

NEWSLETTER **TECH-TONIC** February 2023

SPOTLIGHT: RECENT DEVELOPMENTS IN THE UAE FOR VIRTUAL ASSETS



WHAT'S INSIDE THIS ISSUE:
**VARA REGULATIONS, TOGETHER WITH THE
RULEBOOKS, INTRODUCE A COMPREHENSIVE
REGULATORY FRAMEWORK FOR VIRTUAL ASSETS
ACTIVITIES AND VASPS**

The Dubai Virtual Assets Regulatory Authority (VARA) issued the much-anticipated executive regulations under the Law No. (4) of 2022 Regulating Virtual Assets in the Emirate of Dubai' ("DVAL") on February 07, 2023. DVAL governs virtual assets activities undertaken in and from the Emirate of Dubai ("**Emirate**"), including the special development zones and free zones but excluding the Dubai International Financial Center.

VARA has issued the over-arching Virtual Assets and Related Activities Regulations 2023 ("**VARA Regulations**") and a suite of rulebooks thereunder, including (i) four Compulsory Rulebooks (namely, Company Rulebook; Compliance & Risk Management Rulebook; Technology & Information Rulebook and Market Conduct Rulebook) that set out, amongst others, mandatory conduct of business obligations and compliance requirements for Virtual Asset Service Providers ("**VASPs**") who meet VARA's licensing requirements; (ii) seven Activity-Specific Rulebooks that will apply to VASPs based on the activities they are licensed to provide; and (iii) a Virtual Assets Issuance Rulebook that regulates issuance of virtual assets in the Emirate (collectively referred to as "**Rulebooks**"). Previously, VARA had issued the 'Administrative Order No. [01] of 2022: Relating to Regulation of Marketing, Advertising and Promotions Related to Virtual Assets' which regulates marketing, advertising and promotional activities relating to virtual assets in the Emirate ("**Marketing Order**").

The VARA Regulations, together with the Rulebooks, introduce a comprehensive regulatory framework for virtual assets activities and VASPs. Issuance of this regulatory framework demonstrates the Emirate's commitment towards promoting innovation and growth in this rapidly evolving sector.

In this article, we provide an overview of the VARA Regulations, the Rulebooks and certain key aspects that VASPs must take into consideration.

A. GENERAL PROHIBITION

VARA Regulations contain a general prohibition wherein no entity may carry out by way of business, promote, offer a regulated virtual asset activity or purport to do so, unless (i) it holds a license from VARA; or (ii) qualifies as an exempt entity (defined as a UAE government entity or a public, not-for-profit and charitable entities of an UAE government entity).

B. PERMITTED VIRTUAL ASSETS ACTIVITIES

We have assessed below VARA's regulatory framework in relation to certain key virtual assets activities. It is noteworthy that VARA has not assigned any prudential category to the activities. Depending on the business model, VASPs may need to obtain approvals for more than one virtual asset activity and may have to ensure compliance with multiple Activity Specific Rulebooks.

S. No	Type of virtual assets activity	Applicable Rulebook	Regulatory treatment	License Application Fee (for one regulated VA Activity only)	Annual Supervision Fee (For each regulated VA Activity)
1.	Advisory Services	Advisory Services Rulebook	Advisory services are defined as offering, providing or agreeing to provide personal recommendations to a client regarding any actions or transactions related to virtual assets. VASPs providing advisory services must assess a broad range of virtual assets available to the client which must be sufficiently diverse such that the client's investment objectives are met.	AED 40,000	AED 80,000
2.	Broker-Dealer Services	Broker-Dealer Services Rulebook	The broker-dealer services encompass a variety of activities and include the following: a) arranging orders for the purchase and sale of virtual assets; b) soliciting or accepting orders for virtual assets and accepting fiat currency, or other virtual assets, for such orders; c) facilitating the matching of transactions between buyers and sellers of virtual assets;	AED 100,000	AED 200,000

			<p>d) entering into virtual asset transactions as a dealer for own account; e) making a market in virtual assets using client assets; and f) providing placement, distribution or other issuance related services to clients issuing virtual assets.</p> <p>Considering the broad scope of the definition, a variety of business models may fall under the Broker-Dealer Services. For example, market makers or firms that arrange transactions.</p> <p>Broker-Dealers may provide margin trading services if explicitly approved by VARA and subject to compliance with the conditions specified in the Rulebook. Margin trading can only be offered to qualified investors and institutional investors.</p>		
3.	Custody Services	Custody Services Rulebook	<p>Custody Services is defined as safekeeping of virtual assets for or on behalf of another entity and acting only on verified instructions from or on behalf of such entity.</p> <p>Only VASPs which segregate each client's assets in separate VA wallets will qualify for a custody services license. Certain key considerations in relation to custody services are as follows:</p> <ul style="list-style-type: none"> • Client virtual assets held in custody are not depository liabilities or assets of the VASP. • A VASP providing custody services is not permitted to rehypothecate client's virtual assets held in custody, regardless of client's consent • VASPs providing custody services must undertake custody operations under a separate legal entity, distinct from any group company that provides regulated virtual assets services. 	AED 100,000	AED 200,000

4.	Exchange Services	Exchange Services Rulebook	<p>Exchange Services are defined to include:</p> <ul style="list-style-type: none"> conducting the exchange, trade, or conversion between virtual assets and fiat currency or two or more virtual assets; matching orders between buyers and sellers; and maintaining an order book <p>VASPs providing Exchange Services may also provide margin trading, with express authorisation from VARA. Margin Trading can only be provided to qualified and institutional investors.</p> <p>VASPs providing Exchange Services must complete final settlement of a virtual asset transaction within twenty-four [24] hours of the transaction being executed on their trading venues, subject to any factors outside the VASP's control.</p>	AED 100,000	AED 200,000
5.	Lending and Borrowing Services	Lending and Borrowing Services Rulebook	<p>Defined as 'Carrying out a contract wherein a virtual asset is transferred or lent by one person to another, where the borrower commits to return the virtual asset.</p> <p>VASPs must provide clear disclosures in relation to interest payments including denomination of interest payments, the amount and nature [e.g., whether it is a fixed rate or a variable rate] of interest, frequency at which interest accrues and is credited to client accounts.</p>	AED 100,000	AED 200,000
6.	Payments and Remittances Services	Payment and Remittances Services Rulebook	<p>Defined as 'receiving virtual assets for the purpose of transmission or transfer of such virtual assets from one entity to another or from one entity to another virtual asset wallet, address, or location'.</p> <p>As of February 22, 2023, VARA had not released the Payment and Remittances Services Rulebook.</p>	AED 40,000	AED 80,000

7.	VA Management and Investment Services	Management and Investment Services Rulebook	<p>Defined as 'acting on behalf of an entity as an agent, or fiduciary, or otherwise taking responsibility for the management, administration or disposition of such entity's virtual assets'.</p> <p>This includes:</p> <ul style="list-style-type: none"> • Investment management services • Managing virtual assets; and • Staking virtual assets for the purpose of earning fees or other amounts paid to validators and/or node operators of a proof-of-stake Distributed Ledger Technology (DLT). <p>VASPs are not permitted to rehypothecate client's virtual assets, unless they have explicit prior consent from the client to do so. VASPs providing VA Management and Investment Services shall ensure that all assets under management are subject to ongoing independent valuation.</p>	AED 100,000	AED 200,000
8.	Virtual Assets Issuance	Virtual Assets Issuance Rulebook	<p>Any entity in the Emirate that issues a virtual asset in the course of business is required to comply with the Virtual Assets Issuance Rulebook.</p> <p>Further, issuers of virtual assets must obtain a prior approval from VARA, unless the proposed virtual assets qualify as "Permitted Virtual Assets". The following types of virtual assets fall under the Permitted Virtual Assets category:</p> <ul style="list-style-type: none"> • Free & Non-Transferable Virtual Assets; • Non-Redeemable & Non-Transferable Virtual Assets; and • Redeemable Closed-Loop & Non-Transferable Virtual Assets. <p>The Rulebook specifies several requirements in relation to, amongst others, content and disclosures in the whitepaper, compliance obligations and technology systems and controls.</p>		

C. LICENSING PROCESS

As of February 24, 2023, VARA is continuing to operate its Minimum Viable Product (MVP) program wherein it has issued MVP permits to a select number of VASPs. Under the MVP program, each VASP must pass four stages of licensing process, as shown below. Until a Full Market Product license is obtained, VASPs are not permitted to provide services to mass retail investors; they may only provide services to qualified and/or institutional investors upon securing a MVP Operating Permit. VARA has stated that it will issue Full Market Product licenses only after the current regulatory regime is tested.



Under Stage 1 and Stage 2 above, VASPs are required to undertake readiness steps such as establishing offices, onboarding employees with work visas and securing domestic bank accounts. VASPs are not permitted to undertake any market operations during these stages.

The VARA Regulations state that VARA may prescribe a licensing process from time to time, which implies that VARA may in due course notify a new licensing process for VASPs. As of February 24, 2023, VARA has not released any application forms or opened an online portal where new applications for a license can be submitted.

D. KEY FACTORS TO CONSIDER:

- a) **Capital requirements:** The capital requirements range from AED 100,000 to AED 1,500,000 or may depend on the fixed annual overheads. The capital requirements vary with each regulated activity and the number of regulated activities undertaken.
- b) **Net Liquid Assets and Reserve Assets:** VASPs must at all times hold and maintain sufficient current liquid assets such that the surplus over current liabilities is at least 1.2 times their monthly operating expenses. In addition, VASPs must maintain reserve assets equivalent to 100% of their liabilities towards clients for all virtual assets activities. VASPs must hold reserve assets on a one-to-one basis in the same virtual asset that liabilities are owed to its clients.

- c) **Insurance:** VASPs must maintain multiple types of insurances including (i) professional indemnity insurance; (ii) directors' and officers' insurance; (iii) commercial crime insurance or similar types of insurance for all virtual assets stored in hot wallets; and (iv) any other type of insurance as directed by VARA.
- d) **Proprietary trading:** VASPs that actively invest in their own portfolio in virtual assets where the investment volume is equal to or more than USD 250 Million (equivalent value of Virtual Assets) during any rolling thirty [30] calendar days period, must register with VARA, prior to investing or within 3 working days from the date such volume is invested. Proprietary traders must not accept or trade virtual assets of a third party. VASPs that do not meet this registration criteria may choose to voluntarily register with VARA. It must be noted that registration with VARA is not equivalent to a license and it does not authorize the proprietary trading entity to provide any regulated services.
- e) **Trading on own account:** VASPs are prohibited from actively investing their own or their group's portfolio of virtual assets or any other assets, unless such active investing is undertaken in connection with the management of net liquid assets required to be held by the VASP.
- f) **Scope of virtual assets:**
 - i. VARA Regulations prohibit issue of privacy tokens and associated virtual assets activities in the Emirate. On the other hand, virtual assets activities in relation to Central Bank Digital Currency will remain under the regulatory purview of the CBUAE.
 - ii. VASPs may not be required to seek specific approval for each virtual asset that they intend to provide services in relation to; VASPs must however establish their own standards for such virtual assets. The virtual assets standards must be disclosed on the website and must meet certain minimum criteria specified by VARA.
- g) **Voluntary registration:** VASPs involved DLT services may voluntarily register with VARA. Such registration does not however authorize the DLT entity to engage in any regulated virtual assets activities.
- h) **Conduct of business obligations (COBS) and compliance requirements:** VASPs must comply with various COBS and compliance requirements including: (i) undertaking assessment of client suitability; (ii) making mandatory staff appointments;

(iii) implementing a compliance management system; (iv) making required public disclosures; and (v) implementing policies, systems and procedures for AML/CFT compliance, risk management, handling of client assets and client money, data protection, handling of client complaints, whistleblowing, business continuity and cybersecurity. Few VASPs (such as VASPs providing Custody Services or Exchange Services) are required to appoint an independent director on the board and constitute committees of the board.

E. **CONCLUSION**

VARA's regulatory framework is tailored to address specific needs of the virtual assets sector. For instance, activities such as staking, lending and borrowing of virtual assets and issuance of virtual assets are addressed in the regulatory framework. At the same time, the regulations do not compromise on requirements in relation to corporate governance, regulatory reporting, public disclosures, market integrity, risk management, consumer protection and compliance. Overall, VARA's regulatory framework is a step in the right direction, as it introduces a nuanced regulatory regime for virtual assets activities and VASPs.



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