INTRODUCTION OF CRYPTO ASSET REGULATORY FRAMEWORK IN ADGM
<table>
<thead>
<tr>
<th>CONTENTS</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>INTRODUCTION</td>
<td>3</td>
</tr>
<tr>
<td>BACKGROUND</td>
<td>6</td>
</tr>
<tr>
<td>PROPOSED LEGISLATIVE FRAMEWORK</td>
<td>7</td>
</tr>
<tr>
<td>REGULATORY APPROACH</td>
<td>7</td>
</tr>
<tr>
<td>RISK MITIGATION</td>
<td>8</td>
</tr>
<tr>
<td>NEW REGULATED ACTIVITY</td>
<td>9</td>
</tr>
<tr>
<td>REGULATORY REQUIREMENTS</td>
<td>11</td>
</tr>
<tr>
<td>SUPPLEMENTARY GUIDANCE</td>
<td>11</td>
</tr>
<tr>
<td>RISK-BASED FEE STRUCTURE</td>
<td>12</td>
</tr>
<tr>
<td>DRAFT AMENDMENTS TO OTHER FSRA RULEBOOKS</td>
<td>13</td>
</tr>
</tbody>
</table>
WHY ARE WE ISSUING THIS PAPER?

1. The Abu Dhabi Global Market ("ADGM") together with the Financial Services Regulatory Authority ("FSRA") have issued this Consultation Paper to invite public feedback and comments on proposed amendments to ADGM regulations and specific FSRA rulebooks.

2. In October 2017, ADGM was the first jurisdiction in the MENA region to publicly support the development of certain digital assets, including Initial Coin Offerings (ICOs). Noting the value that ICOs can generate in transforming capital raising activities and the capital markets landscape generally, ADGM clarified its regulatory treatment of ICOs in respect of coins or tokens that have the characteristics of a Security. The guidance also confirmed the FSRA’s treatment of crypto assets as commodities, and clarified that derivatives over crypto assets would be regulated within ADGM.

3. In February 2018, the FSRA issued a press release informing the market that it is ‘reviewing and considering the development of a robust, risk-appropriate regulatory framework to regulate and supervise activities of virtual currency exchanges and intermediaries’.

4. The FSRA would now like to invite comments on its proposed regulatory framework for the regulation of crypto asset activities conducted in or from ADGM, including exchanges, custodians and other intermediaries engaged in crypto asset activities (the “Spot Crypto Asset Framework”).

5. The proposed framework involves amendments to the ADGM’s regulations and FSRA Rules, including:

   a. the introduction of a new Regulated Activity of Operating a Crypto Asset Business ("OCAB"), to be set out in Chapter 17B of the Financial Services and Markets Regulations 2015 ("FSMR");

   b. amendments to the FSRA Fees Rules 2015 ("FEES") to introduce fees for the new Regulated Activity of Operating a Crypto Asset Business;
c. amendments to the FSRA Conduct of Business Rules ("COBS") to introduce a new Chapter 17 addressing specific requirements for the Regulated Activity of Operating a Crypto Asset Business;

d. amendments to the FSRA Market Infrastructure Rulebook ("MIR") proposing rules applicable to Recognised Investment Exchanges operating a Crypto Asset Exchange; and

e. amendments to terms defined in FSMR and the FSRA Glossary ("GLO").

6. The proposed Spot Crypto Asset Framework is set out in Annex A and Appendices 1 - 4 to this Paper.

7. Unless otherwise defined, capitalised terms referred to in this Paper have the meanings attributed to such terms as contained in FSMR or GLO.

WHO SHOULD READ THIS PAPER?

8. This Consultation Paper may be of interest to a number of parties, including individuals, organisations and investors looking to carry on crypto asset activities in or from ADGM and their professional advisers, as well as Recognised Investment Exchanges wishing to operate a Crypto Asset Exchange within ADGM.

HOW TO PROVIDE COMMENTS

9. All comments should be in writing and sent to the address or email specified below. If sending your comments by email, please use the Consultation Paper number in the subject line. If relevant, please identify the organisation you represent when providing your comments.

10. FSRA reserves the right to publish, including on its website, any comments you provide, unless you expressly request otherwise at the time of making any comments. Comments supported by reasoning and evidence will be given more weight by FSRA.
WHAT HAPPENS NEXT?

11. The deadline for providing comments on this proposal is **28 May 2018**. Once we receive your comments, we will consider whether any modifications are required to the proposed amendments to the ADGM’s legislative framework. The Board and FSRA will then proceed to enact the proposed regulatory framework. We will issue a notice on our website when this happens.

COMMENTS TO BE ADDRESSED TO:

Consultation Paper No. 2 of 2018
Financial Services Regulatory Authority
Abu Dhabi Global Market Square
Al Maryah Island
PO Box 111999
Abu Dhabi, UAE
Email: consultation@adgm.com
1. Technological innovation is transforming the financial services industry. Rapid advances in new technologies, including the development of distributed ledger technologies and creation and utilisation of crypto assets, have provided opportunities for significant change and disruption to financial services and other related activities globally.

2. From being almost non-existent ten years ago, crypto assets have now become an asset class in their own right, and are increasingly recognised as a medium of exchange for the payment of goods and services. Over 200 trading venues now exist worldwide for spot trading of over 1500 crypto assets.

3. To date, regulators have been monitoring developments in the trading activities of crypto assets very closely, given the significant risks involved, including the potential for criminal activity and fraud (e.g., tax evasion, money laundering and counter-terrorist financing (AML/CTF)) and significant consumer losses (due to price volatility and technology governance issues), as well as custody issues, information asymmetry and a lack of market integrity.

4. Worldwide, regulators have taken divergent approaches to the regulation of crypto asset spot trading:
   - The majority of regulators do not licence spot crypto asset activities, focusing rather on AML/CTF risks;
   - In some jurisdictions regulators have banned spot trading of crypto assets; and
   - In a limited number of jurisdictions regulators have licenced entities undertaking crypto asset activities and sought to take a more holistic approach to their regulation.

5. This year has seen a significant shift in the position of regulators in relation to spot trading of crypto assets. The G20 has required that recommendations for the effective regulation of spot trading be put
forward by July 2018 and a general consensus appears to be forming amongst regulators that a global standard is required for the regulation of crypto asset spot trading.

**PROPOSED LEGISLATIVE FRAMEWORK**

**REGULATORY APPROACH**

6. Noting the growing global consensus that spot trading of crypto assets should be regulated, the FSRA has sought to implement an appropriate and effective regulatory regime.

7. Based on its engagement with industry experts, one of the principal issues that the FSRA has identified is that crypto asset markets have so far been predominately ‘retail’, and therefore highly volatile in nature, with institutional players remaining on the sidelines due to their concerns over current regulatory controls.

8. In formulating the proposed Spot Crypto Asset Framework, the FSRA has identified and sought to address each of the key risks associated with spot crypto asset activities appropriately, in order to create a comprehensive framework so as to allow for both conventional institutional players as well as large crypto asset players to operate in ADGM.

9. While extremely important, the FSRA believes that the regulation of AML/CTF/KYC risks alone will not sufficiently mitigate certain wider Crypto Asset related risks, and therefore would not allow us to meet our medium to long term regulatory objectives.

10. In order to provide regulatory certainty to operators, participants, and investors both institutional and retail, engaged in crypto asset activities, the FSRA has addressed issues around consumer protection, custody, technology governance, disclosure/transparency, Market Abuse, and by applying controls over Crypto Asset Exchanges such that they are regulated in a manner similar to how securities exchanges are regulated globally.
11. By extending our regulatory oversight in this way, FSRA’s aim is to establish a first-in-the-world crypto asset market that all relevant players are comfortable participating in.

**RISK MITIGATION**

12. The FSRA has identified five main risk areas associated with spot Crypto Asset markets, and has developed mitigations for each of these risks, as identified below.

<table>
<thead>
<tr>
<th>RISK</th>
<th>MITIGATION STRATEGY</th>
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<tbody>
<tr>
<td>AML/CTF/TAX</td>
<td>The FSRA AML Rulebook applies in full to the new Regulated Activity of Operating a Crypto Asset Business (OCAB). Entities engaged in OCAB must consider their reporting obligations in relation to FATCA and Common Reporting Standards.</td>
</tr>
<tr>
<td>CONSUMER PROTECTION</td>
<td>All material risks associated with Crypto Assets generally, each particular Crypto Asset, and an OCAB entities’ products, services and activities must be disclosed.</td>
</tr>
<tr>
<td>TECHNOLOGY GOVERNANCE</td>
<td>Systems and controls in relation to:</td>
</tr>
<tr>
<td></td>
<td>• Crypto Asset wallets</td>
</tr>
<tr>
<td></td>
<td>• Private keys</td>
</tr>
<tr>
<td></td>
<td>• Origin and destination of Crypto Asset funds</td>
</tr>
<tr>
<td></td>
<td>• Security</td>
</tr>
<tr>
<td></td>
<td>• Risk management.</td>
</tr>
<tr>
<td>‘EXCHANGE-TYPE’ ACTIVITIES</td>
<td>Crypto Asset Exchanges will be regulated in a manner similar to FSRA’s regulation of Multilateral Trading Facilities (MTFs), and will be required to have in place, among other requirements, the following:</td>
</tr>
<tr>
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<td>• Market surveillance</td>
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NEW REGULATED ACTIVITY

13. To implement the proposed Spot Crypto Asset Framework, the FSRA proposes to introduce a new Regulated Activity of Operating a Crypto Asset Business. This will differentiate the regulation of Crypto Asset activities from the FSRA’s current regulatory framework which was designed with traditional Financial Instruments in mind.

14. The new Regulated Activity would include:

(a) General activities, such as -

- buying or selling Accepted Crypto Assets (see paragraph 17 below) as principal or agent;
- making arrangements with a view to another person buying, selling or providing custody of Accepted Crypto Assets; and
- advising on the merits of buying or selling Accepted Crypto Assets.

(b) Specific activities, that will attract additional regulatory requirements, namely -

- Operating a Crypto Asset Exchange; or
Operating as a Crypto Asset Custodian.

### ISSUES FOR CONSIDERATION

**Q1:** Do you agree with proposed approach to regulate Crypto Asset exchanges and custodians as well as intermediaries?

**Q2:** Do you agree with the proposed distinction between general activities captured within the regulated activity of OCAB and specific activities (such as operating a Crypto Asset exchange or a Crypto Asset custodian) attracting additional regulatory requirements?

15. OCAB will not cover certain activities, such as –
   - the creation or administration of Crypto Assets that are not Accepted Crypto Assets;
   - the development, dissemination or use of software for the purpose of creating or mining Crypto Assets;
   - the transmission of Crypto Assets; and
   - loyalty point schemes denominated in a Crypto Asset.

16. The FSRA’s definition of ‘Crypto Assets’ is based on the well accepted definition of ‘virtual currency’ of the Financial Action Task Force (FATF).

17. FSRA would have a general power to determine Accepted Crypto Assets – those Crypto Assets that will be permitted in relation to OCAB activities within ADGM, in order to prevent higher-risk activity involving or relating to illiquid or immature Crypto Assets, by –

   (a) applying a market capitalisation/maturity threshold (proposed to be of at least 4 USD billion); and

   (b) retaining sufficient discretion for the FSRA to take additional factors (e.g., security, connectivity, market demand/volatility, type of distributed ledger, innovation and practical application) into account in order to assess the suitability of Crypto Assets based on our risk appetite.
18. Please refer to **Annex A** for the proposed amendments to FSMR, including the new Regulated Activity, definitions and consequential amendments.

**REGULATORY REQUIREMENTS**

19. Once granted a Financial Services Permission, OCAB entities will be regulated under the FSMR and the FSRA Rulebooks as Authorised Persons.

20. To implement the Spot Crypto Asset Framework, the FSRA proposes to introduce a new Chapter 17 to COBS setting out additional Rules applicable to the OCAB activity. These requirements will be applied proportionately, depending on the level of risk that the proposed activity poses, with -

- general obligations imposed on all OCAB entities, including dealers and advisors (such as AML/CTF protections, capital requirements, technology governance and controls, and specific disclosure requirements); and

- further obligations applicable to Crypto Asset Exchanges and Crypto Asset Custodians in addition to the general obligations (in the case of a Crypto Asset Exchange, specific MTF obligations, including market surveillance, settlement processes, transaction recording and transparency requirements, and in relation to a Crypto Asset Custodian, additional client asset protections).

21. Please refer to **Appendix 1** for the proposed amendments to COBS.

**SUPPLEMENTARY GUIDANCE**

22. The features and regulatory requirements of the Spot Crypto Asset Framework, as well as FSRA’s approach to the regulation of OCAB activities,
will be set out in detail in Guidance. The FSRA will publish this Guidance shortly.

**RISK-BASED FEE STRUCTURE**

23. The proposed risk-based fee structure for the new Regulated Activity is tiered, as set out in Table 1 below:

<table>
<thead>
<tr>
<th>Activity</th>
<th>Authorisation Fee</th>
<th>Supervision Fee</th>
<th>Trading Levy</th>
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<tbody>
<tr>
<td>OCAB - General</td>
<td>$20,000</td>
<td>$15,000</td>
<td>N/A</td>
</tr>
<tr>
<td>Operating a Crypto Asset Exchange</td>
<td>$125,000</td>
<td>$60,000</td>
<td>0.0015% of daily trading value, payable monthly</td>
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24. The proposed fee structure sets a high watermark in order to –

- recognise the substantial risks posed by the new Regulated Activity; and
- cater to those Applicants who are able to demonstrate their willingness and ability to comply with the requirements of the Spot Crypto Asset Framework.

25. The higher authorisation and supervision fees and Trading Levy proposed for Crypto Asset Exchanges reflect a heightened supervisory burden for FSRA in terms of human resources, technology and technical costs.

26. Please refer to Appendix 2 for the proposed amendments to FEES.

27. The FSRA is also considering the establishment of a Compensation Scheme in the future, aimed to assist with compensation of Crypto Asset Exchange clients who have suffered a loss in certain circumstances, and is proposing to apply a proportion of the Trading Levy towards this scheme. The FSRA is currently considering the manner in which such a scheme would be governed, the circumstances in which it would offer an avenue of redress for clients and the appropriate timeframe for the scheme to be established. We will update the market on the developments in this regard in due course.
ISSUES FOR CONSIDERATION

Q5: DO YOU HAVE ANY COMMENTS ON THE PROPOSED FEES IN RELATION TO EACH CRYPTO ASSET ACTIVITY?

Q6: DO YOU HAVE ANY COMMENTS ON THE PROPOSAL TO ESTABLISH A COMPENSATION SCHEME OR VIEWS ON THE MANNER IT OUGHT TO BE GOVERNED?

DRAFT AMENDMENTS TO OTHER FSRA RULEBOOKS

28. FSRA also proposes to introduce a number of consequential amendments, including -

a. amendments to MIR, proposing rules applicable to Recognised Investment Exchanges operating a Crypto Asset Exchange, as set out in Appendix 3 to this Paper; and

b. new definitions associated with the Spot Crypto Asset Framework, mirroring the definitions introduced in section 258 of the FSMR, in GLO, as set out in Appendix 4 to this Paper.

ISSUES FOR CONSIDERATION

Q7: DO YOU HAVE ANY CONCERNS ABOUT ANY OF THESE PROPOSALS? IF SO, WHAT ARE THESE CONCERNS AND HOW SHOULD THEY BE ADDRESSED?