An Update on the Regulatory Framework for Crowdfunding Platforms in the UAE

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April 2018

In the June-July 2016 edition of Al Tamimi's Law Update Article, we have previously provided an overview on the Crowdfunding Platforms in the UAE and highlighted some of the key regulatory issues commonly encountered. In an effort to facilitate the growth of the SME sector and FinTech innovations in the region while managing investors risks, there have been a number of welcomed developments and regulatory updates in the alternate funding space.

In this article, we set out the latest regulatory updates governing the operation of crowdfunding platforms in the Dubai International Financial Centre ("DIFC"), Abu Dhabi Global Market ("ADGM") and onshore UAE respectively.

DFSA Regulatory Framework

In August 2017, the Dubai Financial Services Authority ("DFSA") launched its regulatory framework ("DFSA Framework") for loan and investment-based crowdfunding platforms, the first such regulatory framework in the GCC countries. The DFSA Framework aims to license, organise and protect the rights and obligations of all parties involved in specific crowdfunding activities which provide finance solutions for SMEs in the region.

Some of the key requirements under the DFSA Framework include:

Introduction of a new Financial Services Activity

A new financial service activity of "Operating a Crowdfunding Platform" has been established, which covers both operating a "Loan Crowdfunding Platform" and an "Investmen Crowdfunding Platform".

Note that the DFSA will not be regulating crowdfunding operators who run a reward or donation based platform.

Restrictions on Provision of Advice / Assets Management / Managing a Collective Investment Fund

An operator of a crowdfunding platform is not permitted to provide advice or have the discretion to manage assets or manage a collective investment fund; and must not operate a platform that facilitates a person investing in specified investments (i.e. warrants, certificates, units, structured products or derivatives through the platform.

New Category of Exempt Offers

A new category of exempt offers has been introduced and is available exclusively to issuers of securities made through an Investment Crowdfunding Platform.

Prudential Requirements

The Prudential Requirements as set out in Prudential, Investment, Insurance and Banking Module

(PIB) is applicable to an operator of a crowdfunding platform whereby it is required to comply with the prescribed base capital requirement and expenditure based capital minimum requirements depending on its business model.

Legal Form

All crowdfunding operators must establish as a body corporate in the DIFC (i.e. they cannot be a branch) and must hold capital according to the PIB requirements.

FSRA Proposed Framework

In March 2018, the Financial Services Regulatory Authority ("FSRA") has published a discussion paper setting out its proposed regulatory framework (the "PFP Framework") for operators of financing platforms for non-public companies ("Private Financing Platforms" or "PFPs").

The PFP Framework aims to facilitate access by start-ups and SMEs to new alternate sources of funding, albeit primarily from Professional Clients (as defined in the relevant FSRA regulations), as an alternative to more traditional channels for financing, while applying the necessary regulatory safeguards to ensure they operate in a safe and sound manner for those clients.

Currently, the FSRA is seeking comments on its proposal to create a new regulated activity specifically for PFPs operators. This would be called "Operating a Private Financing Platform" that would capture two types of PFP Transactions to be offered in or from the ADGM. These would be loan-based or investment-based crowdfunding, where activity may be undertaken on a single or distinct PFP. For loan-based PFPs, the operator would connect several clients to a single borrower, but for investment-based PFPs, the operator would seek to connect several clients to a single issuer – with clients investing money in expectation of dividend payments and a positive return on investment over time. In this regard, the FSRA is considering the introduction of a new regulated Activity of "Operating a Private Financing Platform" that would solely capture loan-based and investment-based PFPs and fall within Category 4 for the purposes of prudential supervision.

In view of the potentially high lending risks associated with PFP transactions, the FSRA proposes to restrict accessibility to PFPs under the PFP Framework to Professional Clients. In this regard, the FSRA also believes that Professional Clients are better placed to assist start-ups and SMEs by contributing their expertise, experience and contact networks. Nevertheless, the FSRA proposes to allow PFP operators to serve Retail Clients (as defined in the relevant FSRA regulations), on an exceptional basis, subject to the PFP operator putting in place proper policies and procedures to perform pre-qualification of Retail Clients by way of a client suitability test.

Depending on its business model, a PFP operator would be subject to the specific capital requirements as prescribed under the Prudential Rulebook. As with other Category 4 firms, the PFP operator would be required to maintain professional indemnity insurance cover appropriate to the nature, size, and risk profile of its business. PFP operators will also be subject to risk disclosure requirements.

As the FSRA Framework is still in the discussion paper phase, it remains to be seen whether or not additional requirements will be put in place.

SCA Initiative

On the sidelines of the 14th Annual One on One Conference held in March 2018, the Securities and Commodities Authority ("SCA") revealed that it is about to introduce a quality initiative for crowdfunding SMEs, in collaboration with the Organization for Economic Co-operation and Development. Such initiative is intended to offer a platform similar to crowdfunding for companies operating in free zones to facilitate their access to funding.

Central Bank Initiative

During the fifth Middle East Banking Forum hosted by the UAE Banks Federation held in November 2017, the Central Bank governor had indicated the Central Bank's intention to regulate crowdfunding platforms in the emirates as part of measures to boost financing for small and medium enterprises.

Conclusion

The implementation of robust governance frameworks and legislative initiatives is a healthy sign evidencing that regulators are proactive in adapting to market needs and developments in the financial services sector. Notwithstanding so, it should be borne in mind that the regulatory ambit of financial free zones only extend to such activities performed in or from the relevant financial free zones. Therefore, any regulated activities that are performed out of the financial free zones but within UAE would still be subject to the regulation of either the Central Bank in respect of banking and debt financing activities or the SCA in respect of securities, fund formation and operation or other financial services related activities.

Al Tamimi & Company's Financial Regulatory team regularly advises on licensing issues relating to the provisions of regulated activities in the UAE, DIFC and ADGM. For further information please contact Divya Abrol Gambhir (D.Abrol@tamimi.com)