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THE DEVELOPING CRYPTOASSET LANDSCAPE IN THE UAE

Spotlight on the regulation of cryptoassets

David Berman and Victoria Ferres

Victoria: Welcome to this Allen & Overy podcast. My name is Victoria Ferres and I'm a senior associate in Allen & Overy's Middle East Financial Services Regulatory group. I'm joined by fellow senior associate David Berman who is part of our Middle East Litigation, Investigations and Contentious Regulatory group ["Hello"].

This podcast forms part of a series where we will be focusing on key considerations relevant to the emerging cryptoasset landscape in the UAE. This episode will be an introduction to cryptoassets, looking at what cryptoassets are and the key legal considerations relevant to cryptoassets in the UAE. We will also touch on each of the key regulatory regimes governing crypto in the UAE, implemented both in mainland UAE as well as in the UAE's financial free zones. This will hopefully be of interest to anyone already involved in the crypto space, or anyone who is seeking to become involved in the crypto sector in the UAE, or in the broader GCC region.

So, against that backdrop, I suggest we dive straight in. David, the UAE is the Middle East's third largest crypto market, with a transaction volume of approximately USD26 billion, trailing only Lebanon and Turkey. So let's start with the obvious, but maybe not easy, question. What is a cryptoasset?

David: Not a straightforward question at all! The key point is that there really is not any firm definition of what a cryptoasset is. Instead, 'cryptoasset' is essentially an umbrella term that captures a range of digital assets within it. For example, both cryptocurrencies and non-currency assets such as security tokens are types of cryptoassets.

But if we break down the term 'cryptoasset' there are basically two parts to it. The first part, 'crypto' refers to the fact that these assets use cryptographic encryption as a secure way of recording who owns what assets. The second part, 'asset', tells us that these are a digital representation of value or contractual rights. In other words, they can be transferred, stored or traded electronically using some form of distributed ledger technology.

Victoria: The use of distributed ledger technology or 'DLT' is one of the key points to remember when thinking about cryptoassets. There will be a standalone podcast dedicated to DLT considerations so we won't go into too much detail on it here, but essentially DLT is a decentralised database managed by multiple participants across multiple nodes.

David: Let's perhaps put it into context – Bitcoin is probably the most well known of the cryptocurrencies, so let's use that as an example. Bitcoin is a peer-to-peer electronic cash system where there is no physical currency and no central bank or other organised authority standing behind the currency. What that means is that instead of being backed by a central authority, there is actually a decentralised network of peers which vouches for the validity of the ownership of the cryptocurrency. So underlying the verification of Bitcoin and other cryptocurrencies is the distributed ledger system called 'blockchain'.

Victoria: The two terms 'blockchain' and 'DLT' are often used interchangeably, but distributed ledger technology is essentially the framework that underpins blockchain.

David: Exactly. Many traded assets rely on a central repository to verify ownership and its transfer. The DLT system relies instead on verification by a community of participants. 'Blockchain' refers to technology supporting a decentralised, distributed information repository that does not depend on one specific entity for verification. This system holds the promise of much lower costs than centralised authorities and much more rapid processing.

Victoria: So essentially cryptoassets are cryptographically secured digital representations of value or contractual rights that use some type of distributed ledger technology and can be transferred, stored or traded electronically.

And that really helps to explain why cryptoassets and particularly cryptocurrencies were created in the first place – they were designed to be used as a form of payment for goods or services.

There are thousands of cryptoassets but let's stick with the Bitcoin example. Bitcoin was initially intended to be used as a form of payment for goods or services, so instead of using traditional fiat currency to pay for something, you could instead use Bitcoin. But the difficulty is that the value of Bitcoin and similar tokens has historically been fairly unstable, which makes it difficult to use Bitcoin as a means of payment.

David: Because the value of Bitcoin can fluctuate?

Victoria: Exactly. As a result, Bitcoin actually has become more widely used as a form of speculative investment – in other words people trade in Bitcoin, purchasing it in the hope that its value goes up and they can sell it and make money. So Bitcoin really failed in terms of its intended purpose. As a result, so called 'stablecoins' were developed, which are not dissimilar to cryptocurrencies such as Bitcoin, except that the value of a stablecoin is pegged to another form of asset, including traditional fiat currencies such as the U.S. dollar. Because of this, the value of a stablecoin is, as the name suggests, much more stable, thereby allowing it to be used more effectively as a payment or exchange token to pay for goods or services.

David: However, one of the key points to note about cryptoassets is that they are decentralised, meaning that they are not backed by any central authority in the same way that, for example, traditional fiat currencies will be backed by a central bank. As a result, central banks have been exploring whether they can issue their own digital currency, generally referred to as central bank digital currencies or CBDCs. This is a big area of focus for many jurisdictions at the moment, including in the UAE. For example, last year the UAE Central Bank announced that it was set to introduce a digital currency as part of its 2023-2026 strategy, so it is very much an area to watch.

Victoria: Absolutely. So if we come back to the original question, what is a cryptoasset, I think what is clear is that it is a term that is constantly evolving and developing and that is shown through the progression of cryptocurrencies such as Bitcoin, through to stablecoins and central bank digital currencies.

David: I think that explains the basics about what cryptoassets are, so let's look at what this means in terms of the UAE regulatory landscape. The UAE, both in 'onshore' UAE as well as the two financial free zones, the ADGM and the DIFC, has been doing a lot of great work to position the UAE as a hub for fintech and payments firms. As a result, there has also been a host of legislation issued in both the onshore and offshore UAE regimes aimed at bringing certain cryptoassets and activities connected with cryptoassets within scope of regulation.

In particular, the UAE regulators, so the Central Bank and the Securities and Commodities Authority or the SCA in onshore UAE, as well as the DFSA and FSRA in the financial free zones, have published legislation specifically targeted at bringing these activities and products within scope of regulation.

Victoria: Correct. Most jurisdictions and authorities have yet to enact laws governing cryptoassets, so this really makes the UAE stand out as particularly progressive in this space. If we look at the developments in the onshore regime, as we know the provision and marketing of financial products in the UAE is regulated by both the UAE Central Bank and the SCA. Generally speaking, banking services and products are under the jurisdiction of the Central Bank, and securities services and products are under the jurisdiction of the SCA.

Both the SCA and the Central Bank have issued regulations relevant to cryptoassets and, as a result, activities connected with cryptoassets are regulated in different respects by both regulators. For example, security tokens will be regulated by the SCA whereas fiat tokens will be within the regulatory perimeter of the Central Bank.

David: There has also been a lot of development in the regulation of cryptoassets aside from the 'onshore' UAE, hasn't there?

Victoria: Definitely. The ADGM financial free zone in Abu Dhabi is very well established in respect of its cryptoasset regime. In fact, it was the first jurisdiction in the world to introduce a comprehensive framework for the regulation of virtual asset activities. The framework substantively deals with cryptoassets in the same way the ADGM does with more traditional assets and financial instruments. In particular, firms that carry out regulated activities in respect of cryptoassets will have to obtain a licence with the financial services regulator, the Financial Services Regulatory Authority or the FSRA. That licensing process is generally aligned with the FSRA's standard licensing process, with of course a few nuances.

David: Exactly. One of those nuances is that the ADGM framework does not necessarily permit the use of all forms of cryptoasset. In fact, only activities relating to 'Accepted Virtual Assets' will be permitted. The FSRA has broad scope to determine what will amount to an Accepted Virtual Asset, so whilst there are criteria, this will very much be tested on a case-by-case basis. What is also important to mention is that whether a virtual asset is an Accepted Virtual Asset is specific to each authorised person – in other words, what may be an Accepted Virtual Asset for one authorised person does not necessarily mean it will be an Accepted Virtual Asset for another authorised person. So this is all information that would need to be set out in a prospective licence application.

Victoria: Outside of the financial free zones, the Emirate of Dubai is still in the process of developing its cryptoasset framework but is ambitious to become a leading jurisdiction in this space.

David: There have been some recent interesting developments in relation to this, I believe?

Victoria: Correct. In particular there is the recent publication of the Dubai Virtual Assets Law, or DVAL, which will apply to all of the Emirate of Dubai aside from its financial free zone, the DIFC. First and foremost, the DVAL establishes the Dubai Virtual Asset Regulatory Authority, commonly referred to as VARA. VARA will be an independent entity affiliated to the Dubai World Trade Centre tasked with regulating, overseeing and controlling all virtual asset activities.

David: Whilst some of the finer details will not be clarified until implementing decisions have been issued, the DVAL will essentially prohibit virtual asset activities carried out in Dubai unless subject to licence. Securing a licence will entail meeting certain conditions, for example, interested undertakings on the face of it will need to establish a Dubai entity from which they offer their services. This may create difficulties for businesses already established elsewhere in the UAE that wish to offer cross-border services into Dubai. Our understanding is, however, that VARA will have discretion to waive certain requirements, so it remains to be seen how strictly this is applied in practice.

Victoria: It will also be interesting to see how the powers of the VARA interact with those of the onshore UAE regulators, notably the SCA. So this is very much a key area to watch.

Well, that brings us to the end of this episode. As we mentioned at the outset, this does form part of a series of podcasts we are releasing on all things crypto, so do look out for the other episodes. Thanks for listening and please do get in touch if you have any thoughts or comments on this podcast.

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