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FINMA clarifies its practice on the staking of digital assets

In a newly published guidance, FINMA provides clarity on the treatment under Swiss financial market law of staked digital assets from a balance sheet and licensing perspective. Importantly, it provides a path for banks to hold staked client assets off-balance sheet and clarifies the regulatory perimeter for non-bank digital asset service provider.

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FINMA Guidance 08/2023 – Staking

On 20 December 2023, the Swiss Financial Market Supervisory Authority ("**FINMA**") published its Guidance 08/2023 (the **"Guidance"**), in which it has laid out how FINMA will interpret financial market laws in relation to the staking of digital assets. As the first formal guidance from Swiss authorities on staking, this document provides valuable insights and clarity for banks, financial institutions, and service providers active in the field of digital assets.

In this context, "staking" generally refers to the process of locking up digital assets on a blockchain network in order to participate in the validation mechanism of the network. Persons who engage in staking earn rewards, generated by the protocol, for providing this service to the network. Staking is relevant to blockchains based on a proof-of-stake consensus mechanism, such as Ethereum.

Swiss banks offering staking services

In its supervisory practice, FINMA had initially hinted that banks offering staking services to their client may be required to include the staked digital assets on their balance sheet. Such a treatment would have rendered this activity economically unviable, since staking is mostly relevant for cryptocurrencies and holding such assets on balance sheet triggers hefty capital adequacy requirements.

Following industry engagement, the Guidance now provides a more granular assessment and outlines a path towards an off-balance sheet treatment of staked assets held for clients:

- If the bank directly operates the technical means to stake the relevant assets (so-called "**direct staking**"), staked assets held for clients can be recorded off-balance sheet if certain conditions are satisfied. These serve to ensure that staking is taking place at the client's initiative, that operational risks associated with this activity are understood and mitigated by the bank and that appropriate disclosures have been made to the client.
- If the bank has delegated the operation of the technical means to stake and access the relevant digital assets to a third party provider (so-called "**staking chain**"), the bank can record the relevant assets as off-balance sheet items when the operation qualifies as a "fiduciary" relationship. For this to be the case, FINMA considers that a number of requirements must be satisfied and, surprisingly, the list of these requirements is notably longer than those imposed on banks operating a direct staking model. In short, FINMA is requiring the relevant banks to (i) properly structure the bank-client relationship, with the client agreeing to bear the risk of the staking operations and a potential default of the third party staking provider, (ii) perform extensive due diligence on the third party service provider, and in any event (iii) only work with third party staking providers who are subject to prudential supervision.

When all the requirements are met, staked client assets can be considered off-balance sheet and, most importantly, the respective capital adequacy requirements do not apply to such staked assets.

Non-banks offering staking services

Putting an end to a growing controversy, the Guidance also clarifies that staking services providers operating in Switzerland do not necessarily need to obtain a FinTech or banking license under the Swiss Banking Act.

If the staked assets of each client are held on individual addresses (wallets), no license under the Swiss Banking Act is required. The service provider however remains subject to the Swiss Anti-Money Laundering Act. Nonetheless, if the staked assets of clients are pooled on common addresses (wallets), the service provider is deemed to be involved in the collective custody of digital assets and is required to obtain a license under the Swiss Banking Act.

Key takeaways

Though unlikely to satisfy the industry's wish for straightforward solutions, the Guidance has the merit to bring much needed clarity, which will be beneficial for both banks and non-banks, in particular for new market entrants from either background. With the Guidance, FINMA's practice is however not carved in stone. As FINMA itself has noted, it will continue to evolve as case law and bankruptcy practice develop.

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