
FINANCIAL SERVICES REGULATORY AUTHORITY
سلطة تنظيم الخدمات المالية

**Supplementary Guidance –
Regulation of Initial Coin/Token Offerings and Virtual Currencies under the
Financial Services and Markets Regulations**

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1. INTRODUCTION

- 1.1 This Guidance is issued under section 15(2) of the Financial Services and Markets Regulations 2015 (“**FSMR**”). It should be read in conjunction with FSMR, the relevant Rulebooks of the Financial Services Regulatory Authority (“**FSRA**”) and the Guidance & Policies Manual of FSRA.
- 1.2 This Guidance is applicable to those considering the use of Initial Coin or Token Offerings (“**ICOs**”, also known as a Coin or Token Sale) to raise funds. The Guidance is also applicable to those considering transacting in, and the general use of, virtual tokens and currencies.
- 1.3 The Guidance sets out FSRA’s approach to token issuers seeking to raise funds through ICOs, and market intermediaries or operators dealing in or offering services in virtual tokens and currencies.
- 1.4 This Guidance is not an exhaustive source of FSRA’s policy on the exercise of its regulatory mandate, and FSRA may impose other, specific conditions to address any specific risks posed by the proposed activities set out herein.
- 1.5 FSRA is not bound by the requirements set out in this Guidance and may waive or modify this Guidance at its discretion where appropriate.
- 1.6 Unless otherwise defined or the context otherwise requires, the terms contained in this Guidance have the same meanings as defined in FSMR and the Glossary (GLO).

2. BACKGROUND

- 2.1 Globally, the use of virtual tokens (including virtual currencies) to raise funding and facilitate economic transactions has been on the rise in recent years. This has resulted in increased attention from financial services regulators. A number of financial services regulators have issued comments or consumer alerts setting out their regulatory status or position on virtual tokens and/or virtual currencies. This is especially relevant since the use of virtual tokens and currencies can be subject to risks arising from fraud, money-laundering and terrorist financing, as well as the observed volatility of the “value” of virtual currencies.
- 2.2 FSRA adopts a technology-neutral approach to regulation, where regulatory requirements are applied to the conduct of Regulated

Activities or activities envisaged under a Recognition Order¹, as opposed to the technological means used to execute a Regulated Activity. To the extent that virtual tokens are used as a mechanism to enable or facilitate a Regulated Activity to be carried out, they are generally permitted. For example, subject to fit and proper safeguards, an authorised money remittance house may receive fiat currencies from Clients and use virtual currencies to securely remit an equivalent value overseas directly to a regulated foreign counterparty via the internet in real-time; the foreign counterparty can then pay out in fiat currencies to the intended end-clients.

- 2.3 Given the evolving developments in the space of virtual tokens, FSRA will continue to closely monitor industry developments. FSRA may issue further Guidance as necessary, to ensure the regulatory framework is updated and risk-appropriate in order to facilitate the sound development and deployment of promising financial technology innovations.

3. INITIAL COIN OFFERINGS

- 3.1 ICOs can take many forms, but all of them utilise Distributed Ledger Technology (“DLT”). Investors will typically give virtual currencies to an ICO issuer in exchange for a proprietary digital medium of exchange on the DLT platform, being termed a “coin” or “token” (where the latter term will be used hereafter). In some cases the proprietary tokens will not represent an underlying financial asset; for example, a DLT token may represent a digital identity record, a voting right, or simply access to software running on a DLT platform.
- 3.2 Alternatively, an emerging method of fund-raising uses DLT with the tokens representing a “traditional” regulated issuance, such as Shares, Debentures or Units in a Collective Investment Fund. In these instances, a DLT platform may also comprise a share or bond register. We are aware

¹ Pursuant to Section 124 of the FSMR, these include activities of Recognised Investment Exchanges and Recognised Clearing Houses.

that there are many companies seeking to raise money through such traditional and regulated means using a DLT-enabled platform.

Regulatory treatment of tokens deemed to be Securities

- 3.3 Whether an ICO is to be regulated under FSMR will be assessed by FSRA on a case-by-case basis. To this end, if the tokens in an ICO are assessed to exhibit the characteristics of a Security, FSRA may deem the tokens as a Security pursuant to Section 58(2)(b)² of FSMR, hereinafter referred to as “**Security Tokens**”. Consequently, an issuer seeking to launch an ICO in or from ADGM should approach FSRA at the earliest opportunity.
- 3.4 For regulatory purposes, issuances of Securities (as defined in Section 258 of FSMR), whether through a DLT platform or other means, will see no difference in their treatment under our regulatory framework. Those issuers/market actors who seek to raise funds in a regulated, robust and transparent manner using new business models or technologies such as DLT are encouraged to engage with us as early as possible in the fund-raising process.
- 3.5 The requirements for Offers of Securities fall under Sections 58 to 71 of FSMR and Chapter 4 of the Markets Rules (“MKT”). When an Issuer wishes to make an Offer of Securities to the Public in or from ADGM, these requirements include, for example, the obligation to publish a Prospectus under Section 61 of FSMR.
- 3.6 Offers of Securities may benefit from an exemption under the Exempt Offers regime set out in Rule 4.3 of MKT. In the circumstances specified in that Rule, it should be noted that a Person may make an Offer of Securities to the Public without a Prospectus where any one of the following conditions, amongst other conditions in that Rule , is met:
 - (i) an Offer is directed at Professional Clients;
 - (ii) fewer than 50 Persons in any 12 month period; or
 - (iii) where the consideration to be paid by a Person to acquire Securities is at least USD100,000.
- 3.7 Additionally, any market intermediaries and primary / secondary market operators dealing in Security Tokens and/or their Derivatives will need to

² Section 58(2) of FSMR sets out that FSRA may, by written notice ‘deem any investment which is not a Security to be a Security for the purposes of these Regulations and the Rules made under these Regulations’.

be licensed / approved by FSRA as Financial Services Permission (“**FSP**”) holders, Recognised Investment Exchanges or Recognised Clearing Houses (collectively referred to as “**Regulated Firms**”).

Innovation

- 3.8 In our engagement with innovative firms in the financial services sector, we have been made aware of business models using a DLT platform to facilitate the issuance of Securities on a private placement basis. These business models may include a high level of disclosure and transparency with investors, and a robust reconciliation and reporting mechanism. These types of business models may benefit from the Exempt Offers regime set out above.
- 3.9 We are also aware of firms seeking to build investment funds using DLT platforms for the purposes of investor reporting and funds management. In such cases, the token issued as a result of the ICO may be Units in a Collective Investment Fund as defined in Section 106 of FSMR. This may fall within our FUNDS Rules, and again we encourage firms considering such DLT-enabled business models to engage with us as early as possible.

Tokens not deemed to be Securities

- 3.10 It should also be noted that not all ICOs constitute an Offer of Securities under the FSMR or MKT. Where tokens do not have the features and characteristics of Securities such as Shares, Debentures or Units in a Fund, the offer of such tokens is unlikely to be an Offer of Securities, nor is the trading of such tokens likely to constitute a Regulated Activity under FSMR.
- 3.11 In unregulated ICOs, investors do not benefit from any of the safeguards that accompany a regulated Offer of Securities. Reliable information regarding the issuer, and what it plans to do with the funds raised may be lacking. The risk of fraud and loss of capital is therefore significantly higher. This is particularly likely to be the case where a token issuer promises extremely high investment returns that are disproportionately high relative to those generally available in the market. We advise potential investors in unregulated ICOs to exercise extreme caution before committing any funds.
- 3.12 However, there are instances of such unregulated ICOs being used to raise money for legitimate companies and development efforts. In such cases,

while these do not fulfil the same requirements as a regulated Offer of Securities, issuers of the ICO may disclose detailed information on their products / tokens and business plan. We welcome engagement from the industry, in particular from trade bodies, in developing voluntary best-practice standards in relation to the use of such unregulated ICOs as a legitimate method for raising funds.

4. VIRTUAL CURRENCIES

- 4.1 For the purposes of this Guidance, the definition of virtual currencies follows that set out by the Financial Action Task Force (FATF) in 2014³.

“Virtual currency is a digital representation of value that can be digitally traded and functions as (1) a medium of exchange; and/or (2) a unit of account; and/or (3) a store of value, but does not have legal tender status (i.e., when tendered to a creditor, is a valid and legal offer of payment) in any jurisdiction. It is not issued nor guaranteed by any jurisdiction, and fulfils the above functions only by agreement within the community of users of the virtual currency. Virtual currency is distinguished from fiat currency (a.k.a. “real currency,” “real money,” or “national currency”), which is the coin and paper money of a country that is designated as its legal tender; circulates; and is customarily used and accepted as a medium of exchange in the issuing country. It is distinct from e-money, which is a digital representation of fiat currency used to electronically transfer value denominated in fiat currency. E-money is a digital transfer mechanism for fiat currency—i.e., it electronically transfers value that has legal tender status.”

- 4.2 Virtual currencies, unlike fiat currencies, are not legal tender. However, virtual currencies have “value” in that they can be exchanged for other things of value, with that value being dependent on considerations of supply and demand. In this respect, virtual currencies have much in common with physical commodities such as precious metals, fuels and agricultural produce. Therefore from a regulatory perspective, virtual currencies are treated as commodities, which are not Specified Investments as defined under the FMSR. This means that a “mining” or spot transaction in virtual currencies will not constitute a Regulated Activity in itself.

Safeguards

- 4.3 Given the volatility of virtual currencies and that transactions in them are unregulated, they constitute high-risk investments. Investors seeking a

³ “Virtual Currencies Key Definitions and Potential AML/CFT Risks” (June 2014 , www.fatf-gafi.org/.../Virtual-currency-key-definitions-and-potential-aml-cft-risks.pdf)

return on capital by purchasing virtual currencies should be aware that they do not benefit from any of the protections afforded to them when investing in Specified Investments (such as Shares, Debentures or Units). FSRA therefore advises consumers and companies to consider the risks of investing in virtual currencies carefully before committing any funds.

- 4.4 Although virtual currencies are not regulated, where a Regulated Firm uses them as a means to enable or facilitate the carrying on of any financial services businesses, the Regulated Firm will have to demonstrate that the controls for the virtual currency transactions are fit for purpose. This includes putting in place control requirements to address any AML/CFT risks, technology risks, etc. associated with the use of virtual currencies.

Derivatives of virtual currencies

- 4.5 While the spot trading and dealing of virtual currencies is not regulated under FSMR, dealing in the Derivatives (e.g. Futures, Options, CFDs) of virtual currencies is regulated. In line with the policy treatment of virtual currencies as commodities, Derivatives of virtual currencies are regulated as Commodity Derivatives and hence, a type of Specified Investment under the FSMR. Consequently, any market intermediaries or primary / secondary market operators dealing in Derivatives of virtual currencies will be subject to the appropriate regulations and rules applicable under FSMR.
- 4.6 For avoidance of doubt, where a virtual currency has the features and characteristics of a Security Token, it will be subject to the applicable regulatory requirements as explained in section 3 above.

5. SUMMARY

5.1 A summary of the regulatory treatment of virtual tokens and currencies is shown in the table below.

Category of Instruments	Regulatory Approach
Virtual tokens that have the features and characteristics of a Security under the FSMR (e.g. Shares, Debentures, Units in a Collective Investment Fund).	<p>Deemed to be Securities pursuant to Paragraph 58(2)(b) of the FSMR.</p> <p>All financial services activities in relation to an ICO, such as operating primary / secondary markets, dealing / trading / managing investments in, advising on such tokens, etc. will be subject to the relevant regulatory requirements under the FSMR.</p> <p>Market intermediaries and market operators dealing in such tokens or their Derivatives will need to be licensed / approved by FSRA as FSP holders, Recognised Investment Exchanges or Recognised Clearing Houses.</p>
Other virtual tokens that do not exhibit the features and characteristics of a regulated investment / instrument under the FSMR.	<p>Treated as commodities and hence not regulated as Specified Investments under the FSMR.</p> <p>Spot transactions will not constitute Regulated Activities or activities envisaged under a Recognition Order (i.e. those of a Recognised Investment Exchange or Recognised Clearing House).</p>
Virtual currencies	<p>However, a regulated firm under the FSMR (i.e. an FSP holder or Recognised Body) that is involved in the use or transaction of such tokens will have to demonstrate that it is fit and proper in carrying on such transactions, and to comply with all applicable regulatory obligations as a regulated firm (e.g. in relation AML/CFT controls, fit and proper management team, etc.).</p>
Derivatives of virtual currencies and Security Tokens	<p>Regulated as Specified Investments under the FSMR.</p> <p>Market intermediaries and market operators dealing in such Derivatives will need to be licensed / approved by FSRA as FSP holders, Recognised Investment Exchanges or Recognised Clearing Houses.</p>