



## **Guidance – Regulation of Virtual Asset Activities in ADGM**

\*In this attachment underlining indicates new text and striking through indicates deleted text.

**BACKGROUND**

- 8) ....
- 9) This Guidance primarily focuses on the FSRA's regulatory treatment of Virtual Assets, and the financial services activities that can be conducted in relation to Virtual Assets within ADGM. Consistent with the definition used by the Financial Action Task Force<sup>1</sup>, ~~f~~For the purposes of the Virtual Asset Framework, the FSRA has defined Virtual Assets in the FSMR as follows:

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- 11) For clarification, the Virtual Asset Framework does not ~~is not intended to~~ apply to:
- a) initial token or coin offerings (ICOs), (whether Digital Securities or Utility tokens), or other capital formation/ capital raising purposes. For details on FSRA's regulatory treatment of ICOs, Digital Securities and utility tokens please refer to the FSRA's ICO Guidance and Digital Securities Guidance; nor

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- 17) The principal Rules for Authorised Persons conducting a Regulated Activity in relation to Virtual Assets are set out in Chapter 17 of the FSRA Conduct of Business Rulebook ("COBS"). These product specific Rules apply in addition to any other Rules applicable to the Regulated Activity being conducted by Authorised Person (e.g., Operating a Multilateral Trading Facility, Providing Custody or Dealing). Though the requirements set out in COBS Rule 17.1.2 already apply to Authorised Persons generally, COBS Rule 17.1.2 operates as a 'sign-post' Rule designed to draw the attention of Authorised Persons conducting a Regulated Activity in relation to Virtual Assets to the fact that they must comply with all Rules applicable to Authorised Persons, including:
- a) all other relevant chapters of COBS;
- b) the FSRA General Rulebook ("GEN");
- c) the FSRA Anti-Money Laundering and Sanctions Rules and Guidance ("AML"); and
- d) the FSRA RulesCode of Market Conduct ("RCMC").

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- 19) COBS Rule 17.1.3 operates such that 'Client Investments' in GEN and 'Financial Instruments' in RMCCMC are read to include Virtual Assets. This means that the various Rules using these terms throughout the FRSA Rulebooks are expanded to capture Virtual Assets, including in particular the Rules contained in Chapters 3 and 6 of COBS.

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<sup>1</sup> "Guidance for a Risk-Based Approach to Virtual Assets and Virtual Asset Service Providers", updated October 2021 (www.fatf-gafi.org/publications/fatfrecommendations/documents/guidance-rba-virtual-assets-2021.html)

## Accepted Virtual Assets

24) ...

25) A Virtual Asset that meets the FSRA's requirements, as demonstrated by an individual Authorised Person, will constitute an Accepted Virtual Asset for that individual Authorised Person only. COBS Rule 17.2.2 states that for the purpose of determining whether, in its opinion, a Virtual Asset meets the requirements of being an Accepted Virtual Asset, the FSRA will consider those factors it considers relevant, which at the date of this Guidance include seven key factors as set out below:

- a) ~~Maturity/market capitalisation: the market capitalisation of the Virtual Asset, the sufficiency, depth and breadth of Client demand, the proportion of the Virtual Asset that is in free float, and the controls/processes to manage volatility of a particular Virtual Asset;~~

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27) An Applicant applying for an FSP will need to submit the details of each Accepted Virtual Asset that they propose to use, setting out separately for each proposed Virtual Asset how it meets the tests set out in paragraph 25 above. The use of each Accepted Virtual Asset will be approved by the FSRA as part of the formal FSP application process or otherwise in accordance with the process outlined in paragraph 29 below.

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### Principle 3: Customer Risk Assessment and Customer Due Diligence

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- j) ~~In the case of non-face-to-face Client on-boarding and ongoing due diligence of Clients who are natural persons, the FSRA expects that an Authorised Persons will take the necessary action, and develop appropriate policies, to ensure correct identification of a Client as a natural person. that the Client's identity is duly verified in accordance with all applicable Laws and Rules. This may include obtaining a "selfie", together with two currently valid forms of the Client's facial ID, or by conducting a "liveness test". Irrespective of the method employed, it should validate that the individual being on-boarded is present during the on-boarding process, matches the individual in the identity documentation, and that the ID presented is valid and authentic. It should also include obtaining and authenticating a valid form of the Client's facial ID, which should one must be either the Client's passport with all applicable details clear and visible, or the original version second should be a copy (front and back) of an official government issued document, such as a national ID or driver's license. For the purposes of residents of the UAE, the primary form of documentation used should be the Client's Emirates ID card.~~

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### Principle 6: Record keeping

- y) As proper documentation is one of the main pillars of ensuring AML/CFT compliance, Authorised Persons are required to have policies and procedures in place to ensure proper record keeping practices. It is expected that an Authorised Person will maintain up to date records in accordance with the CDD obligations

applicable to it and be prepared to provide the records upon request from the FSRA.

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### Technology Governance and Controls

- 47) ....
- 49) GEN Rule 3.3 requires an Authorised Person to establish systems and controls to ensure its affairs are managed effectively and responsibly, and to ensure such systems and controls are subject to continuous monitoring and review. COBS Rule 17.5 sets out additional requirements for appropriate technology governance and controls specific to Authorised Persons, with a focus on:
- a) Virtual Asset Wallets;
  - b) Private and Public Keys;
  - c) Origin and destination of Virtual Asset funds;
  - d) Security; and
  - e) Risk Management.

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### Virtual Asset Risk Disclosures

- 93) Given the significant risks to Clients transacting in Virtual Assets, Authorised Persons are required to undertake a detailed analysis of the risks and 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. As this disclosure obligation is ongoing, and given the rapidly developing market for Virtual Assets, Authorised Persons are required to continually update this analysis and the resultant disclosures to its Clients to reflect any updated risks relating to:
- a) the Authorised Person's products, services and activities;<sup>2</sup>
  - b) Virtual Assets generally; and
  - c) the specific Accepted Virtual Asset.
- 94) The FSRA expects that the disclosures to be made by an Authorised Person in order to satisfy COBS 17.6 may include:
- a) Virtual Assets not being legal tender or backed by a government;

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<sup>2</sup> These disclosures should cover any specific arrangements, or lack of arrangements, for any product, service and activity of an Authorised Person. For example, in relation to custody of Client's Virtual Assets, where an Authorised Person allows/requires Clients to self-custodise their Virtual Assets, this must be fully disclosed to Clients upfront, and Clients must be informed that the Authorised Person is not responsible for custody and protection of Clients' Virtual Assets. Where an Authorised Person is outsourcing part or all of the custody arrangements to a third party, this should also be disclosed to Clients.

- b) the value, or process for valuation, of Virtual Assets, including the risk of a Virtual Asset having no value;
- c) the volatility and unpredictability of the price of Virtual Assets relative to Fiat Currencies;
- d) that trading in Virtual Assets may be susceptible to irrational market forces;
- e) that the nature of Virtual Assets may lead to an increased risk of Financial Crime;
- f) that the nature of Virtual Assets may lead to an increased risk of cyber-attack;
- g) there being limited or, in some cases, no mechanism for the recovery of lost or stolen Virtual Assets;
- h) the risks of Virtual Assets being transacted via new technologies, (including distributed ledger technologies ('DLT')) with regard to, among other things, anonymity, irreversibility of transactions, accidental transactions, transaction recording, and settlement;
- i) that there is no assurance that a Person who accepts a Virtual Asset as payment today will continue to do so in the future;
- j) that the nature of Virtual Assets means that technological difficulties experienced by the Authorised Person may prevent the access or use of a Client's Virtual Assets;
- k) any links to Virtual Assets related activity outside ADGM, which may be unregulated or subject to limited regulation; and
- l) any regulatory changes or actions by the Regulator or Non-ADGM Regulator that may adversely affect the use, transfer, exchange, and value of a Virtual Asset.

~~The FSRA is of the view that merely restating this non-exhaustive list of risks, either in its application or in the risk disclosures to its Clients, does not satisfy an Authorised Person's risk disclosure requirements. COBS Rule 17.6 sets out a non-exhaustive list of risks that are required to be disclosed to Clients. The FSRA is of the view that merely restating this non-exhaustive list of risks, either in its application or in the risk disclosures to its Clients, does not satisfy an Authorised Person's risk disclosure requirements. Instead, Authorised Persons are expected to undertake a detailed analysis of the risks, and to make all necessary disclosures to their Clients. As this disclosure obligation is ongoing, and given the rapidly developing market for Virtual Assets, Authorised Persons are required to continually update this analysis and the resultant disclosures to its Clients to reflect any updated risks relating to:~~

- ~~a) — the Authorised Person's products, services and activities;~~
- ~~b) — Virtual Assets generally; and~~
- ~~c) — the specific Accepted Virtual Asset.~~

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110) Virtual Asset brokers / dealers are required to disclose the following information to eClients:

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### **Application of FSRA's stablecoin position to the conduct of Regulated Activities within ADGM**

166) A number of possible scenarios for the use of stablecoins within ADGM, and the proposed regulatory approach for each, are set out below:

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- e. **MTF (using Virtual Assets): using third-party issued fiat tokens as a payment/transaction mechanism:**
- i. In the context of using third party fiat tokens, the Authorised Person must directly meet the requirements of the Accepted Virtual Assets, Technology Governance and AML/CFT sections of this Guidance.
  - ii. For the related fiat currency custody activities, FSRA preference is to have the MTF utilise a Virtual Asset/Fiat Custodian authorised on the basis of paragraphs 139 - 145 or 166(b) above.
  - iii. In relation to the issuance of the related fiat token, in circumstances where the issuer is not authorised under paragraph 166(a) above, it is expected that the Authorised Person undertake the same due diligence as that it would apply for the purposes of determining Accepted Virtual Assets (focusing on Technology Governance requirements, the seven factors used to determine an Accepted Virtual Asset, and requirements relating to reporting and reconciliation).

### **NON-FUNGIBLE TOKENS**

167) Non-fungible tokens ("NFTs") are cryptographic assets on a DLT with unique identification codes and metadata that distinguish them from each other. Unlike Virtual Assets, they cannot be replicated, thus cannot be traded or exchanged at equivalency. Essentially, therefore, NFTs operate similar to a collector's item, but are digital instead of physical.

168) The FSRA recognises the growing relevance of NFT markets within the wider digital asset markets. While the FSRA is not proposing to establish a formal regulatory framework for NFTs at this point, it will continue to monitor industry, market and regulatory developments. The FSRA is, however, in certain circumstances only, open to NFT activities being undertaken within ADGM, but only by its regulated, and active, MTFs which are also authorised to Provide Custody in relation to Virtual Assets (a "MTF / Virtual Asset Custodian") where both of those Regulated Activities are conducted within ADGM. No other firms, including unregulated firms or Virtual Asset firms conducting non-MTF activities, are permitted to engage in NFT activities.

169) The FSRA's current position in relation to NFTs is therefore as follows:

- a. Relevant MTFs / Virtual Asset Custodians, should establish within their ADGM Group an unregulated NFT entity (the 'NFT Entity'). The NFT Entity would primarily be used as the entity to engage with NFT issuers and market participants

and would therefore be 'ring-fenced' from the MTF / Virtual Assets Custodian from a legal (and therefore liability, resources, and funding) perspective;

- b. An NFT Entity is to outsource back to the MTF/Virtual Asset Custodian all client, trading, auction and custody activities;
  - c. All NFT activities will be captured for KYC and AML/CTF purposes, as the AML rules within ADGM will apply to the NFT Entity, and continue to apply as relevant to the MTF/Virtual Asset Custodian (including as set out in paragraphs 37-46 of this Guidance);
- 170) While the FSRA will allow these regulated MTF/Virtual Asset Custodian Groups to undertake certain NFT activities within ADGM, it is important to note the following:
- a. NFTs themselves remain outside FSRA regulatory oversight;
  - b. the NFT Entity, and the MTF/Virtual Asset Custodian, will need to satisfy the FSRA of its approval process for the Issuers of the NFTs (noting that an Issuer cannot be themselves, or part of their Group); and
  - c. NFTs should be transferred into the MTF for auction/trading purposes and to the Virtual Asset Custodian for custodial purposes, but if not the MTF/Virtual Asset Custodian would need to satisfy the FSRA that it has proper systems and controls in place. An MTF/Virtual Asset Custodian would therefore need to allow/onboard only suitable third-party NFT registries and relevant auction houses, outside of themselves.

## **APPLICATION PROCESS**

171) 167 Applicants seeking to become an Authorised Person conducting a Regulated Activity in relation to Virtual Assets must be prepared to engage heavily with the FSRA throughout the application process. The Application process is broadly broken down into five stages, as follows:

a) ...

*Due diligence and Discussions with FSRA team(s)*

172) 168) Prior to the submission of an Application, all Applicants are expected to provide the FSRA with a clear explanation of their proposed business model and to demonstrate how the Applicant will meet all applicable FSRA Rules and requirements. These sessions will also involve the Applicants providing a number of in-depth technology demonstrations, across all aspects of its proposed Virtual Asset activities. The FSRA generally expects these meetings, where possible, to take place between the Applicant and the FSRA in person. Given the complexity of the activities associated with the Virtual Asset Framework, it is likely that a number of meetings will need to be held between an Applicant and the FSRA before the Applicant will be in a position to submit a draft, then formal, application.

*Submission of Formal Application*

173) 169) Following discussions with the FSRA, and upon the FSRA having reasonable comfort that the Applicant's proposed business processes, technologies and capabilities are at a sufficiently advanced stage, the Applicant will be required to submit a completed Virtual Asset Application Form, and supporting documents, to the FSRA. Payment of the

fees applicable to the Application, as set out in paragraphs 175 - 183, must also be made at the time of submission. The FSRA will only consider an Application as having been formally submitted, and commence its formal review of the Application, upon receipt of both the completed Application and the associated fees.

#### *Granting of In Principle Approval (IPA)*

- ~~174)~~ 170) The FSRA will undertake an in depth review of the Application, and supporting documents, submitted by an Applicant. The FSRA will only consider granting an IPA for a FSP to those Applicants that are considered able to adequately meet all applicable Rules and requirements. An Applicant will be required to meet all conditions applicable to the IPA prior to being granted with final approval and an FSP for the relevant Regulated Activity.

#### *Granting of Final Approval (Financial Services Permission)*

- ~~175)~~ 174) Subject to being satisfied that the Applicant has met all conditions applicable to the IPA, the FSRA will grant the Applicant with final approval for an FSP for the relevant Regulated Activity. Final approval will be 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.

#### *'Operational Launch' Testing*

- ~~176)~~ 172) An Applicant (particularly an MTF (seeking to use Virtual Assets) and/or Virtual Asset Custodian) will only be permitted to progress to operational launch when it has completed its operational launch testing to the FSRA's satisfaction, including completion of third party verification of the Applicant's systems, where applicable.
- ~~177)~~ 173) Noting the heightened risks associated with activities related to Virtual Assets, Authorised Persons will be closely supervised by the FSRA once licensed. Authorised Persons will be expected to meet frequently with the FSRA, will be subject to ongoing assessments and should be prepared to undergo thematic reviews from time to time.

#### *Opening a bank account*

- ~~178)~~ 174) Given the associated risks within the Virtual Asset space, the global banking sector is focusing on account opening requests from entities associated with Virtual Assets with increased scrutiny. The FSRA has engaged in extensive discussions with local and international banks for the purposes of providing an overview of the Virtual Asset Framework and the stringent authorisation requirements imposed on Applicants when applying to become an Authorised Person. It is intended that those banks with a risk appetite to bank Virtual Asset players will glean comfort from the regulatory oversight of the FSRA and the issuance of an IPA to entities demonstrating that they have a clear roadmap of development of their business towards final approval and issuance of an FSP. The process for approval for the opening of a bank account with local or international banks will typically include a full explanation and review of an Applicant's AML and Client on-boarding processes and procedures, as well as its ability to monitor the source and destination of funds, amongst other areas of its Virtual Asset activities.

## **FEES**

### **Authorisation and supervision fees**

- ~~179) 475)~~ The Fees applicable to Authorised Persons conducting a Regulated Activity in relation to Virtual Assets have been established in consideration of the risks involved in relation to Virtual Asset activities and the supervisory requirements placed on the FSRA to suitably regulate these Authorised Persons and Virtual Asset activities in ADGM.
- ~~180) 476)~~ Pursuant to FEES Rule 3.14.1, an Applicant for an FSP to conduct a Regulated Activity in relation to Virtual Assets must pay, at the time of submission of its Application, an initial authorisation fee of (as applicable):
- a) \$20,000; or
  - b) \$125,000 if the Applicant is seeking to operate an MTF (in relation to Virtual Assets).
- ~~181) 477)~~ As set out earlier in paragraph 169, the FSRA will only consider an Application as having been formally submitted, and commence its formal review of the Application, upon receipt of both the completed Application and the associated fees.
- ~~182) 478)~~ Pursuant to FEES Rule 3.14.2, annual supervision fees for an Authorised Person conducting a Regulated Activity in relation to Virtual Assets, payable in accordance with paragraph 1 of the FEES Rulebook, are set as follows:

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#### **Cumulative application of Fees**

- ~~183) 479)~~ Subject to paragraph 181 below, if an Applicant/Authorised Person will be conducting multiple Regulated Activities in relation to Virtual Assets as part of its FSP, the fees (authorisation and supervision) payable by that Authorised Person will be cumulative, and considered across the following:
- ....
- ~~184) 480)~~ In practice, and to further clarify, this results in several scenarios for FEES in relation to Virtual Asset activities, being:
- a) ....
- ~~185) 481)~~ Noting the above paragraph, if an Applicant/Authorised Person will be undertaking a Regulated Activity involving conventional assets (e.g. securities or derivatives) in addition to Virtual Assets, as noted in paragraphs 20 to 21, it will need to seek approval from the FSRA to carry out its Regulated Activity in relation to both asset types (conventional and Virtual Asset). The fees attributable to that Authorised Person for its Regulated Activities (conventional and Virtual Asset-related), will likely not be cumulative (considering the high fees already imposed on Applicants/Authorised Persons conducting a Regulated Activity in relation to Virtual Assets, subject to the considerations set out in paragraph 183 below). The FSRA recommends that that Applicants discuss any questions relating to FEES with the FSRA as early as practicable.
- ~~186) 482)~~ Pursuant to FEES Rule 3.14.3, an MTF using Virtual Assets must pay to the FSRA a trading levy on a sliding scale basis (as set out in the table below), payable monthly in USD. Unless otherwise determined by an MTF (and agreed to by the FSRA), the FSRA

expects that the calculation of average daily value should occur at 12am Abu Dhabi time (+4hr GMT).

<b>Average Daily Value (ADV) (\$USD)</b>	<b>Levy</b>
ADV ≤ 10m	0.0015%
10m < ADV ≤ 50m	0.0012%
50m < ADV ≤ 250m	0.0009%
ADV > 250m	0.0006%

- 187) ~~183)~~ Pursuant to FEES Rule 1.2.6(a), the FSRA reserves its right to impose additional fees in circumstances where a 'substantial additional' regulatory burden is imposed on FSRA. In such circumstances, including the migration of an MTF to become a conventional 'Securities' Recognised Investment Exchange, the FSRA recommends that the Applicant/Authorised Person discuss FEE implications with the FSRA as early as practicable.