

Security Token Offering (STO)

A Snapshot in Switzerland
August 2021

From Disruption towards Regulation

The rising popularity of asset tokenization is bridging the gap between traditional and new capital markets. An STO enables new opportunities for a token-based fundraising in a regulated environment. Following the principle of technology neutrality, the Swiss regulation of the token economy builds on existing financial market law, both of which are constantly evolving.

Classification of security tokens under Swiss financial market law

- ▶ Instead of "security token", the Swiss regulator FINMA uses the term "asset token". Such tokens represent assets like debt or equity claims on the issuer, and promise, e.g. a share in future company earnings or future capital flows. In terms of their economic function, they are thus analogous to equities, bonds or derivatives. Tokens which enable physical assets to be traded on the DLT/Blockchain also fall under this category. A token that qualifies as an asset token is classified as a security under Swiss financial law.

Application of prospectus requirements

- ▶ The Swiss Financial Services Act (FinSA) has introduced a general duty to publish a prospectus for securities. However, there are numerous exemption provisions, e.g. for offerings to (i) professional investors, (ii) less than 500 investors, (iii) investors that invest more than CHF 100'000, or (iv) which are limited to total amount of CHF 8 Mio calculated over 12 months.

KYC/AML requirements

- ▶ According to FINMA, issuers of asset tokens do generally not fall under the Swiss AML regulation. However, this must be assessed on a case-by-case basis.

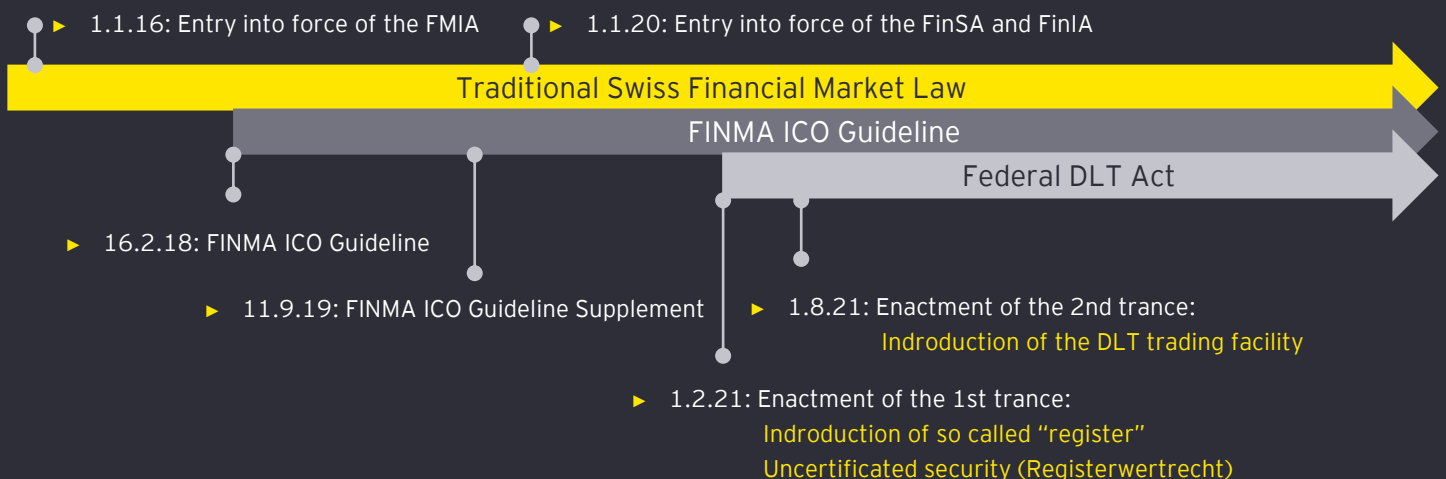
Financing through an STO has significant structural differences compared with traditional fundraising methods. Essentially, in contrast to traditional sources of financing (e.g. IPO) an STO does not necessarily require a financial intermediary.



Every STO must be analyzed, on a case-by-case basis, in view of the application of the Swiss financial market law. Relevant provisions are, for example, the regulations for banks and securities dealers, the prospectus requirement or the collective investment schemes act.

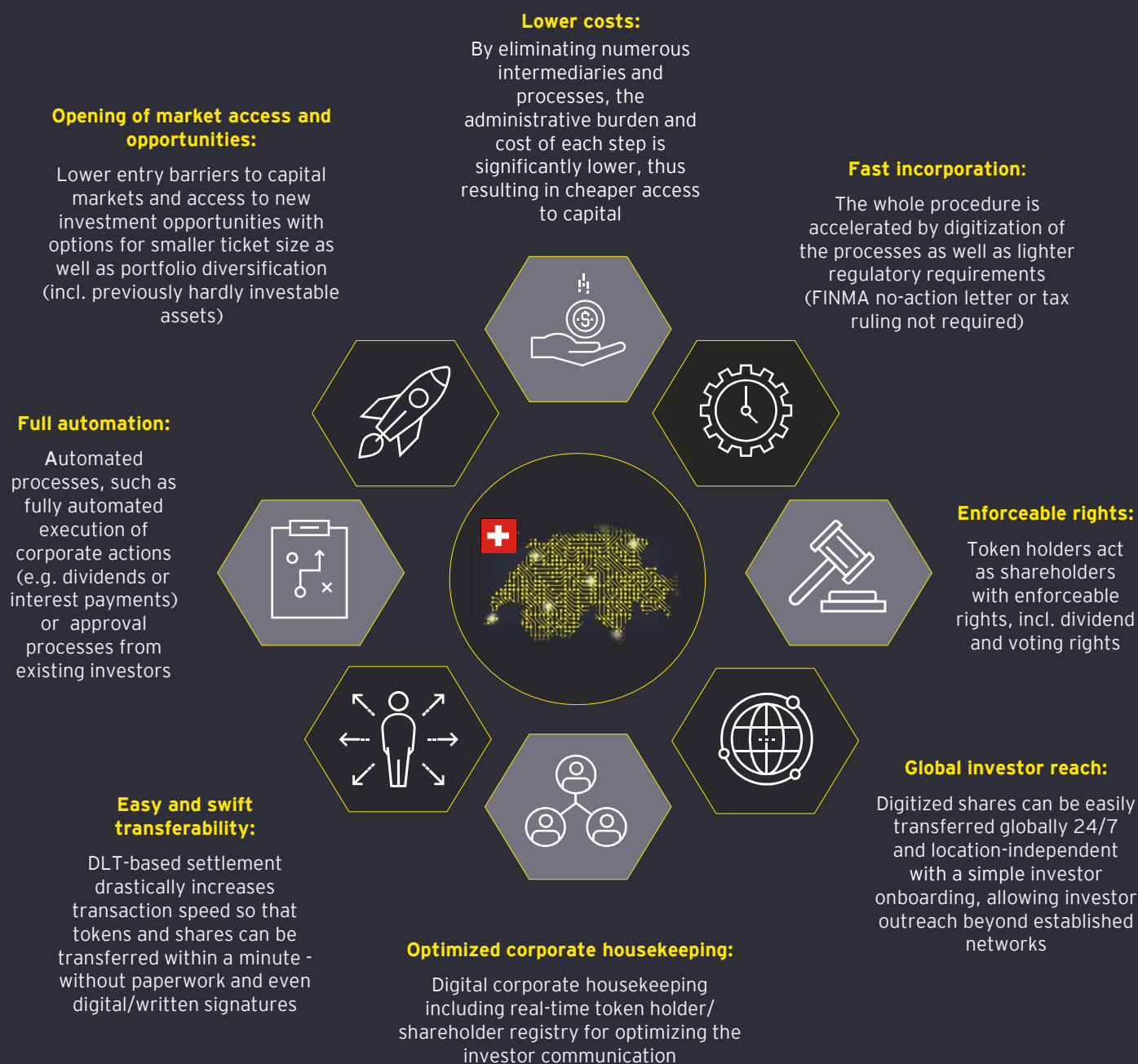
In September 2020, the Swiss parliament has approved the Federal law to developments in distributed ledger technology (Swiss DLT Bill). In line with the technology-neutral approach by the Swiss legislation, selective adjustments were made to existing laws:

- ▶ As of February 2021, the so-called "register uncertificated security" (Registerwertrecht) has come into force. Notably, the newly introduced register uncertificated security does not require a regulated institution such as a bank, securities firm or central securities depository for its creation and transfer. Instead, the creation of such register uncertificated security is subject to the so-called "registration agreement" via a ledger-based register that must fulfil certain material requirements (Art. 973d para. 2 items 1 - 4 Swiss Code of Obligations). In addition, the segregation of crypto-based assets has been clarified in the case of bankruptcy.
- ▶ In June 2021, the Federal Council brought the Swiss DLT Bill fully into force as of 1 August 2021. Namely, a new authorization category for DLT trading systems has been established in financial market infrastructure law, thus creating a flexible legal framework for new forms of financial market infrastructure.



Key Advantages of STOs in Switzerland

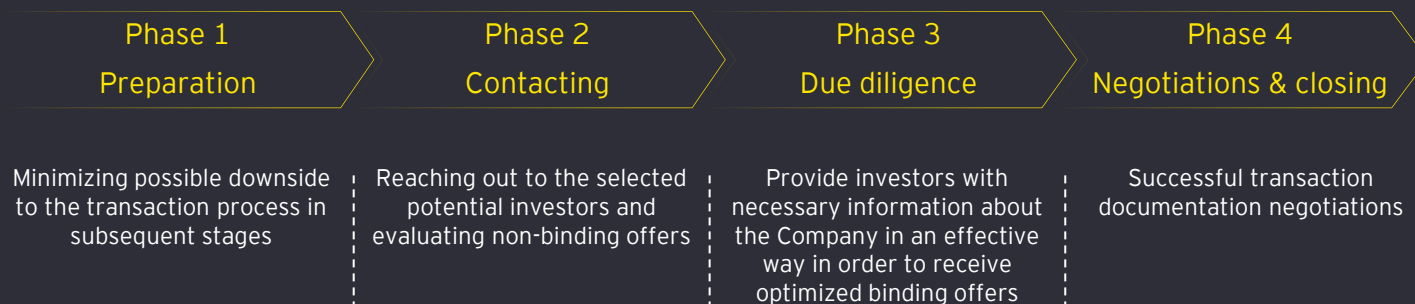
Switzerland is one of the most advanced countries in the world in terms of DLT adaption and is an international hub for innovative companies comprising a wide network and profound expertise. The strong collaboration between the DLT ecosystem and the conventional finance industry helps to promote a sustainable growth of STOs in Switzerland.



Fundraising Approach

Capital raise

Due to the advantages as described on the previous page, STOs are an attractive option for a company to raise capital. However, besides the technical and regulatory aspects of a security tokenization, firms need to prepare extensively to gain broad interest from potential investors. This includes the preparation of a conclusive equity story, a coherent business plan and the definition of the entire transaction structure. The fundraising process is structured into four phases



Fundraising process overview

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| <ul style="list-style-type: none"> ▶ Define project time table and milestones ▶ Define transaction structure and investor approach strategy ▶ Draft equity story together with management ▶ Draft/challenge existing business plan and indicative valuation ▶ Draft investor documentation, i.e. teaser, investor presentation and process timetable/deadlines ▶ Identify and select potential investors (determine the optimal approach and who to contact whom) ▶ Prepare documents for data room | <ul style="list-style-type: none"> ▶ Approach potential investors and generate transaction momentum ▶ Send-out teaser and enter into confidentiality disclosure agreements ("CDAs") ▶ Arrange pitch meeting and share investor presentation ▶ Answer initial questions on investment documents and transaction process ▶ Solicit term sheets/letters of interest ▶ Evaluate and compare TS'/LOI's received ▶ Finalize due diligence preparation ▶ Draft investment agreement | <ul style="list-style-type: none"> ▶ Invite participants for due diligence ▶ Open and continuously administer data room ▶ Prepare and hold expert sessions, Q&A meetings, site visits ▶ Finalize investment agreement and distribute to potential investors ▶ Confirm financial terms/solicit updated terms from investors as well as feedback on the investment agreement ▶ Evaluate and compare investor feedback and decide upon final negotiation (parties, terms etc.) | <ul style="list-style-type: none"> ▶ If applicable, prepare and provide final Information updates (confirmatory due diligence) ▶ Final negotiations ▶ Signing of investment agreement/commitment letters ▶ Support throughout closing process, if applicable ▶ Closing |
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Considerations when choosing an STO for a fundraising

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| <ul style="list-style-type: none"> ▶ Regardless of the approach (issuing shares or tokens), the commercial considerations and preparation of key documents remain the same ▶ The design of the token (debt vs. equity, rights and benefits for the investors, etc.) must match the company's specific business situation and the current shareholder structure | <ul style="list-style-type: none"> ▶ Besides reaching out to investors directly, issuing tokens on a platform of a tokenization provider could be an additional possibility ▶ A broader range of investors can be reached. Not only institutional investors such as venture capital funds, but also retail investors will be able to invest and provide funds | <ul style="list-style-type: none"> ▶ The pricing mechanism of a publicly traded token may vary from privately held shares ▶ The extent of the due diligence will vary depending on the investor types and amounts raised. An institutional investor willing to contribute a larger investor will be more diligent than a retail investor | <ul style="list-style-type: none"> ▶ Depending on the approach chosen, the legal form of agreements may differ ▶ The technical tokenization is completed at lower costs than issuing shares due to fewer intermediaries ▶ After closing, investors will benefit from advantages such as optimized corporate housekeeping and trading tokens on a secondary market |
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How EY can support your Tokenization Journey

Getting started: No matter where you are, EY is your trusted business advisor in every step of your tokenization journey, and may act as a one-stop-shop combining different skill sets.

EY Law

EY offers support understanding and complying with applicable legal and regulatory requirements in Switzerland and globally.

Selected offerings:

- ▶ Issuance support (e.g., token analysis, drafting or reviewing of prospectus, term sheets, investor agreements)
- ▶ Coordination/clearance with authorities/regulators
- ▶ Establishing/strengthening of governance framework: e.g. policy framework, internal control system and functions, AML/CTF, risk management leveraging EY tools (e.g. Blockchain Analyzer, Legal Managed Services)
- ▶ Advising on cross-border regulatory consideration

EY Tax

EY Tax services exist to help our clients meet all the tax requirements related to their industry, business activities and

operating locations in the most financially efficient way.

Selected offerings:

- ▶ Analysis of Swiss tax consequences, incl. corporate income taxes, capital taxes, withholding taxes, stamp duties, VAT, individual income and wealth tax
- ▶ Meeting with the tax authorities, if required (i.e. Zug Cantonal Tax Authorities and Swiss Federal Tax Administration "SFTA")
- ▶ Formal agreement ("tax ruling"), with the tax authorities on the Swiss tax treatment of the projected set-up

EY Strategy and Transactions

Strategy and Transactions offers services that are designed to help companies make better decisions about how to strategically manage capital and transactions.

Selected offerings:

- ▶ Valuation and business modelling of tokenized assets
- ▶ M&A Advisory
- ▶ Advising on corporate strategy and business case

EY Assurance

EY offers multidisciplinary insights across different business types to help clients mitigate the risk of material misstatement in their financials and accurate reporting matters.

Selected offerings:

- ▶ General assurance services such as external audits, attestation or review services
- ▶ Smart contract review
- ▶ SOC reports and Internal controls review
- ▶ Forensics service
- ▶ Accounting advisory for digital asset holdings and transaction

EY Consulting

EY assists companies and organizations improving their performance, assisting them to identify and mitigate business risk and giving advice on IT controls.

Selected offerings:

- ▶ Assessment of product strategy and business planning incl. custody solutions evaluation and asset management products, platform selection, Token Model Design
- ▶ Engineering consortium ecosystem including the assessment of potential partners and its incentives
- ▶ Assessing risk and control including cyber risks, technology and process risks to facilitate an efficient crypto client onboarding e.g. Token and smart contract review tool



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