Crypto Valley

Crypto Valley Association
Regulatory Working Group
Geneva, Switzerland
February 2nd, 2021

+ + +

Federal Department of Finance

Bern, Switzerland

Dear Madame / Sir,

In the name of the Crypto Valley Association Regulatory Working Group, the Association addresses its feedbacks to the Proposal for a blanket ordinance in the area of blockchain.

Best regards,
Florian Ducommun, Attorney at Law
on behalf of the Crypto Valley Association Regulatory Working Group

Table of Content

Contributors 03

01 / Ordinance on the Administration of Bankruptcy Offices (OABO) 04

i. Data 04

ii. Claim and restitution of cryptoassets 05

iii. Terminology and qualification 05

iv. Other 05

02 / Banking Ordinance 06

03 / The Anti-Money Laundering Ordinance (AMLO) 08

04 / Ordinance on Financial Market Infrastructure (FMIO) 09

Contributors

Florian Ducommun
Attorney at law

Gabriel Jaccard
PhD Candidate University of Geneva, Switzerland

Chris McAteer (Gschwend)
Founder
McAteer Advisory

Lars Hodel
Head Legal & Compliance, Bitcoin Suisse

Ekaterina Anthony
Senior Manager
gwp

Introduction

The draft ordinance submitted for consultation seeks to adapt federal law to the developments of Distributed Ledger Technology (DLT). The amending act put out for consultation entails an adaptation of several federal ordinances (OAOF, BO, FinIO, ALMO, FMIO).

The present position paper will focus on the adaptations that, in our view, require a different approach, namely:

1. Administration of Bankruptcy Offices Ordinance (OABO)
2. Banking Ordinance (BO)
3. Anti-Money Laundering Ordinance (AMLO)
4. Financial Institutions Ordinance (FMIO)

Before going into specific considerations, we feel it is necessary to welcome the rapidity with which the federal legislator has taken up the topic to adapt the law to a very promising technology for the Swiss financial hub in order to position it at the forefront of technology on an international level.

This element - which was the driving force behind the Federal Council's approach - must be kept in mind when adopting the Ordinances implementing the new regulations, because a law can miss its objective if its implementation in practice is made too complicated or vague by excessively high regulatory requirements.

With this in mind, the following remarks can be made with respect to the draft Ordinance of the Federal Council on the Adaptation of Federal Law to Developments in Distributed Ledger Technology.

01 / Ordinance on the Administration of Bankruptcy Offices (OABO)

i. Data

The new Article 242b LP creates a right of access to data and restitution, which can be invoked against the bankrupt estate independently of other claims.

In our view, the procedure should be specified according to the type of data involved. It can indeed be personal data, sensitive data, financial data, commercial data or even business secrets. Thus, in our opinion, it is necessary to first define what type of data is concerned by this provision and to specify, in the case of data that does not concern the company but identifiable third parties, that the latter must be informed of the access by creditors to their data and should be able to oppose it.

Furthermore, referring to the message, the explanatory report indicates that, since the data claimed will not necessarily have a pecuniary value, there will often be no assignment within the meaning of Article 260 LP.

However, in an increasingly data-driven economy, this seems far from reality and it will be necessary to assess on a case-by-case basis whether databases have commercial value or not. If this is the case, an assignment procedure within the meaning of Article 260 LP will have to be organized by the bankrupt estate.

ii. Claim and restitution of cryptoassets

Concretely, in order to be able to return the bankrupt company's cryptoassets, it will be necessary for the bankruptcy estate to have access to the private keys of the wallets on which the cryptoassets are stored. It would therefore be advisable to provide a legal basis requiring the directors of the bankrupt company to communicate the said private keys to the bankruptcy estate.

Further, the DLT legal framework foresees, in art. 973f Section 2 SCO, that in case of bankruptcy the DLT-rights embedded in a token locked in a smart contract would be, under certain conditions, distracted from the assets of the creditor. In this regard, we believe it would have been recommended for the ordinance to provide further details about the conditions of this distraction.

iii. Terminology & qualification

We agree on the terminology used, which brings more legal clarity. The notion of "good" (bien) rather than "object" (objet) and the clear distinction with property law regime is notable, especially since part of the scholars is still keen to assimilate dematerialized token to a physical object.

02 / Banking Ordinance (BO)

It should be remembered that the primary purpose of the new Article 16 ch. 1bis Banking Act (BA) is to extend the definition and scope of deposited securities that can be distracted from bankruptcy for the purpose of investor protection. The purpose of the law is not to extend the authorization regime to the holding of cryptoassets.

One shall clearly distinguish between (i) cryptoassets which can be distracted from the bankruptcy (deposited securities) and which do not qualify as deposits and (ii) cryptoassets which can be considered as deposits.

By mixing both notions, the current definition infuses confusion.

We would therefore propose to amend the definition of cryptoassets proposed in Article 5a BO for the following reasons:

Formally

The proposed provision refers to Article 16 para. 1bis, letter b, although the law refers to Article 16 para. 1bis, ch.2 BA.

Even if the text of Article 5a BO expressly refers to Article 1b para. 1 BA, the notion of "cryptoassets" is also used in Article 16 ch. 1bis BA and this reference has the result of creating a circular definition as Article 16 ch. 1bis BA concerns specifically cryptoassets which can be distracted from the bankruptcy.

Materially

Reference to Article 16 para. 1bis, ch.2 in the definition of "cryptoassets" runs against our understanding of the legal text of Article 16 para. 1bis, which allows for the distraction from the bankruptcy of cryptoassets that are allocated to a pool provided the share accruing to the depositing customer is clearly determined. As long as such distraction is possible, investors' protection is ensured in the same way as for other deposited securities within the meaning of Article 16 BA, it is not necessary to subject this type of holding to authorization.

Thus, it appears that the reference to Article 16 ch. 1bis ch. 2 BA in the definition proposed in Article 5a para. 1 BA is a source of confusion and adds complexity.

Cryptoassets should not be considered as deposits from the public as long as they can be distracted from bankruptcy and are consequently held off balance sheet. Therefore, CVA would recommend to use such criteria in the proposed definition of "cryptoassets" in Article 5a BA.

We also note that the proposed definition lacks clarity with regards to the notion of means of payment "which serves for the transmission of funds or value". This could theoretically apply to tokens for the clearing and settlement of securities transactions, which would obviously not be desirable. Further, the burden to assess if a token is a payment token under FINMA's guidelines would be with companies active in the crypto sphere. As FINMA does not assess tokens that have already been issued, we believe it to be a detrimental shifting of the risks. This could also create legal uncertainties regarding balance sheet management as it will depend on the qualification of the deposit and, hence, the token's classification. It is also notable that a token classification is subject to change during the life cycle of a project issuing the token. It therefore seems contrary to the carefully developed doctrine of the definition of deposits, that there seems to be a limitation to "payment tokens".

Moreover, the reasons stated by the Federal Council for subjecting payment tokens to an authorization similar to the holding of fiat money do not appear to be relevant.

The decisive criterion must be the recognition of assets in the balance sheet as is the practice in the area of public deposits (FINMA Circular 2008/3, n. 10) and not the fact that payment tokens would have the same function as fiat currency.

In fact, contrary to what is stated in the explanatory report, there is an objective reason to distinguish between fiat currency and payment tokens, namely that the latter can be distracted in bankruptcy as deposited securities under Article 16 BA, which is not the case with fiat currency.

There is therefore no need to add regulatory requirements for the custody of payment tokens or other type of cryptocurrencies which can be distracted in bankruptcy. This would be tantamount to privileging regulated actors over other market actors, whereas one of the main potentials of the DLT is precisely to open the financial market to new actors.

In addition, we would recommend adding an exception to the 60 days deadline in Art. 5 para. 3 let. c BO in relation to cryptoassets traded on crypto exchanges or on DLT financial market infrastructures.

Finally, we stress that, whatever the position adopted by the Federal Council on this topic, it will be necessary to provide a compliance period for market players who would be concerned by this new obligation to obtain a "FinTech" license in connection with the holding of cryptoassets.

In conclusion, in order to be consistent, the definition of "cryptoassets" should:

1. Be generic and not be limited to Article 1b para. 1 BA.

2. Not contain a reference to Article 16 ch. 1bis ch. 2 BA, but on the contrary exclude from the definition cryptoassets that can be distracted in bankruptcy.

3. Focus on the function of the tokens rather than on their actual use.

4. Specify that the goods or services that the tokens make possible to acquire are separate than those placed on the market by the organizer or issuer in order to distinguish them from utility tokens.

5. Specify that authorization is only required for cryptoassets that are recorded as assets on the balance sheet.

The definition of cryptoassets that we propose would therefore be as follows:

"1. Are deemed to be cryptoassets, assets which are intended, to a large extent, actually or on the basis of the intention of the organizer or issuer, to function as means of payment for the acquisition of goods or services other than those placed on the market by the organizer or issuer, which are (i) held collectively (pooled) (ii) recorded on the assets side of the balance sheet and (iii) not deposited securities that can be distracted from bankruptcy under Article 37d BA".

We respectfully draw the attention of the Federal Council on the fact that the proposed definition of "cryptoassets" could lead to an increased regulation of new players in the sector from the perspective of the Banking Act (whereas deposited securities can be distracted from bankruptcy), which would be contrary to the aim of the law, which is to promote innovation in the field of DLT and to boost the financial hub thanks to this new technology.

03 / The Anti-Money Laundering Ordinance (AMLO)

"Art. 4 Abs. 1 und 1bis

Eine Dienstleistung für den Zahlungsverkehr nach Artikel 2 Absatz 3 Buchstabe b GwG liegt insbesondere vor, wenn der Finanzintermediär: …

b. die Überweisung virtueller Währungen an eine Drittperson ermöglicht, sofern er mit der Vertragspartei eine dauernde Geschäftsbeziehung unterhält und er die Dienstleistung nicht ausschliesslich gegenüber Finanzintermediären erbringt."

The proposed changes to Article 4 para 1 of the AMLO seek to establish that a financial intermediary who *enables* the transfer of virtual currencies to a third party is subject to the AMLA if it maintains a lasting business relationship with the contracting party ("*dauernde Geschäftsbeziehung*"). We note this adaptation constitutes a paradigm shift from the current power of disposal concept to the frequency of the business relationship criterion.

We are of the view that an application of the criterion would be difficult in practice. Concretely, in establishing whether a transaction is to be classified as a single event, or can be related to a more frequent or permanent business relationship, data on the identity or beneficial ownership of all sending

/ receiving wallets / addresses would be required at all times. In the case of value transfers on the Bitcoin blockchain, where addresses change with each input/output, or in the case of dynamic wallets which create new send/receive addresses for each transaction to enhance transaction privacy (slowly becoming an industry standard), such onerous beneficial ownership tracking would be largely disproportionate to the value that would be gained from identifying counterparties that transact on a repeat ("permanent") basis. Although this criteria seemingly aims to reduce the burden on the financial intermediary by introducing the responsibility of AML/CFT to "permanent" businesses only, the use of this criteria would significantly increase the administrative burden of all services and contribute to an increase in the retention of sensitive personal data, representing a disproportionate effort in support of AML/CFT, counter to the principle of a risk-based approach.

Moreover, we doubt that this important paradigm shift can be achieved by means of an ordinance. In our view, it is a matter of the legislator, which has not considered it useful to amend Article 2 paragraph 3 letter b AMLA in the context of the Federal Act on the Adaptation of Federal Law to Developments in Distributed Ledger Technology. The interpretation of "payment traffic services" within the ordinance seems to us to be broad, not to say extra legem.

In applying this criterion, the legal uncertainty is transferred from the regulator to potential financial intermediaries. If we look how the requirements will be implemented in practice, it will be very difficult for the private sector to identify with certainty what type of providers they belong to and whether they are treated as financial intermediaries. It is very important to clarify and categorize which type of providers can be exempted from AML reporting.

Further clarification is also requested on the intended sense and interpretation of the term "ermöglicht", used in the sense of "enabling" the transfer of virtual assets. We note the Federal Council's supportive explanation and aim of qualifying all activities that enable the transfer of value, such as the addition of a single signature in a multi-signature transaction ("multisig"), as financial intermediation. In practice, parties to a multisig, in which a limited number of signatures are required from a pool of many possible signatories, will be unable to complete essential AML due diligence, such as ongoing transaction monitoring, asset freezing, risk management, etc., owing to the fact that several parties may or may not participate in the validation of a transaction. Such vague and open interpretations of the designation of a financial intermediary leave further room for uncertainty and stifles innovation.

Similarly, the inclusion of private key management services as financial intermediaries on the basis that they could theoretically "enable" transfers does not take into consideration technological evolutions (i.e. cryptographic innovations have allowed the issuance and management of private keys without the knowledge or access of counterparties). It is therefore entirely possible for back-end services to provide infrastructure for the creation of wallets or the management of private keys, which may have technical access to a private key, but in no way perform value or assets transfer activities. Placing such services in the financial intermediation "bucket" would be akin to designating any password management service as financial intermediaries. Certainly, in the case of private key and wallet management services, there is a need to limit the application of the AMLA to asset transfer transactions carried by a designated service provider on a contractual basis.

In addition, there is also the legal uncertainty from the wording used ("virtuelle Währungen"): From an AML perspective, power of disposal over assets belonging to a third-party trigger AML duties. So, the question whether one can be treated as a financial intermediary while supporting the transfer of tokens, which do not qualify as payment tokens remains to be clarified. It is our opinion that an additional distinguishing feature will increase the legal uncertainty further.

In the context of this discussion, we take this opportunity to highlight, as the CVA has done in previous consultations, the unique challenges faced by Swiss financial intermediaries operating in the DLT space to comply with the requirements elaborated in FINMA's Guidance 02/2019, Payments on blockchain. Obtaining identity documentation, beneficial ownership and technical proof of control for all external private wallets continues to represent an enormous burden that has resulted in real (although immeasurable) loss to the economy by dissuading small and large fintech alike from establishing or continuing business in Switzerland. Concretely, today a large crypto exchange

registered anywhere in the world, except for a very limited number of countries, can receive or transfer a client's assets to/from an external private wallet without the additional burden of performing due diligence on 3rd parties. Such requirements go beyond those of the FATF recommendations and have been identified by Europol and Interpol as unnecessary in the fight against money laundering or terrorism financing. As such, we urge the SIF to consider the impact of such measures on Switzerland's ability to remain a competitive jurisdiction for the DeFi industry today and into the future.

04 / Ordinance on Financial Market Infrastructure (FMIO)

First of all, with regard to the definition proposed in Article 2 para. 1 FMIO, it seemed necessary for us to exclude from the definition:

- offers made directly by companies that issue (primary issue) their securities in the form of uncertificated securities - simple or registered - in order to avoid that this type of issue made with the aim of raising capital from private investors be subject to the rules of the FMIO, which are intended for the secondary market;

- utility tokens that are issued in the form of registered uncertificated securities within the meaning of Article 973d of the Swiss Code of Obligations, as set out in the Federal Council's Message. Indeed, it is not desirable that such utility tokens can only be traded on a trading system based on the DLT.

Thus, we propose to add at the end of the draft Article 2 para. 1 FMIO "are not issued by commercial companies in the primary market or do not permit the acquisition of goods or services proposed by the issuer".

With regards to the question of outsourcing within the meaning of Article 11 FinMIA and Article 12 FMIO, the issue was dealt with satisfactorily in the explanatory report and the criterion for determining whether there is outsourcing - i.e. whether an outsourcing contract with an identifiable third party can be concluded or not - appears to us to be relevant in the context of a private blockchain. On the other hand, it should be specified that neither the entity responsible for a public distributed network, nor the various nodes forming part of this network can be considered as identifiable third parties. In relation to smart contracts, the question is not whether the code was provided by an identifiable developer, but rather who has effective control over it.

For the rest, the main FMIO amendments relate to the authorization conditions and obligations imposed by DLT-based trading systems. The draft Ordinance adopts a modular and flexible approach for small DLT-based trading systems. This approach is to be welcomed.

On the other hand, the following remarks should be made in this context:

- Article 58f FinMIA: We believe the message set at art. 58 f al.2 let.b. is detrimental. Privacy coins are not the problem as such and shall be authorized as encryption and anonymity is not the issue under AML, non-compliance is. At the opposite, anonymisation in general is a great tool to comply with data protection issues on the blockchain.

- Article 58i FinMIA: it is necessary to provide for an exception to the obligation to make the prospectus or the information sheet available to the participants when one of the exceptions of

Articles 36 to 38 FinSA is applicable. A reference to these provisions must therefore be added to Article 58i FinMIA.

- 58j / 58l FinMIA: there is a need for more extensive lighter rules on custody for small DLT-based trading systems that provide services referred to in Article 73a para. 1 let. b or c FinMIA. The derogations provided for (Art. 66 and 67 FinMIA) are not sufficient. Generally speaking, it is also necessary to provide for relief in the event of default by a participant (Art. 68 FinMIA), since the DLT-based trading systems will be open to private participants for which the system concerned cannot be responsible, and in the area of links between central depositories and in particular interoperability links (Art. 70 lit. a FinMIA) or access links (Art. 70 lit. b FinMIA) between central depositories, since the DLT will not necessarily be compatible with the technologies used by the central depositories up to now.

- Article 73d para. 3 FinMIA: to justify an exclusion of derivatives designed as securities based on the DLT, the explanatory report seems to equate them with assets that make their traceability more difficult through technical measures. This justification does not seem relevant to us since the fact that derivatives are issued in the form of tokens is more likely to increase their traceability than the opposite. A technology-neutral approach should be adopted in this respect and asset tokens, which potentially represent a significant number of financial products issued in the form of registered uncertified securities, should be admitted to trading in the same way as other investment tokens. The fact that the technology is new, and that the derivatives market is in its early days are not valid grounds of exclusion from our view.

Building the World's Leading Blockchain Ecosystem

www.cryptovalley.swiss