

## Briefing August 2019

# Swiss Financial Market Supervisory Authority Introduces Strict Requirements for Payment Transactions on Blockchain

On 26 August 2019, the Swiss Financial Market Supervisory Authority FINMA published the FINMA Guidance 02/2019 regarding payments on the blockchain (the "**Guidance**").<sup>1</sup> This Guidance informs market participants on FINMA's interpretation of Swiss anti-money laundering ("**AML**") regulation in the context of blockchain payment services, in particular with regard to the requirements for financial service providers under FINMA supervision to transfer payment originator and beneficiary information to the recipient institutions. The practice adopted by FINMA is rather restrictive and goes beyond the standards established by the Financial Action Task Force FATF in this regard. For the time being, this practice will substantially limit affected Swiss market participants in offering payment transactions in digital tokens. While the Guidance applies to service providers subject to FINMA supervision only, such as banks, it can be expected that recognised Swiss AML self-regulatory organisations ("**SRO**") will be required to follow suit with respect to their interpretation of analogous provisions in their regulations.

## Introduction and Background

In the Guidance, FINMA starts by reaffirming its technology neutral approach to regulation, which has generally been considered well-suited to enable and support innovation in the financial marketplace. However, FINMA also points out that operators of blockchain-based business models cannot be allowed to circumvent the existing regulatory framework, in particular AML regulation, and that FINMA has therefore consistently applied the Swiss Anti-Money Laundering Act ("**AMLA**") to blockchain service providers. The stated purpose of the Guidance

(which, in the typology of FINMA communications, sits above a plain press release, yet below the more formal and structured FINMA circular) is to clarify FINMA's position with respect to the application of the requirements of article 10 of the FINMA-Anti Money Laundering Ordinance ("**AMLO-FINMA**") to payment transactions on blockchain. Pursuant to article 10 AMLO-FINMA, the financial intermediary of a payment originator is required to provide and transmit information on the originator and the beneficiary to the financial intermediary on the receiving end of the payment transaction.

<sup>1</sup> See the media release of 26 August 2019, available under: <https://www.finma.ch/en/news/2019/08/20190826-mm-kryptogwg/>.

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The issuance of the Guidance is set against the background of the FATF Guidance on the application of the risk-based approach to virtual assets and virtual asset service providers of June 2019 (the "**FATF VASP Guidance**")<sup>2</sup>. The FATF VASP Guidance addresses, together with previous interpretative notes, the application of FATF Recommendation 16 (which forms the basis for article 10 AMLO-FINMA) to transfers of virtual assets. Furthermore, FINMA's Guidance comes at a point in time at which FINMA granted, for the first time, banking and securities dealer licenses to two pure-play blockchain service providers. As prudentially regulated entities subject to FINMA supervision, these new banking and securities dealer licence holders (and other Swiss banks and securities dealers pursuing blockchain-related business activities) will be subject to article 10 AMLO-FINMA as interpreted by FINMA pursuant to the Guidance.

### Key Points

Under article 10 AMLO-FINMA, the financial intermediary of a payment originator is required to transmit the originator's name, account number (or, alternatively, a transaction-based reference number) as well as its address (or, alternatively, the place and date of birth, client number or national identity number). In respect of the payment's beneficiary, the name and account number (or transaction-based reference number) must be transmitted. This should enable the financial intermediary on the receiving end of the payment transaction to review the transaction and take appropriate action. Against this background, we note the following key points in connection with the Guidance:

- Article 10 AMLO-FINMA "also applies to services based on blockchain technology" in the same way as to traditional wire transfers, i.e. it must also be complied with in connection with "token transfers". FINMA does not further define the term "tokens", leaving room for interpretation within FINMA's previously established token classification framework, which distinguishes between (i) payment tokens, (ii) utility tokens and (iii) asset tokens.
- The transmission of the data required pursuant to article 10 AMLO-FINMA does not need to be performed using blockchain architecture. Instead, according to the Guidance, other communications channels may be used. FINMA emphasises the purpose of the provision to "make it more difficult for sanctioned persons or states to act anonymously in the payment transaction system".
- However, FINMA further states that it is currently neither aware of any system at national or international level (such as the SWIFT messaging system) nor of any bilateral agreements between individual service providers that would enable the reliable transmission of originator and beneficiary identification data for payment transactions on blockchain. According to the Guidance, for such systems or agreements to meet Swiss requirements, they would need to be implemented between service providers subject to appropriate AML supervision only.
- The FATF VASP Guidance concedes that not every transfer of virtual assets may be bookended by entities that are subject to AML supervision (so-called "obliged entities"). It consequently provides for certain leeway in the application of FATF Recommendation 16, focussing on compliance at the end of the party that is a client of an obliged entity. For example, where a transfer of virtual assets is made to a beneficiary that is not a client of an obliged entity, one example being an individual using an unhosted wallet, the FATF VASP Guidance does not expect the obliged entity servicing the payment originator to transfer identification information to such individual user. Conversely, if a transfer of virtual assets originates from an individual user that is not a client of an obliged entity, the obliged entity at the beneficiary's end of the transfer is expected to obtain the originator information from its client, namely the beneficiary. Consequently, FATF member states such as Switzerland have been given the opportunity to provide for exemptions to the identification data transfer obligation in specific cases of transfers of virtual assets and still be compliant with the FATF Recommendations.

<sup>2</sup> Available under: <http://www.fatf-gafi.org/media/fatf/documents/recommendations/RBA-VA-VASPs.pdf>.

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- In the Guidance, FINMA notes that its interpretation of article 10 AMLO-FINMA goes beyond what is required by FATF and confirms its intention not to provide for any exemptions in respect of payments involving unregulated service providers. In FINMA's view, this would create an imbalance between unregulated and regulated service providers and would defeat the purpose of article 10 AMLO-FINMA.
- As a consequence of the above, an information transfer system for blockchain payments fulfilling FINMA's requirements or, alternatively, a suitable network of bilateral or multilateral agreements between regulated correspondent institutions, is necessary. Otherwise, the financial institutions subject to FINMA's supervision will in principle need to ensure that transfers of tokens to or from external "wallets" only involve their own clients who were appropriately onboarded. This also means that "ownership" of the external wallet by a client must first be verified using "suitable technical means", which are not further specified and might be challenging to determine in practice. The same applies to exchange transactions involving an external wallet of a client.
- Therefore, if a token transfer involves an external wallet of a third party, i.e. a person who is not a client of the FINMA supervised financial institution, the financial institution will need to complete a full onboarding of the third party, as if it were onboarding a new client. This goes not only beyond the requirements of the FATF, but also beyond existing rules of Swiss AML regulation regarding the ad hoc acceptance of cash payments by regulated financial intermediaries.

**Conclusion and Outlook**

In the recent past, FINMA emphasised its focus on AML regulation and enforcement, and this approach has clearly found its way into the Guidance. In the accompanying media release, FINMA notes that its treatment of payment transaction on a blockchain is among the most stringent in the world, going beyond the expectations set by the FATF. This certainly sets the tone for the Swiss financial institutions offering blockchain services as their key business activities or as an additional service. While the Guidance can be welcomed as providing more legal certainty at the time FINMA granted licences to the first Swiss "crypto banks", the specifics of the Guidance testify that FINMA has at best a reserved attitude to financial services on blockchain.

The Guidance only applies to FINMA regulated blockchain service providers. While those are currently few and far between, we expect the interpretation of Swiss AML regulation that is at the base of the Guidance to also become the applicable standard for financial intermediaries that are subject to AML supervision by an SRO, such as certain custody wallet providers, trading or exchange platforms, due to FINMA's oversight role in respect of the recognised Swiss SROs. This could thus have far-reaching impact on existing market players, who should carefully consider the implications of this Guidance for their own business model.

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