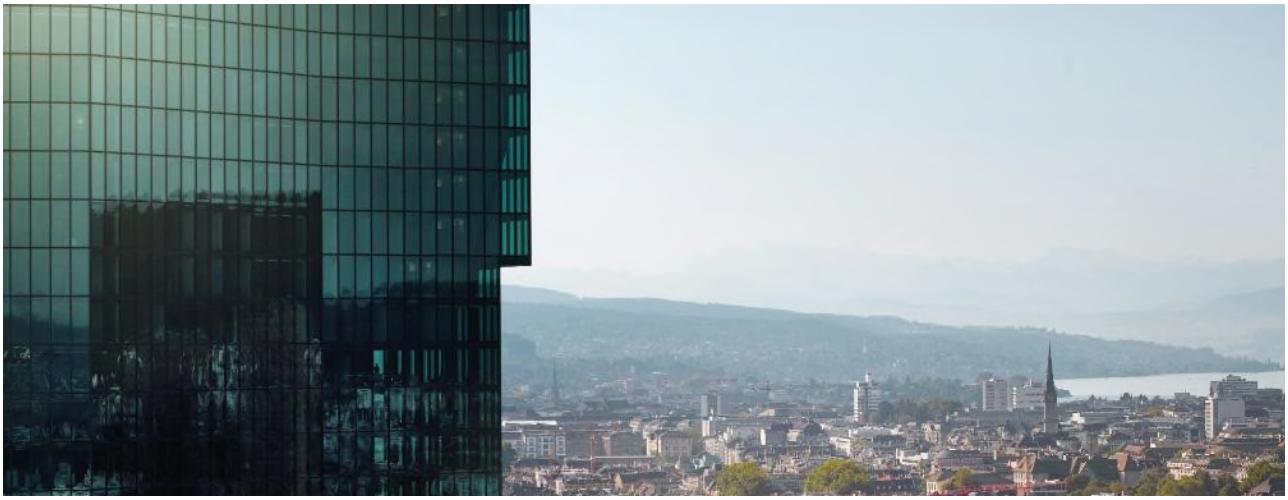

FINMA Specifies Sandbox Exemption for Fintech Providers

Partially Revised FINMA Circular "Public Deposits at Non-Banks"

On December 14, 2017 the Swiss Financial Market Supervisory Authority FINMA published the partially revised Circular 2008|3 "Public Deposits at non-Banks", which will enter into force on January 1, 2018. The partially revised circular specifies the recently enacted provisions of the Banking Ordinance relating to the sandbox exemption and settlement accounts for fintech providers.

I. Background

On August 1, 2017, certain amendments to the Banking Ordinance entered into force. By adopting these amendments, the Federal Council intended to reduce unnecessary regulatory obstacles for innovative fintech business models, including, in particular, by (i) creating a so-called innovation space that does not require a banking license (**Sandbox**), and (ii) extending the time limit (*i.e.*, the time during which funds may be held without a banking license) for settling customer transactions.

Due to these amendments to the Banking Ordinance, an amendment of FINMA's "Public Deposits at non-Banks" circular became necessary. In September | October 2017, FINMA ran a consultation. Based on feedback received during the consultation period, FINMA in its now published circular made some adjustments to its draft.

II. Key Amendments

1. Exceeding the Sandbox Threshold

In general, only banks are allowed to accept deposits from the public on a commercial basis. A person or an entity is considered to be operating on a commercial basis under the Banking Ordi-

nance if it continuously accepts more than 20 deposits from the public or publicly advertises for acceptance of deposits from the public.

The Banking Ordinance, as amended per August 1, 2017, now provides the so called **Sandbox Exemption** to the above-described rule, which is intended to create an innovation space that does not require a banking license. Generally, under the Sandbox Exemption, a person or an entity accepting deposits from the public will not be considered to be operating on a commercial basis, so long as (i) the accepted deposits do not exceed CHF 1 million (the **Sandbox Threshold**), and (ii) the deposits are neither invested nor subject to the payment of interest, and (iii) the depositors are informed prior to their deposit that neither supervision by FINMA nor deposit insurance protection will apply (see II.2 below).

Any person or entity who crosses the Sandbox Threshold must notify FINMA within 10 days. In addition, an application for a banking license must be filed within 30 days of crossing the Sandbox Threshold.

So far uncertainties existed as to what the consequences of exceeding the Sandbox Threshold would be. In particular, one question was whether a person or entity that has exceeded the Sandbox Threshold would be required to bring itself into compliance with such threshold until such time as it receives its banking license (or until such time as the banking license is denied).

In the partially revised circular, FINMA clarifies that during the notification period, the period for filing an application for a banking license and during the license application proceeding, the deposited amount does not have to be reduced. In other words, **the Sandbox Threshold may be (and remain) exceeded until completion of the license application proceeding.**

However, certain requirements apply: the relevant person or entity must notify FINMA within 10 days and must file an application for a banking license within 30 days of exceeding the Sandbox Threshold. Furthermore, the other requirements of the Sandbox Exemption will continue to apply with respect to any additional deposits accepted from the public. This means that, in general, any such deposits may not be invested or subject to interest, and, prior to acceptance of any such deposits, the information duties owed to the depositors must be complied with.

Finally, FINMA may on an individual basis prohibit a person or entity from accepting additional deposits from the public, provided that the protective rationale of the Banking Act requires such prohibition.

2. Compliance with Information Duties via Website

With respect to a non-bank deposit taker's duty to inform depositors that neither supervision by FINMA nor deposit insurance protection will apply (as described above, II.1), the partially revised circular specifies *the manner in which* the depositors must be so informed.

The draft circular that was subject to the consultation process had stated that an information on the non-bank deposit taker's website would be insufficient for purposes of fulfilling its duty to inform depositors. However, FINMA changed its position as a result of the consultation process. Under the partially revised circular, it is **permissible** for a non-bank deposit taker **to fulfill its duty to inform by providing the required information on its website.** The non-bank deposit taker must meet the following requirements in order to be able to fulfill its duty to inform via its website:

1. The information (concerning the lack of FINMA supervision and deposit insurance

protection) must be displayed in a way that it is isolated from other information displayed on the website;
2. The information must be displayed as a text in reproducible form; and
3. The potential depositor must explicitly confirm that is has taken notice of the information.

It is advisable that the non-bank deposit taker installs a pop-up window that is immediately visible upon visiting the website and clearly provides notice regarding the lack of FINMA supervision and deposit insurance protection. The pop-up window should not contain any other information. In addition, the information must explicitly be accepted by the potential depositor (*e.g.*, by clicking a button). In any event, any non-bank deposit taker must ensure that it is not possible to enter into an obligation to make a deposit, without having given a confirmation that the depositor has taken notice of the information. Finally, the information must be displayed as a text. Both this text and the confirmation must be in reproducible form that cannot be manipulated.

Fulfilling this duty to inform by providing the required information to potential depositor's in the general terms and conditions is still insufficient – in this regard, the partially revised circular follows the original draft circular that was subject to the consultation.

3. Settlement Accounts of Cryptocurrency Dealers and Platforms

According to the amended Banking Ordinance, credit balances on customer accounts of securities dealers or dealers of precious metals, asset managers or similar companies that exclusively serve the purpose of settling customer transactions do not qualify as deposits (and hence do not require a banking license), provided that (i) no interest is paid on such credit balance, and (ii) that the settlement is completed within 60 days.

The Federal Council has noted that the above-described settlement account exemption also applies to the funding and transfer of money (or value of money) by crowdfunding platforms or money transmitters. However, if a foreign exchange dealer holds accounts in order for its customers to invest in different currencies, such accounts qualify as deposits. In other words, the settlement account exemption does not apply to foreign exchange dealers.

There was some uncertainty as to whether cryptocurrency dealers and platforms could also invoke the settlement account exemption.

This uncertainty has been clarified in the partially revised circular, which states that a **cryptocurrency dealer** cannot invoke the settlement account exemption if it performs activities comparable to the activities of foreign exchange dealers. FINMA's rationale for this consists of investor protection, equal treatment of financial market participants and technology neutrality.

However, the partially revised circular does not address when an activity is considered "comparable" to the activities of foreign exchange dealers or what criteria FINMA will apply in its assessment of any such comparability. In its explanatory notes to the consultation, FINMA states that it will assess any such comparability on a case-by-case basis, taking the goal of investor protection into consideration.

Still, from a practical standpoint, some questions still appear not to be clarified:

- With regard to money that a dealer (or a platform) accepts in order to buy cryptocurrencies on behalf of its customers, there seems to be a significant likelihood that such money will qualify as a deposit (unless there is another applicable exemption, such as the Sandbox Exemption).

- With regard to balances in cryptocurrencies stated by a wallet provider to its customer, the comparability should (based on the practice by FINMA to date) be assessed on whether the customer has a claim for segregation or similar protection in the case of insolvency of the wallet provider.

III. Conclusion

In comparison to the original draft circular that was subject to the consultation, the partially revised circular includes desirable clarifications (regarding the crossing of the Sandbox Threshold) and reliefs (the permissibility of fulfilling the information duties via website subject to certain conditions).

Still, some questions regarding the qualification of deposits in cryptocurrencies remain unsettled, in particular how the comparability of cryptocurrency dealers' and platforms' activities with the activities of foreign exchange dealers is measured. In this regard, from a practical standpoint, further clarification would be welcome.

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