BFCM COMMISSION

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INTERNATIONAL ASSOCIATION OF YOUNG LAWYERS

Quarterly Newsletter

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Editorial

President

Gerard Correig

Dear Commission Members,

After 6 years as Commission officer (the last 3 years as President), it is time to say good bye to the front line and let other colleagues lead the Commission to new challenges.

I want to thank all of you for all these years and for having given me the opportunity and the trust to transform this small Commission in one of the most active Commissions of AIJA. We have been present in all the big AIJA events and regularly organized small events on stand-alone basis or together with other Commissions.

This is a collective success, which was possible thanks to the support and hard work of my other Commission colleagues such as our past President Andreas Driver, former Vice Presidents Xavi Costa and Bethan Waters and present Vice Presidents Stephanie Hodara and Jennifer Maxwell. I thank all of them for such rewarding time and wish Jennifer, our next President, all the best.

Best regards,

Gerard

Tokyo Annual Congress

- The Annual Congress in Tokyo is about to take place and will start this Monday 28 August 2017.
  We hope to see numerous of you during the Congress and especially during the Working Session number 5 organized by the BFCM Commission and focusing on Fintech on **31 August 2017 at 9 am** at the Hilton Shinjuku.
  .
- Election of a new Vice-President
  As Gerard's mandate as President will end during this Annual Congress and as Jennifer Maxwell will become the new President of the BFCM Commission, a new Vice-President needed to be elected. Natalia Danilova has presented her candidature for this position. This Newsletter is therefore the occasion to let her introduce herself to the BFCM's members she has not yet met at AIJA:

By way of introduction, my name is Natalia Danilova, I am an Associate in ALRUD Law firm which is a Russian well known full service company. I form a part of our Banking and Finance team and work with a wide variety of matters including but not limited to assisting our clients with both transactional and regulatory part of work. Moreover, my practice includes participation in numerous projects dealing with issuance of both shares and bonds and consulting in connection with Russian securities regulations.

I am a new member as I joined AIJA in 2016. However, I participated in several events so far, acted as a national reporter and as speaker. Moreover, my contribution is not limited to participation, but includes arrangement of BFCM Commission events as well.

I know that being part of AIJA and BFCM Commission implies additional responsibilities. Given this, I would be happy to contribute to recognition of AIJA in general and to work on success of BFCM Commission in particular, including by way of expanding AIJA members list, collaboration with other commissions and assisting in arranging of AIJA events.

I look forward to seeing you all in Tokyo at the BFCM Commission seminar, which promises an interesting discussion of FinTech developments!

Best regards,
Natalia Danilova

- Call Notice:
  The BFCM Commission meeting during the Annual Congress will be held in Tokyo on Wednesday, 30 August 2017 at 4 pm (See Call notice) – We encourage all the BFCM Members to come to the meeting and meet, if you have not had the chance to do so yet, our next President Jennifer Maxwell !

Previous Events

- Riga, May 2017 – Half Year Conference
  As Matthias Gstoehl, a member of the BFCM Commission who actively participated to the Half Year summarizes it so well, last May, hundreds of lucky AIJA members gathered in splendid Riga for the Spring 2017 half-year Conference, offering a double-seminar on environmental & energy transactions and on the start-up world.

  At the forefront of innovation, the BFCM Commission organized the workshop "*Start-up 4.0 – FinTechs and the Online World*" during which speakers from various countries explained to the audience what FinTech is. Providing an overview of its main applications and technology, the focal points of interest revolved around the legal challenges posed by crowdfunding, robo-advice and blockchain.

  The social program was outstanding too, including a spectacular dining experience by the Baltic Sea (see picture), convivial home hospitality dinners and the traditional post-dinner gathering, in true AIJA- and Baltic-spring atmosphere.

See Minutes of the BFCM Commission meeting in Riga

Upcoming events for the BFCM Commission

- Girona, November 2017 – Half Year Conference

  The 2017 Half Year November Conference will be held in the beautiful Spanish city of Girona as from 15 November 2017 up to 18 November 2017. The full scientific program has just been released.
  It will focus on Crowdfunding and Alternative Financing and on law on Cinematography. The BFCM Commission will of course actively participate to this event. Our Vice-President, Stéphanie Hodara, will notably participate to a panel on Thursday 16 November 2017 at 2.15 pm regarding "*Equity crowdfunding: Regulation, practice and challenges*".
  Further information will become available in the coming weeks, especially regarding the social program, but don't miss out on this event and save the dates now!

- Valbella, January 2018 - Winter seminar

  Next year Winter seminar will take place in Valbella. The seminar will commence on the evening of Sunday 21 January 2018. The seminar's scientific programs will take place between Monday 22 January 2018 and Wednesday 24 January 2018 in the mornings. In the afternoons, you will have time to explore and enjoy winter sports activities in one of the biggest ski areas of Switzerland. The alpine oasis of Valbella is probably THE young and upcoming ski resort in the Swiss Alps.
  The scientific program will treat two different subjects: "*Sector specific M&A on the rise*" and "*Surviving after death – how to avoid nightmare estate*".

  Call for speakers: the OC is still looking for a speaker regarding M&A in the banking sector. If you are interested do not hesitate to send an e-mail to Stéphanie Hodara.

- Warsaw, May 2018 – Half Year Conference

  The May Half Year Conference will be held in Poland, in Warsaw, one of the most vibrant and fastest growing EU cities.
  The Conference will be divided into two seminars focused on corporate governance ("*Corporate governance – current trends and development*") and the lawyer-client relationship ("*Happy ever after! In-house counsels' and law firms' perspective on how to successfully develop client-attorney relationship*").

Both the social and the scientific programmes will of course provide for plenty of excellent networking opportunities.

Call for speakers: the OC is looking for speakers specializing in capital markets. If you are interested do not hesitate to send an e-mail to Stéphanie Hodara.

Future Projects

- The BFCM Commission will organize in autumn next year, together with the Insolvency Commission, a seminar focusing on insolvency in the banking sector.
  We already received some candidature to join the OC but any further help will be welcome. So if you are interested in actively participate to the organization of this event, please contact Jennifer Maxwell.

In general, do not hesitate to contact us if you would like to organize a seminar and need the support of the BFCM Commission

Scientific Contribution

We encourage all members of the BFCM Commission to provide us with any presentation/article of interest. We will publish them in the next BFCM Newsletter and on the AIJA Banking Finance & Capital Markets LinkedIn Group.

Presentation of interest

- **Switzerland** – In line with the topics of the Tokyo Annual Congress please find below a presentation on: Fintech and Insurtech regulation - Is the Swiss market place competitive enough? by Diana Lafita, Attorney-At-Law, LL.M., Switzerland

Technology and especially digitalization are having a disrupting effect in almost every sector of the economy, including the financial sector. Big corporations, start-up companies and state agencies are more than ever investing great amounts of money and paying their full attention to find out where the real trends are going to be set and how this will impact their environment.

No doubt that the **competitiveness** of economies, measured by the level of social infrastructure, the development of technology and quality of professionals, as well as flexibility for business to grow and develop new projects will play a central role for the establishment of the new players.

However, in the financial arena seen as a whole, the developments will very intensively depend on one factor that initially may be underestimated: **regulation**. Regulators and lawmakers over the world are well aware of that fact, reacting with different strategies. In Switzerland for instance, they mainly rely on the basic principles of their regulations[1], which will allow them to interfere also ***ex-post*** when the effect of a particular business model is considered a threat to the public interests protected. This is helpful due to the

[1] See i. a. www.finma.ch: "FINMA is committed to principles-based and internationally compatible regulation, which allows the authority to perform its supervisory tasks in the right place at the right time and using the right tools."

fact that certain business models can not necessarily be subsumed into a particular regulatory status like a bank, an insurance company or an investment fund[2]. Other regulators like for instance in the European Union have been on the contrary very active in the development of regulations that are tailored to the fintech solutions and therefore much more complex, trying to foresee the several constellations that may become relevant from a regulatory perspective.

Whatever the regulatory approach is, it becomes clear that the legal background as a whole does not only need to be checked once an idea has been defined, but it is one of the **success factors** of a new business model. As such, regulation and its objectives should be understood while an idea is being shaped. Due to the fact that regulators over the world are mainly embracing fintech based on the advantages it may offer by making financial services more efficient and accessible, most jurisdictions are developing regulatory mechanisms to allow fintech start-ups to grow, leaving them some space to initially develop their ideas. That does not mean that later on, as soon as their size and shape may become a threat for any of the public interests to be protected, they will have to intervene with less favorable consequences for the initial investors. This may be the case with bitcoin and many other technologies that from a business perspective are completely disruptive: they will have to be reshaped in order to find real acceptation and the first movers that will envisage the new viable shape will have a clear competitive advantage.

It is important to understand that regulation in this context should not – at least exclusively – be seen as an obstacle for the development of a business model. On the contrary, the basics of regulation of financial institutions follow the objective to protect customers and the overall functioning of the financial markets. This makes business models that are built according to regulation basically interesting from a customer perspective and provide certain degree of stability and security which are key to long-term success. Many of the business models that have been developed in the fintech area do not really take principles of regulation into account, and are therefore in some ways already obsolete before they are even born.

This article intends to make the concepts behind regulation clear and apply them to the several trends that have been appearing in the fintech world. While the article will base on **Swiss regulation**, given that such regulation is mostly **principle-based**, a conceptual approach will be followed which is certainly similar to the approach in other jurisdictions. Moreover, it is not the purpose of this article to analyze in detail any business model, but to find out whether the **particular new business trends encounter any legal and regulatory obstacles** and how such obstacles might be set aside.

For the purpose of this article, the fintech sector will be broadly defined, and not only trends in the banking or investment sector will be presented, but also such trends belonging to the insurance world, commonly referred as „**insurtech**".

Several trends can be observed on the different business models that have emerged: some of them simply allow **online access** to financial services enhancing accessibility and

[2] DOBRAUZ-SALDAPENNA, GÜNTHER/ SCHÄREN, SIMON, Neuste Entwicklungen in der Fintech-Regulierung, Expert Focus, Ed. 10'778, August 2016, S. 1.

competitiveness, **analyze data and use digitalized solutions** and algorithms to offer a service improving quality and reducing costs and/or they allow customers to get financial services **on a peer-to-peer basis**, without interaction of any real service provider.

Clear advantages can be observed compared to the traditional services. However, they share one common weakness: most of them offer broadly speaking **reduced security features** for customers than the traditional services offered by the former financial institutions. With the exception of the real-time payment applications, which mostly work together with a financial institution to provide their services, most of the other models operate quite individually and can therefore not offer the same level of reputation, security and stability of infrastructure of an established financial institution. That is why the basic principles of many regulations will either need to be differently applied or new regulatory concepts will be created.

Broadly speaking, the main objectives of financial regulation are **protecting creditors, investors, and insured persons** as well as ensuring the **proper functioning of the financial market**, contributing thereby to sustaining the reputation and competitiveness of the particular financial centre[3].

Some basic principles of the Swiss regulation should be referred to for starting:

1) Clearly the **professional collection of funds**, that means taking deposits from the public, is an activity reserved for (licensed) banks. In Switzerland, the activity is considered to be professional insofar the number of customers amounts to 20[4]. Even if the typical banking activity consists of lending the collected funds or investing them whatsoever, creating a risk for the customers that have deposited such funds, in Switzerland, the sole fund collection is prohibited to any company which does not have a banking license. This quite stringent principle allows some exceptions[5], the most relevant of them from a fintech perspective will be set out below, especially if the collected funds are not lent by the company and do not bear interest. This having been said and generally speaking, when a company is **mainly active in the financial sector** the question of whether a banking license is required has to be analyzed as the Banking Ordinance (BO)[6] leaves some open space for intervention of the regulator depending on the necessity of supervision required by a particular business model.

2) As a second important general rule, individuals or companies that professionally accept or hold third parties' assets[7] or accept cash by the professional trade with goods and services qualify as "**financial intermediaries**" and have to comply with the **AML** regulations. This means that they have to establish a compliance system to follow the duties to identify their customers, resp. the beneficial owner as well as any irregularities related to the transactions of their customers, being supervised by either a self-regulatory organization or directly by the Swiss Financial Supervisory Authority (FINMA). The regulator has provided with a technology-neutral set of rules embodied within the FINMA Circular 2016/7 **Video and Online Identification** (so called *Digital Onboarding),* which

[3] Swiss Financial Market Supervision Act of June 22, 2007, (FINMASA), Art. 5.
[4] Art. 6 of the Banking Ordinance.
[5] See art. 5 BO.
[6] Art. 2 para. 1 BO.
[7] Art. 2 para. 3 Federal Anti-Money Laundering Act.

allows the use of audio-visual communication means to establish a customer relationship (i.e. *video-identification*).

3) The issuance of participations on an **investment fund** is subject to the Collective Investment Schemes Act (CISA), and the **trading with, offering of securities or derivatives as well as the clearing, settlement and listing of securities** are mainly regulated by the Financial Market Infrastructure Act (FMIA) and the Stock Exchange and Securities Trading Act. Furthermore, conducting an **insurance activity** is regulated by the Insurance Supervision Act (ISA).

Based on the above, many of the fintech and insuretech business models would require some level of authorization, and so the question arises of whether their regulatory treatment would be proportional to the risks (initially rather minimal) they entail for the public interests protected. Due to this fact, the Swiss Federal Council and FINMA have manifested that regulation should be **technology neutral** and proportional to the interests protected as the Swiss Constitution sets out. Accordingly, particular **amendments to the Banking Act and the Banking Ordinance** (BO) are being enacted. They operate as either exemptions to licensing duties (so called ***sandbox***) or as a simplified banking license category (so called **banking license *light***). The amendments to the BO are already enforceable from August 1, 2017.

Under the new exemption, a company will be able to keep deposits collected from customers which are not interest-bearing and on-lend for a period of maximum **60 days** without being required to apply for a banking license. This extends the already existing exception of 7 days foreseen for so called **settlement accounts**[8]. Furthermore, a company not authorized as a bank will be allowed to hold customer deposits up to the **threshold of CHF 1 million** (so called **"sandbox"**)[9], provided that they are not interest-bearing and not invested by the collecting company. This gives start-ups certain space to test their business. Customers have to be informed accordingly. In addition, the Banking Act amendment establishes the field of application of the **banking license light**. According to it, lower deposit guarantee and accounting requirements shall apply to banks that accept **up to CHF 100 million of customer deposits** and do not invest them or pay interest on such amounts[10]. All the exemptions share the common element that they apply to companies that do not conduct the typical banking activity of collecting deposits and borrow them, i.e. the so-called interest difference transaction. Furthermore, the Swiss approach offers a high degree of flexibility not customizing the banking license light to a particular business model.

In the following pages, the most observed forms of fintech-services will be explained along with a short analysis of their regulatory qualification according to Swiss law. It has to be acknowledged that there is an enormous diversity of possible fintech business models and sub-models and it is not the intention of the author to be complete on the following schedule, but more to define the trends along with their regulatory and legal treatment.

[8] Art. 5 para. 3 lit. c BO, as detailed by FINMA Circular 2008/3 *Public Deposits with Non-Banks*.
[9] This differentiates from the UK Sandbox regime, which is only made available to a limited number of chosen companies.
[10] Swiss Federal Council, official notice from July 5, 2017, Bern. See also FAVRE OLIVIER/ELSENER FABIO, Schellenberg Wittmer Newsletter Banking and Finance of April 2017.

One of the simplest form of digital solution within the financial sector is the financing of companies or projects through an internet platform. This can be referred to as **crowdfunding** when share capital is raised, or **crowdlending** when debt is created. As soon as money is centrally pooled at the platforms operator (be it an intermediary or the project originator) and this party enters a **repayment obligation (borrower)**[11], the question of whether a banking license is needed becomes real, especially when the company offers the opportunity to invest through such a platform to the public, reaching up to 20 individuals, or advertises itself for the referred purpose. With the new provisions of the BA and the BO set out above, there will be certain more flexibility in this respect. First, the threshold of CHF 1 million of total deposits helps as starting point to raise the referred amount without needing a banking license. Secondly, any intermediary that would collect money from investors for any fintech start-up would have 60 days time to allocate the required amounts to a project without being supervised as a bank. Finally, from the threshold of CHF 1 million upwards and up to CHF 100 million of customer deposits, the company would fall into the field of application of the banking license light and therefore be subject to less stringer regulatory requirements.

Many fintech applications offer **payment solutions** – like for instance PayPal as online payment company, Twint or Apple Pay. Legally speaking, payment systems are defined as *institution that clear and settle payment obligations based on uniform rules and procedures*[12]. They require an authorization from FINMA as a financial market infrastructure if the **functioning of the Swiss financial market or the protection of the Swiss users** do require it[13]. This is an example of the Swiss regulatory approach, which is much more principle-based and therefore does not particularly focus on electronic or online solutions, but on the effect that a payment system may have to the interests protected. In this context, there is no doubt that systemically relevant payment systems will require an authorization. Until the date, solely the Swiss Interbank Clearing system (SIC) has been qualified as systemically relevant by the Swiss National Bank. Payment systems that are used by financial institutions or big corporations are more likely to affect the functioning of the financial markets and the interests protected by financial regulations than such designed for use of consumers. On top of that, foreign providers of payment services are mostly out of the scope of Swiss regulation, to the extent that they are not considered systemically relevant[14]. To complete the analysis, the payment systems may also be regarded as banks as they typically receive funds of customers to be transferred. Here, the same reasoning as with crowdfunding set out above applies and therefore **especially the exception of settlement accounts** and potentially the other exemptions to be introduced with the BO and the BA can be applied depending on the particular business model. The BO also contains an exception related to the **use of funds collected for the acquisition of goods and services**[15], however the maximum payment balance per customer cannot exceed CHF 3,000[16], which makes the exception less

[11] FINMA report, *How investors can protect themselves against unauthorized financial market providers*, October 2, 2015, p. 11-12.
[12] Art. 81 Financial Market Infrastructure Act (FMIA).
[13] Art. 4 para. 2 FMIA.
[14] For more detail see FLUHMANN DANIEL/ HSU PETER CH. / ENDER TIFFANY, Regulation of Electronic Payment Service Providers in Switzerland, GesKR 1/2017, para. 2.2. and 2.3.
[15] Art. 5 para. 3 lit. e BO.
[16] FINMA Circular 2008/3 *Public Deposits with Non-Banks*, N 18[bis].

attractive. These are the reasons why most of the payment system service providers such as PayPal are not supervised by FINMA even if Swiss customers are using it[17].

One of the most popular fintech solutions, also based on its initial use, is **bitcoin**[18]. Bitcoin is a particular virtual currency that uses blockchain technology. To be conceptually clear, the meaning of virtual currency has to be distinguished from the blockchain technology, even if they can converge and create a product like bitcoin.

In the past years, thousands of **virtual currencies** have been created. They can be defined as investments bought through the internet or any digital means by a customer that can be used to pay for a good or service if accepted by a particular counterparty based on a contractual obligation. The main difference with public official currencies is that they are not generally accepted as means of payment within a country and that they are not represented by physical notes.

Their weakness is therefore that they do not have the infrastructure of public money and national banking system behind them and therefore their stability, liquidity and acceptation depend on other factors. National banks buy reserves in assets and foreign currencies to keep stability of their currencies. They also play an important role in promoting stability of prices (inflation) within a country. The question therefore is how the **value** of a virtual currency will be determined. If the value is quoted at par with a national currency, then the risk of volatility with regard to such currency will be avoided. If a virtual currency defines its value based on other factors like offer and demand, a higher risk of volatility will exist (like with bitcoin).

Further to the risk of volatility, there will be an **issuer risk**, i.e. the risk that the offeror of the currency will comply with its contractual promise to either pay the value of the invested amount back or whatsoever other duty may exist like the real possibility to use such investment as a payment method at any agreed contractual terms. The offeror may offer also some collateral to reduce or even make such risk disappear.

A company or individual that raises money to issue a virtual currency is collecting funds from the public and therefore again the question of whether a banking license is needed arises. The exceptions and new amendments in the BO and the BA explained above will facilitate any start-up project. Especially a virtual currency issuer may require that the virtual currency deposited in any virtual accounts of customers have to be **used for payment/ transferred within 60 days** to keep the issuer within the exception of **settlement accounts**. The subsequent use of a virtual currency for buying goods or services is exempted from the requirement of a banking license, yet only up to CHF 3,000[19]. Also the **anti-money laundering** regulations apply to any company that would offer accounts of virtual currencies, transfer them to other accounts or exchange them into cash, precious metals or other virtual currencies[20].

[17] PayPal Switzerland is registered and managed from Singapore, Economie, May 27, 2015.
[18] See regulatory report FINMA, *How investors can protect themselves against unauthorized financial market providers*, October 2, 2015, p. 12.
[19] Art. 5 para. 3 lit. c BO.
[20] See Art. 4 Anti-Money-Laundering Ordinance, which includes virtual currencies as payment instrument.

Also, the question of which **instrument** is used to embody a virtual currency arises and will be relevant to its regulatory treatment. Either debt or equity may theoretically be used, while debt is probably the most reasonably means. Besides typical financial instruments, a virtual currency may also be shaped by a **simple agreement** between the issuer and the customer. Under Swiss law, securities issued in accordance with the **Act on Intermediated Securities** (*Bucheffektengesetz*) are particularly adequate for embodying a virtual currency, given that intermediated securities can be transferred without the requirement of a written contract and do not require to be physically certificated[21]. The depositor of the intermediated securities (which can be the issuer or a third party) has to be licensed as a bank.

If the issuer of a virtual currency intends to use collateral for guaranteeing the value of such currency with reference to a particular asset, it may be shaped in the form of a **derivative instrument.** That would require that the issuer is licensed as a bank or as a *securities house*[22] or that a guarantor is licensed as a bank. Given that regulation should be technology neutral, also the banking license light should be a reasonable option for this business model. To the issuance and trade with derivatives, the Collective Investment Schemes Act (CISA) and in the future, the Financial Services Act (FinSA)[23] shall apply.

Blockchain technology applications allow to establish a system for registration of rights or parts of a virtually represented asset (for instance a currency, a financial instrument, or simply a part of something – can also be referred to as **tokens**[24]) for their transmission or other means of administration of such rights[25]. Blockchain applications are suitable for a number of processes, for instance as register, as voting system or as transaction system. Blockchain technology uses the technology of **distributed ledgers**, which means that it is programmed to register the information on registrations and transactions **decentral** with all participants of the blockchain, and not centrally with a sole administrator. This reduces the possibilities of fraud, given that a single participant may not change any entry in the blockchain that has been recorded and that all participants can see all transactions. Certain participants with a more powerful system function as so-called **miners** and record the transactions in a general ledger as well as do verify transactions, in exchange of which they receive bitcoins. Registration of a new participant is generated under a private key which entitles the user to transact with his acquired rights. The **private key** in itself does not necessarily give information on the identity of the particular user, reason why transactions can be completely anonymous[26].

Blockchain technology can be used for instance to **register and transfer rights** like shares, and even to **vote** or **manage share registers**, to create rights on certain assets and transfer them virtually or to create and transfer a **virtual currency**. The potential of use is certainly huge and still not fully defined.

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[21] Art. 6 para. 2 Intermediated Securities Act. See more at

[22] *Wertpapierhaus*, following Art. 11 lit. b of the Draft of the Federal Institutions Act (FinIA).

[23] Both the FinSA and the FinIA are still in form of draft and debated by the Parliament. Their entry into force is expected for 2019.

[24] The private law treatment of tokens still being unclear within the Swiss system.

[25] For more detail, see WEBER, ROLF H., Blockchain als rechtliche Herausforderung, in: Jusletter IT, May 18, 2017, para. 1.

[26] See HESS, MARTIN, Wenger & Vieli, *Cryptocurrencies, Digitalisierte werte als Zahlungsmittel – und mehr*, Presentation at Capital Markets, Law and Transactions XII, Europa Institut Zurich.

The trading of securities[27] (for instance the above referred tokens) on a platform is also subject to regulatory implications. Multilateral and bilateral trading of securities following discretionary or non-discretionary rules can be subsumed under either the definition of a **multilateral trading facility** or of an **organized trading facility**[28]. The second concept is particularly adequate for trading of tokens using blockchain technology, given that participants are not required to be supervised institutions and can therefore be any kind of customers[29].

The blockchain technology encounters generally also certain regulatory obstacles when used in the financial arena. Due to anonymity of transactions, **anti-money laundering** rules may not be implemented properly. The problem could be technically solved if the system would use a particular system to identify users. Further criticism of the bockchain system is that due to the fact that there is no central administrator, the counterparty of a payment is difficult to identify and transactions cannot be reversed, the **intervention of any regulator** to solve a problem at a particular point in time (for instance if any regulatory issue would arise) would be very difficult. Changes or updates of the system need consensus of for instance the majority of users. From a user perspective, the lack of regulatory power may lead to a lack of protection. All these issues may be solved in the future when systems are created that take the regulation into account, either by private initiative to be the first mover of a long term successful application or by enforcement of a regulator or the regulation itself.

A complementary cryptographic system to blockchain is the so called **contracting system**[30], which does not operate on a consensus basis like blockchain. The so called contracting system includes a notary that conducts settlement of transactions. It also can use distributed ledgers and offer peer-to-peer transaction services, being a substitute service to banking deposits for instance. The question arises of whether in future, central banks will be able to issue digital official currencies[31].

The provision of so called **robo-advice** is already a reality in the private banking sector. Based on a computer programmed algorithm, the customer receives personalized financial advice by entering its particular personal information and investment objectives. In a perfect world, the advice would qualitatively be improved, and even the typical conflict of interest problematic would be set aside. The Draft of a Financial Services Act (FinSA) defines the rules of conduct of financial advisors in line with EU regulations. The robo-advisor will need to first analyze the details provided by a customer based on a set of questions and then perform a so-called **customer segmentation** into private, professional and institutional customers. The rules of conduct would apply to the final advice provided by the robo-advisor based on the question of whether the advice reflects sufficient **technical expertise, due diligence and whether the transactions are done in the best interest of the customer**. It would make also sense that the **suitability resp. appropriateness** test is conducted by the robo-advisor before any transaction is executed

[27] See definition in Art. 2 FMIA.
[28] Art. 26 and Art 42 FMIA.
[29] WEBER, ROLF H., *Blockchain als rechtliche Herausforderung*, in: Jusletter IT, May 18, 2017, para. 4.5 lit. b).
[30] See at the example of Monetas, www.monetas.net
[31] See Bank of England, BARRDEAR JOHN, KUMHOF, MICHAEL, *The macroeconomics of central bank issued digital currencies*, Staff Working Paper No. 605, July 2016.

resp. financial advice is provided, as the FinSA provides for personal advice. According to the Dispatch to FinSA, the document containing basic information to certain investment products may be provided electronically[32].

The insurance sector makes progress in the digital era, too, the related developments being referred as **"insurtech"**. Regulatory questions in this field refer to whether an insurance or a brokerage activity is being conducted, as well as whether the different set of digitalized activities can reliably be offered or executed without prejudice of any customer protection or market functioning interests.

Two main principles of regulation have to be considered:

1) Conducting an **insurance activity** has been defined by the Swiss Federal Supreme Court (*Bundesgericht*) by concurrence of five characteristics: a) the risk or danger; b) the payment of a premium by the insured; c) the payment of the compensation amount by the insurer in case of damage/risk occurrence; d) the independence of the operation (non-ancilliary activity) and e) the calculation of premium and amounts to pay for compensation according to the laws of statistics, which allows to systematically conduct such business operations for the insurer.

2) **Insurance brokers** are defined by the Insurance Supervision Act (ISA) as persons who offer the **conclusion of insurance agreements**. From a private law perspective, insurance brokers have a duty of care towards the person by which they are mandated to act. Brokers have a duty to register with FINMA if they are considered as independent[33], i.e. the customer has no reason to believe that they are bound to a particular insurance company. The regulation of brokers concentrates on the requirement of a professional qualification, minimal personal reputational credentials, the coverage through a professional indemnity insurance and the conduct rules. Such conduct rules comprise a duty of information of the customer and may be strengthened in the course of the next years by a new regulation in line with the duties for intermediaries established with FinSA.

To present the different insurtech trends, one can focus on the insurance value chain.

A great number of solutions are being offered at the point of sale (**distribution**), by offering the insurance contracts online. If an insurtech start-ups does manage the online platform where it is possible to conclude insurance contracts, then brokerage activity is happening.

Some other solutions can be defined as **back office applications**, which concentrate on the underwriting of risks, accounting or regulatory reporting. To the extent the solutions are bought by insurers and therefore by supervised institutions, the regulatory treatment is relativized, as the insurers have to make sure that using them, they adhere to their regulatory duties.

[32] See WEBER ROLF H., presentation *Regulation of Robo-Advice*, Zurich Faculty of Law June 8, 2016, Zurich.
[33] Art. 43 ISA.

There is nonetheless a particular business model which is quite disrupting and cannot be considered as a back-office application, given that it will not be integrated within an existing insurance company value chain. That is the so-called **peer-to-peer insurance**. Such business models allow customers to put their risks together with such of other customers, as they would be pooled within an insurance company. There are several forms of how this can be achieved. If the platform offering the underwriting of risks is a company that takes such risks on its balance sheet, then we are still in front of a more or less traditional insurer, given that it conducts regulatory speaking insurance activity and will therefore have to acquire an insurance license. Whether the benefits of such a company, like the example of **Lemonade**[34], are dedicated to a more benefic cause or are for the shareholders is something that does not really have any insurance regulatory impact but more a marketing impact. If a part of the benefits is given back to the customer, then there must be a high price transparency, in order for the customer to understand how prices and return of benefits are calculated. But there is a form of peer-to-peer services that poses more regulatory questions, which is the creation of a platform that simply allows customers to **pool their risks**, without their transfer to any insurance company. Let's say that the customers make a pooling contract with all other customers making use of a digital platform which provides risk underwriting services. At the end of the insurance period, the difference between the income (premiums) and the losses (benefit or loss) are distributed resp. shared among the participants. Within the model explained, there are certain costs saved in comparison with the traditional insurance company, however there is a risk of loss if against the statistical predictions, the customers experiment an accumulated loss. This is the reason why at the end of the system, the inclusion of an **insurance or reinsurance company** makes sense, which would absorb, against a premium, the losses to a particular determined amount (**stop-loss mechanism**). That is the business model of the Swiss insurtech disruptor **Versicherix**[35]. In the view of the author, generally speaking the simple offer of underwriting services for customers within a platform does not qualify as conducting insurance activity as it is defined in Switzerland, but it entails some brokerage activities that can be considered as insurance brokerage according to the ISA. As soon as a company, like Versicherix does, receives cash in the concept of a premium and enters thereby an obligation to pay for an excess of loss, it is conducting insurance activity and requires to be so supervised.

As a final thought, the concept of peer-to-peer financial services as a whole may be one of the most disrupting within the fintech world, as in some way it allows through technical means that the third-party service provider (for instance the insurance company or the bank) disappears, at least partially. They base on the concept of **shared economy**, which allows, in this case due to the technical quality of an internet platform, that users can arrange themselves a service they need and use the **economies of scale** created by the massive use of the platform. That costs are saved and conflicts of interest are set aside is out of the question. The challenge of those models will be, how the interests of **consumers will be protected** if they enter themselves a business without the classic supervised entity acting as advice provider and service provider. That is why the concept of supervision

[34] See www.lemaonade.com Insurance company which saves costs by online offering of all services and so avoiding brokers and infrastructure costs. Benefits are distributed for social causes – so the marketing concentrates on low prices and less of a conflict of interest when paying claims.
[35] www.the-digital-insurer.com/blog/insurtech-introducing-versicherix-switzerlands-1st-p2p-insurer

may change to include more obligations of transparency and information for the manager of a platform, even if the activity is not completely supervised[36].

The fintech journey has just started and questions like the legal qualification of tokens, how peer-to-peer systems driven by a blockchain can be supervised, whether the central banks will end up issuing digital tender or how the landscape of financial services providers will change are still to be answered. One thing is sure, this phenomenon will keep lawyers and regulators around the world extremely busy. Countries like Switzerland, who have promptly launched regulatory initiatives to encourage innovation in the financial services sector will likely contribute to a successful evolution of their market place.

[36] MÄCHLER, MONICA, Presentation on Insurtech – Wirkungen auf die Versicherungsregulierung? UFSP Finanzmarktregulierung, 34. Forum Finanzmarktregulierung, University of Zurich, May 23, 2017, slide 17.

Other News

New members

- We warmly welcome our numerous new members admitted in Riga and look forward to seeing them during the upcoming events in particular at the BFCM Commission meeting in Tokyo.

If you are a new member of the BFCM Commission and would like to introduce yourself in our next Newsletter edition, please send Cecilia Peregrina a short report with picture, explaining the way you became aware of AIJA and perhaps what you like most about AIJA Seminars and Congresses.

New Editor

As from the next Newsletter, Diana Lafita will join the editing team of the BFCM Newsletter. It is therefore the place to let her present herself:

I am a lawyer admitted to the Swiss and the Spanish Bar.

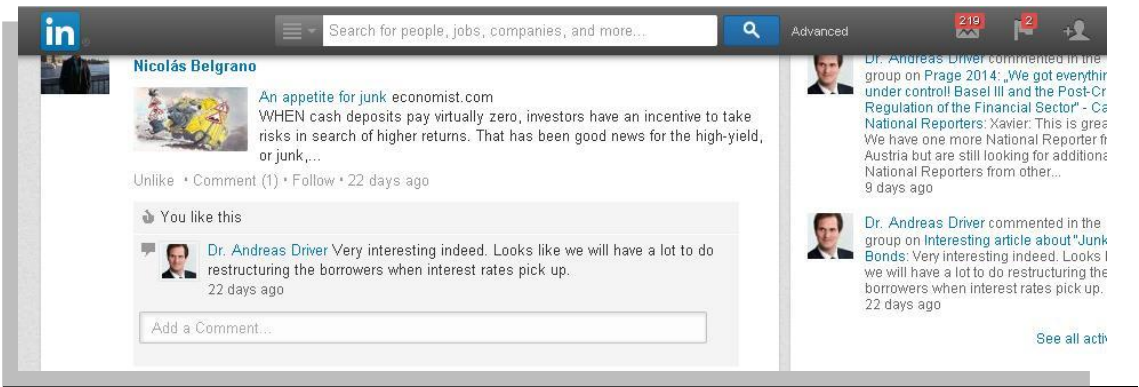
I specialize in banking, finance, capital markets and insurance law, with a focus on regulatory, compliance, distribution and transaction-related matters. I graduated in law at ESADE in Spain and moved later to Switzerland, where I did the Zurich Bar Exam and am admitted to practice since 2011. I have gained experience in advising clients at a big Swiss lawfirm during five years as well as in advising as internal legal counsel of a Swiss multinational insurance company during four years.

Currently, I am working on my doctor's thesis in the fintech field (banking and insurance) and am happy to start as co-editor of the BFCM Commission Newsletter. I am a member of AIJA from 2013. In the past, I have been active with AIJA by writing a National Report on Basel III and organizing the scientific Program of the Conference "Shower of Regulation in the Financial and Insurance Sector" which took place in Zurich last year.

I speak English, Spanish/Catalan, German/Swiss German and French.

Our AIJA Banking Finance & Capital Markets LinkedIn Group:

- Please join our LinkedIn Group in case you haven't done it yet!
  Do not hesitate to share any news or thoughts or publish your presentations of interest.



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