



ABU DHABI GLOBAL MARKET
سوق أبوظبي العالمي

*CONSULTATION PAPER
NO. 3 OF 2023*

**PROPOSAL FOR A LEGISLATIVE
FRAMEWORK FOR DISTRIBUTED
LEDGER TECHNOLOGY FOUNDATIONS**

11 April 2023

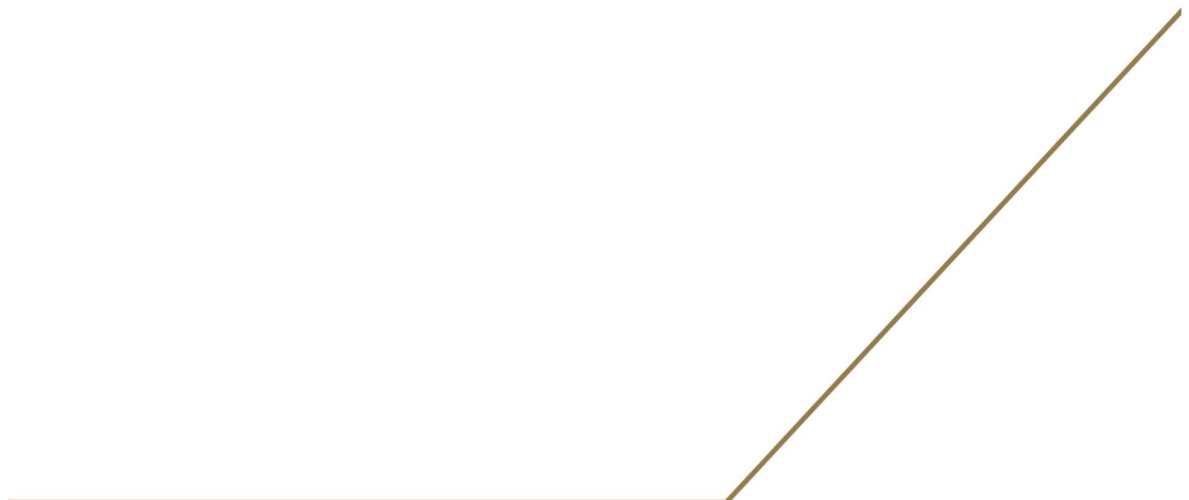


TABLE OF CONTENTS**Contents**

Introduction	3
Background and Scope	4
Our Key Proposals	7
Proposed Legislation	13

Introduction

Why are we issuing this paper?

1. The Registration Authority (**RA**) of Abu Dhabi Global Market (**ADGM**) has issued this Consultation Paper to seek views on its proposed new framework for foundations that facilitate distributed ledger technology (**DLT**) and token issuance (**DLT Foundations**).
2. ADGM has received interest concerning the use of ADGM foundations for DLT purposes and the issuance of non-regulated utility tokens. However, whilst foundations are inherently well suited to DLT projects, there are certain features and requirements within our current foundations regimes that impose constraints that are not desirable for DLT projects.
3. The RA, recognising the overall suitability of foundation structures for DLT projects, and aligned with ADGM's strategy to facilitate and support crypto initiatives, is preparing a new legislative framework to cater for DLT projects and token issuance.

Who should read this paper?

4. This Consultation Paper should be of interest to any persons operating or planning DLT projects, persons engaging in digital asset related activities and their legal advisors, as well as DLT industry participants, associations and stakeholders.

How to provide comments

5. All comments should be made in writing and sent to the email address specified below. Please reference the Consultation Paper number in the subject line. If relevant, please identify the organisation you represent when providing your comments.
6. The RA reserves the right to publish on its website any comments you provide, unless you expressly request otherwise at the time of submitting those comments. Comments supported by reasoning and evidence will be given more weight by the RA.

Comments to be addressed to:

Consultation Paper No. 3 of 2023
Registration Authority
Abu Dhabi Global Market
Email: consultation@adgm.com

What happens next?

7. The deadline for providing comments on the proposed framework is **Friday, 12 May 2023**. After receiving your comments, we shall consider whether any modifications are required to the proposals, and the ADGM Board of Directors (**Board**) will then proceed to enact the proposal in their final form.
8. You should not act on these proposals until final amended regulations are issued by the Board. We shall issue a notice on our website when that happens.

Background and Scope

1. DLT projects typically face two competing objectives: (i) decentralisation; and (ii) a desire to focus and direct efforts and resources to develop the project and realize its full potential.
2. Decentralisation is a core principle of many DLT projects, which prizes the transfer of authority and control away from centralised entities or groups to a distributed network of project participants. The perceived advantages of decentralisation are rooted in this idea of decentralised governance, which its advocates believe promises a number of benefits, including more equitable ownership and value distribution among stakeholders, insulation from the vested interests of particular individuals or groups, reduced risk of censorship, and greater diversity.
3. For these kinds of DLT projects, the concept of the “decentralised autonomous organisation” (**DAO**) has emerged as the ideal-type governance structure.
4. Some DLT projects have chosen to operate solely using unincorporated DAOs, others have chosen to use a legal form to serve as their DAO/DAO equivalent or, in some cases, as a stepping-stone to a DAO (the latter scenario commonly being the case at the outset of a project where the benefits of coordinated action are seen as necessary to develop or scale the project).
5. In this regard, foundations, and similar legal forms, such as companies limited by guarantee, have proven attractive to developers and founders of DLT projects on account of their specific legal features which mitigate some of the perceived disadvantages of centralisation whilst also providing the utilitarian efficiency of a centralised body.
6. Foundations are particularly suited to DLT projects because foundations typically do not have owners in whose interests they are operated, but instead are required to operate in accordance with certain objects or purposes set out in their constitutions.
7. However, most foundations regimes, ADGM’s included, were designed and enacted prior to the advent of DLT, and hence with other purposes in mind, predominately charitable or wealth management purposes. Hence, whilst foundations are inherently well suited to DLT projects, there are certain features and requirements within current foundations regimes that impose constraints that are not desirable for DLT projects.
8. For example, ADGM’s Foundation Regulations 2017 (**Existing Foundations Regulations**) was designed for wealth management purposes. Thus, whilst full disclosure generally is required to the RA, the design of the Existing Foundations Regulations places an emphasis on confidentiality and privacy, rather than transparency, which is favourable for decentralisation and most DLT projects. In addition to transparency, other considerations to further enable foundation structures to be highly suited to facilitate DLT projects include requirements around decentralisation and governance (such as setting out the rights of token holders).
9. There is therefore an opportunity for the RA to design a new framework specifically for DLT Foundations (**New Regime**) in a manner which ‘cherry-picks’ the features of foundations that might be attractive to developers of DLT projects, whilst discarding or amending those

which are not, subject to the need to retain features which promote transparency and mitigate the risk of the New Regime being misused for illegal or immoral ends.

10. It is important to note, however, that the RA is the commercial regulator of the ADGM, responsible for overseeing compliance with ADGM's commercial legislation, including ADGM registered auditors and insolvency practitioners. The RA, however, is not ADGM's financial services regulator and this Consultation Paper concerning the New Regime is, therefore, limited to matters concerning the proposed entity type, governance etc. The RA cannot determine whether any token issuance is regulated nor issue any financial services permits.
11. This Consultation Paper aims to explain the proposed:
 - a. Distributed Ledger Technology Foundations Regulations 2023.
12. In summary, the proposals for the design of the New Regime include:
 - a. **Framework Structure** - the creation of a standalone DLT foundations framework (rather than amending ADGM's existing foundations regime);
 - b. **Legal Personality** – providing that DLT foundations shall have separate legal personality;
 - c. **Objects** - Allowing DLT Foundations to conduct any activity that is not unlawful or contrary to public policy but allowing the founders to limit the purposes in the Charter;
 - d. **CSP** - 'non-exempt' DLT Foundations are to have an ADGM licensed Company Service Provider;
 - e. **Initial Asset Value** – DLT Foundations shall have a minimum initial asset value of USD 25,000;
 - f. **Beneficiaries** - the DLT Foundation's charter shall specify if the foundation has beneficiaries;
 - g. **Tokens** - the framework shall not restrict the types of token to facilitate a DLT Foundation nor determine whether a token is regulated;
 - h. **Profit Distribution** - the foundation charter must specify details concerning token buy back rights as well as distribution of any income / assets and the means of distribution;
 - i. **Council** - the foundation council will have a duty of skill, care and due diligence in the performance of their duties with non-delegable obligations and limited powers to reject the wishes of token holders in certain circumstances;
 - j. **Guardian** – DLT foundations may have as optional, a guardian;
 - k. **Tokenholder voting** – tokenholders' legal status is recognised and decentralised governance is expressly provided for with tokenholders having the right to vote on certain matters, unless expressly stated otherwise in the Charter;
 - l. **Beneficial Ownership** – the beneficiary owners of the DLT Foundation shall include the founders, council members, guardian, beneficiaries and persons in 'control', which will include tokenholders holding more than 25% voting rights;

- m. **Reporting & Disclosure** – DLT foundations should be subject to transparency obligations, and a requirement to file an annual return and audited annual accounts, which are to be published; and
- n. **Marketing** – no specific marketing obligations are proposed, but the Registrar shall have the power to impose temporary prohibition orders on marketing on public policy grounds.

Our Key Proposals**Structure of DLT Foundations**

13. Although many of the general concepts of foundations under the Existing Foundations Regulations will apply to DLT Foundations as well, the DLT Foundations will have many additional features and obligations. The RA, therefore, proposes to have a standalone regulatory framework for DLT Foundations (**DLT Foundations Regulations**).
14. DLT and DAOs are part of a dynamic and fast-moving space, and many things cannot be generalised across all DLT Foundations, but rather will depend on the individual foundation, the underlying project, rights of tokenholders (if any) etc. Thus, the RA's general recommended approach will be to allow as much optionality as possible, but with a requirement to disclose the DLT Foundation's chosen approach in its Charter, which will be publicly available.

Legal Personality

15. Legal personality, to some degree, undermines the decentralisation which is at the core of DAOs, and some DAOs have been structured as unincorporated organisations with no legal personality. This is arguably the "purest" form of a DAO because the DAO will consist purely as a set of smart contracts with no external owner or governance. Nevertheless, from a legal, regulatory and practical operational perspective, the existence of an entity with legal personality within a DAO structure is beneficial. The RA, therefore, proposes giving DLT Foundations legal personality.

Objects

16. The RA proposes that the DLT Foundations should be permitted to conduct any activity that is not unlawful or contrary to public policy but allowing the DLT Foundation's founders to limit or specify purposes in the Charter.

Company Service Provider

17. Consistent with the Existing Foundations Regulations, the RA proposes that DLT Foundations be required to appoint and maintain an ADGM licensed company service provider, unless the DLT Foundation demonstrate to the Registrar to have fulfilled the requirements of an 'exempt foundation', which will be similar to those stated in the Existing Foundations Regulations.

Minimum Initial Asset Value

18. Having a higher minimum capital requirement is beneficial for tokenholders and the regulator, as it demonstrates the founders' commitment to the project. The RA, therefore, recommends that the nominal minimum initial asset value for DLT Foundations be set at USD 25,000, which should be paid in within 6 months from the date of the DLT Foundations' incorporation.

Beneficiaries

19. Beneficiaries under the current Foundations Regulations do not have any ownership or governance rights, rather they receive distributions and can request certain information. Whether a DLT Foundation has beneficiaries will depend on the project/platform but having beneficiaries does not by itself go against decentralisation. Even where no tokens are issued by the DLT Foundation, assets could potentially be distributed to certain persons

depending on the structure and purpose of the project/platform. The RA proposes to have sufficient flexibility for the Charter to specify if any category(ies) of persons would constitute beneficiaries.

Distribution of Profit

20. The Existing Foundations Regulations require the distribution of assets/income to beneficiaries in certain circumstances as set forth in the constituent documents. However, if tokenholders receive rights to distribution of assets/income from a DLT Foundation, this may lead to a number of issues. In particular, the receipt of these rights through purchase of a token could risk the token being characterised as a security (and therefore as a financially regulated activity) across a range of jurisdictions. Moreover, this construct does not allow for the desired flexibility nor decentralisation for a broad range of DAO structures. The RA proposes to take a flexible approach and have the founders state in the Charter whether they want to have income/assets distributed and the mechanism for any such distribution.

QUESTION 1: Do you have any concerns with, or feedback on, the proposed structure of the DLT Foundations?

Governance and Control

Foundation Council

21. The RA proposes that the requirements in the Existing Foundations Regulations of appointing a foundation council applies to DLT Foundations as well as this is aligned with the concept of decentralisation. In this respect, the RA suggests that tokenholders and founders can be appointed to the council as they will have a stake/vested interest in the running of the protocol. Other than the recommendation that council members must exercise their duties with skill, care and due diligence, the RA does not recommend a specific fit and proper requirement for council members that go above and beyond that included in the Existing Foundations Regulations as any such additional requirements could undermine decentralisation and the recommended approach on potential representation of tokenholders in the council.
22. The RA further proposes that the New Regime should apply (i) a set of non-delegable matters/obligations which must remain the responsibility of the foundation council; and (ii) limited powers for the foundation council to, in certain circumstances, reject the wishes of tokenholders with voting rights (i.e., in case of Charter violations or illegal acts).

Tokenholder voting

23. A DAO is a member-controlled organisation that is intended to operate without a centralised body. To achieve this, DAOs typically rely on tokenholder voting mechanisms for decision-making in relation to the relevant blockchain protocol (tokenholders typically therefore comprise the “members” of the DAO), with specified control rights relating to the code of the underlying protocol and any treasury of digital assets for the protocol. It is generally accepted, however, that decentralised governance comes at the cost of efficiency and stability. Historically, this is the reason that enterprises and projects beyond a certain scale have tended towards the use of centralised structures (e.g., companies) with shareholders delegating day-to-day management control to the board of directors.
24. With respect to governance, the RA proposes that the New Regime:

- a. introduces the notion of tokenholders (if the DLT Foundation is issuing tokens) and clarifies their legal status, including key powers and protections;
 - b. expressly allows for decentralised governance models and requires transparency in the DLT Foundation's Charter with respect to the governance mechanism (e.g., rules for voting, how are voting proposed and called etc.) so that tokenholders are able to determine what their governance rights are; and
 - c. includes an express duty on the DLT Foundation and foundation council to comply with the delegated governance rights of tokenholders with specific liability or penalties for failure to do so (except in cases where the tokenholders are proposing an action or omission which would be illegal).
25. The RA proposes that, by default (unless the Charter provides for otherwise), if tokens are issued, the 'Delegated Matters' shall include 'Qualified Matters' which go to the core functioning of the DLT Foundation (e.g., change of name, Charter, objects, jurisdiction etc.) and allow all tokenholders who have voting rights to vote on them. If no tokens are issued, this does not apply. If a different approach is desired, it must be expressly stated in the Charter such that tokenholders know their rights and that, for example, the DLT Foundation may be liquidated without their approval.
26. The recommendation in respect of decentralisation is to generally allow as much optionality as possible in respect of governance as it often will depend on the type of DLT project. However, although it assumes that, in most cases, decentralised governance may be preferred, it may not be the sole option that the founders/tokenholders would like to have.

Guardian

27. Under the current Foundations Regulations, a guardian is appointed to supervise the actions of the foundation council upon the founder(s) death. The guardian's functions are mainly to ensure that the constitutional documents are complied with by the foundation council and the guardian typically does not have any major discretion. In the context of DLT Foundations, the appointment of a guardian may also be helpful to add a further layer of supervision with respect to the functioning of the DLT Foundation in accordance with the constitutional documents. That said, the appointment of a guardian may not always need to be mandatory.
28. The RA proposes that the New Regime includes an ability for the DLT Foundation to add a requirement to its Charter that the founder(s) will step down from the foundation council and lose any other powers with respect to the DLT Foundation and that an independent guardian will be appointed within a certain timeframe or following completion of certain milestones to oversee the council. This will help the New Regime demonstrate that it is committed to achieving full decentralisation (on the basis that the founder will no longer be involved in the central management of the foundation following the stated condition).

QUESTION 2: Do you have any concerns with, or feedback on, the proposed governance and control of the DLT Foundations?

QUESTION 3: In particular, do you have any concerns with tokenholders, who has voting rights, being granted the right to vote on certain 'qualified matters' unless otherwise expressly stated in the Charter?

QUESTION 4: Should we make it mandatory to require the founder to step down and appoint a guardian, rather than including an ability for the DLT Foundation to add a requirement to its Charter that the founder(s) will step down from the foundation council

and that an independent guardian will be appointed within a certain timeframe or following completion of certain milestones to oversee the council?

Tokens

29. Tokens have a potentially broad scope of use within DLT projects and could for example be used for governance, raising finance or proving rights (e.g., use of file storage on the blockchain, the grant of loyalty benefits and rewards, or the grant certain voting rights etc.). Categorisation of tokens is typically an exercise for financial regulators in the jurisdictions where such tokens are offered, with categorisation as a security token potentially bringing the issuance and offering of such tokens under the securities regulatory regimes, while categorisation as other forms of tokens may potentially bring the issuance under parallel virtual asset service provider regimes.
30. The New Regime will not prohibit DLT Foundations receiving the necessary registrations and licences for regulated activities.
31. However, the RA is not a financial services regulator and the RA, therefore, proposes that the New Regime does not address the types of tokens in detail nor the scenario where a token issued by the DLT Foundation moves from being a non-regulated token to regulated. The New Regime, however, will define what a token is, which will be aligned with the definition issued by the ADGM's Financial Services Regulatory Authority.
32. The RA proposes that the New Regime should require that a description of the intended use of any tokens must be specified in the DLT Foundation's Charter.
33. In certain cases, the DLT Foundation may wish to buy back all (or part of) the issued tokens. However, it is not deemed necessary to mandate buy back rights or the value (e.g., market value) in the legislation as this generally would depend on the type of DLT Foundation, its purposes, rights of tokenholders etc. Rather, the RA proposes including a requirement that if a buy back right is needed, it should be disclosed transparently in the Charter.

QUESTION 5: Do you have any concerns with, or feedback on, the proposals concerning tokens?

Reporting, Disclosures and Publication

Accounts and Audit

34. Under the Existing Foundations Regulations, there is limited publicly accessible/disclosed information, which typically is appealing to founders of wealth management foundations and investors. However, DLT Foundations will be public-facing, and there are increased demands for transparency in the crypto industry.
35. The RA, therefore, proposes that the New Regime should require preparation and filing of annual audited financial statements which will be required to be published. To this effect, the New Regime will include accounting and auditing provisions, which will be aligned to those included in the ADGM Companies Regulations.

Annual Return Form

36. The RA further recommends that DLT Foundations file an annual return in which the current nature of any tokens is confirmed, together with confirmation on beneficial owners and any other information required by the Registrar as prescribed in the return form.

- Publication
37. To address the increased demands for transparency in the crypto industry, the RA proposes that the following is published: i) the DLT Foundation's Charter; (ii) its audited annual accounts; and (iii) information on the founders, council members and guardian (when appointed).

- Other Disclosures
38. The RA further proposes that the New Regime be drafted to include requirements for transparency / disclosures in the Charter concerning DAO tokenomics, vesting schedules, smart contracts, security audits, treasury (virtual asset wallets, real world assets etc.) and whether the DLT Foundation operates on a single-chain or multi-chain structure.

QUESTION 6: Do you have any concerns with, or feedback on, the proposals concerning reporting, disclosures, and publication?

Beneficial Ownership

39. Foundations generally are considered to be an 'owner less' legal form (i.e., there are no shareholders), which raises certain issues in identifying the beneficial owners – in particular with respect to the proposed DLT Foundations, which may not have beneficiaries, but instead may have tokenholders with certain 'control' rights and where the tokens may shift owners on a frequent basis.
40. The definition of beneficial owner in respect of foundations generally includes (i) founders; (ii) foundation council members; (iii) guardians; (iv) beneficiaries; and (v) a natural person who has control over the foundation.
41. The RA, therefore, proposes a way of defining 'control' for the purposes of capturing DLT Foundations under an amendment to the Beneficial Ownership and Control Regulations so that control would be satisfied by persons owning more than 25% of voting rights in a DLT foundation. The RA proposes that these persons would have to self-declare or their votes above 25% will not be allowed to be counted towards quorum/voting threshold. It will also cover 'shadow votes' (i.e., achieved by borrowing of tokens at low cost for the purpose of voting). Such 'control' will also have to be declared by founders, foundation council members or guardians under the risk of liability for failure to report.

QUESTION 7: Do you have any concerns with, or feedback on, the proposals concerning the definition of beneficial owners in a DLT Foundation?

Supervision

- AML and Sanctions
42. AML and sanctions requirements are an important factor in the credibility of the jurisdiction for DLT projects. However, the applicability of AML and sanctions requirements will depend on the nature of the platform, the location of its users and tokenholders and the jurisdictions in which the platform operates. Thus, the RA does not envisage the need for a bespoke AML/sanctions regimes to be built into the New Regime. Rather, the RA proposes addressing such risk by including a general compliance provision in the New Regime.

- Data Protection and Cyber Security
43. As DLT Foundations often process data or act as software ownership companies (e.g., owners of the relevant DLT), the RA recommends that DLT Foundations should be subject

to ADGM's existing data protection and data security requirements. However, the exact list of measures and protections the DLT Foundation would need to have in place, would depend on the exact technology used, purposes of the DLT Foundation, etc. The RA does not envisage the need for a bespoke data protection/ cyber security regime to be built into the New Regime. Rather, the RA proposes addressing such risk by including a general compliance provision in the New Regime.

Marketing

44. The RA does not recommend setting forth specific requirements relating to marketing of tokens in the New Regime as the relevant measures would largely depend on the activities the DLT Foundation undertakes and may be a subject matter of other regulations. However, the RA proposes that the Registrar may issue a temporary prohibition order on any marketing, provided that the Registrar may only exercise this power where, in the reasonable discretion of the Registrar, public policy grounds exist.

QUESTION 8: Do you have any concerns with, or feedback on, the proposals concerning supervision?

Insolvency and Liquidation / Voluntary Strike Off

Insolvency

45. Generally, tokenholders' rights in insolvency should depend on the tokenholders' rights in the DLT Foundation, which may be purely governance related, or tokens may grant additional asset rights. To the extent that tokenholders have rights relating to assets, tokenholders could be included into the waterfall in respect of payments at liquidation/insolvency (i.e., distributions could be made to tokenholders in a way in which they would be made to beneficiaries in foundations in the Foundations Regulations).
46. The RA proposes that any beneficiaries (including tokenholders who are beneficiaries) are deemed to have a right to obtain assets in proportion to, as applicable, the percentage of assets they are entitled to or the number of tokens they own, and be treated and ranked as 'members' for the purposes of section 225 (Distribution of Company's property) of the ADGM Insolvency Regulations 2022. Tokenholders who are not beneficiaries shall have no monetary claims in respect of the DLT Foundation's assets).
47. The RA does not consider that it is necessary to implement a special insolvency regime or asset distribution regime under the New Regime in the event that the DLT Foundation goes insolvent, is struck off the register or otherwise de-registered, and the existing ADGM processes should apply. There may be a case for additional tokenholder or consumer protections with respect to a blockchain protocol, but these would depend on the type of business being conducted by the DLT Foundation and would typically be imposed by the regulator of that kind of business and not sit within the entity type legislation.
48. The RA considered whether the New Regime should allow for the creation of segregated cells within a DLT Foundation to create bankruptcy remoteness between different cells. While this may be appealing in fund management structures, the RA's view is that segregated cells would be complex to implement as it would be challenging to divide the assets of segregated cells and could potentially require changes to ADGM's banking and insolvency legislation to ensure segregation. Moreover, to ensure that liability is indeed segregated, each cell needs to be carefully managed, which goes against decentralisation and would be challenging to implement under a decentralised model, especially where certain matters are decided by tokenholders. Another issue is that segregated cells are not recognised in most jurisdictions, so a segregation within DLT Foundations may not be

enforceable outside ADGM. The RA is not, therefore, proposing to introduce segregated cells in the New Regime.

Liquidation / Voluntary Strike Off

49. The grounds on which an entity may be wound up or struck off the register have an impact on the DAO principles of decentralisation and reputation and resistance to censorship. The RA proposes to include provisions concerning voluntary strike off similar to those included in the ADGM Companies Regulations.

QUESTION 9: Do you have any concerns with, or feedback on, the proposals concerning the tokenholders rights in connection with an insolvency?

QUESTION 10: Do you agree with our proposals not to introduce segregated cells in the New Regime?

QUESTION 11: Do you have any concerns with, or feedback on, the proposals concerning liquidation and voluntary strike off of the DLT Foundation?

Other

50. The proposed framework will principally be effective by the enactment of the DLT Regulations 2023, the Distributed Ledger Technology Foundations Regulations (Fees) Rules 2023, and the Distributed Ledger Technology Foundations Regulations (International Accounting Standards) Rules 2023.
51. Finally, some consequential changes may be made through amendments of the Commercial Licensing Regulations (Conditions of Licence and Branch Registration) Rules 2023, the Commercial Licensing Regulations (Controlled Activities) Rules 2022 to include DLT activities as ‘controlled’ activities which require compliance with the Distributed Ledger Technology Foundations Regulations 2023.

Proposed Legislation

Annex A	Distributed Ledger Technology Foundations Regulations 2023
Appendix 1	Distributed Ledger Technology Foundations Regulations (Fees) Rules 2023
Appendix 2	Distributed Ledger Technology Foundations Regulations (International Accounting Standards) Rules 2023