



# Striking the perfect balance

Alisha Sullivan and Ksenia Andreeva of Morgan, Lewis & Bockius take a closer look at the new regulatory measures in the rise of digital and virtual assets in the UAE.

**A**midst the rising appetite for digital assets, regulators in the UAE are striving to strike the right balance in encouraging and regulating a new and complex area for investment. We take a high-level look at the regulatory landscape and the digital and virtual asset regulation milestones.

## REGULATORY LANDSCAPE

Digital asset regulation in the UAE sits against the backdrop of the UAE's federal cross-emirate, individual emirate level legal landscape and "financial free zone" legal systems. At the federal level, financial and capital markets are governed by regulations issued by the UAE Securities and Commodities Authority (SCA) and the Central Bank of the UAE (Central Bank). Exceptions to SCA and Central Bank regulations include the Dubai International Financial Centre (DIFC), which is regulated by the Dubai Financial Services Authority

(DFSA), and the Abu Dhabi Global Market (ADGM), which is regulated by the Financial Services Regulatory Authority (FSRA). The Emirate of Dubai also issued regulations establishing the Virtual Asset Regulatory Authority (VARA), which is a new regulatory authority responsible for virtual asset regulatory oversight in Dubai, except in the DIFC, in addition to the federal level regulators.

As a threshold matter, regulators in each UAE jurisdiction have taken a slightly nuanced approach with respect to identifying assets to be regulated as digital assets. Three of the jurisdictions, the federal level SCA with CAAR, Dubai with the Virtual Asset Law (VAL), and the ADGM with its bespoke digital assets regulatory regime, similarly define crypto assets, digital assets and virtual assets in a broad manner with common features being essentially that the asset is a *record* or a *representation of value* that is capable

of being transferred from holder to holder electronically through computer software or an algorithm. The VAL expands upon this, including also a digital representation of a set of rights that can be digitally offered and traded through a virtual asset platform and *any digital representation of any other value determined by the VARA*. Digital assets issued by government entities are exempted from each of these definitions. Importantly, CAAR does not apply to (inter alia) crypto assets issued by government entities, and digital currencies issued by entities licensed by the Central Bank. These exemptions could encourage the Central Bank to enter the crypto world, experiment, and test out its capabilities without being subject to scrutiny and restrictions of the SCA. Unlike the other three jurisdictions, the DFSA has taken a phased approach to identifying assets as being subject to its digital asset regime, beginning with the Investment Token as further discussed below.

#### IMPORTANT MILESTONES IN THE REGULATION OF DIGITAL AND VIRTUAL ASSETS IN THE UAE

##### 2018 – ADGM Digital Framework

The ADGM states that it is the first jurisdiction in the world to have introduced a comprehensive and bespoke regulatory framework for the regulation of spot virtual asset activities, including those undertaken by multilateral trading facilities, brokers, custodians, asset managers and other intermediaries. As early as 2018, the ADGM's FSRA introduced a virtual asset regulatory regime in the context of its Financial Services and Markets Regulations (FSMRs), and the FSRA has continued to build upon this framework with modifications to reflect global trends and the issuance of guidance notes to aid in implementation. These regulations require people to obtain a license to engage in regulated activities relating to virtual assets, and many of the same rules apply to virtual asset market participants as traditional financial services providers in relation to capital adequacy and conduct of business. The ADGM's digital asset framework is comprehensive, addressing the full range of associated risks, including those relating to market abuse and financial crime, consumer protection, technology governance, custody and exchange operations.

##### 2020 – UAE Level Developments

In 2020, SCA issued its Crypto Assets Activities Regulation (CAAR) regulating the offering, issuing, listing and trading of crypto assets in the UAE (excluding the financial freezones). Later in 2020 the Central Bank of the UAE (Central Bank) issued the Stored Value Facilities Regulation (SVF Regulation), which included crypto assets in the definition of "Stored Value Facility". The SVF Regulation requires the licensing of entities who issue or provide 'stored value facilities' (including crypto assets) in the UAE. The SVF Regulation was a market friendly regulatory development designed to facilitate easier access to the UAE market for fin-tech firms while protecting customers' funds, ensuring proper business conduct and supporting the development of payment products and services. The SVF Regulation clarifies that crypto assets may be used as a stored value facility when purchasing goods and services however, the Central Bank maintains that crypto assets are not considered legal tender in the UAE.

##### 2021 – DIFC Begins Phased Approach

With the launch of its regulatory framework for Investment Tokens in **October 2021**, the DIFC's DFSA began a phased approach with respect to regulating digital and virtual assets. It appears that the DIFC does not intend to introduce a separate law governing digital and virtual assets, but rather will issue new regulations to supplement the current DFSA regulatory regime on financial activities. DFSA has brought digital assets within scope of the existing regime for "investments," subject to certain changes such as technology and governance requirements for the companies operating trading venues for investment tokens.

One key advantage of DIFC's approach is the immediate familiarity with the regime for "investments", at least for existing market participants. However, some but not all "traditional" financial services activities are permitted in relation to Investment Tokens. Persons who are interested in trading in Investment Tokens at DIFC must present a detailed analysis to the DFSA to obtain approval to conduct activities related to that Investment Token. The DFSA defines an "Investment Token" as either a security token or a derivative token. Interestingly, the Phase One definition does not capture



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key cryptocurrencies such as Bitcoin and Ethereum, as well as stable coins such as Tether; all of these remain unregulated under the Investment Tokens regime.

### February 2022 – Cornerstone of Emirate of Dubai’s Framework

In February 2022, the government of the Emirate of Dubai issued the VAL, the UAE’s most recent digital asset regulation and the cornerstone of Dubai’s regulatory framework for digital assets and established the VARA. Hailed as the world’s first specialised regulator for the sector, the VARA is a unique feature of Dubai’s approach to digital asset regulations. As a regulatory authority, VARA is authorised and empowered to make future determinations about what assets are deemed to be digital assets. It will provide a full range of services and will set the rules in Dubai for conducting activities related to virtual assets.

As an indication that Dubai will coordinate closely with the Central Bank, the VARA is required to coordinate with the Central Bank on all matters relating to the protection and stability of the UAE’s financial system, which is important to arrive at a cohesive regulatory framework within the UAE. The VAL does not expressly impose any obligations or requirements on individuals who invest in or trade crypto assets in Dubai and the creation or offering of a Virtual Asset itself does not seem to be a regulated activity (although ‘services related to offering’ is regulated). These matters may be clarified in the upcoming guidance which is to be issued by VARA regarding the exact scope of its powers and competencies.

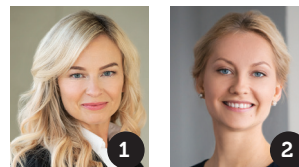
### May 2022 – DIFC’s Phase Two

The consultation period for the DFSA’s Phase Two rules ended in May 2022, which rules propose to cover a broader scope of “Crypto Tokens” but excluding utility tokens, NFTs and Central Bank digital currencies. Importantly, the DFSA has not to date proposed to allow for the issuance of new Crypto Tokens in or from the DIFC. It states that it will, however, keep that policy position under review as it gains experience of regulating Crypto Tokens. Interestingly, and in contrast to the ADGM regime, once a Crypto Token is designated as “accepted”, it will be added to a centralised register, maintained by the DFSA, and anyone with

the required regulatory permissions can provide regulated services in respect of that Crypto Token. The ADGM’s regime currently involves maintaining an individual list of accepted crypto assets for each person providing relevant regulated services, which permits only that person to use the crypto assets on that list. In addition, the DFSA intends to prohibit activities in and from the DIFC involving so-called “prohibited tokens,” consisting, at this time, of privacy tokens and devices and algorithmic tokens.

### OUTLOOK

The UAE is emerging as a global hub for the digital and virtual assets industry. Continuing the balancing act required to encourage emerging technologies and safeguard the market and its participants, the regulators in the UAE have demonstrated a willingness to break new ground in the area by introducing bespoke digital and virtual asset regulatory regimes, establishing new regulatory authorities or supplementing existing regulations to account for virtual assets. The UAE’s openness to digital assets is a pragmatic approach reflective of the country’s efforts to ensure the diversification of its economy. As some major jurisdictions impose bans and severe restrictions on digital assets, and others tread slowly, the UAE is moving fast to become a place with clear, safe rules for the digital asset industry. 🚀



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