

## UAE's SCA to Regulate ICO Tokens as Securities

***The SCA's decision marks a significant step towards achieving enhanced regulation of digital securities and commodities in the UAE.***

### Key Points:

- The announcement signals a change in the SCA's position following its previous cautionary statement to the market.
- The proposed framework will regulate crypto-asset activities, including ICOs, exchanges, and other intermediaries, and will cover key risks such as anti-money-laundering and counter-terrorist financing, consumer protection, technology governance, and safe custody.
- Entities looking to issue, promote, or market ICOs or token offerings onshore in the UAE should seek to comply with SCA securities regulations and discuss any such proposed token offering further with the SCA.
- The SCA must also approve market intermediaries and secondary market operators dealing with ICOs.

### Background

Sultan bin Saeed Al Mansouri, Chairman of the United Arab Emirates' (UAE's) Securities and Commodities Authority (SCA) and Minister of Economy, recently announced that the SCA has approved a plan to recognize digital tokens as securities and to introduce a proposed framework to regulate crypto-asset activities, including initial coin offerings (ICOs), exchanges, and other intermediaries. The SCA's plan appears to be among a number of initiatives aimed at ensuring that the securities industry in the UAE generally aligns with top international standards, following a review by the UAE securities regulator of best global practices.

According to the SCA's statement, the new regulations will address the full range of the issuance cycle associated with crypto-fundraising, including: "... *the type of issue (private/public), the entities that can make the issuing and the legislative requirements thereof, such as, inter alia, registration and fees, Blockchain operators, the targeted entities by issue type, the minimum content of the prospectus (white paper), liability thereof, and whether registration is or is not required by issue type.*" The new framework is expected to include detailed regulations covering key risks, such as anti-money-laundering and counter-terrorist financing, consumer protection, technology governance, and safe custody. The proposed resolution will take effect once it is published in the UAE's Official Gazette.

This announcement signals a change in position by the SCA, which had previously indicated that it would not regulate or recognize ICOs. The SCA's jurisdiction covers securities offerings in and from "onshore" UAE, which excludes the UAE's two financial free-zones, the Dubai International Financial Centre (DIFC)

and the Abu Dhabi Global Market (ADGM). The DIFC and ADGM each have their own separate framework for securities laws and regulations, which are regulated by the Dubai Financial Services Authority (the DFSA) and the Financial Services Regulatory Authority (the FSRA), respectively.

The FSRA has led the way in recognizing crypto-asset activities in the UAE, having previously published guidance on the regulation of ICOs and virtual currencies in and from the ADGM free zone. Prior to the SCA's new announcement, the position in onshore UAE had been that ICOs were not regulated. Furthermore, there was no legislation dealing specifically with the topic, nor any explicit restrictions on the manner in which a token offering should be implemented.

Notably, however, the SCA had cautioned investors against the risks associated with investments in digital, token-based fundraising activities or fundraising schemes, including ICOs and token presales or crowd sales, in a public warning statement issued on February 4, 2018. In particular, the SCA highlighted the highly speculative nature of ICOs and the price volatility of tokens. The SCA also advised digital token issuers to seek legal and regulatory advice to ensure compliance with applicable laws and regulations.

Under the new framework to be introduced by the SCA, entities proposing to issue, promote, or market ICOs or token offerings onshore in the UAE should seek to discuss the proposed token offering with the SCA at the earliest opportunity to ensure compliance with the SCA securities regulations. If a digital token has the characteristics of a security, such as giving a person ownership of shares in a company, then the token will likely be regulated by the SCA. However, the SCA has not yet provided any further guidance about how it will treat ICOs that offer what is known as "utility tokens," which some regulators do not classify as securities. It is presently unclear as to whether the SCA intends to treat every single digital token as a security, including those that do not purport to give any ownership rights or that are not marketed as tokens that will rise in value and can be later sold to make a profit. The authors of this *Client Alert* expect that the SCA's approach will become clearer once the proposed framework is published.

## Conducting Offerings in Practice

Any issuers proposing to offer digital tokens are encouraged to take a conservative approach while the market awaits the publication of the SCA's new framework, in the absence of any existing guidance from the SCA addressing the regulation of digital tokens. Issuers would be wise to assume that all digital tokens will be treated as securities by the SCA to ensure that they are complying with applicable SCA securities regulations in conducting any such offering. Clearly, once the SCA publishes its new framework and provides further clarity as to the types of digital token offering that it will seek to regulate, any potential issuer of digital tokens will need to be cognizant of applicable securities laws in the UAE. Furthermore, potential issuers should obtain legal advice before proceeding with any such offering.

The current regulatory framework governing the offering of securities in onshore UAE primarily consists of (i) the UAE Commercial Companies Law (Federal Law No. 2 of 2015) (the CCL), and (ii) SCA Board of Directors' Chairman Decision No. 3 R.M. of 2017 Concerning the Regulations as to the Promotion of Financial Products and the Introduction of Financial Services and Activities within the UAE (the PIRs). The CCL generally prohibits public offerings of securities in the UAE, unless conducted with the approval of the SCA. As noted above, the two financial free zones in the UAE, the DIFC and ADGM, are each governed by their own separate framework of securities laws and regulations and each have their own financial regulator.

The PIRs regulates the offering of "Financial Products," which include securities. In accordance with the PIRs, any offering of Financial Products in and from onshore UAE must be conducted by way of a

prospectus to be registered with the SCA and marketed by an SCA-licensed promoter, unless one of the following exemptions applies:

- The offer is carried out by way of a reverse solicitation in response to an initiative made by an investor in the UAE, provided that the reverse solicitation is evidenced in writing.
- The Financial Products are offered to Qualified Investors.

For the purpose of the PIRs, Qualified Investors include:

- Federal and local governments, government establishments and bodies, and any companies wholly owned by them
- International bodies and organizations
- Entities licensed to carry out commercial activities in the UAE, provided that investing is one of their business activities

The issuer and any other third parties involved in the offering of Financial Products are also subject to anti-money laundering obligations set forth in SCA Board of Directors' Chairman Decision No. 17/R of 2010 Concerning Anti-Money Laundering and Terrorism Financing Combatting Procedures (as amended), unless the offering is carried out in accordance with the above exemptions.

In the event that the offering of securities is not carried out in accordance with the PIRs, the SCA may impose a warning or fine on the violator, and/or cancel the promoter's license and suspend the promoter from practicing business. Given the potential civil and/or criminal liability that may arise in the UAE as a result of securities laws violations, issuers proposing to conduct an offering of digital tokens (including ICOs) in or from the UAE should seek legal advice at the earliest opportunity from advisers with capital markets expertise.

## Conclusion

The SCA's decision to recognize digital tokens as securities and to introduce a proposed framework to regulate crypto-asset activities marks a significant step towards achieving enhanced regulation of digital securities and commodities in the UAE, particularly in light of the development of the crypto-asset and digital token market in other parts of the world. Nevertheless, how the SCA will apply the newly proposed legislative framework in practice remains to be seen. In particular, as noted above, it is still unclear as to whether the new regulatory framework will treat every digital token, including "utility tokens," as securities, and therefore whether these will also fall within the SCA's regulatory purview. Potential issuers of digital tokens should seek legal advice at the earliest opportunity in order to protect against the risk of securities laws violations in the UAE.

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If you have questions about this *Client Alert*, please contact one of the authors listed below or the Latham lawyer with whom you normally consult:

**Brian Meenagh**

brian.meenagh@lw.com  
+971.4.704.6344  
Dubai

**Basil Al-Jafari**

basil.al-jafari@lw.com  
+971.4.704.6403  
Dubai

**Donya Fredj**

donya.fredj@lw.com  
+971.4.704.6315  
Dubai

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