Crypto Valley

The Custody of Crypto Assets in the Banking Act

Published by CVA's Regulatory Working Group

www.cryptovalley.swiss

@thecryptovalley

Contributors

Gabriel Jaccard
UNIGE PhD Candidate
Founding Partner of Arbitri

Acknowledgements: Mr. Loïc Staub, Ms. Anne-Grace Kleczewski and Mr. Leandro Lepori for their discussion

Table of Contents

1 / Introduction

The "lex DLT" has anchored new practices regarding the custody with an intermediary of cryptoassets[1]. Within this revision, the Banking Act (BA) has been significantly amended. The present contribution aims to shed light on the content of these amendments.
Under the current regulation, there are two types of authorisations in the BA specific to the banking activity in Switzerland. The first one is the classical authorization as a Bank (art. 1a BA), while the second one - the FinTech license (art. 1b BA) - represents a lighter form aimed mainly at new innovative business models. In both hypothesis, the activity targeted by the regulation concerns persons active in the financial sector who accept deposits from the public on a professional basis (hyp. art. 1a BA; art. 1b BA), or even cryptoassets (hyp. art. 1b BA), and who do not invest or remunerate these deposits or assets.

2 / The Deposit

The notion of deposit is understood in a cross-cutting way depending on the legal field of application. It has given rise to heated debates in the context of cryptoassets and banking law. In particular, with regard to the question of whether a token can already be considered as "deposited" stricto sensu with an intermediary.

3 / Deposit and Control

At the basis of the bank deposit is the concept of deposit in the sense of civil law, which has its own scope. In particular, it is the case of the so-called irregular deposit under Art. 481 CO that is most often referred to. Deposit in the sense of civil law, presupposes a direct and exclusive power of disposal of the intermediary in order for the object to be considered as « deposited ».

1 Message of 27 November 2019 on the Federal Act on the Adaptation of Federal Law to Developments in Distributed Electronic Registry Technology, FF 2020 223 (lex DLT); Ordinance of the Federal Council on the Adaptation of Federal Law to Developments in Distributed Electronic Registry Technology of 18 June 2021 (amending act).

In the case of a regular deposit, the object is deposited as a result of a transfer of possession of the material thing (Art. 472 CO); whereas in the case of an irregular deposit (Art. 481 CO), sums of money or other fungible goods are transferred to the depositary, with the depositor retaining only a claim against the depositary. In both cases, the intermediary has de facto exclusive and often direct control over the deposited asset.

By analogous reasoning applied to cryptoassets, partial control or non-exclusive power of disposal of the third party's private key by the intermediary is therefore not sufficient to consider securities as deposited stricto sensu under civil law. Such reasoning would then bring such activities closer to those of a service contract.[2]

Currently, in the context of banking and financial law, FINMA in its practice and part of the doctrine admit - in our opinion correctly- that only exclusive control allows an asset to be considered as a value subject to the control of the bank, i.e. "deposited" within the meaning of banking law. [3]The intermediary's partial control of a multi-signature wallet by means of one of the keys required to open the wallet should therefore not be considered as a deposit in the absence of exclusive power of disposal[4].

Finally, with a view to refining the legal vocabulary according to constellations, the notion of "control" versus "deposit" would benefit from being developed separately in the context of cryptoassets, as these two notions call for different constellations of cases.

4 / Fungible Thing or Sum of Money?

Moreover, the notion of irregular deposit (art. 481 CO), which is the most similar to the case of a crypto asset deposit, seems to refer only to "sums of money" according to the letter of the text of this article. In reality, the notion is broad and applies to any fungible thing, including, for example, securities.[5]

In the case of cryptoassets such as cryptocurrencies that represent means of payment (e.g. BTC), a strict application of the rules on irregular deposit appears at first sight to be excluded, as such tokens cannot be qualified as money. This is due to the fact that tokens usually represent values that are neither legal tender

2 Fedor Poskriakov, Custody and trading of cryptoassets - selected aspects of financial market law, in: digital law and economy CEDIDAC, 2021.

3 Fedor Poskriakov, Custody and trading of cryptoassets - selected aspects of financial market law, in: Digital Law and Economy CEDIDAC, p. 104.

4 MME, Custody von Digital Assets unter Schweizer Recht, in: Weblaw Forum LegalTech, Die Regulierung von Blockchain-Technologie, 26 August 2021. However, the AMLA remains potentially applicable in case of partial control.

5 Guillaume Braidi/Richard Barbey, in: CR-CO I, 3rd ed. 2021, ad art. 481, n°2.

nor incorporate legal counterparties against anyone. In addition, it should be noted that cryptoassets may alternatively constitute securities or similar securities insofar as the tokens, as securities, are assimilable to existing categories of securities (e.g. registered right-to-value, right-to-value[6]).

In any event, we believe that cryptocurrencies should generally be considered as fungible (Art. 71 CO), which makes the rules on irregular deposit applicable. However, it should be noted that this point is debatable since some Protocols attribute a unique character to their tokens, which makes them irreplaceable and therefore non-fungible (e.g. NFTs). Similarly, the fact that the number of tokens is strictly limited to a small number by the Protocol could, in our opinion, tip the balance towards the observation that a token is not fungible.

Having said that, it is nevertheless noted that payment tokens and fiat currencies are quite similar in practice. The recognition by States of certain crypto-currencies as legal tender (e.g. BTC in El Salvador in 2021) could eventually lead to a more obvious assimilation of payment tokens with the very notion of "money". Moreover, such an analogical reasoning could be justified in order to maintain equal treatment between payment tokens and fiat currencies, especially in the context of banking regulation. [7]This assertion would, however, have no practical effect with regard to irregular deposit since tokens would already be considered as fungible things.

5 / The “Public Deposits”

Public deposits are defined under Art. 5 BO in a lapidary way as "all liabilities towards customers". This definition forms a nodal element of the scope of application of the BA as discussed above (cf. art. 1a BA and 1b BA). It follows from the FINMA interpretation (FINMA Circular08/3, no. 10) that all liabilities fall into this category, which is deliberately interpreted broadly. Therefore, the classification of assets in the intermediary's balance sheet is decisive. Moreover, we note that in the texts of the BA, the notion of public deposit (art. 5 BO) and crypto assets (art. 5a BO) coexist by name. Therefore, these notions are not mutually exclusive but rather add up to each other.

Therefore, a token can theoretically fall under both the notion of cryptoassets and that of public deposits depending on the case. However, in principle, FINMA in its practice does not consider crypto assets kept exclusively by the intermediary as "public deposits" within the meaning of Art. 5 BO. Their safekeeping therefore does not in principle require authorisation as a bank (Art. 1a BA), as the text of Art. 1a BA only

6 In this case, the token can be considered in an irregular deposit as it represents a paper of value.

7 Message of 27 November 2019 on the Federal Act on the Adaptation of Federal Law to Developments in Distributed Electronic Registers Technology, p.19

mentions "public deposits" and not cryptoassets. Moreover, the authorisation under the FinTech licence is discussed below.
In the same vein, since cryptoassets do not qualify as public deposits within the meaning of Art. 5 BO but only as cryptoassets through 5a BO, their safekeeping will consequently also not have any influence on the capital requirements that the depositary intermediary must hold in relation to the public deposits it keeps. However, the custody of crypto assets may still have an effect on the capital requirements. Indeed, even if the cryptoassets do not constitute public deposits, FINMA may decide to increase the minimum capital value of the company subject to the FinTech licence in order to take into account the risk of the activity (Art. 17a para. 2 BO) if they are kept as a collective deposit and a FinTech licence pursuant to Art. 1b BA is required.

6 / Crypto Assets in Collective or Individual Custody, Held On or Off-Chain

Cryptoassets are generally defined as assets that are held at any time by the intermediary on behalf of his client and that are used to a large extent, either actually or according to the intention of the organiser or issuer, as a means of payment for the acquisition of goods or services or that serve for the transmission of funds or values (Art. 5a BO). In addition, the Federal Council has reserved its prerogative to designate directly and by name which specific tokens would fall under the definition of cryptoassets (Art. 1b para. 1 let. a BA). However, it has not yet made use of this possibility.
From the point of view of banking regulation, the BA provides that only the custody of cryptoassets within the meaning of Art. 5a BO, i.e. cryptoassets in collective custody, require a FinTech license according to Art. 1b BA. Therefore, the method of custody, which differentiates between collective and individual custody, will be of crucial importance in determining the regulation of the activity.
In addition, among the existing types and methods of crypto asset storage, a distinction is made between crypto assets held individually on a particular address or account (individualised deposit), collectively on an omnibus address or account (collective deposit), or on the blockchain (individualised or collective on-chain), or even outside the blockchain (individualised or collective off-chain).

7 / The Deposited Values

Deposited assets are defined in Art. 16 BA, of which para. 1 ch. 1bis (let. a & let. b) now explicitly refers to cryptoassets. In line with the content of this paragraph, cryptoassets are generally considered as deposited

assets regardless of their method of custody whether on-chain or off-chain, individualized or collective. In any case, cryptoassets will be qualified as deposited assets within the meaning of Art. 16 para. 1 ch. 1 bislet. a (individual) or let. b (collective) BA.

The main consequence of this qualification is the distraction of deposited crypto assets from the Bank's assets in case of bankruptcy of the intermediary (art. 37d BA). It should be noted that the cryptoassets, even if they are segregated during the bankruptcy of the bank, may be claimed by the depositor in the context of the bankruptcy according to the general rules under the conditions of art. 242a LP (Bankruptcy Act)[8]. The latter may take place irrespective of their balance sheet qualification or their method of custody.

Finally, FINMA may, if it deems necessary, set a maximum amount of cryptoassets that the intermediary may hold, regardless of whether the intermediary is a Bank or a FinTech (Art. 4sexies BA). In order to guide the application of this measure, FINMA takes into account in particular the function of cryptoassets, the underlying technologies as well as risk mitigation factors. Beyond the maximum amount, additional equity capital or an increase of the minimum capital of Art. 1b BA may be required; alternatively, the intermediary may decide at its own discretion to include the said cryptoassets in its balance sheet, thus increasing the equity capital required for its activity.

In our opinion, art. 4sexies BA should also apply to intermediaries not regulated as banks or fintechs, as long as they also hold deposited assets in the sense of art. 16 BA. In our opinion, this is justified in view of equal treatment (debatable) and although the Message of the DLT Law, the letter of art. 4sexies, and the systematic analysis of the BA do not necessarily go in this direction. We nevertheless believe that this interpretation would be more compatible with a broad protection of depositors and the reputation of the Swiss financial centre. However, we note that difficulties related to supervision would then exist, as these intermediaries are neither qualified as Banks nor as FinTechs, they would indeed not be subject to an active obligation to declare the amounts of deposited cryptoassets.

8 / Conclusion

Within the framework of the authorisations of the banking law, art. 1a BA (Bank) only targets, according to the letter of its text, deposits from the public and does not mention cryptoassets, regardless of the type of deposit (individual or collective) to which they are attached. Contrary to the banking authorisation, the Fintech licence (art. 1b BA) is broader and covers both public deposits and cryptoassets. However, art. 1b BA only

8 Note that this assumption only applies in the case of indirect storage. In effet, if the Client retains direct access to its cryptoassets, then the claim is no longer necessary.

covers cryptoassets held as collective deposits (see art. 1b para. 1 let. a BA in connection with the definition of cryptoassets retained by art. 5a BO and art. 16 para. 1 bislet. b BA[9]).
Consequently, deposits and individualized custody on the blockchain of cryptoassets (individualized on-chain deposit) as referred to in art. 16 al. 1 bislet. a BA, do not require any authorization under the BA[10] as long as they do not generate interests and are not the object of active operations. These crypto assets in individual on-chain deposit may be held in unlimited quantities, off-balance sheet and may be segregated in case of bankruptcy, or even claimed by the depositors under the general rules of the Bankruptcy Act.
In our view, the unlimited acceptance of crypto assets without the need for authorisation is questionable because it poses a risk to the security of depositors, who are less well protected than in the case of public deposits and collective deposits of crypto assets, even though these activities are similar. Conversely, this breathing space within the regulation could allow interesting business models to be attracted to Switzerland, resulting in the creation of a competitive advantage. The future will tell!

9 The article provides that: "Cryptoassets within the meaning of Art. 1b para. 1 let. a BA are the assets referred to in Art. 16 para. 1bis let. b BA (cryptoassets in collective custody)".

10 In principle, however, a licence under the Money Laundering Act (AMLA) is still required. This contribution does not deal with the AMLA further.

Building the World's Leading
Blockchain Ecosystem
www.cryptovalley.swiss