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## **Crowdlending – swiss regulatory regime – Quo vadis?**

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Crowdlending is a type of financial business activity which has been growing in the recent years despite significant regulatory barriers. To address these issues, a new Swiss fintech regulation model has been issued for consultation on 1 February 2017 based on three «pillars»: (1) banking license «light», (2) innovation «sandbox», and (3) «light touch» targeted regulatory adjustments. Fintech businesses will need to assess the legal implications (including with respect to technical and organizational measures), opportunities and risks of the proposal.

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## 1. Introduction

[Rz 1] Crowdfunding as an alternative way of raising capital from many participants using online platforms with or without professional intermediaries has dramatically expanded in the recent years, including in Switzerland. The funds raised from the «crowd» may be applied to finance all kinds of projects, such as consumer loans, participating in a business start-up, acquiring a property or publishing a photo book. Although crowdfunding projects cover a wide range of business models and genres, they all have one thing in common: generally, a large number of individuals or companies (funders) each provide an amount that is often small, taken alone, to enable the project to be realised by the project developer. A simple to use direct communication via an IT platform or application is a key element of all types of crowdfunding.

[Rz 2] As at the end of April 2016, around 40 crowdfunding platforms were operating in Switzerland, according to statistics compiled by the Institute of Financial Services Zug IFZ<sup>1</sup>.

[Rz 3] Crowdfunding can occur under different forms and typically the following four main subtypes of crowdfunding are distinguished: (1) crowddonating, (2) crowdsupporting<sup>2</sup>, (3) crowdinvesting and (4) crowdlending. The main criterion for drawing a distinction between these subtypes is the consideration or reward received by the participants for their funding of the project.

[Rz 4] Crowdlending represents the largest type of crowdfunding by volume globally, according to statistics compiled by Massolution showing a total crowdlending volume of USD 25 billion

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<sup>1</sup> Prof. Dr. ANDREAS DIETRICH, SIMON AMREIN, Crowdfunding Monitoring Switzerland 2016, p. 3.

<sup>2</sup> Crowdsupporting is also referred to as «reward-based crowdfunding».

in 2015<sup>3</sup>. In Switzerland, crowdlending raised CHF 7.9 million in 2015, and is expected to have doubled in 2016 because of lending to SMEs and the burgeoning real estate crowdlending<sup>4</sup>.

[Rz 5] This article will focus on the Swiss regulatory requirements applicable to crowdlending, as well as the impact on the development of this type of funding of contemplated regulatory developments aimed at strengthening Switzerland's competitiveness for fintech businesses generally.

## 2. Regulation of crowdlending in switzerland

[Rz 6] The Swiss regulatory framework for financial services<sup>5</sup> and institutions<sup>6</sup> is currently subject to a complete overhaul and it is thus worthwhile to analyse how the current and future regulation affects crowdlending business models in Switzerland.

### 2.1. Definition of crowdlending

[Rz 7] Crowdlending refers to loans for funding companies or individuals, which is consequently categorised as borrowed capital. Crowdlending is also known as peer-to-peer (P2P)<sup>7</sup> or social lending because funding is provided by individuals or companies that are not financial institutions or financial intermediaries<sup>8</sup>. Referring to the distinguishing criterion mentioned above to differentiate sub-types of crowdfunding, participants (funding providers) receive a payment in return for their funding made available to the project developer (borrower), typically in the form of interest, although participating loans<sup>9</sup> or bonds / notes issuances are also possible. The amount of the interest or return payment varies depending on the risk of the project and borrower, but typically represents a lower interest charge for the borrower than traditional bank lending.

[Rz 8] Crowdlending exists in various forms and uses diverse business models, depending on the legal, regulatory and tax requirements applicable to the chosen form; however, it invariably involves three main actors: (A) the platform operator or the platform, referring to the manager of the crowdfunding online platform on which projects are published and through which the project developers and the participants (backers) can connect, (B) the participants or funding providers, referring to the individuals or companies providing funding, and (C) the project developer or funding recipient, referring to the individual or company seeking to raise funding for a particular project or purpose. From a contractual perspective, there will exist bi-lateral contractual

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<sup>3</sup> Massolution/Crowdsourcing.org 2015CF Crowdfunding Industry Report, 31 March 2015, available at: [http://reports.crowdsourcing.org/index.php?route=product/product&product\\_id=54](http://reports.crowdsourcing.org/index.php?route=product/product&product_id=54) (All websites visited on 7 March 2017).

<sup>4</sup> Crowdfunding Monitoring Switzerland 2016, p. 3.

<sup>5</sup> See draft Financial Services Act (FinSA), submitted to Parliament on 4 November 2015, available here: <https://www.news.admin.ch/news/message/attachments/41734.pdf> (English translation).

<sup>6</sup> See draft Financial Institutions Act (FinIA), submitted to Parliament on 4 November 2015, available here: <https://www.news.admin.ch/news/message/attachments/41750.pdf> (English translation).

<sup>7</sup> The terminology of peer-to-peer (P2P) lending is being gradually abandoned in favour of lending platform, which better reflects the market reality and the role of platform operators in such transactions.

<sup>8</sup> ANDREAS SCHNEUWLY, Crowdfunding aus rechtlicher Sicht, AJP 2014, p. 1611.

<sup>9</sup> Participating loans are loans where instead of, or in addition to, an interest payment, the borrower would undertake to pay to the lender an additional amount calculated as a percentage of the profits of the project being financed by the loan or of the borrower's business.

relationships as between each pair of involved parties (i.e., between each participant and the platform operator, between the platform operator and the project developer and, most importantly, between each participant and the project developer). The characteristics and legal classification of such contractual relationships will depend on the business model and the specifics of each transaction.

[Rz 9] Typically, from a contractual viewpoint, the relationship between the project developer and the participants / funding providers will usually be characterized as a loan within the meaning of Articles 305 ff. of the Swiss Code of Obligations (SCO)<sup>10</sup>. In some circumstances, however, the funding may be packaged into securities (bonds or notes) issued by the project developer; in other situations, the contractual relationship can be characterized as a consumer credit, which is regulated under the Swiss Consumer Credit Act. The characterization of the relationship may trigger various legal and regulatory obligations for each of the parties involved, as we will see below. Finally, in the context of crowdlending, the platform often plays a more active role<sup>11</sup>, managing the funding, collection of principal and interest payments and thus handling financial assets on behalf of others, something which typically triggers the application of financial regulations<sup>12</sup>.

## 2.2. Current regulatory requirements

[Rz 10] The current Swiss regulatory framework for financial activities does not contain any specific rules regarding crowdlending activities. Further, Swiss financial regulation is typically «principles-based» and does not focus on detailed specific prescriptions for each possible existing business model for each type of regulated activities, but rather enacts general principles aiming at protecting financial markets and consumers/investors, respectively. Hence, the regulatory implications for each of the actors involved, namely the platform operator, the project developer and the funding provider, must be assessed under the ordinary principles governing the provision of financial services in Switzerland<sup>13</sup>. Whilst the below presents the general principles, each business model must be assessed individually, to the extent that arguably small changes to the way a crowdlending business operates can trigger significant implications from a Swiss regulatory perspective<sup>14</sup>.

### A) Funding provider (lender/project financier)

[Rz 11] The funding providers act as mere lenders, investors or bondholders depending on the business model chosen by the platform. As such, to the extent the funding providers act as private investors only, making available their own funds, without refinancing themselves through the

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<sup>10</sup> For a detailed analysis of the contractual aspects of the respective relationships in a crowdlending scenario, see ANDREAS SCHNEUWLY, Crowdfunding aus rechtlicher Sicht, AJP 2014, pp. 1610 ff., § III.

<sup>11</sup> Swiss Crowdfunding Association, White paper – Crowdfunding in Switzerland, 2015, p. 26.

<sup>12</sup> ANDREAS SCHNEUWLY, Crowdfunding aus rechtlicher Sicht, AJP 2014, pp. 1610 ff., p. 1611.

<sup>13</sup> See the respective legislative acts referred to in Article 1 (1) of the Swiss Act on financial markets supervision (LFINMA); Jana Essebier and Rolf Auf der Maur, Fidleg als Chance für die Schweiz als Crowdfunding-Standort, in: Jusletter 28 September 2015, N 9.

<sup>14</sup> JULIETTE ANCELLE / PHILIPP FISCHER, Regulation of Crowdfunding Activities in Switzerland: Where do we Stand?, in: Jusletter 22. Februar 2016, Rz 20.

public or third party banking institutions to finance their lending activities<sup>15</sup>, they should not typically be subject to any regulatory requirements.

[Rz 12] The only additional caveat to this applies in the situation where the relationship between the funding providers, acting as lenders, and the project developer, acting as borrower, would be characterized as a consumer loan under the Swiss Consumer Credit Act. Indeed, the issuance of consumer loans<sup>16</sup> on a professional basis is subject to a cantonal authorisation requirement<sup>17</sup> for the lender, as well as for any intermediary involved. Theoretically, absent any clear guidance on this subject from respective cantonal authorities, a person which extends significant loans on a regular basis on crowdfunding platforms in a manner which amounts to a quasi-business activity runs the risk of falling within the ambit of the Swiss Consumer Credit Act. This risk only arises in relation to «private» financing projects (i.e., personal loans), as opposed to commercial projects funding (e.g., loans to SMEs). Where such risk applies, a possible solution to minimizing the risk is to structure the business model of the lending platform in a manner where the platform operator is itself authorized as a consumer credit lender under applicable cantonal law, which should insulate the crowdfunding participants (sub-participants in the loans) from the relevant authorization requirements.

## **B) Platform operator**

[Rz 13] Crowdfunding platforms that funding providers (lenders / project financiers) use for allocating funds to project developers may be subject to various licensing requirements under the Swiss financial market legislation depending on the business model and structuring of the operations of the platform.

[Rz 14] In the simplest setup where the crowdfunding platform allows the funding providers to **directly** allocate funds to the project developer, without any intermediation in the flow of funds by the platform operator, the platform operator would generally not be subject to any regulatory requirements under Swiss financial regulation<sup>18</sup>. The same would apply when funds are channelled through an independent third party (e.g., an escrow agent)<sup>19</sup>, it being understood that the relevant third party intermediary may in turn be subject to regulatory requirements depending on the circumstances.

[Rz 15] By contrast, in any situation where funds are received by and booked on the accounts of the platform operator, before being made available to the project developer, it must be assessed whether the platform operator needs a banking license. Indeed, a banking license is required for anyone who accepts deposits from the public in a professional capacity without immediately

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<sup>15</sup> Article 2 (1) of the Swiss Banking Ordinance (BO).

<sup>16</sup> The Swiss Consumer Credit Act applies to loans between CHF 500 and CHF 80'000 (Article 7 (1) (e) of the Swiss Consumer Credit Act), that are made for private (as opposed to commercial) purposes.

<sup>17</sup> Article 39 of the Swiss Consumer Credit Act and the applicable cantonal legislation.

<sup>18</sup> FINMA Factsheet: Crowdfunding, Status: 1 December 2014, available at: <https://www.finma.ch/en/{~}/media/finma/dokumente/dokumentencenter/myfinma/faktenblaetter/faktenblatt-crowdfunding.pdf?la=en> («FINMA Factsheet»).

<sup>19</sup> FINMA Factsheet; see also: JULIETTE ANCELLE / PHILIPP FISCHER, Regulation of Crowdfunding Activities in Switzerland: Where do we Stand?, in: Jusletter 22. Februar 2016, Rz 22 and cited references.

applying those funds to the settlement of the contemplated transaction (i.e., passing the funds to the project developer), absent any of the other available exemptions<sup>20</sup>.

[Rz 16] Funds channelled through a platform operator's accounts are also subject to money laundering provisions if the operator renders a professional service, because they constitute a payment transaction service that requires a «financial intermediary» licence under the Swiss Anti-Money Laundering Act (AMLA). If a platform operator is not required to obtain a banking licence, they must either obtain a licence from FINMA as a directly supervised financial intermediary or become a member of a self-regulatory organisation (SRO) recognised by FINMA<sup>21</sup>.

### 1) **Authorization under the Swiss Banking Act – soliciting or accepting «deposits from the public» on a professional basis**

[Rz 17] The Swiss Banking Act (BA) requires anyone who accepts or solicits (a) deposits (b) on a professional basis (c) from the public to obtain a banking licence under the BA<sup>22</sup>.

#### a) **Deposits...**

The definition of « deposit » encompasses any undertaking for own account to repay a certain amount (debt)<sup>23</sup>. In other words, as a matter of principle, all debts assumed for own account are generally presumed to constitute «deposits»<sup>24</sup>, subject only to the exhaustive list of exceptions provided for in Article 5 (3)(a) to (f) BO<sup>25</sup>.

Although there are various theories and arguments – all of which having their merits – militating in favour of considering crowdfunding transactions, at least under certain conditions, as not constituting deposits<sup>26</sup>, in the strict regulatory sense one can only rely on the following explicit exceptions, whereby do not constitute «deposits» under the Banking Act and Banking Ordinance:

- Bonds or other debt instruments that are standardized and issued in large number or non-certificated rights with a similar function (value rights) if the creditors are informed in a manner equivalent to the requirements of Article 1156 of the Swiss Code of Obligations (SCO)<sup>27</sup>. In practice, however, the issuance of a prospectus under the current legislation is an onerous exercise and is infrequent

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<sup>20</sup> By way of example, funds the reimbursement of which is guaranteed by a Swiss bank do not constitute «deposits» (Article 5 (3)(f) BO / § 34 of the FINMA Circular 2008/3 on deposits by the public at non-banking entities).

<sup>21</sup> Article 12 (c) AMLA.

<sup>22</sup> Articles 1 (2), 46 (1)(a) and 49 (1)(c) BA.

<sup>23</sup> ATF 136 II 43, consid. 4.2.

<sup>24</sup> FINMA Circular 2008/3, Cm 10; FLORIAN SCHÖNKNECHT, Der Einlagebegriff nach Bankengesetz, GesKR 2016, p. 300, 302.

<sup>25</sup> ATF 132 II 382, consid. 6.3.1, and references cited.

<sup>26</sup> PETER V. KUNZ, Crowdfunding, in: Jusletter 25. August 2014, Rz. 34; ANDREAS SCHNEUWLY, Crowdfunding aus rechtlicher Sicht, AJP 2014, 1610 ff., 1622; JANA ESSEBIER/ROLF AUF DER MAUR, Fidleg als Chance für die Schweiz als Crowdfunding-Standort, in: Jusletter 28. September 2015, Rz. 20; KARIM MAIZAR/ARMIN KÜHNE, Crowdinvesting – Ein neues Kapitel im Kapitalmarkt?, in: Thomas U. Reutter/Thomas Werlen (Hrsg.), Kapitalmarkttransaktionen X, Zürich 2016, 87 ff., 113; FLORIAN SCHÖNKNECHT, Der Einlagebegriff nach Bankengesetz, GesKR 2016, p. 300, 303.

<sup>27</sup> Article 5 (3)(b) BO.

in practice, with some limited exceptions<sup>28</sup>. In addition, each person involved in the preparation of the issuance prospectus becomes subject to prospectus liability.

- Credit balances on client accounts of securities dealers, precious metal traders, asset managers or any similar companies which solely serve the purpose of the settlement of client transactions, provided no interest is paid on them (the so-called «settlement account» exception)<sup>29</sup>. This exception is of direct practical relevance<sup>30</sup> to most crowdlending platform operators to the extent that it allows for acceptance of funds from the participants (funding providers) without banking licence, if funds are immediately transferred to the project developer. Per FINMA's current practice, a maximum holding period of seven (7) days is generally permissible under the «settlement account» exception<sup>31</sup>. This exception further requires that the transaction to be executed is already organised or immediately foreseeable<sup>32</sup>, something which is typically the case of crowdlending projects, insofar as the details of the project are made available on the platform to potential funding providers. The effective ability of crowdlending platforms to pool funding at the level of the platform before the funds are made available to the project developer (borrower) is therefore significantly hampered by the short holding period rule for settlement accounts. As an alternative, platform operators may seek to structure their business model in a manner whereby participants only make funding commitments, which are drawn only upon the closing of the funding or when a certain level (milestone) is reached. This may, however, raise practical difficulties depending on the number of commitments, as well as the default rate on promised commitments.
- Funds the repayment of which and any interest to be paid are guaranteed by a bank (default guarantee)<sup>33</sup>. This exception presupposes a close cooperation of the crowdlending platform with a Swiss bank. To the extent that crowdlending is perceived as a competitor or alternative to traditional banking lending, banks are not likely to be willing to accept to act in such capacity given the equity requirements, risk management and compliance duties and burdens that would be triggered, especially for low volume transactions with multiple small funding providers (lenders). However, by contrast, some real estate crowdlending business models involve a bank as escrow agent to collect the proceeds of the financing structured as a bond issuance by the promoter of the real estate project. In most cases, the bank will be the same that provides partial construction finan-

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<sup>28</sup> By way of example, Swiss Lending ([www.swisslending.com](http://www.swisslending.com)), one of the first real estate crowdlending platforms, seems to operate on a model where the investors acquire a note/bond issued by the project developer, with a maximum of 20 bondholders per issuance, given that the minimum «ticket» is stated to represent 5% of the amount of the financing sought.

<sup>29</sup> Article 5(3)(c) BO.

<sup>30</sup> Federal Council press release of 20 April 2016, and §3.1 of the «Background documentation» document of 2 November 2016, available at: <https://www.news.admin.ch/news/message/attachments/45938.pdf>.

<sup>31</sup> See Explanatory report, Consultation on new fintech regulations, 1 February 2017, p. 14, available at: <https://www.news.admin.ch/news/message/attachments/47047.pdf> (in French).

<sup>32</sup> Swiss Federal Court decision 2C\_929/2010 of 13 April 2011 consid. 3.4.2.

<sup>33</sup> Article 5 (3)(f) BO.

cing for the same project already, so that the due diligence and risk management will have already been completed anyway.

**b) ... on a professional basis...**

The acceptance of deposits is characterised as a banking activity if the acceptance or solicitation of deposits is conducted «on a professional basis». Pursuant to Article 6 BO, anyone who accepts on an ongoing basis more than 20 deposits from the public or solicits deposits from the public, even if upon doing so, fewer than 20 deposits are finally made, acts on a professional basis.

The effective limitation to 20 deposits negates the purpose of a crowdfunding model, which is by design aimed at as many investors as possible<sup>34</sup>. Furthermore, given that any public solicitation for deposits (even if the number of deposits obtained is below 20) falls within the ambit of «banking» activity, the mere publication of a project soliciting participation on a publicly open crowdfunding platform may already trigger this regulatory risk, notwithstanding any stated limitation to accepting only a maximum of 20 participants per project. Some crowdlending platforms have adopted as proposed mitigation of such risk a combination of: (i) the granting of access to projects solely to registered users, which are identified and accepted after a screening process, so that the offer is arguably no longer «public» but rather limited to a closely defined circle of persons (to address the «public solicitation» limb of Article 6 OB), and (ii) the limitation of the effective number of lenders in any given project to 20 (to address the «acceptance» limb of Article 6 OB). Although there is support for this approach in case law on the concept of «public offering»<sup>35</sup>, there are no precedents addressing specifically such situation and, hence, there remains some uncertainty and risk.

The 20 participants per project limitation appears to be the most significant restrictive factor in terms of further development of crowdlending in Switzerland, insofar as it practically defeats the underlying core purpose of using the distributed «crowd» elements to increase liquidity and speed of funding of various projects, as an alternative to traditional bank lending.

**c) ... from the public**

Anyone other than persons exhaustively listed in Article 5 (2) BO are considered as being members of the «public». In practice, crowdlending is specifically aimed at P2P and individuals unconnected with the project developers (borrowers), so that none of the exceptions available to the circle of person (participants) are likely to apply.

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<sup>34</sup> JANA ESSEBIER and ROLF AUF DER MAUR (note 27), N 16.

<sup>35</sup> See for example Judgement of the Federal Supreme Court 2C\_89/2010, 2C\_106/2010 of 10 February 2011 consid. 5.3.2, which analyses the concept of «public» in the collective investment schemes context, which was at the time similar to the Banking Act concept (see BSK BankG, Bahar/Stupp, Art. 1 N 62 ff.), i.e., prior to the revision of the Collective Investment Schemes Act (CISA).

**d) Consequences of the conditions being met**

The Banking Act subjects the granting of a banking license to very strict conditions. In the crowdfunding space, the most onerous requirements would typically be the minimum capital of CHF 10 million<sup>36</sup>, equity and liquidity requirements<sup>37</sup>, as well as organisational constraints and qualified regulatory audit. The banking licensing requirements represent a barrier to entry for all crowdfunding platforms, insofar as those rely mostly on lean substance and technology to promote a business model that may appeal to individuals (the «crowd»).

**2) Authorization under AMLA – acting as a «financial intermediary»**

[Rz 18] Financial intermediaries in the non-banking sector within the meaning of AMLA include all persons who on a professional basis accept or hold for safekeeping or help to invest or to transfer assets belonging to a third party<sup>38</sup>. Hence, a platform operator which has the power to allocate the funds made available to it by the participants (funding providers) is likely to be characterized as a «financial intermediary» and, consequently, will be required to register with, and is subject to, the supervision of a self-regulated body recognized by FINMA or to become directly supervised by FINMA.

[Rz 19] The duties imposed on the financial intermediary are essentially KYC due diligence rules and procedures (in particular, identification of the contracting party and of the beneficial owner), as well as certain organizational requirements (e.g., internal controls, documentation, continuing education, etc.). In addition to these KYC rules and procedures, financial intermediaries must also comply with the duties to report and to block assets in the event they have knowledge or suspicion of criminal activity. The reporting duty presupposes that the financial intermediary is aware of or has reasonable suspicion about the criminal origin of the assets involved or their use for the financing of terrorism, or, since 1 January 2016, that the assets derive from a qualified tax offense.

[Rz 20] Compliance with AMLA registration and continuing requirements is generally not a significant barrier to entry into the crowdfunding market. Crowdfunding platforms may take advantage of the due diligence and onboarding via digital channels in accordance with the requirements set out in FINMA Circular 2016/7 «Video and online identification», to fully integrate the participant experience in a streamlined IT environment and help reduce costs.

**3) Other financial markets legislation requirements**

[Rz 21] In addition to the above requirements under the Banking Act and/or the AMLA, crowdfunding platforms may under certain circumstances be subject to the Swiss Stock Exchanges and Securities Trading Act (SESTA) or the Collective Investment Schemes Act (CISA).

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<sup>36</sup> Article 3 (2)(b) BA and Article 15 BO.

<sup>37</sup> Article 4 BA and related provisions.

<sup>38</sup> Article 2 (3) AMLA.

[Rz 22] Those situations are typically not relevant for crowdlending platforms and will not be further detailed here, but are mentioned for the sake of completeness<sup>39</sup>.

### C) Project developer (funding recipient/borrower)

[Rz 23] Project developers may also need to be licensed by FINMA.

[Rz 24] A banking licence may be necessary if project developers accept funds from project financiers in their own accounts on a professional basis. This applies if funds are accepted in the form of third-party capital (e.g., loans) as discussed in § 2.2(B)(1) in relation to the licensing requirements under the Banking Act.

[Rz 25] Typically, the Swiss regulatory requirements under the Banking Act would apply to the project developer if neither of the following exceptions applies:

- *No deposits from the public*: The most relevant exception for project developers is the bond prospectus issuance exception pursuant to Article 5 (3)(b) BO, as described in §2.2(B)(1)(a) above. The project developer may avoid the onerous requirements of being regulated as a banking institution by issuing a prospectus compliant with Article 1156 SCO and issuing bonds or notes in exchange for the funding provided. The issuance of a prospectus, however, triggers costs and subjects all participants in the issuance to prospectus liability, something which may be an obstacle for some of the crowdlending platforms who would not want to be associated to the prospectus issuance and/or distribution.
- *No activity on a professional basis*: See §2.2(B)(1)(b) for the conditions relating to the acceptance or solicitation of deposits on a professional basis. In practice, this requirement results in a significant restriction on the ability to raise capital by virtue of a combination of: (i) the granting of access to projects solely to a limited circle of registered users of a platform, so that the offer is arguably no longer «public» (to address the «public solicitation» limb of Article 6 OB), and (ii) the limitation of the effective number of lenders in any given fundraising project to 20 (to address the «acceptance» limb of Article 6 OB). As mentioned above, this restriction significantly limits the ability to raise capital from the «crowd».

## 2.3. Main regulatory issues and obstacles

[Rz 26] The various business models of crowdlending rely on aggregating funds from many non-financial funding providers (generally individuals) and channelling those to project developers in the form of loans or debt securities (e.g., notes or bonds), something which may imply deposit-taking under the Banking Act either at the level of the platform operator and/or the project developer.

[Rz 27] The main issues and obstacles to crowdlending from a Swiss **regulatory perspective** include:

- The definition of acceptance and solicitation of «deposits» «on a professional basis», which effectively limits the number of fund providers to 20 per project selected from a limited cir-

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<sup>39</sup> For an analysis of the reasons why Swiss Stock Exchanges and Securities Trading Act (SESTA) or the Collective Investment Schemes Act (CISA) do not apply to typical crowdlending business models, see Andreas Schneuwly, Crowdfunding aus rechtlicher Sicht, AJP 2014, pp. 1610 ff., §§ V.B and V.C.

cle of registered users on any given platform, irrespective of the amounts of the respective funding provided by each of the participants, does not allow for the development of most crowdfunding business models.

- The seven (7) day execution deadline to benefit from the settlement account exception from the definition of «deposit» under Article 5 (3)(c) BO for non-securities dealers is extremely short in practice and severely hampers the flexibility of most of the business models on the market today.

## 2.4. Excursus – Tax implications

[Rz 28] Although the regulatory constraints represent the main limiting factors, in the current state of legislation, tax aspects are not to be forgotten. In a nutshell, although loans usually trigger no adverse tax consequences for the project developer (borrower), it should be mentioned that:

- Loans from affiliated persons must be at arm's length (market conditions).
- Thin capitalization rules apply irrespective of whether loans are sourced through crowdfunding or otherwise, and require that (a) the part of borrowed capital deemed to be excessive is added to the taxable capital of the borrower, and (b) any interests paid thereon are deemed to constitute constructive dividends and subject to withholding tax.
- The loan may be characterized as a bond for Swiss tax purposes if (i) a Swiss tax resident borrower of one syndicated facility with identical conditions owes interest-bearing money of more than CHF 500'000 to more than 10 non-bank lenders; or (ii) a Swiss tax resident borrower under debt relationships with different conditions owes interest-bearing money of more than CHF 500'000 to more than 20 non-bank lenders (the so-called «10/20 Non-Bank Lender Rules»). Such re-characterization results in the interests paid thereon to be subject to withholding tax (with full or partial refund per the normal conditions for creditors residing in Switzerland or double-taxation treaties for creditors residing abroad)<sup>40</sup>.

[Rz 29] The tax consequences are not overly onerous, but still represent an administrative burden and cost (i.e., registration as «bank» for withholding tax purposes with the tax administration, calculation, withholding and remittance of withholding tax), which may result in some business models to become less profitable or simply impracticable, especially for smaller borrowers.

## 3. Proposed legal and regulatory developments

[Rz 30] Switzerland wishes to create a competitive regulatory framework for fintech generally, which allows for various innovative business models to develop without material barriers to entry that significantly hamper innovation in this area. In this respect, the Swiss financial regulators position is to adopt a technologically neutral approach to regulation, to all extent possible. There are also several legislative and regulatory revision projects in the pipeline aiming at addressing the emergence of digital technologies and new business models. Those include the draft Financial Services Act (FinSA) and Financial Institutions Act (FinIA), which are pending before the Swiss

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<sup>40</sup> JEAN-BLAISE ECKERT and FLORAN PONCE, *Swiss withholding tax aspects of financing*, in ASA 83, Nr. 11/12, 2014/2015, pp. 969 ff.

Parliament (see § 3.1), as well as the draft fintech regulations which were issued by the Federal Council for consultation in February 2017 (see § 3.2).

### 3.1. Draft Financial Services Act (FinSA) and Financial Institutions Act (FinIA)

[Rz 31] The draft Financial Services Act (FinSA) and Financial Institutions Act (FinIA) are part of the new financial market architecture. The drafts were issued by the Federal Council on 4 November 2015, together with the accompanying dispatch<sup>41</sup>. Both drafts are expected to create uniform competitive conditions for financial intermediaries and improve client protection, also in the crowdfunding space, without however issuing specific legislation on the subject<sup>42</sup>.

[Rz 32] There are no specific provisions dealing with crowdfunding or the supervision of crowdfunding platform operators or intermediaries in the original draft FinIA.

[Rz 33] By contrast, the draft FinSA indirectly addressed some aspects of crowdfunding, and crowdlending, by way of the proposed requirements to issue a prospectus<sup>43</sup> and/or a basic information sheet<sup>44</sup> for the issuance and offering of financial instruments. Debt certificates, notes or bonds issued as part of a crowdlending project would fall within the definition of «financial instruments»<sup>45</sup>. The preparation of a prospectus is indeed one of the available exceptions from the definition of «deposits» under the Banking Act<sup>46</sup>, and the original draft FinSA intended to extend such exception to all debt financial instruments for which a prospectus or a basic information sheet was issued<sup>47</sup>. This aims at facilitating capital raising for SMEs by lowering the threshold for a debt securities issuance (i.e., in some instances only a relatively simple basic information sheet would be sufficient), whilst excluding the same from the definition of «deposit» thereby not triggering any licensing requirement under the Banking Act.

[Rz 34] However, the Council of States amendments to the draft FinSA<sup>48</sup> significantly changed the original draft:

- On the one hand, the new proposed revisions of the Council of States aim at bolstering innovation by introducing an «innovation» space where deposits from the public up to CHF 100 million may be accepted by a business active principally in the financial sector without requiring a banking license, on the condition that such deposits are neither invested, nor remunerated<sup>49</sup>.

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<sup>41</sup> [https://www.efd.admin.ch/efd/en/home/dokumentation/nsb-news\\_list.msg-id-59331.html](https://www.efd.admin.ch/efd/en/home/dokumentation/nsb-news_list.msg-id-59331.html).

<sup>42</sup> Dispatch of the Swiss Government regarding Draft FinSA and Draft FinIA, 4 November 2015, pp. 40 et seq.; Response to the parliamentary question n° 15.3917 (available in French at: [http://www.parlament.ch/f/suche/pages/geschaefte.aspx?gesch\\_id=20153917](http://www.parlament.ch/f/suche/pages/geschaefte.aspx?gesch_id=20153917)).

<sup>43</sup> Article 37 ff. Draft FinSA.

<sup>44</sup> Articles 60 ff. Draft FinSA.

<sup>45</sup> Article 3 (c) Draft FinSA.

<sup>46</sup> See § 2.2.(B)(1)(a) above.

<sup>47</sup> Draft Article 1b (3) Banking Act, as amended by the original draft FinSA.

<sup>48</sup> See draft FinSA and related amendments, as revised by the Council of States: <https://www.parlament.ch/centers/eparl/curia/2015/20150073/S11%20F.pdf>.

<sup>49</sup> New draft Articles 1a (1)(a<sup>bis</sup>) and 1a<sup>bis</sup> Banking Act, as amended by the Council of States draft FinSA.

- On the other hand, the proposed draft exception from the definition of deposits for debt financial instruments for which a prospectus or a basic information sheet has been deleted by the Council of States. One of the explanations for such amendment may be that the exception from the definition of «deposit» may be dealt with by way of an ordinance of the Federal Council and does not absolutely require a formal legal provision. The situation is not clear on this point.

[Rz 35] In view of the above, the current draft FinSA / FinIA do not address in any meaningful way the main regulatory issues and obstacles for crowdfunding, namely (i) the scope of the definition of «deposits», making it impossible for borrowers to attract funding from more than 20 non-bank lenders, and (ii) the absence of realistic carve out for collecting and channelling funds to the project developer. However, the proposed «innovation» facilitated status may be welcome for fintech development generally and should be further analysed to assess its potential impact.

[Rz 36] The draft FinSA / FinIA are now to be examined by the National Council and there is therefore still time to introduce improvements and changes which would enable the development of a new regulatory framework which genuinely promotes innovation, in line with the spirit of the proposed new fintech regulations, issued for consultation on 1 February 2017. In particular, the carve out from the definition of «deposit» of debt financial instruments for which a prospectus or basic information sheet has been issued could be reinstated, although arguably this exemption does not need to be introduced at the level of the law, but may be addressed at the level of the implementing ordinance by the Federal Council. That being said, other improvements and consequential amendments to other legislative acts would be welcome to address secondary issues and roadblocks to new digital business models.

### 3.2. Consultation on new fintech regulations

[Rz 37] On 1 February 2017, the Federal Council initiated the consultation on amendments to the Banking Act and Banking Ordinance in the fintech area. The revision should ensure that barriers to market entry for fintech firms are reduced and that the competitiveness of the Swiss financial centre is enhanced. The consultation will last until 8 May 2017<sup>50</sup>.

[Rz 38] The proposed amendments to the Banking Act and Banking Ordinance aim to regulate fintech and other firms which provide services outside normal banking business per their risk profile. A form of deregulation with three main elements is being proposed:

- First, the exception provided for in the Banking Ordinance for the acceptance of funds for settlement purposes (Article 5 (3)(c) BO) would be extended to allow for **settlements within 60 days** (instead of only seven days under current practice). This is a simple change of the Banking Ordinance.
- Second, a new carve out is proposed for the acceptance of **deposits up to CHF 1 million** (in aggregate, irrespective of the number of deposits) which would not be classified as operating «on a professional basis» and would therefore be exempt from bank licencing, if those deposits are neither invested, nor remunerated (if the deposit taker is principally active in the

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<sup>50</sup> <https://www.admin.ch/gov/en/start/documentation/media-releases.msg-id-65476.html>.

financial sector). This amendment would also only require a change to the Banking Ordinance.

- Third, simplified authorisation and operating requirements are proposed for financial businesses that accept public funds of up to a maximum of CHF 100 million, but do not operate in the lending business. This third amendment would require a change to the Banking Act and, in substance, correspond to the provisions proposed by the Council of States as part of the review of the original draft FinSA<sup>51</sup>.

[Rz 39] The first two changes may well be adequate to address meaningfully the major current restrictions to crowdlending, so that under the proposed new regulations:

- *Project developers (borrowers)*: Borrowers (other than financial institutions) would be able to attract lending from an unlimited number of non-banks up to an aggregate amount of CHF 1 million, without being considered as conducting a banking business. The borrower would be required to issue a risk warning to the lenders/depositors that (i) the borrower is not regulated by FINMA and (ii) the deposits are not covered by the deposit protection<sup>52</sup>. An additional restriction that deposits may not be invested or remunerated is proposed to only apply if the borrower is acting in the financial sector, so that commercial borrowers would not otherwise be limited in attracting interest-bearing loans from the «crowd».
- *Platform operators*: Platform operators would both benefit from the CHF 1 million threshold for professional deposit taking (same conditions as briefly described above), and from the longer settlement account deadline extension, which will allow them much more flexibility in organising their business model.

[Rz 40]

That being said, funds held in settlement accounts and/or otherwise deposits below the CHF 1 million would not benefit from any deposit protection. Whereas the current seven day settlement account practice effectively limits the risk of bankruptcy occurring within that window, under the proposed regulation there would be no time-limit for holding deposits of less than CHF 1 million, and a time-limit of 60 days otherwise, something which may render bankruptcy risk – of the platform operator – a reality, without any protection to investors.

[Rz 41] The consultation process which has only just begun and is open until 8 May 2017 will likely bring to light additional ideas and improvements, so that hopefully an efficient regulatory package may then be quickly put in force and implemented.

## 4. Conclusion

[Rz 42] As was expected, in response to calls from many crowdfunding entrepreneurs<sup>53</sup>, Switzerland is now following the path of the United States and some European countries by taking the opportunity of a complete overhaul of its financial regulations to adopt rules aiming at providing a competitive framework for fintech and innovation, without issuing strict and specific regulation

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<sup>51</sup> See § 3.1 above.

<sup>52</sup> Proposed draft Article 6 (2)(c) BO.

<sup>53</sup> Swiss Crowdfunding Association, White paper – Crowdfunding in Switzerland, 2015, p. 44.

which would not consider all possible future business models. Indeed, overregulating or adopting regulation that is too specific could backfire and result in stopping the current growth of crowdfunding activities in Switzerland<sup>54</sup>.

[Rz 43] Contrary to some other jurisdictions, Switzerland thus did not choose to adopt a detailed regulation, limiting access to confirmed professionals or setting financial thresholds to protect both project developers and project financiers. Rather, the proposed «light touch» changes are aimed at deregulating partially barriers to business models which do not present an otherwise significant risk. Due to the rapidly progressing digitisation in the financial sector, in particular in the blockchain area, it can be assumed that business models will develop which are not yet conceivable today.

[Rz 44] Overall, the proposed regulatory changes are welcome, for fintech generally and for crowdlending business models in particular, but some areas require additional assessment and creative thinking as to how to efficiently address the (new) risks and (remaining) issues, including: (a) the new bankruptcy risk of the platform operator<sup>55</sup>, (b) aligning tax and other administrative burdens with the new regulatory concepts of deposit and thresholds (e.g., raise the characterization of bond / note for withholding tax purposes to CHF 1 million (in aggregate) and more than 20 non-bank lenders).

[Rz 45] Incidentally, the opportunity may be taken to codify some of the rules governing fiduciary relationships<sup>56</sup>, at least in the fintech area, to facilitate business models where «crowd» aggregation through a single nominee may be the only practicable solution (in particular in crowdinvesting, and some forms of crowdlending), which does not benefit from sufficient bankruptcy protection by contrast with simple foreign law instruments (trusts) which are recognised under Swiss law.

[Rz 46] In any event, the evolution of business models and the regulatory framework should be monitored closely and corresponding «light touch» changes should be introduced as and when appropriate to address any material barriers to innovation and economic development, respectively new significant risks to investors or markets.

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<sup>54</sup> ANDREAS DIETRICH and SIMON AMREIN, Crowdfunding monitoring Switzerland 2015, p. 28.

<sup>55</sup> Such risk may in theory be addressed by requiring the platform operator to hold the funds as nominee only, in an account with a Swiss bank. However, funds held by a nominee do not benefit from any segregation privilege in a bankruptcy and this would not solve the issue. By contrast, the platform operator may well settle a foreign law trust for each project (where the platform operator would act as trustee), so as to benefit from the better treatment of trust property in case of bankruptcy of the trustee (Article 284b Debt Collection and Bankruptcy Act, DCBA).

<sup>56</sup> A detailed proposal has already been established, but probably ahead of its time, see Prof. LUC THÉVENOZ, Trusts in Switzerland, Ratification of The Hague Convention and Codification of Fiduciary Transfers, Schulthess, Zurich 2001, available at: [https://www.cdbf.ch/site/wp-content/uploads/2013/08/Trusts\\_in\\_Switzerland\\_EN\\_.pdf](https://www.cdbf.ch/site/wp-content/uploads/2013/08/Trusts_in_Switzerland_EN_.pdf).