

REGULATION OF CRYPTO ASSET ACTIVITIES ON THE ABU DHABI GLOBAL MARKET

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INTRODUCTION

Recent technological innovations are transforming how financial activities are conducted and regulated. The technological advances have also resulted in disrupting traditional financial services and other related activities globally. For instance, advances in distributed ledger technologies have led to the emergence of digital assets, such as virtual coins or tokens for capital raising and crypto assets or crypto currencies used in economic transactions.

On June 25, 2018, the Financial Services Regulatory Authority ("FSRA") of the Abu Dhabi Global Market ("ADGM") introduced its legal framework regulating spot trading of crypto assets, including activities carried on by crypto asset exchanges, crypto asset custodians, and, where applicable, intermediaries engaged in crypto asset activities. In addition to regulating spot trading of crypto assets, this framework addresses the risks and issues around the trading of crypto assets and their impact on financial stability, consumer protection, safe custody and market abuse.

The legal framework for spot trading of crypto assets consists of relevant ADGM Registration Authority laws and regulations, the Financial Services and Markets Regulations 2015, the FSRA Rulebook (which includes the Conduct of Business Rulebook, the Rules of Market Conduct, the General Rulebook, the Anti-Money Laundering and Sanctions Rules and Guidance, the Islamic Finance Rules, and the Rules of Market Conduct) and the FSRA Guidance on the Regulation of Crypto Asset Activities in ADGM (collectively, the "Framework"). (Unless stated otherwise, capitalized terms contained in this Client Alert have the meaning given to them in the Framework).

This Client Alert provides a high-level overview on operating a crypto asset business in the ADGM in accordance with the newly enacted Framework.

APPLICABILITY OF THE FRAMEWORK

The Framework applies to any person applying for a Financial Services Permission ("FSP") to carry on the Regulated Activity of Operating a Crypto Asset Business ("OCAB") in or from ADGM, an Authorised Person in respect of its carrying on the Regulated Activity of OCAB in or from ADGM or a Recognised Investment Exchange with a stipulation on its Recognition Order permitting it to carry on the Regulated Activity of OCAB within ADGM. (We refer to such an Authorised Person that holds a FSP to carry on the Regulated Activity of OCAB as an "OCAB Holder").

To be authorized as an OCAB Holder, an Applicant must demonstrate to the FSRA that all applicable requirements under the Framework have been, and will continue to be, complied with. Applicants carrying on other Regulated Activities within ADGM in addition to OCAB will need to apply to add such other Regulated Activities to the FSP and comply with the requirements of the FSRA applicable to such other Regulated Activities. In certain circumstances, existing FSP holders carrying on a Regulated Activity that may incidentally involve the use of Crypto Assets, but who are not deemed as carrying on OCAB as defined under the Framework, may not need to apply for the Regulated Activity of OCAB.

WHAT IS A "CRYPTO ASSET"?

The Framework defines Crypto Assets as a digital representation of value that can be digitally traded and functions as a medium of exchange and/or a unit of account and/or a store of value, but it does not have legal tender status in any jurisdiction. A Crypto Asset is neither issued nor guaranteed by any jurisdiction and fulfills the above functions only by agreement within the community of users of the Crypto Asset and is distinguished from Fiat Currency and E-money.

The Framework defines Fiat Currency as government-issued currency that is designated as legal tender in its country of issuance through government decree, regulation or law. E-money is defined as a digital representation of Fiat Currency used to electronically transfer value denominated in Fiat Currency.

OPERATING A CRYPTO ASSET BUSINESS

Which activities constitute OCAB?

Pursuant to the Framework, the Regulated Activity of OCAB includes undertaking one or more Crypto Asset activities in or from ADGM, including buying, selling or exercising (whether as principal or agent) any right in Accepted Crypto Assets (defined below); managing Accepted Crypto Assets belonging to another person; making arrangements with a view to another person (whether as principal or agent) buying, selling or providing custody of Accepted Crypto Assets; marketing of Accepted Crypto Assets; advising on the merits of buying or selling of Accepted Crypto Assets; or any rights conferred by such buying or selling or operating a Crypto Asset Exchange or as a Crypto Asset Custodian.

Operating a Crypto Asset Exchange means the trading, conversion or exchange of (a) Fiat Currency or other value into Accepted Crypto Assets, (b) Accepted Crypto Assets into Fiat Currency or other value, or (c) one Accepted Crypto Asset into another Accepted Crypto Asset. Operating as a Crypto Asset Custodian involves (a) safeguarding, storing, holding or maintaining custody of Accepted Crypto Assets belonging to another person or (b) controlling or administering Accepted Crypto Assets for the purpose of (a).

Are any activities excluded?

The Framework does not consider the following activities as OCAB: the creation or administration of Crypto Assets that are not Accepted Crypto Assets; the development, dissemination or use of software for the purpose of creating or mining a Crypto Asset; the transmission of Crypto Assets; a loyalty points scheme denominated in Crypto Assets; or any other activity or arrangement that is deemed by the FSRA to not constitute OCAB where necessary and appropriate in order for the FSRA to pursue its objectives.

Accepted Crypto Assets

An OCAB Holder is only permitted to carry on the Regulated Activity of OCAB by using Accepted Crypto Assets. In determining whether a Crypto Asset meets the requirements of being deemed an Accepted Crypto Asset, the FSRA will consider the maturity/market capitalization threshold in respect of a Crypto Asset. The maturity/market capitalization threshold of Crypto Assets that the FSRA will accept is typically in excess of US\$4 billion. The FSRA will also look at other factors that, in the opinion of the FSRA, are to be taken into account in determining whether or not a Crypto Asset in question meets the requirements to be considered appropriate for the purpose of the Regulated Activity of OCAB in or from ADGM. Such factors may include the security of a Crypto Asset, whether OCAB Holders will be able to trace and monitor the origin and destination of a Crypto Asset and the market demand of a Crypto Asset.

The FSRA will not maintain a "public" list of Accepted Crypto Assets; however, it may provide this information to potential Applicants of an OCAB FSP and OCAB Holders.

Are there any capital requirements for OCAB?

The Framework requires OCAB Holders to hold an amount equal to 6 months' operational expenses plus (unless the FSRA directs otherwise) an additional buffer amount of up to a further 6 months' operational expenses.

Operational expenses should be calculated in accordance with the International Financial Reporting Standards ("IFRS"), generally accepted accounting principles of a third country determined by the FSRA to be equivalent to IFRS or accounting standards of a third country the use of which is permitted by the FSRA. Practically speaking, operational expenses generally include all of the overhead, non-discretionary costs (variable and exceptional items can be excluded) incurred (or forecast to be incurred) by an OCAB Holder in its operations over the course of a 12-month accounting period; technology-related operational expenses, such as the use of information technology ("IT") servers and technology platforms; storage and usage of IT equipment; and technology services required for the overall operability of the OCAB Holders' platform. Development costs (such as research and intellectual property patenting) can be excluded.

Technology governance and controls

The Framework requires OCAB Holders to establish systems and controls to ensure their affairs are effectively and responsibly managed and to ensure that such systems and controls are regularly reviewed. The Framework sets the minimum technology governance and controls that any OCAB Holder must put into place in respect of Crypto Asset wallets, private keys, origin and destination of Crypto Asset funds and security and risk management.

In meeting their responsibilities under the technology governance and controls requirements, OCAB Holders should ensure that they put in place systems and policies relating to maintenance and development of systems and architecture, security measures and procedures for the safe storage and transmission of data, business continuity and client engagement planning in the event of both planned and unplanned system outages, processes and procedures specifying management of personnel and decision-making by qualified staff, and procedures for the creation and management of services, interfaces and channels provided by or to third parties.

Disclosure requirements

The Framework requires an OCAB Holder to disclose in a clear, fair and truthful manner all material risks associated with its products, services and activities; the Crypto Assets generally; and the Accepted Crypto Assets when entering into an initial transaction for, on behalf of, or with a Client. The FSRA provides a non-exhaustive list of the risks that it would typically expect to be disclosed. These risks include, without limitation, Crypto Assets not being legal tender or backed by a government; the value, or process for valuation, of Crypto Assets, including the risk of a Crypto Assets having no value; the volatility and unpredictability of the price of Crypto Assets relative to Fiat Currencies, that trading in Crypto Assets may be susceptible to irrational market forces; and that the nature of Crypto Assets may lead to an increased risk of Financial Crime or of cyberattack.

FEES

In addition to the relevant fees payable for incorporating a suitable corporate vehicle to operate Crypto Asset business activities, an Applicant wishing to become an OCAB Holder must pay to the FSRA an initial authorization fee of US\$20,000. If the Applicant is seeking to operate a Crypto Asset Exchange, the fee will be US\$125,000.

Furthermore, an annual "supervision" fee is payable to the FSRA in the amount of US\$15,000 for OCAB Holders or US\$60,000 for OCAB Holders operating a Crypto Asset Exchange.

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