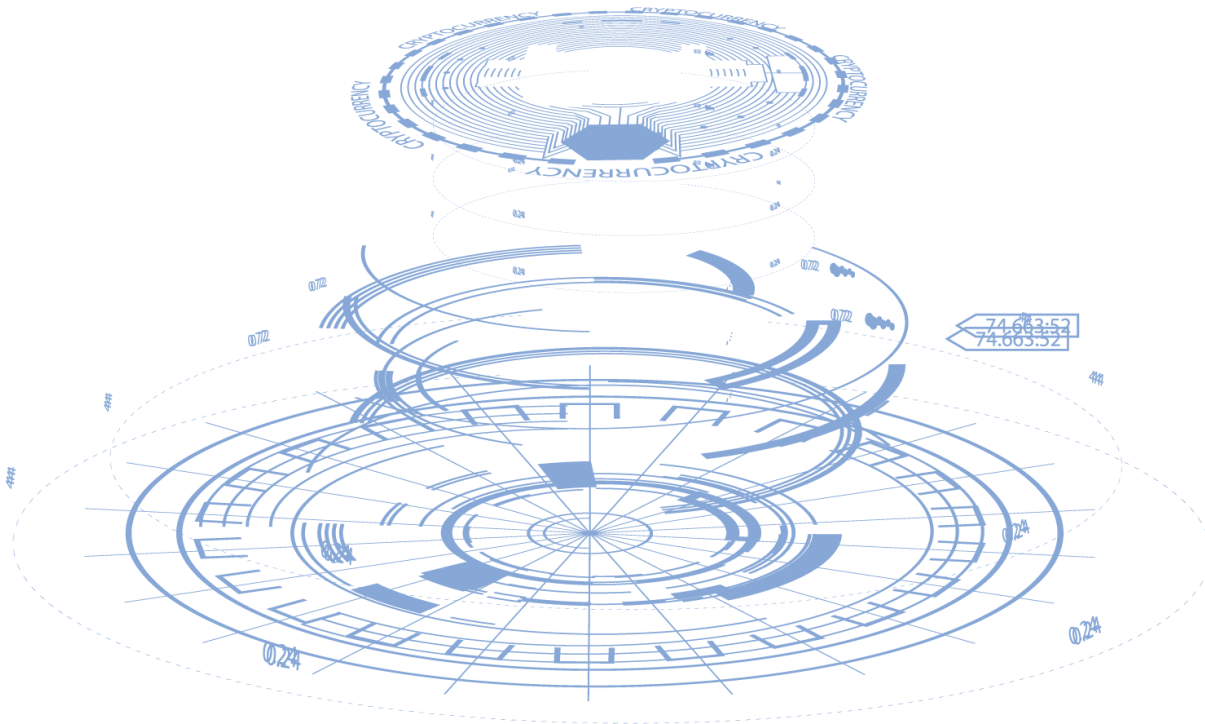


Crypto Asset Exchange at ADGM

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'Crypto Assets' / 'Crypto Currencies' have been a point of interest in recent times along with concerns around the risks associated with these. To address the global demand from industry players, the ADGM Financial Services Regulatory Authority ('FSRA') introduced a comprehensive framework last year for the regulation of exchanges, custodians and other intermediaries engaged in crypto asset activities.

While the framework provides for standard regulation of arranging, advising, dealing, and managing crypto assets, crypto asset exchanges are treated similarly to multilateral trading facilities, which require applicants to meet certain additional requirements in addition to those applicable for other crypto asset activities.

What is a Crypto Asset Exchange in the ADGM?

A crypto asset exchange is a multilateral digital system, operated by a person authorised to operate a crypto asset business in the ADGM or a recognised investment exchange (whose recognition includes a stipulation permitting it to do so). The system brings together multiple third-party buying and selling interests in crypto assets in accordance with non-discretionary rules, in a way that results in a contract in accordance with Financial Services and Market Regulations 2015 and such other rules in connection thereto ('FSMR').

Who can set up a Crypto Asset Exchange in the ADGM?

A crypto asset exchange can be set up by either: (a) a person holding a financial services permission to carry on the regulated activity of 'Operating a Crypto Asset Business' ('OCAB'); or (b) a recognised investment exchange holding an OCAB stipulation on its recognition order.

To be authorised to set up a crypto asset exchange, an applicant must satisfy the FSRA that all applicable requirements of FSMR have been and will continue to be complied with. Upon authorisation, as a holder of financial services permission, an applicant is considered to be authorised to carry out the regulated activity of operating a crypto asset exchange in and from the ADGM.

What Assets can be Traded on a Crypto Asset Exchange in the ADGM?

While there is no general restriction on the crypto assets that can be traded on an exchange, each crypto asset is required to meet certain criteria in order to be designated an '*Accepted Crypto Asset*' and thus eligible for trading. This is a measure to prevent higher-risk activities involving or relating to illiquid or 'immature' crypto assets. Therefore, one should not presume that a financial services permission for operating a crypto currency exchange is a blanket permission to deal with any or all crypto assets in and from the ADGM.

In determining if a crypto asset is eligible to be dealt in by duly authorised persons, the FSRA considers:

1. the market capitalisation threshold of the particular crypto asset. This is usually calculated at the time of an applicant seeking a financial services permission from the FSRA. While there are no prescribed criteria for the calculation of market capitalisation, the FSRA may rely on certain recognised sources, as may be available from time to time;
2. whether the particular crypto asset is able to withstand, adapt, respond to or improve specific risks and vulnerabilities, including testing, maturity, ability to allow appropriate safeguarding of secure private keys;
3. whether the particular crypto asset is traceable i.e. source and destination of such crypto asset;
4. the trading history of such crypto asset in terms of exchanges where such crypto assets have been traded in the past, the jurisdiction where such crypto assets have been traded and the level of regulation in such jurisdiction;
5. the level of demand of the crypto asset, the proportion of the crypto asset that is in free float and controls/processes in place to manage the volatility of the particular crypto asset;
6. the distributed ledger technology involved, if such technology is secured, if it is an existing distributed ledger for network and synergies involved, if at all;
7. the objective purpose of the particular crypto asset; and
8. the application and functionality of the crypto asset.

This is merely an indicative list and therefore there may be circumstances where the FSRA could request further information before it recognises a particular crypto asset as an Accepted Crypto Asset. Each of the criteria is assessed on a case by case basis and therefore each applicant may be assessed on different criteria.

Upon its review, the FSRA shall provide a list of Accepted Crypto Assets that can be traded by the prospective applicant along with its financial services permission for operating a crypto asset exchange.

What are the Considerations for Operating a Crypto Asset Exchange?

1. **Operational risk management framework** – Similar to other multilateral trading exchanges, a crypto asset exchange may be prone to risks that the key participants, service providers, utility providers, outsourced personnel or other parties may pose. Therefore, the FSRA expects authorised persons holding a financial services permission to undertake the activity of operating a crypto asset exchange to have a robust risk management framework with appropriate systems and controls to identify, monitor and manage such risks. The applicants/authorised persons are expected to undertake extensive due diligence and conduct tests to ensure the operational aspects of their crypto asset

- exchange are sufficiently robust to monitor and manage operational risks to which its exchange may be prone and provide reports of such due diligence and tests to the FSRA for their review.
2. **Recording of transactions** – The crypto asset exchanges are expected to have systems in place which would smoothly facilitate recording and reporting of transactions. This would include having in place a system for reconciliation of transactions between the distributed ledger technology and internal register of the crypto asset exchange, in the event of any discrepancy.
 3. **Access** – Typically crypto asset exchanges work on an ‘access’ model i.e. it does not involve client accessing exchanges through members, but rather clients accessing the exchanges directly. It therefore, creates an obligation on the crypto asset exchange to ensure that it has appropriate systems in place to protect the orderly, functioning of the market, its facilities and interests of the investors. In addition to this, under the ‘access’ model, given there are no intermediaries, to assist with ‘know your customer’ and customer due diligence requirements of the end clients, such obligations fall directly on the crypto asset exchanges. Therefore, they need to have systems and controls in place to ensure that they are in compliance with the FSRA’s anti money laundering and combating the financing of terrorism requirements.
 4. **Internal rules and regulations** – The FSRA would expect crypto asset exchanges to have mechanisms in place whereby they can draft and amend rules in order to ensure robust internal management and ways of dealing with clients.
 5. **Public disclosures** – Under the relevant rules of the FSMR, a crypto asset exchange may be required to make certain information public. The FSRA would expect systems to be in place to ensure that any such information or any other information which is made public is reliable, monitored cautiously and is made available to the public on a non-discriminatory basis. While the exchange can choose the format and structure of the information, it should ensure that the format and structure is consistent and in line with market practice.
 6. **Settlement and clearing** – Settlement and clearing are the basis of any forms of exchange and therefore, like other multilateral exchanges the FSRA and other regulators, would expect to have a clear process in place for the settlement and clearing of all accepted crypto asset transactions including the capabilities of such exchange interacting with third parties in relation to movement of accepted crypto assets.
 7. **Disclosures** – Given the significant risks that the crypto assets pose for its clients, all OCAB holders, including a crypto asset exchange, are required to have processes in place that enable them to disclose all material risks associated with crypto assets generally and any specific risks that a particular to accepted crypto may have. While the law provides for a non-exhaustive list of disclosures that an OCAB holder should make, given the rapid development in the crypto asset industry, such disclosures will have to be updated from time to time to ensure that clients are fully aware of the risks that they may encounter in a crypto asset transaction.

Are there any other Considerations?

The considerations we have set out above are merely an indicative list and an overview of what needs to be considered prior to making an application to the FSRA for undertaking a regulated activity of a crypto asset exchange. There are other factors such as compliance with anti-money laundering and countering financing of terrorism regulations, technology governance and controls, market abuse, transaction reporting, misleading impression, human resources and general commercial compliance related issues, which must also be considered.

Generally, OCAB licence holders will be issued with a single financial services permission for the purposes of ‘Operating a Crypto Asset Business’ irrespective of the Crypto Asset activity that they are conducting. However, given the very nature of operating a Crypto Asset Exchange or operating as a Crypto Asset Custodian, the activities attract a higher regulatory requirement, which makes the licensing process lengthier than usual. Therefore, applicants intending to obtain such licence at the ADGM, are expected to plan the process well in advance i.e. with considerable time in hand between starting the application

process and starting the operation of the exchange.

Al Tamimi & Company's [banking and finance team](#) regularly advises on issues in relation to crypto assets. For further information please contact Ashish Banga (a.banga@tamimi.com).