



ABU DHABI GLOBAL MARKET
سوق أبوظبي العالمي

CONSULTATION PAPER NO. 4 OF 2018

25 JULY 2018

**PROPOSED REGULATORY
FRAMEWORK FOR OPERATORS OF
PRIVATE FINANCING PLATFORMS**

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INTRODUCTION

WHY ARE WE ISSUING THIS PAPER?

1. The Financial Services Regulatory Authority (“**FSRA**”) of Abu Dhabi Global Market (“**ADGM**”) has issued this consultation paper to invite public feedback and comments on its proposals to introduce a regulatory framework tailored for operators of private financing platforms (“**PFPs**”) for non-public companies.
2. In March 2018, the FSRA published a discussion paper (see **Annex C**), which should be read in conjunction with this consultation paper, setting out its introductory considerations in the area of PFPs that would facilitate access by non-public start-up businesses and small- and medium-sized enterprises (“**SMEs**”) to alternative sources of financing. The discussion paper provided initial, high-level proposals on the scope and form of a risk-proportionate regulatory framework for PFPs that might route funding from primarily Professional Clients to SMEs, while applying the necessary regulatory safeguards to ensure that they operate in a safe and sound manner.
3. The FSRA received a number of comments in response to the discussion paper, which have informed the development and refinement of the proposals detailed here.
4. The FSRA would now like to invite comments on the proposed legislative and regulatory framework for the Regulated Activity of Operating a Private Financing Platform (the “**PFP Framework**”).
5. Unless otherwise defined, capitalised terms used in this paper have the meanings attributed to such terms as contained in the Financial Services and Markets Regulations 2015 (“**FSMR**”) and/or the Glossary (“**GLO**”).

WHO SHOULD READ THIS PAPER?

6. This Consultation Paper may be of particular interest to operators of funding platforms as well as those seeking to lend to or invest in start-ups and SMEs, organisations active in the credit and investment sector,

businesses that might seek funding under the proposed framework, and any respective professional advisors to those persons.

HOW TO PROVIDE COMMENTS

7. 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.
8. The 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 the FSRA.

WHAT HAPPENS NEXT?

9. The deadline for providing comments on the proposed framework is **16 August 2018**. Once we receive your comments, we will consider whether any modifications are required to the proposed amendments to the legislative and regulatory framework in ADGM. The Board and the FSRA will then proceed to enact the proposed framework.
10. You should not act on these proposals until the final regulations, rules and guidance are issued by the FSRA. We will issue a notice on our website when this happens.

COMMENTS TO BE ADDRESSED TO:

Consultation Paper No. 4 of 2018
Financial Services Regulatory Authority
Abu Dhabi Global Market Square
Al Maryah Island
PO Box 111999
Abu Dhabi, UAE
Email: consultation@adgm.com

BACKGROUND

1. Given the importance of non-public start-ups and SMEs as key engines of economic growth and diversification in the MENA region, it is important to develop alternative financing solutions for them to launch and scale their businesses. Online PFPs that leverage data and technology to facilitate equity funding, invoice financing and private investment / placement can unlock new ways of raising money for small businesses from a qualified network of investors comprising primarily professionals. These may include corporate ventures, private equity, venture capital, family offices, accelerators / incubators, insurance firms, alternative asset managers, private banks and other wealth management service providers.
2. The FSRA has considered the development of a risk-proportionate, calibrated PFP framework in order to facilitate such funding. This has been informed by the responses received to the discussion paper on this topic, published in March 2018. The proposed framework will permit a number of alternative financing arrangements to be offered in or from the ADGM to start-ups and SMEs in the region.
3. The key, high-level features of the proposed PFP framework, as previously outlined in the discussion paper, are set out in the table below. Where the term “client” is referred to it only represents those on the buy-side of a transaction conducted through a PFP (a “**PFP Transaction**”), not to a business receiving funding (a “**PFP Prospect**”).

Area	Proposals – Discussion Paper
Permitted activity	The FSRA will introduce a new Regulated Activity of “Operating a Private Financing Platform”.
Client base	A PFP Operator must only allow registered clients to access its platform.
	The FSRA will restrict accessibility to PFPs primarily to Professional Clients. On an exceptional basis, Retail Clients may be allowed by the FSRA where certain conditions are met.
	All buy-side clients must meet the eligibility criteria to be regarded as either Deemed or Assessed Professional Clients.
	A PFP Prospect must be a Body Corporate and would therefore qualify as a “Service-Based” Professional Client.

Area	Proposals – Discussion Paper
Exempt Offers	Offers must qualify as Exempt Offers.
Client Assets	As best practice, a PFP Operator should appoint a third party escrow agent or custodian to safeguard Client Assets. However, alternative arrangements may be permitted where a PFP Operator implements appropriate safeguards. In order to facilitate this, the FSRA may remove the current prohibition on Category 4 firms from holding Client Money.
Prudential requirements	A PFP Operator will fall within Category 4 for the purposes of prudential supervision. The FSRA will calibrate the capital requirements for those PFP Operators within that category that hold or control Client Assets.
Risk warning and Disclosures	A PFP Operator must provide a risk warning to each client, which must be acknowledged by the client. A PFP Operator will also be required to provide appropriate information and disclosure to clients on how its platform model works, its remuneration model, its roles and obligations, and the available recourse in the event of the failure of the PFP Operator (in addition to the existing disclosure obligations).
Due diligence	A PFP Operator must undertake due diligence on a potential PFP Prospect before accepting it on to the PFP that covers, at a minimum: assessments of its fitness and propriety; established safeguards against fraud; and that its disclosures to clients are adequate, clear, fair and not misleading.
Conflicts of interest	A PFP Operator will not be permitted to carry on the Regulated Activities of Managing a Collective Investment Fund or Managing Assets.
	PFP Operators must establish and maintain adequate policies and procedures to identify, address and manage any potential conflicts of interest arising from proprietary or staff transactions.
Exit Facility	Conditions will be imposed on the operation of exit facilities. In particular, they must not resemble trading platforms.
Special purpose vehicle	Where appropriate a PFP Operator may arrange for clients to participate in a PFP transaction via a special purpose vehicle.
Marketing	A PFP Operator must not communicate any specific information about a PFP Prospect or a PFP Transaction to the public. However, it will be permitted to promote its platform to the public and in doing so may provide general information about those PFP Prospects listed on its platform.

DEVELOPMENTS FOLLOWING THE DISCUSSION PAPER

4. The discussion paper elicited a number of useful responses that have informed the elaboration of the high-level proposals outlined in that paper into the detailed regulatory framework proposed in this consultation. The most significant developments in relation to the high-level proposals, as they appeared in the discussion paper, are outlined below.

(a) Client base

5. After considering the responses to the discussion paper, the FSRA no longer intends to specify conditions under which it may allow the participation of Retail Clients in PFP Transactions. A PFP Operator wishing to consider offering financing proposals through its platform to prospective clients that do not meet the Professional Client criteria will need to satisfy the FSRA that those prospective clients adequately understand the risks associated with PFP Transactions. Further, the PFP Operator's Financial Services Permission ("**FSP**") must permit it to deal with Retail Clients.

6. Additionally, the FSRA is no longer proposing that PFP Operators establish a client relationship with PFP Prospects that would require them to be recognised as "Service-Based" Professional Clients. The original proposal to permit a PFP Prospect to be considered a client may have allowed potential conflicts of interest to arise for a PFP Operator acting on both sides of a PFP Transaction.

(b) Prudential requirements

7. As previously proposed, the new Regulated Activity of Operating a Private Financing Platform will fall under prudential Category 4 in the Prudential Rulebook ("**PRU**") and the PFP Operator will be subject to capital requirements determined as the higher of the relevant Base Capital Requirement ("**BCR**") or the Expenditure Based Capital Minimum ("**EBCM**"). The BCR and the EBCM for PFP Operators will be calibrated as

set out in the following table, depending on whether they hold or control Client Assets. A PFP Operator that holds or controls Client Assets will also be subject to the Client Money and Safe Custody provisions in the Conduct of Business (“COBS”) Rulebook, as appropriate.

Client Asset Arrangements	Base Capital Requirement (USD)	Expenditure Based Capital Minimum
PFP Operator does not hold or control Client Assets	10,000	6/52nds of AAE ¹
PFP Operator holds or controls Clients Assets	150,000	18/52nds of AAE

(c) Conflicts of interest

8. Rather than prohibiting a PFP Operator from undertaking other specific Regulated Activities, the FSRA is now proposing that an applicant applying to become a PFP Operator will have to demonstrate adequately how it would manage any potential conflicts of interest that might arise from it undertaking any other Regulated Activity at the same time. This approach will allow PFP Operators the scope to develop alternative business models encompassing other Regulated Activities in addition to that of Operating a Private Financing Platform, which may be more cost-effective for them.

(d) Intermediate entities

9. A PFP Operator may arrange for its clients to participate in a PFP Transaction through a special purpose vehicle for the reasons set out in the discussion paper. The FSRA is now proposing that any such special purpose vehicle must be domiciled in ADGM for ease of administration and greater regulatory oversight in the event of the failure of the PFP Operator. The FSRA may consider modifying this requirement where a PFP Operator proposes establishing a special purpose vehicle in an

¹ Annual Audited Expenditure, calculated in accordance with PRU 3.7.2

alternative jurisdiction and it provides a sound rationale for doing so and, additionally, where that jurisdiction is acceptable to the FSRA.

ISSUES FOR CONSIDERATION

Q1: DO YOU HAVE ANY COMMENTS ON THESE REVISED PROPOSALS FOR THE PFP FRAMEWORK?

PROPOSED LEGISLATIVE AND REGULATORY FRAMEWORK

10. The proposed framework will require amendments to the Regulations of ADGM and the FSRA Rules, including:
 - a. the introduction of a new Regulated Activity of Operating a Private Financing Platform, as defined in Schedule 1, Chapter 17C, Section 73E of FSMR, and consequential amendments to defined terms therein (see **Annex A**);
 - b. amendments to the COBS Rulebook, as set out in a new Chapter 18, proposing rules applicable for Operating a Private Financing Platform (**Appendix 1**); and
 - c. consequential amendments to a number of other FSRA Rulebooks (**Appendices 2 - 4**).

ISSUES FOR CONSIDERATION

Q2: DO YOU HAVE ANY COMMENTS ON THE PROPOSED LEGISLATIVE AND REGULATORY FRAMEWORK?

11. Additionally, the FSRA is proposing to provide guidance (see **Annex B**) to applicants seeking to undertake the Regulated Activity of Operating a Private Financing Platform, which will also cover their ongoing regulatory requirements after the granting of an FSP.

ISSUES FOR CONSIDERATION

Q3: DO YOU HAVE ANY COMMENTS ON THE PROPOSED GUIDANCE?