

Virtual asset activities

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Over the last couple of years Abu Dhabi Global Market ('ADGM') has positioned itself as a destination of choice for dealing in virtual assets (previously known as 'crypto assets' in ADGM parlance). As part of ADGM's ongoing commitment to update and improve its regulatory framework, the Financial Services Regulatory Authority ('FSRA') of the ADGM, earlier this year, announced the enactment of various amendments to the FSRA's regulations and rules concerning the authorisation and supervision of virtual asset activities within the ADGM.

What are these amendments?

Change of terminology

"Virtual Assets" is an updated term for what was previously known as "Crypto Assets". The need for such change was to ensure that the use of the terminology in the ADGM is aligned with the terminology used by the Financial Action Task Force, the inter-governmental body established to set standards and promote effective implementation of legal, regulatory and operational measures for combating money laundering, terrorist financing and related threats to the integrity of the international financial system.

This change, however, does not amend the underlying concept of crypto asset and the term "Virtual Asset", continues to be defined as what "Crypto Asset" was prior to the amended regime coming into effect. Similar to the term "Crypto Asset", "Virtual Asset" is defined as "a digital representation of value that can be digitally traded and functions as: (1) a medium of exchange; and/or (2) a unit of account; and/or (3) a store of value, but does not have a legal tender status in any jurisdiction. A Virtual Asset is: (a) neither issued nor guaranteed by a jurisdiction, and fulfils the above functions only by agreement within the community of users of the Virtual Asset; and (b) distinguished from Fiat Currency and E-money".

Regulated activity

The pre amendment regime provided for a bespoke activity of "Operating a Crypto Asset Business", which dealt with activities relating to crypto assets such as arranging, managing, providing custody of crypto assets as one single activity, independent of other existing similar regulated activities, in the context of investments. The amended regime has now moved the elements of that activity to already existing regulated activities of a similar nature. The activity of "Operating a Crypto Asset Business", no longer exists. For example, a person wishing to manage virtual assets in the ADGM, is no longer required to apply for an authorisation of Operating a Crypto Asset Business, but instead will need to apply for an authorisation for "Managing Assets", where the scope of managing assets, as a regulated activity is widened to include managing virtual assets.

However, this does not mean that a person holding a financial services permission for "Managing Assets", by default, can manage virtual assets as well, in the ADGM. This means, an applicant who intends to deal with virtual assets is required to apply for the relevant regulated activity, in the context of virtual assets, as opposed to in the context of investments or other assets. The activity of such an authorised person would be limited to conducting activities in relation to virtual assets. Such permission does not automatically extend to conducting activities in relation to specified investments or financial instruments,

by virtue of its financial services' permission. Therefore, a person intending to conduct activities in relation to specified investments or financial instruments, in addition to those in relation to virtual assets, is required to obtain an additional authorisation from the FSRA.

The fact that the bespoke activity has been split and moved to the underlying regulated activity, which was, pre amendment, limited to dealing with investments and financial instruments, does not mean that FSRA has accorded virtual assets a similar status to that of investments and financial instruments. The FSRA continues to view virtual assets as commodities.

FSRA expects to see substantive operational commitment within the ADGM, including operations, relating to commercial governance, compliance, technology and human resources. Considerations, around these would vary according to multiple factors, most importantly the nature of virtual asset activity proposed to be conducted within the ADGM.

Who does the amended regime apply to?

The amended virtual asset regime applies to:

- applicants applying for financial services' permission to carry on a regulated activity, involving virtual assets, in the ADGM;
- persons authorised to carry on a regulated activity, involving virtual assets;
- recognised investment exchange permitted to carry on regulated activity of operating a multilateral trading facility dealing in virtual assets within the ADGM; and
- applicants and authorised persons dealing with stable coins.

Overview of the amended regime

Application process

This means, while the activities of dealing with virtual assets have been moved to the relevant regulated activities, which also deal with investments and financial instruments, as the case may be, the application process for dealing with virtual assets is slightly different and more rigorous. Applicants for virtual asset activities are expected to be prepared to engage heavily with the FSRA throughout the application process, which includes:

- due diligence and discussion with the FSRA, involving explanation of the proposed business model, demonstration of proposals to meet the requisite regulatory standards and providing in-depth technology demonstrations across all aspects of proposed virtual asset activities;
- submission of relevant forms and fees, following the discussions with the FSRA and the FSRA having reasonable comfort that the applicant's processes, capabilities and technologies are at a sufficiently advanced stage;
- granting of in-principle approval, which approval will be granted after FSRA has considered the relevant forms and supporting documents and is of the view that the applicant meets all relevant rules and requirements;
- granting of final approval, where the conditions prescribed under the in-principle approval are met to the satisfaction of the FSRA, within the stipulated timeline. While, generally, this is the last step before the relevant activities could be commenced, in the context of virtual assets, this is conditional upon the FSRA

- being further satisfied in relation to the applicant's operational testing and capabilities and completion of a third party verification of the applicant's systems where applicable; and
- operational launch testing and third party verification of the proposed virtual assets to the satisfaction of the FSRA.

Fees

While the virtual asset activities have now moved to the respective underlying activities, fees for authorisation of virtual asset activities continue to be similar to those that existed under the pre amended regime.

Similar to the pre amended regime, if an applicant or an authorised person intends to conduct multiple regulated activities in relation to virtual assets as part of its authorisation, the fees, including authorisation and supervision fees, payable by such person will be cumulative and shall be considered across the following:

1. intermediary activities i.e. non-custody intermediary activities;
2. providing custody in relation to virtual assets; and
3. acting as a multilateral trading facility.

Where the relevant persons intend to undertake regulated activity involving investments and financial instruments along with virtual assets, the fees attributable to the combined activity are likely not to be cumulative. However, this is something that will be determined by the FSRA on a case-by- case basis. In such cases, it is recommended that clarifications be sought from the FSRA, in the early stages, where determination of fees is a concern, to the overall application.

Regulatory approach

The regulatory approach continues to be similar to the pre amended regime:

- requiring authorised persons to be in compliance with a code of business rules applicable to activities in relation to virtual assets, with applicable additional rules to persons providing custody and multilateral trading facilities relating to virtual assets;
- limiting the use of virtual assets to 'accepted virtual assets' as determined by the FSRA, in order to prevent potential higher risk activities relating to illiquid or 'immature' virtual assets;
- requiring capital in connection with virtual asset activities to be held in fiat form;
- requiring compliance with the relevant anti-money laundering rules and regulations, noting the warnings issued by the International Monetary Fund, the Financial Action Task Force, the Bank for International Settlement and the International Organisation for Securities Commission, to investors and market participants, highlighting the risks associated with digital assets including virtual assets;
- expecting applicants and authorised persons to meet particular requirements in terms of their technology systems, governance and controls, noting that the FSRA does not seek to regulate virtual asset technologies directly; and
- requiring authorised persons to have processes in place that enable them to disclose, prior to entering into an initial transaction, all material risks to their clients in a manner that is clear, fair and not misleading.

Operational issues

Historically, virtual asset applicants or established entities dealing with virtual assets have faced difficulties and increased scrutiny while opening and operating bank accounts, primarily because of the potential risks associated with virtual asset space. The FSRA has engaged in extensive discussions with local and international banks regarding the purpose of providing them with an overview of ADGM's virtual asset framework with a view to demonstrating its stringent authorisation requirements, in the hope that those banks with a risk appetite to bank virtual assets will glean comfort from the regulatory oversight of the FSRA and the issuance of an in-principle approval to entities demonstrating that they have a clear roadmap of development of their business moving towards final approval and the issuance of a financial services' permission.

Conclusion

The amended regime streamlines the regulated activities to accommodate additional class of assets i.e. the virtual assets and thereby generally aligns the nature of activities across various classes of assets. While the amendments seem to be substantive, because of the movement of elements between the activities, the regulatory approach appears to be similar to the pre amendment regime. Therefore, we do not expect a considerably different application review process or ongoing regulatory obligations.

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