

Proposal STO



Security Token Offerings (STOs) in a Nutshell

Definition & Characteristics

In its “Guidelines for enquiries regarding the regulatory framework for in Initial Coin Offerings (ICOs)” (“ICO-Guidelines”) of February 2018, the Swiss Financial Market Supervisory Authority (FINMA) classified tokens issued in ICOs as either **asset, utility or payment tokens** or a combination thereof (hybrid).

The term **Security Token Offering** (STO) is commonly used for raising capital by issuing **asset tokens qualifying as securities** (hereinafter “security tokens”). **Security tokens** may represent a share in a company or an investment fund or one or several specific (financial) claims against the issuer. For example, some security tokens promise a share of future company earnings or a share in future turnover. **Utility tokens**, which provide digital access to an application or service by means of a blockchain-based infrastructure and **payment tokens**, which are intended to be used as a means of payment for acquiring goods or services or as a means of money or value transfer do generally not qualify as securities.

If a token is classified as a security, this can have various **regulatory implications** depending on the tokenomics and the business model of the issuer. STOs are therefore from a regulatory perspective more complex than in particular utility token offerings. If the regulatory requirements are not complied with, FINMA may impose sanctions (e.g. initiate enforcement proceedings). In addition the violation of applicable financial market laws can lead to criminal prosecution of the responsible individuals.

STOs Might Become the Standard for Venture Funding

Whereas the number of ICOs (i.e. the offering of utility and payment tokens) and the volumes of capital raised therewith has declined dramatically since mid-2018, **STOs are expected to be the financing instrument of the future**. Whereas in particular with utility tokens it was often not clear what the investors really could expect when investing in a offering, STOs are much clearer in the definition of the rights the token holder will get. Therefore, they match with the evident professionalization of the still very young crypto industry. It can be expected that as soon as there is a functioning ecosystem of regulated exchanges, brokers and banks there will be significant increase in STOs.

Why Switzerland?

Switzerland is known for its **secure and stable legal framework**, for its **liberal, solid and friendly regulatory environment** as well as its **favorable tax system**. However, there are many more reasons to choose Switzerland as your preferred jurisdiction for an STO: The Swiss regulator has proven to be open and supportive of FinTech ventures and technology as well as predictable in its practice. Switzerland has a great pool of talents and service providers for young ventures. And, Switzerland has currently a rather liberal regulation for issuers of securities and security tokens.

Key Aspects

Legal and Regulatory

Depending on the tokenomics and the business model of the token-issuing entity (hereinafter “security tokens”) various financial market laws can be affected.



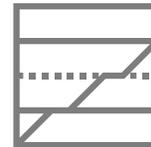
Anti-Money Laundering Regulation

- Swiss regulation on anti-money laundering (AML) may apply to the issuer, if the tokens issued qualify as a payment instrument.
- FINMA clarified that the issuance of asset tokens is in principle not subject to Swiss anti-money laundering regulation. Nevertheless, compliance with certain KYC/AML rules on a voluntary basis is recommended and common practice.
- In case an asset token has also the characteristic of a payment token (hybrid token) compliance with KYC/AML regulation is mandatory.



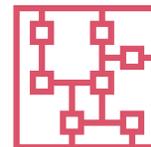
Banking Regulation

- If the issuer of security tokens has a repayment obligation towards the token holders, the invested money can under certain circumstances be qualified as a public deposit. The acceptance of public deposits is an activity subject to banking regulation and may trigger the need to become licensed as a bank.



Collective-Investment-Schemes Regulation

- Collective investment schemes are assets raised from investors for the purpose of collective investment, and which are managed for the account of such investors on an equal basis. If a security token offering is structured similar to a collective investment scheme the respective regulation may apply. This cannot only lead to licensing obligations for the issuing vehicle, the manager of the funds and the distributor of the tokens but also to restrictions with regard to the eligible investor base and the marketability of the tokens.
- Depending on the structure and the tokenomics, a security token offering can qualify as a structured product. The application of the respective regulation can also have an impact on the eligible investor base.



Securities Trading and Financial Market Infrastructure Regulation

- If the issuer of a security token provides for a market place for or liquidity in the issued tokens, this may lead to the consequence that the issuer qualifies as a securities dealer or a financial market infrastructure.
- In this case, the issuer will become subject to apply for a license as a securities dealer or a financial market infrastructure (e.g. stock exchange).

Key Aspects

Regulatory Clearance and Prospectus

Issuers can seek regulatory clearance from FINMA and may be required to issue a prospectus.



Swiss Financial Market Supervisory Authority (FINMA)

- In its ICO-Guidelines FINMA gives guidance on how to apply Swiss financial market laws in the context of ICOs of Swiss issuers. The ICO-Guidelines cover in particular the following topics:
 - ✓ how to seek no-action comfort from FINMA in regard to ICOs of Swiss issuers;
 - ✓ categorization of tokens;
 - ✓ scope of securities law; and
 - ✓ scope of the Swiss anti-money laundering law.
- In order to ensure compliance with applicable laws, it has become common practice for issuers to seek guidance in the form of a “no-action letter” from FINMA prior to launching an ICO/STO.



Prospectus

- Depending on the structure of the STO, Swiss law may require the issuer of the security tokens to prepare a prospectus.
- Prospectus according to the Swiss Code of Obligations (CO): Issuers that publicly offer tokens that represent shares or bonds are required to issue a prospectus under the CO. This obligation is not a requirement based on regulatory but on civil law. The issued prospectus is not subject to approval from any authority. However, a severe liability can result to anyone who intentionally or negligently participates in the drafting of an incomplete, incorrect or misleading issuance prospectus.
- Prospectus according to specific financial market laws: For certain financial instruments regulatory law does require the issuance of a prospectus (or an alike document). This is in particular the case for Swiss collective investment schemes and structured products.
- As of 1 January 2020, there will be a significant change of the Swiss regulatory landscape with the entry into force of the Financial Service Act (FinSA). The FinSA will introduce a general obligation to prepare a prospectus in connection with public offerings of securities. Those prospectuses are also subject to an ex ante review and approval process by a Review Board. As a consequence (and in contrast to the current regulation) all issuers of security tokens will have to prepare a prospectus.
- If the security tokens are offered in other jurisdictions than Switzerland this may require to comply also with local (prospectus) regulation (e.g. EU Prospectus Regulation).

Key Aspects

Tax

Depending on the qualification of the proceeds of the STO, different tax consequences can result. Issuers can seek tax clearance from the cantonal and federal tax authorities.



Tax Rulings

- There is the possibility to obtain a tax ruling from the cantonal/federal tax authorities in order to confirm the income tax treatment / withholding tax and stamp duty questions of the STO and subsequent operations.



Income Tax, Withholding Tax, Stamp Duty Tax, VAT

- Since STOs can have various forms they can either qualify as equity, debt or any other type of financial arrangement (e.g. sharing of profits or EBIT). Whilst proceeds from equity or debt STOs do not constitute taxable income, other type of arrangements typically would. Hence, it is crucial to analyse the income tax consequences and the possibility of offset (part of) the income with corresponding provisions for future development.
- Payments to token holders for tokens qualifying as debt or equity would generally be subject to 35% withholding taxes. For other types of STOs it should be analysed whether the payments are treated as deemed dividends and therefore subject to 35% withholding tax as well. Even buy-back-and-burn arrangements might be subject to withholding tax and therefore a careful analysis and tax ruling is essential. If withholding tax cannot be mitigated, Liechtenstein should be evaluated as an alternative location.
- Since most security tokens would qualify as taxable for Swiss stamp duty purpose, the activities of the trading with such tokens need to be analysed to avoid stamp duty liability.
- Whilst security tokens are typically exempt from VAT, the operational model of the Swiss entity needs to be carefully analysed to avoid VAT leakage on services imported. Such services might be subject to 7.7% reverse charge VAT which might not be recoverable depending on the overall activities of the entity.

Key Aspects

Cross Border

Cross-border marketing and distribution of security tokens can trigger the application of foreign financial market laws; cross-border sales of security tokens can have an impact on taxation.



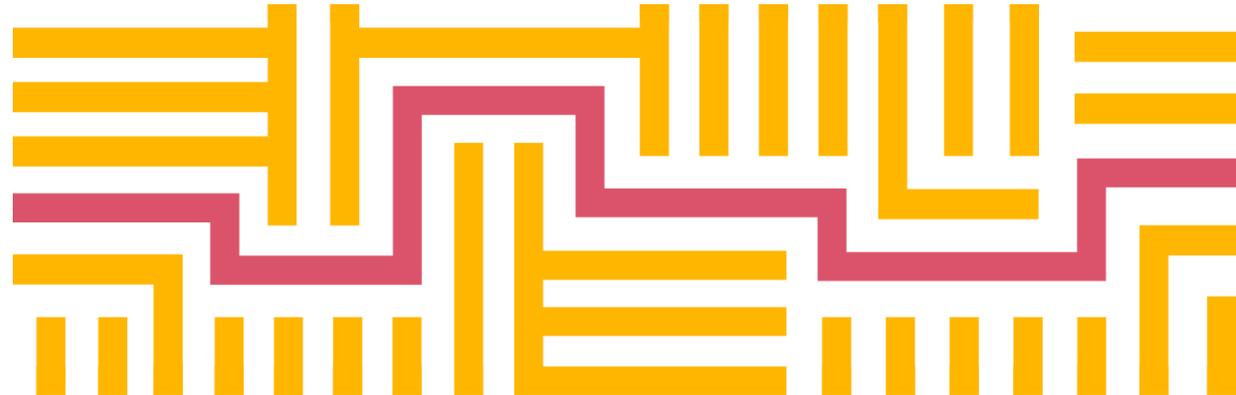
Cross-Border Aspects

- With an STO, the issuer regularly intends to attract investors from many different countries.
- If the token is also classified as a security in the countries in which the targeted investors are domiciled, the issuer must comply not only with the financial market laws of its home country (e.g. Switzerland) but also with the financial market laws of the countries in which the investors are domiciled.
- Amongst others, the following topics have to be considered on a country-by-country basis:
 - ✓ How will the issuer reach its target market and what are the statutory concerns regarding marketing of security tokens?
 - ✓ Can the security token be qualified as financial product/investment product in the jurisdiction where the targeted investors are domiciled?
 - ✓ Can the security token be distributed into every country of the target market?
- Therefore, in case the issuer intends to market and distribute its security tokens on a cross-border basis, it is highly recommended to perform a country-by-country legal and regulatory assessment.



Cross-Border Tax

- When issuing and selling tokens cross-border, it should be ensured that such issuance does not constitute a taxable services for local VAT purposes which could lead to a local VAT liability and registration / filing obligations. This would have to be checked and confirmed from the local perspective (e.g. in the biggest markets).



Key Aspects Cyber Security

To launch and operate a STO, a holistic cyber security strategy to prevent major threats for the organisation and its investors is necessary. In the world of STO, trust is an essential element of reputation and brand.



Challenges

An agile and commercially pragmatic approach is required to protect against Cyber risks while enabling the growth and innovation required to thrive in this new world. Cyber resilience is an essential business capability in a digital world and a competitive differentiator.

The real benefit of Cybersecurity isn't just in defending value. It's about creating new value by enabling the trust that's so central to doing business today.

Cyber risk is multi-faceted and wide-ranging. There are many and diverse challenges that we as organisations, leaders and employees need to address.

Examples include:

- Which measurement have be taken to successfully prepare the STO from a operational and cybersecurity perspective?
- What needs to be considered to launch and operate a STO in a secure way to protect the investment?
- What operational and technical validation is necessary?



Important Aspects to Be Considered

Organisational:

- Identify cybersecurity risk that are associated with the STO
- Ensure verification and validation of governance, policies and processes
- Security and Privacy by Design approach

Technical:

- Ensure and validate including security controls, access rights and handling and storing of sensitive information and secrets
- Ensure technical resilience by assessments (penetration testing, vulnerability scanning)

Cybersecurity relevant activities:

- Risk and risk control assessment, assessment of platform, policies and procedures and platform and process assurance
- Technical assessment (penetration testing, vulnerability testing)

Value Proposition

PwC's End-to-End Approach

We are your STO one-stop-shop and have a dedicated service offering combining various fields of expertise to one powerful package. In addition, due to PwC's global network and our well established relationships to regulators in Switzerland and worldwide we are the ideal partner also for international STOs.



Legal

- Company incorporations, incl. drafting of by-laws, organizational regulations
- Complex legal entity structures
- Corporate governance and corporate actions



Regulatory

- Regulatory strategy and advice for all relevant regulations
- Compliance, KYC and AML support, incl. turnkey-solutions for digital client on-boarding or industry utilities
- Support in receiving licenses from regulators in different jurisdictions and in particular with FINMA
- Cross-border activities



Tax

- Tax structuring and advise (cantonal, federal, international) for all relevant tax categories
- Discussions and rulings from the competent tax authorities
- Preparation of tax returns



Business Strategy

- Design of overall business strategy and STO strategy
- Business, financial and target operating model (incl. value for client)
- Design and review of token economics (e.g. usage and functionality)
- Timing of STO, detailed analysis of the market situation
- Project Management / PMO Services



Technology

- Web agency services (end-to-end), incl. design, coding and maintenance
- Data and analytics services, incl. AI/ML, Quant, Algorithm
- Technical support, coding Blockchain-as-a-service, integrated technology solutions



Assurance

- Risk management and assurance services and solutions for all relevant risk categories
- Cybersecurity strategy and services, incl. forensics in fraud or malicious attacks
- Finance advise and audit / assurance services (incl. full / partial audits based on legal requirements)



Corporate Finance

- Development of a sale strategy, incl. STO marketing advisory
- Pricing of STO, valuation of token and business model
- Sale characteristics
- Fundraising with institutional investors

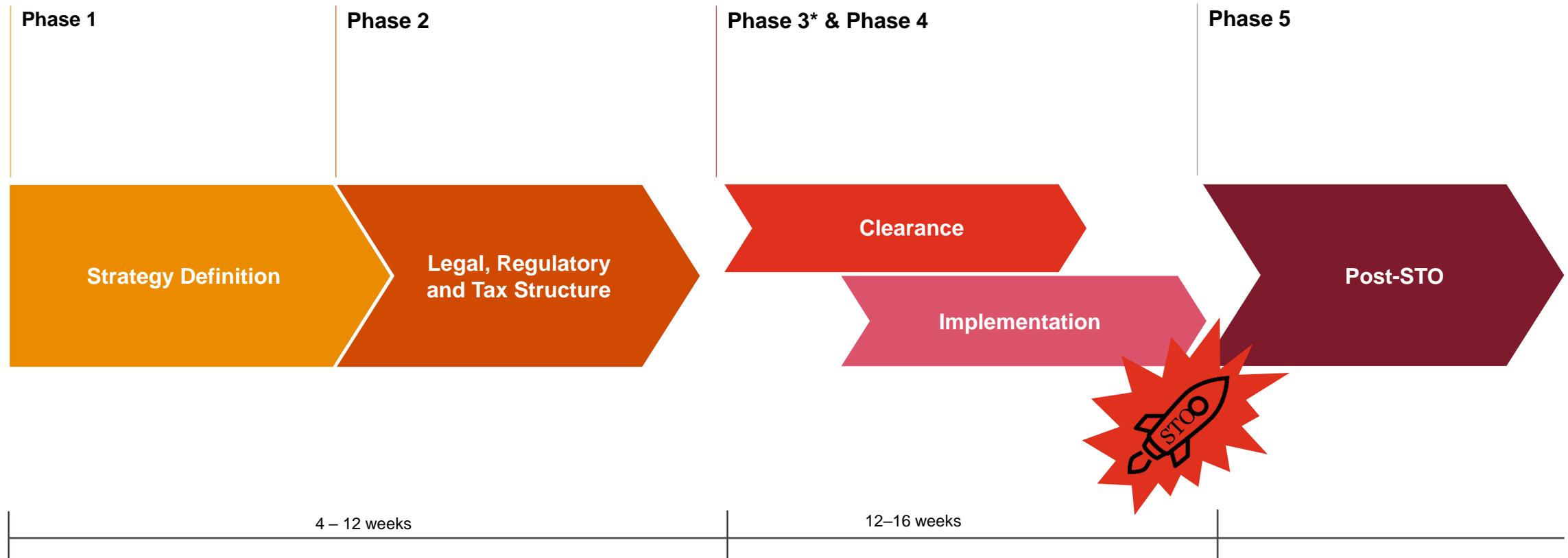


3rd Party Provider

- Support in evaluating 3rd party providers such as:
 - KYC / AML
 - Marketing
 - IT Solutions
 - Banking

Project Overview and High-Level Timeline

Our 5 Phases Approach



* The duration of the clearance phase is in particular dependent on the response time of the concerned authorities. However, a diligently prepared written application reduces interactions and avoids unnecessary questions. For the FINMA clearance (if necessary) we currently have to calculate with a response time of 12–16 weeks. In order to save time we usually start with the internal implementation work (but not the selling and issuance of tokens) before having received the involved authorities.

Credentials

Our Experience Relevant for Your STO Project

Various STOs, ICOs and other crypto related projects

We have been involved in numerous STO projects. Amongst other we have provided:

- **Strategic, legal, regulatory and tax advice to a company which plans to revitalise the music industry by creating a blockchain-powered music data tracking platform** that will automatically administer and distribute royalty payouts. In order to fund the project, the company will conduct a ICO/STO. The token to be issued is designed in the form of a profit-share token.
- **Legal, regulatory and tax advice to a company operating in the field of real estate development and marketing of luxury goods.** In order to fund the project the company will launch a STO. The token to be issued is structured as a profit-share token, which grants the token holders a certain fraction of the EBTDA and the revenues.

Our qualification as your trusted advisor for the STO complements with our following experiences:

- **Legal, regulatory and tax advice to a company operating in the cash back service sector.** The company intends to set up a decentralized marketplace platform based on blockchain technology. In order to fund the project the company intends to launch an ICO. The token to be issued is designed in the form of a utility token which grants its holders cashback rates and exclusive membership access to its marketplace.
- **Licensing of two companies in Switzerland,** which aim to provide its clients and partners secure, fast and convenient access to digital assets globally in a fully regulated and licenced banking environment.
- **Licensing of a cryptocurrency exchange,** which will fundamentally revolutionize the Swiss financial and banking environment. In order to finance part of the digital exchange the company will conduct an ICO in Switzerland.
- We advised several clients in structuring, setting-up, registering and licensing their **crypto-currency brokerage and advisory companies in Switzerland.**
- We advised numerous clients in **structuring and setting-up crypto-related investment products,** such as structured products and funds.

Benefits to clients

STO experienced team with all perspectives required:

We have proven exposure and experience in a yet very juvenile industry with market dynamics that have never been seen before. Our team consists of experts from all angles such as STO strategist, regulatory and tax experts as well as cyber security specialist and blockchain enthusiasts with detailed knowledge and working expertise – the diverse mix you need to launch your STO.

Proximity to FINMA:

Our team is in regular and close contact and exchange with FINMA and other regulatory bodies enabling them to give you the right notion and guidance which you need to launch your STO on a regulatory sound basis.

Global network:

We are a global network of blockchain specialists with thorough understanding of country differences, supporting worldwide alignment of your STO concept.

The Team

Martin Liebi
PhD, Attorney-at-law, LL.M.
Director



Martin has **more than 20 years experience with leading Swiss and US law firms** as well as Big 4 companies in the areas of capital market law, derivatives regulation, banking law (private banking, asset management, and investment banking), financial market regulation, securities law, corporate law, M&A, and general commercial law. He has been Head Legal with a Swiss bank and Head Compliance with a Swiss Fund-of-Hedge Funds active in the commodities futures markets.

He **represents financial market participants in licensing procedures of trading venues**, banks and securities dealers/investment firms and other issues with Swiss and European regulators.

Martin plans, structures, and manages as Head L&C Capital Markets with his team large regulatory and compliance projects. He collaborates in these activities with many different internal and external stakeholders such as, but not limited to, IT, risk, strategy, compliance, and the line functions.

Silvan Thoma
Attorney-at-law
Manager



Silvan is a Manager in the Regulatory & Compliance Team and is advising traditional financial institutions as well as **fintechs** on Swiss and EU financial market regulation. He has **more than 7 years experience** with PwC, law firms and Swiss courts. Before joining PwC, Silvan was an Associate with a business law firm specializing in cross-border disputes.

Silvan drafted numerous **license applications**, legal memoranda and regulatory impact assessments. Furthermore he led cross-divisional implementations of large scale regulatory change and compliance alignment projects at international private and investment banks as well as asset managers and commodity traders in Switzerland and abroad. In addition he supported the structuring, authorization and ongoing lifecycle management of financial intermediaries and their products. Silvan also **advised several digital asset start-ups applying for a license**, structuring and listing of products.

Marc-André Schauwecker
PhD, Attorney-at-law, MBA
Manager



Marc-André is a Manager in the Regulatory & Compliance Team and is advising traditional financial institutions as well as **fintechs** on Swiss and EU financial market regulation. He has **more than 8 years experience** with banks, blockchain /fintech companies, insurances, law firms and Swiss courts in the areas of capital market law, IT law, banking law, investment banking, private banking, corporate law and general commercial law.

Before joining PwC, Marc-André was Head Legal and Compliance with Bitcoin Suisse in Liechtenstein.

Marc-André **represents financial market participants in licensing procedures**, banks and securities dealers/investment firms and other issues with Swiss and European regulators. He plans, structures, and manages as Manager L&C Capital Markets with the team large regulatory and compliance projects.

We are looking forward to working with you!

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