transaction, the receiver, and the party who validates a transaction under the consensus mechanism). Swiss law requires each of these processors to comply with the principles of transparency (recognisability of data procurement and its purpose), purpose limitation, proportionality, correctness and security of the data.

9. Mining and Staking

9.1 Mining

Mining activities are allowed in Switzerland.

The mining of cryptocurrencies, confirming transactions and validating blocks do not constitute financial services per se, nor are they deemed to be regulated activities subject to Swiss financial market regulation.

That said, if, for example, a mining company domiciled in Switzerland validates transactions and is rewarded with cryptocurrency (such as bitcoins), that company should not qualify as a financial service provider or financial intermediary.

However, if the mining company involves third party assets and carries out the mining activities on behalf of others, it may be deemed a financial intermediary, which could trigger licensing or registration activities subject to Swiss financial market regulation.

9.2 Staking

Staking activities are allowed in Switzerland.

Staking processes and activities (eg, based on proof of stake (PoS) consensus protocols) do not constitute financial services per se, nor are they deemed to be regulated activities subject to Swiss financial market regulation. Depending on the business models, however, the use of such protocols by an intermediary to provide staking rewards to investors may have regulatory implications in Switzerland.

For example, if tokens are created on a PoS consensus protocol that have integrated "token farming functionalities" (ie, asset pools being deployed for various staking processes), the activities of an issuer and operator of such tokens could resemble the activities of an asset manager. In such a case, it cannot be excluded that the Swiss Financial Institutions Act and the Swiss Collective Investment Schemes Act may apply to the operator. As a matter of principle, FINMA applies existing financial market regulation to any crypto business model, if required.

10. Decentralised Autonomous Organisations (DAOs)

10.1 General

The Swiss legislator has yet to show any interest in DAOs and the issues that have arisen from the case of The DAO. There is currently no draft Swiss DAO legislation.

10.2 DAO Governance

There is no specific legislation applicable to DAOs, so there is no standard governance for DAOs.

10.3 Legal Entity Options

The case of The DAO and the more recent emergence of other DAOs show that these new forms of entity have the potential to generate legal implications within Switzerland.

In Switzerland, there is no specific legal form for a DAO. However, a structure is often chosen where a company is formed with very broad ownership, typically by numerous token holders that control such company. Another popular possibility is to set up a foundation that controls the code, and whose purpose is to further the code.

Furthermore, DAOs are often governed by non-Swiss laws, possibly having a presence in Switzerland. As a result, DAOs as entities must be recognised and characterised under private international law in order to define their legal effects in Switzerland. The recognition of foreign DAOs in Switzerland is thus determined by the Swiss Private International Law Act (PILA).

A company that meets all the constitution requirements outlined in the law of the state under which it is organised (when Article 154 paragraph 1 of the PILA applies) or in the law of the state where it is actually administered (when Article 154 paragraph 2 of the PILA applies) is automatically (ipso jure) recognised in Switzerland and exists as a subject of law. Article 154 paragraph 2 of the PILA offers a "second chance" to companies that are not validly constituted under Article 154 paragraph 1 of the PILA. In order to preserve transaction security, the legislator wanted to avoid the situation of a company constituted under a foreign law not having legal existence in Switzerland. The principle of automatic recognition of foreign entities is thereby applicable.

A regulated DAO such as a Maltese ITA or a Vermont BBLLC may be recognised ipso jure as a company if it is validly organised under the law

of that state; in other words, it may be granted legal existence in Switzerland. As a result, dOrg LLC is the subject of rights and obligations within the Swiss legal order, to the same extent as any other foreign company. However, maverick DAOs are, by definition, not organised in accordance with the law of a state, as they exist on the internet independent of any jurisdiction so cannot be considered to be validly constituted under the law of a state and are not granted legal existence in Switzerland.

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