



DIGITAL DIRECTIONS

Digital asset developments have been hitting the headlines but as **Irina Heaver**, Partner and Head of Commercial & Technology at Fichte & Co Legal explains with a host of different terms being used, and many different regulators and regulations potentially being relevant depending on the nature of the specific assets it is important to understand the latest regulatory positions.

WHAT ARE DIGITAL ASSETS?



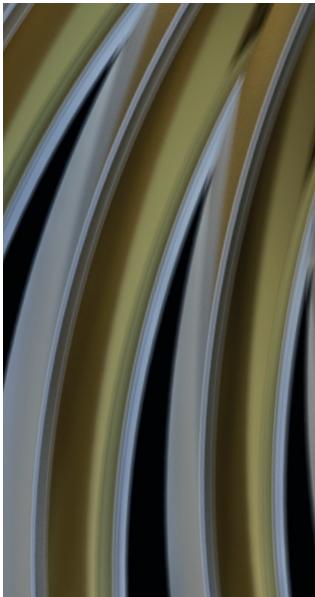
The business world's view of digital assets currently seems to be divided into two camps, basically those who view them as a Ponzi scheme and those (known as HODLers) who are firm believers," Irina Heaver states.

"Broadly speaking 'digital assets' are limited entries made on a Blockchain designed to be used either as a medium of exchange or to attach some sort of right," Heaver explains. "They can be categorised into crypto currencies or payment tokens which are intended to be used, as a means of payment or as a means of money or value transfer. Blockchain applications arguably have data protection by design, as the entries stored on them are encrypted in a way which makes changing or deleting them virtually impossible. "However, privacy

questions can arise because all information recorded on a Blockchain application is visible to all users on the Blockchain, so everyone can see everyone else's transactions."

"As a result, most Blockchains do not show personally identifiable information and individual users are identified by their so-called public key (a string of numbers), so at first sight anonymity may be maintained."

"However, the parties to a transaction will likely know the identity of one another and could publicly disclose the identity behind the other's public key and once known, anyone interested would be able to identify all transactions by a person, which could be very personal. Where the data is instantly made available to a wide network of participants across



a real issue and really need be analysed in the context of existing laws which will not have contemplated Blockchain. There are two main types of token in this context," Heaver adds. "Utility tokens which are intended to provide access to an application or service hosted on a Blockchain-based infrastructure, security tokens or asset tokens which represent assets like a debt or equity claim on the issuer, (e.g. a share in future company earnings). These tokens can be compared to equities in terms of economic functions," Heaver continues.

"Depending on the classification applied, the rules the various regulators may apply vary. For instance, if the digital asset is aimed at being used as currency, then the UAE Central Bank may want to regulate it. However, if it is a security, the UAE Securities and Commodities Authority (SCA) will be important and various securities regulations would apply to issuing and offering these tokens.

When it's a commodity, the Securities and Commodities Authority is probably also relevant again and a separate set of regulations would apply to the digital assets," Heaver adds. "This means each asset needs to be analysed on a case by case basis and a one size fits all model will not work," Heaver explains.

"The anonymous, cross-border nature of virtual currency transactions, makes Regulators particularly concerned with money laundering and terrorist financing risks, and other financial crimes."

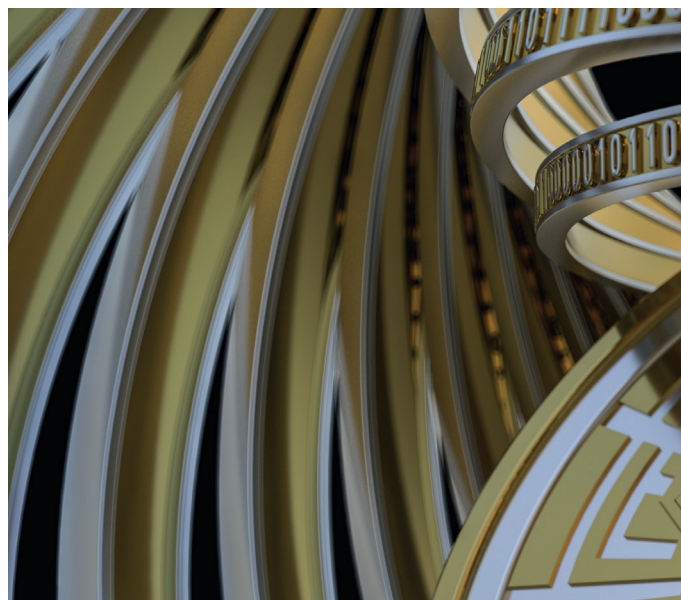
"In addition, with cyber attacks and cyber crime also on the rise, in the eyes of the Regulators the crypto currencies are high risk 'currencies' because they have a perception of a reputation for being a means by which crime and money laundering is facilitated. Businesses who choose to deal in this way, need to follow Know Your Customer (KYC) procedures in the context of transfers of value. This may be difficult in the virtual world because we are not yet at the stage where we have reliable, Government-recognised, digital identities. These issues mean as a result, digital assets are now firmly in the regulatory spotlight and it is anticipated this attention will only increase, so it is not surprising a range of regulators are already starting to take steps and making announcements."

RELATED LEGISLATION

Paragraph 1.3 of Supplementary guidance to ADGM Financial Services Markets Regulations No. 1/2017

The Guidance sets out the Financial Services Regulatory Authority's approach to token issuers seeking to raise funds through ICOs and market intermediaries or operators dealing in or offering services in virtual tokens and currencies.

(Source: Lexis Middle East Law)



Irina Heaver
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UAE POSITION

"In January 2017, the UAE Central Bank issued a Regulatory Framework for Stored Values and Electronic Payment Systems which contained a blanket statement that 'All Virtual Currencies (and any transactions thereof) are prohibited'," Heaver explains. "Then in February 2017, the Governor of the Central Bank clarified in media statements that these regulations do not apply to Bitcoin or other crypto currencies, exchanges, or the underlying technology like Blockchain.

However, unfortunately we haven't seen any official amendments to the Regulatory Framework to reflect this," Heaver adds.

"Then on 2 February 2018, the UAE's Securities and Commodities Authority (SCA) raised the alarm about all digital, token-based fundraising activities and investment schemes in the UAE, which is sometimes referred to as initial coin offerings (ICOs), initial token offerings, token presale, or token crowdsale," Heaver continues.

"The Authority stated it does not currently regulate, mandate or recognise any ICOs. They added no legal protection is currently offered and investors enter into these investments at their own risk. All issuers of digital tokens, intermediaries facilitating or advising on an offer of digital tokens and platforms facilitating trading in digital tokens should therefore seek independent legal advice to ensure they comply with all applicable laws, and consult the Authority where appropriate," Heaver adds.

"However, the Authority's warning definitely stopped short of some Governments' initiatives which have already taken steps to outlaw the digital currencies and on a more positive level, it has also recently entered into an agreement with PriceWaterhouseCoopers to develop a regulatory framework for financial and regulatory technology in



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the UAE capital markets which may cover digital assets but this has not yet been confirmed. Financial activities in the UAE are regulated either by the UAE Central Bank or the Securities and Commodities Authority depending on the activity,” Heaver explains.

“The Central Bank regulates banking, investment and credit businesses and formulates the monetary policies in the country, while the Securities and Commodities Authority is the governing body for all the stock exchanges, securities and commodities listed in the UAE. In addition, when it comes to financial free zones in the UAE, such activities are regulated by the Dubai Financial Services Authority (DFSA) in the DIFC and the Financial Services Regulatory Authority in the ADGM, which could all play a role in the regulation of digital assets.”

FREE ZONE POSITION

“The Dubai Multi Commodities Centre (DMCC) has also recently taken steps which could be relevant, in this area as it has added a new activity called ‘Proprietary Trading in Crypto-commodities’ to the list of activities which are permitted in the free zone,” Heaver notes.

“However the license specifically prohibits crypto exchanges and trading third party funds. Licensed companies are also only allowed to trade on their own behalf. In addition, the DMCC has also issued Dubai gold trader Regal RA DMCC with the region’s first crypto currency license and they will offer storage of Bitcoin, Ethereum and other crypto currency services in a vault in the Centre’s headquarters. Meanwhile, the Abu Dhabi’s Global Market Financial Services Regulatory Authority has announced it is reviewing and considering the development of a robust, risk-appropriate regulatory framework to regulate and supervise virtual currency exchange and intermediary activities,” Heaver states.

“The Authority is also launching a review as virtual currencies, which although not legal tender, are gaining

interest globally as a medium for exchanging goods and services.”

SAUDI ARABIA

“In Saudi Arabia, the Monetary Agency has signed an agreement with Ripple in what is a regional first for a financial services regulator,” Heaver notes. “Under this agreement, a pilot programme will be run which will allow local banks to use xCurrent for cross-border payments. The Agency is actually the only entity except for the Bank of England to use this payment method and interested entities will also get assistance with programme management and training.”

WHAT’S NEXT?

“The UAE is perfectly placed to be the regional Digital Assets Financial Centre as Switzerland is in Europe,” Heaver notes. “A liberal and particular legislative regime and buy-in from the authorities will allow the inflow of innovative Blockchain businesses and capital. What is good to see is the Dubai Leadership has already rolled out a Blockchain Strategy well ahead of most of the world, so the value and benefit of the technology are already very well understood here and even applied in some cases,” Heaver continues.

“With this in mind it is unlikely the UAE Regulators will sit on the sidelines for much longer and many more interesting announcements can be expected very soon. However, despite all this, what’s clear is the legal landscape is uncertain in this area so if you are intending to set up a business in the digital assets space, you will need to seek legal advice and tread carefully, and if you are a potential investor, you will also have to make sure you do your homework before you start investing,” Heaver concludes.

RELATED STORY

Dubai: First Trader Granted Crypto Currency License

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Dubai gold trader Regal RA DMCC has been issued with

the region’s first crypto currency license. The license was issued by the Dubai Multi Commodities Centre. They will offer storage of Bitcoin, Ethereum and other crypto currency services in a vault in the Centre’s headquarters.