

# A Guide to Initial Coin Offerings in the United Arab Emirates

Financial Services

## Introduction

Initial Coin Offerings (“**ICO**”)<sup>1</sup> refers to the innovative mechanism by which start-up businesses and other companies can digitally raise funds from the public.

In 2017 alone, over US\$3 billion was raised through ICOs globally. In April 2018, it has been reported that ICOs have now raised more capital in the first three months of 2018 than the total capital raised in 2017. The subject of ICOs has also sparked an interest in the United Arab Emirates (“**UAE**”) as exemplified by the recent launch of the mCoin ICO in Dubai in April 2018.

Despite the growing trend and interest surrounding ICOs, some countries across the globe have expressly banned ICOs; including the People’s Republic of China (“**PRC**”), where the main regulators jointly outlawed ICOs. In South Korea, the Financial Supervisory Board decided to ban all forms of virtual currencies. More recently, in April 2018, India’s Central Bank announced its ban on the sale and purchase of digital currencies<sup>2</sup>.

The UAE’s position on the legal and regulatory treatment of raising capital through ICOs is still under-developed.

## What is an ICO?

ICOs allow start-up businesses and other companies to digitally raise funds. The investor(s) are provided with the opportunity to participate in the ICO by exchanging fiat currencies such as the Euro or the USD for digital tokens in a business (“**Digital Tokens**”). The Digital Tokens issued to the investor(s) may represent for example: ownership in the business and/or rights over the business. ICOs have notably been classified as high-risk and speculative investments and various regulators

<sup>1</sup> An ICO is also known as a “coin sale” or “token sale”.

<sup>2</sup> <http://www.bbc.com/news/world-asia-india-43669730> accessed on 29 April 2018 at 15:10 pm.



The Digital Token(s) utilise the ‘decentralised’ blockchain technology to operate. The value of the Digital Token(s) can increase or fluctuate depending on the performance and growth of the issuing business.

## The ICO Process and Legal Documentation

Before a business issues an ICO, it will market the ICO to potential investors through a white paper (“**White Paper**”).

Similar to a prospectus or information memorandum in initial public offerings, the White Paper in essence is a marketing tool which provides information on the issuing company, a description of its business, the proposed project for which it is raising funds for, and the rights and structure of the Digital Token(s) being issued. The White Paper is commonly available through the issuing company’s website or through an online platform.

The terms and conditions of the purchase of the Digital Token(s) is typically recorded in a digital token purchase agreement which sets out the rights of each party. The purchase agreement should comply with the specific rules and local legislation of the country in which the Digital Token(s) are being marketed. However, ICOs are a recent phenomenon and like many other countries, the UAE, has no specific statutory provisions or rules that an issuer should comply with when issuing ICOs.

## The UAE’s Position on ICOs

### UAE (Onshore, excluding the DIFC and ADGM)

In the UAE, the Securities and Commodities Authority (“**SCA**”), the governmental body that regulates the UAE’s financial and commodities markets issued a circular on 2 April 2018<sup>3</sup> (the “**Circular**”) in which it warned investors against digital, token-based

<sup>3</sup> <https://www.sca.gov.ae/English/News/Pages/Articles/2018/2018-2-4.aspx> accessed on 29 April 2018 at 16:50 pm.

fundraising activities which includes ICOs. The SCA reiterated that it does not recognise, regulate or supervise any ICOs, and by investing in any ICOs, the investors are doing so at their own risk.

Through the Circular, the SCA raised awareness surrounding the risks associated with ICOs. In particular, the SCA highlighted the following:

- that some ICOs are not subject to regulation and therefore may be subject to fraud risks;
- that ICOs may be issued abroad, and therefore are subject to foreign laws and regulations that can be difficult to verify, and therefore, tracking and recovering funds in cases where ICOs have collapsed may prove to be extremely difficult;
- that ICO trading on the secondary market is subject to opaque, volatile pricing and may possess insufficient liquidity;
- that investors, in particular retail investors may not be able to comprehend the risks, costs, and expected returns associated with ICOs; and
- that the information made available to potential investors through the White Paper or otherwise may be unaudited and/or incomplete and may present the relevant investment in an unbalanced and/or misleading manner.

#### The Dubai Financial Services Authority (the “DFSA”)

Similarly, the DFSA, the independent regulator of financial services conducted in or from the Dubai International Financial Centre (“DIFC”) issued a warning on 13 September 2017<sup>4</sup> to potential investors of ICOs.

In its warning, the DFSA made it clear that it does not regulate “*these types of product offerings or licence firms in the DIFC to undertake such activities*”. In addition, the DFSA urged potential investors to exercise caution and undertake its own due diligence to better understand the associated risks before engaging with firms offering such investments in the DIFC, and/or before making any financial contributions towards such investments.

#### The Abu Dhabi Global Markets (the “ADGM”)

The ADGM, through the Financial Services Regulatory Authority (“FRSA”) issued its own guidance to investors proposing to invest into ICOs. The guidance provided by the ADGM on 8 October 2017 (the “Guidelines”),<sup>5</sup> aims to inform investors on the legal and regulatory treatment of raising funds through ICOs in the ADGM.

The Guidelines should be read in conjunction with the Financial Services and Markets Regulations 2015 (“FSMR”). If tokens in an ICO are assessed to exhibit the characteristics of a ‘Security’ then such tokens can be classified as ‘Security Tokens’ and thus may be

subject to the ADGM’s regulatory obligations/requirements.

Guidance Note 3.10 further clarifies that not all ICOs will constitute an Offer of Securities under the Market Rules or FSMR. If the tokens do not exemplify the features and characteristics of Securities, the offer of such tokens is not likely to be an Offer of Securities (each as defined in the FSMR and the ADGM Glossary) and neither is the trading of such tokens likely to constitute a Regulated Activity under the FSMR.

If an issuer is proposing an ICO in or from the ADGM then it should aim to approach the FSRA at the earliest opportunity to ensure it can rely on certain exemptions and avoid falling foul of the ADGM regulatory regime<sup>6</sup>.

On 30 April 2018, the FSRA published a consultation paper on a proposed framework to administer spot crypto asset activities to be undertaken in the ADGM.<sup>7</sup> It is clearly evident that the FSRA is seeking to instill proper governance, transparency and oversight in and over crypto asset activities. The proposed crypto asset regulatory framework supplements the FSRA’s Guidance on Initial Coin/Token Offerings and Crypto Assets released in 2017. However, until the proposed framework comes into force, ICOs comprising tokens which exhibit the characteristics of securities will continue to be treated as such within the FSRA’s regulatory framework.

***The information mentioned in this article is current at the date of publication of this article and available from public sources. Nothing in this article constitutes legal advice and should not be construed as any form of advice.***

#### Key Contacts



**Hasan Rizvi**  
Managing Partner  
+ 971 4 4019411  
hasan.rizvi@riaabg.com



**Sundeep Thandi**  
Associate  
+ 971 4 4019410  
sundeep.thandi@riaabg.com

<sup>4</sup> <https://www.dfsa.ae/MediaRelease/News/DFSA-Issues-General-Investor-Statement> accessed on 29 April 2018 at 16:52 pm.

<sup>5</sup> <https://www.adgm.com/media/192772/20171009-frsa-guidance-for-icos-and-virtual-currencies.pdf> ADGM Guidance Note accessed on 29 April 2018 at 17:27 pm.

<sup>6</sup> Guidance Note 3.3 of the Guidelines.

<sup>7</sup> <https://www.adgm.com/mediacentre/press-releases/abu-dhabi-global-market-proposes-a-regulatory-framework-for-spot-crypto-asset-markets/> accessed on 2.5.2018 at 13:00 pm.