

## **Client Alert: The Current Legal Status of Cryptocurrencies, Initial Coin Offerings and Distributed Ledger Technology in the UAE (Dubai and Abu Dhabi)**

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*Investors, traders and issuers of cryptocurrencies face an ambiguous regulatory climate in the United Arab Emirates (UAE). On the one hand, the UAE, particularly Dubai, makes it government policy to be at the forefront of new industries and innovation, and promoting distributed ledger technology (including its subset Blockchain) is one government priority. At the same time, the UAE Central Bank, the Securities and Commodities Authority (SCA), and the financial regulators of the Dubai International Financial Centre (DIFC) and the Abu Dhabi Global Marketplace (ADGM) have issued guidance notes, white papers, circulars and announcements on cryptocurrencies, some cautioning and others promoting cryptocurrency innovations. This article sets out the current state of play.*

### **Virtual Currencies**

In January 2017, the UAE Central Bank issued the Regulatory Framework For Stored Values and Electronic Payment Systems (“Stored Value Regulations”). The regulations were issued to regulate electronic payments and stored value. They make only one scant reference to virtual currencies and define them as a digital unit used as a medium of exchange, a unit of account, or a form of stored value. The regulations stipulate that virtual currencies are not covered, but confusingly, go on to suggest that their usage (and any transactions with them) is prohibited.

In February 2017 and October 2017, the UAE Central Bank made statements that were published in the media clarifying that trading in bitcoin or other cryptocurrencies and altcoins was not covered by the Stored Value Regulations. The view of the UAE Central Bank was that trading in cryptocurrencies was a “tolerated practice.”

There have also been some noteworthy announcements of transactions and investments that would be available in bitcoin. One Dubai real estate property announced that it would sell property units in bitcoin.

In January 2018, Emirates NBD announced that it would cease to process “suspicious” bitcoin-related transfers that affected accountholders with cryptocurrency trading platforms. The bank later clarified that it did not prohibit customers from engaging in transactions with trading platforms trading in digital assets but was restricted to prohibiting suspicious transactions flagged for financial crime.

## Cryptocurrency Exchanges and Trading

BitOasis is the UAE's first cryptocurrency exchange. Originally operating from Dubai Silicon Oasis free zone (DSO), at least partially because of the ambiguous regulatory climate, the BitOasis platform now operates as an entity established in the British Virgin Islands, with the DSO entity providing technical and operational support.

In February, Dubai Multi Commodities Centre (DMCC) licensed Regal RA DMCC as the first company in the DMCC free zone to expressly trade in cryptocurrencies. DMCC has clarified that it considers cryptocurrencies a commodity and therefore within its jurisdictional scope. DMCC provides its crypto-commodities owners with a "deep cold storage" solution, by allowing them to store cryptocurrencies in a vault in its headquarters in Dubai, where the company also stores its gold. Not holding cryptocurrency in an online or networked wallet, the solution thus protects against theft by hacking, a widely reported problem with many cryptocurrency exchanges.

## Initial Coin Offerings (ICOs)

An Initial Coin Offering (ICO)—also referred to as Initial Token Offering (ITO)—is an increasingly common crowdsale mechanism on a distributed ledger in which a new project raises capital by selling crypto "coins" or "tokens" in exchange for either cryptocurrency (usually bitcoin or Ether), or fiat currency. Early investors are generally motivated to buy the coins or tokens in the hope that the project is launched successfully, and therefore translate into the value of the coin or token going up. However, the financing method is controversial, due to the many fraudulent schemes that have been clothed as ICOs. Various heavy weights in the blockchain ecosystem are currently working on a fair-ICO standard, designed to prevent fraudulent schemes. Warnings have also been issued by many regulators worldwide.

Although laws regulating ICOs have yet to be issued in the UAE, in October 2017, the Financial Services Regulatory Authority (FSRA) of the Abu Dhabi Global Market (ADGM), the financial free zone in Abu Dhabi, issued a guidance circular on the regulation of ICOs. It clarified that token sales would be treated as either securities, specified investments, or commodities, depending on the underlying legal structure and assets. ICOs that are regulated as securities or specified investments require compliance with its tight securities regulation, whereas ICOs that are categorized as commodities may not necessarily be so regulated.

Other UAE regulators have been more cautious. In September 2017, the Dubai Financial Services Authority (DFSA) of the Dubai International Financial Centre free zone, issued a general warning on investing into cryptocurrencies and ICOs. Moreover, the Securities and Commodities Authority (SCA), the UAE's securities and commodities regulator, issued a warning on 4 February 2018 that token-based fundraising was risky. In both cases, while warning against ICOs/ITOs, the circular was notable in that it did not announce a prohibition of ICOs/ITOs, which remain unregulated by the DFSA and the SCA.

An ICO may also be initiated through a company established in a "ICO friendly" jurisdiction such as Gibraltar, Switzerland, Singapore.

Over the past half year, a number of ICOs have been announced in the UAE, including Afterschool, Royal Kingdom Coin, and FARAD. These ICOs have a spotty record. The Afterschool initiators sold 11 million tokens but then stopped the token sale stating that they would return the collected funds to the buyers in light of the aforementioned circular issued by the ADGM FSRA. The ICO of Royal Kingdom Coin raised only modest sums. Nevertheless, given the UAE's wealth, the risk-friendly attitude of many citizens and residents, and its aims to be a hub of innovation, the UAE is expected to be a fertile ground for ICOs in the near future. Companies considering issuing ICOs should pay close attention to the ambiguous but fast moving legal environment of ICOs and seek, in any case, thorough legal advice.

## Cryptocurrency Mining

“Mining” as it applies to cryptocurrencies is the validation of a transaction, by which the “miner” successfully solves, by use of computer power, a cryptographic hash function, i.e. a mathematical puzzle, to validate a cryptocurrency transaction. The miner is incentivized to do so by payment of a reward in the form of newly issued cryptocurrency allowing cryptocurrency networks to keep transaction fees, which are also incurred in the process of a transaction, low. Since the computing power necessary to validate transactions goes up with the number of people venturing into the world of virtual currency, successfully resolving the mathematical puzzles has become very complex over the years. Most home-based mining has therefore become unprofitable and mining is nowadays done in large data centers using specialized equipment, mainly in jurisdictions with low electricity costs, such as China or Iceland. In the case of Bitcoin, Application Specific Integrated Circuit (ASICs) are used that are designed to for the sole purpose of BTC mining.

Power consumption is a major concern in the increasing uptake of cryptocurrencies, with bitcoin mining currently having the carbon footprint of Costa Rica, and Ethereum of Namibia. Recently, minerless and blockless cryptocurrencies that rely on less energy intensive methods of transaction validation, including the directed acyclic graph “Tangle” protocol used by IOTA, also said to be resistant to encryption hacks using quantum computers.

There is not yet any regulation regarding mining in the UAE. In its October 2017 circular, ADGM FSRSA clarifies that it does not view spot trading or mining of cryptocurrencies a regulated activity.

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**If you would like more information about this topic then please contact us.**

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