

## Swiss Draft Law on Distributed Ledger Technology

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**The Swiss Federal Council starts the consultation period on a draft law intended to improve the regulatory framework for DLT-based business models in Switzerland, in particular in the financial sector**

**On March 22, 2019, the Swiss Federal Council published a draft law concerning blockchain and distributed ledger technology ("DLT Draft Law"). The draft law aims to increase legal certainty, remove hurdles for DLT-based applications and limit the risks of misuse. This bulletin summarizes the key elements of the proposed new legislation.**

### **I. Background**

In December 2018, the Swiss Federal Council released a report on the legal framework for blockchain and DLT in the financial sector. The report was driven by an initiative to enhance innovation and allow Switzerland to evolve as a leading and sustainable location for DLT-based business models. The report concluded that Switzerland's legal framework is already well suited to deal with new technologies, including DLT, but also pointed out the need for selective

action and improvements. The current DLT Draft Law seeks to address a number of the points identified in the report.

### **II. Tokenization of Rights**

One of the main goals of the proposed DLT Draft Law is to increase legal certainty in connection with the issuance and transfer of tokenized rights and financial instruments, such as bonds and shares. To that effect, the DLT Draft Law provides for the introduction of a new concept of so-called "DLT Rights" and specific rules in the Swiss Code of Obligations for corporations looking to issue shares in tokenized form.

#### *DLT Rights*

The purpose of the concept of DLT Rights (*DLT-Wertrechte*) is to allow for a legally robust tokenization of rights by providing for the possibility

of an electronic registration of rights that has the same functionality and entails the same protection as a negotiable security. Uncertificated rights may be issued as DLT Rights if, based on a registration agreement (*Registrierungsvereinbarung*) between the parties involved, such rights (i) are entered into an electronic register that is based on distributed ledger technology, and (ii) can exclusively be asserted and transferred via such register. The distributed electronic register must meet a series of general requirements, which are set out in the DLT Draft Law. Furthermore, the Swiss Federal Council may specify minimum requirements in a more detailed ordinance in the future. However, according to the explanatory report of the Swiss Federal Council ("Explanatory Report") there will be no requirement that a governmental agency review the satisfaction of these requirements. Instead, the debtor under or the issuer of the DLT Rights is required to inform creditors or investors of the mode of operation and the security and integrity of the register, and may be held liable for damages if the distributed electronic register does not satisfy the applicable requirements and the debtor or issuer fails to prove that it applied due care.

Legal positions that qualify as an admissible underlying of a DLT Right include rights against a counterparty | issuer, such as contractual claims and membership rights (e.g., shares in a corporation). Conversely, payment tokens (i.e., "pure" cryptocurrencies, such as for example Bitcoin) that do not give rise to claims against an issuer, may not be issued in the form of DLT Rights.

#### *Corporate Law Aspects*

According to the DLT Draft Law, a company's articles of association may provide for, or may authorize the board of directors to resolve on, the issuance of shares in the form of DLT Rights. In the event of an issuance of tokenized shares, the smart contract(s) will need to be programmed and

deployed in a manner that ensures compliance with the requirements of Swiss corporate law, including, for example, any applicable limitations on the transfer of shares (*Vinkulierung*).

### III. DLT Trading Venues

The Swiss Federal Council further proposes to create a new license category for (centralized) financial market infrastructures (referred to as "DLT Trading Venues", *DLT-Handelssysteme*) in the Swiss Financial Market Infrastructure Act. DLT Trading Venues will be allowed to offer services in the areas of trading, clearing, settlement and custody of DLT-based assets to both regulated financial market participants and unregulated corporates as well as individuals, including potentially retail investors.

A license as DLT Trading Venue can be obtained by trading venues that allow for the simultaneous exchange of offers between several participants and the conclusion of contracts based on non-discretionary rules and, in addition, provide for:

- the admission of unregulated corporates or individuals;
- the custody of DLT Securities based on uniform rules and procedures; or
- the clearing and settlement of trades in DLT Securities based on uniform rules and procedures.

"DLT Securites" are securities that are (i) suitable for mass trading, and (ii) registered and transferred based on distributed ledger technology. According to the Explanatory Report, this definition is confined to asset tokens. However, once a DLT Trading Venue has obtained a license from the Swiss Financial Market Supervisory Authority FINMA ("FINMA"), it may also permit the trading of payment tokens (e.g., "pure" cryptocurrencies, such as for example Bitcoin) as well as utility tokens.

The licensing requirements for DLT Trading Venues are largely modelled on the existing requirements for traditional trading venues (*i.e.*, stock exchanges and multilateral trading facilities) modified by adding specific rules with respect to, for example, the admission of participants and the admission of DLT Securities. Furthermore, the DLT Draft Law requires the Swiss Federal Council to establish, or delegate authority to FINMA to establish, additional requirements for certain types of DLT Trading Venues (*e.g.*, DLT Trading Venues that admit retail investors). At the same time, the draft law confers discretion to the Swiss Federal Council to grant relief, or delegate authority to FINMA to grant relief, from certain requirements applicable to DLT Trading Venues that are considered "small" in terms of number of participants or trading and custody volume, respectively.

#### IV. Segregation of Digital Assets in Insolvency

Digital assets that are based on DLT are often stored by third party custodians (*e.g.*, wallet providers). In the event of bankruptcy of the custodian, it is unclear under current legislation whether crypto assets such as "pure" cryptocurrencies could be segregated from the custodian's bankruptcy estate, especially if the creditor or investor does not hold the private key(s).

The DLT Draft Law proposes to amend the Swiss Debt Enforcement and Bankruptcy Act and the Swiss Banking Act: crypto assets will be segregated for the benefit of the relevant creditors or investors in the event of an insolvency of the custodian provided that the crypto assets can be unambiguously allocated to an individual party. We believe the respective rules may need to be further clarified, especially as regards the segregation of DLT Rights, which in our view would already benefit from protection in an insolvency of the custodian based on general principles of Swiss insolvency laws.

#### V. Outlook

The consultation period ends on June 30, 2019. The DLT Draft Law will subsequently be submitted to the Swiss Parliament.

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