Editorial

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The future of blockchain in the UAE

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Questions about the inherent properties of cryptocurrencies have caused confusion to both the regulator and layperson. Specific issues continue to puzzle the top legal and financial experts in areas of securities and commodities law, capital gains taxes, international transactions, anti-money laundering, and trading and investment practices.

It is claimed that investors and speculators have already been scammed out of millions. ICOs may be utilized for money laundering and terrorist financing. Certain studies report that as many as 59% of Americans don't report appropriate cryptocurrency-based capital gains to the IRS.

You will hear many of such warnings. That cryptocurrencies are risky, that they are not regulated, are being used in illegal activities, in drug trafficking, in illegal arms deal and in may non-legitimate activities in dark web. I would simply say that do not listen to these calls. These calls stem from the fact that regulators and Governments are struggling to control cryptocurrencies and activities based on them, at least for now.

Cryptocurrencies and blockchain are the future, and whether regulators and Governments like it or not, cryptocurrencies will not only survive and prevail but they will most probably dominate. According to the blockchain and cryptocurrency news site CoinDesk, more than $2.4 billion in venture capital has poured into blockchain companies since 2012.

It is the rapid ascent of cryptocurrency valuations that has caught even the most astute regulators off-guard, and they are scrambling to understand the risks and provide guidance. According to Coindesk, the SEC is specifically concerned about Initial Coin Offerings ("ICOs") due to their security-like nature.

The legal status of bitcoin varies substantially from country to country and is still undefined or changing in many of them. Whereas the majority of countries do not make the usage of bitcoin itself illegal, its status as money (or a commodity) varies, with differing regulatory implications. While some countries have explicitly allowed its use and trade, others have banned or restricted it. Likewise, various government agencies, departments, and courts have classified bitcoins differently.

While cryptocurrencies remain a relatively unregulated field, the near future may experience a change to that.

Countries around the world grapple with cryptocurrencies and try to determine how they are going to treat them. Some are welcoming, others are cautious. And some countries are downright antagonistic.

It is no longer a question of “if” or “when”, it is now a matter of “how” and “to what extent” cryptocurrencies and the underlying blockchain technology will be regulated before they permeate almost every aspect of modern business.

There are currently approximately around 200 cryptocurrency exchanges around the world, the overwhelming majority of which are not regulated. This means that they are not subject to the most basic disclosure obligations, such as the disclosure of ownership, financial data or even the location of the business. Most are based outside of sophisticated western jurisdictions to avoid regulation and prosecution. Even regulators in the more sophisticated jurisdictions are still unclear on how to regulate these, and most frameworks are still largely untested or are in the consultation phase.

Japan has a crypto exchange license, and earlier this year the SEC affirmed the need to be licensed as an exchange (or be exempt) if operating such a platform. The effort to come up with regulatory standards for crypto currency exchanges is also hampered by the lack of consensus in that regard by national regulators.

The rule of thumb is that these exchanges would need to be licensed, and that at the moment, they would need to fit in within the existing regulatory frameworks (they can do so by way of waivers and modifications of the rules).

Asia seems to emerge as a powerhouse in that field due to its looser regulations and the presence of cryptofarms from the early days of Bitcoin (and due to the penetration of online transactions in local culture).

In the UAE and to the best of my knowledge there are no regulated blockchain-based exchanges.

It has been purported in the news that BitOasis is one such exchange. However, upon closer inspection, it turns out that BitOasis is a mere bitcoin wallet service which:

1. is based in the BVI and operates in the UAE, Kuwait, Bahrain, Oman and Saudi Arabia; and

2. provides "Transaction Services" which are expressly described under its terms of service as: "does not act as an intermediary or marketplace".

Belfrics Global, a Malaysian-based cryptocurrency technology provider, was granted earlier this year a "sandbox" license from the Bahrain Central Bank. A sandbox license is usually a time-limited and restricted license to allow the applicant to test its technology before going live and receiving a full regulatory license.

More recently, a UAE based venture - Arabianchain Technology, has been purported to also having secured a "sandbox" license for its Palmex platform from the Bahrain Central Bank.

Both Belfrics and Palmex are portraying themselves as the first block-chain based exchange in the region. This may be a bit misleading since they only hold sandbox licenses. There is still much confusion in this sphere since most people have a hard time understanding the subject matter as a whole.

As crypto concepts and technologies evolve, we expect to see a shift in nomenclature and uses. For example, some cryptocurrencies may be more accurately referred to as “tokens”.

Many of the companies working on blockchain and other distributed ledger technologies have chosen to raise funds by unconventional means. These include so-called “initial coin offerings”, whereby companies sell digital tokens to investors to fund projects without offering equity.

This is especially true given the current trend of issuing tokens which represent an underlying asset (i.e. an “asset backed token”), as opposed to using tokens to make payments, much like an actual currency such as Bitcoin (i.e. a “utility token”).

Investing in asset-backed tokens is less risky than doing so with their utility/currency counterparts. That is because asset-backed tokens are supported by a tangible underlying asset which has intrinsic value (such as company shares, property).

This should address the regulators’ fears, especially in the wake of the latest “cryptocrash” which has somewhat tainted the crypto-sphere. We can already see this happening in the DIFC and the ADGM where the regulators have been receptive to business models which deal with asset-backed tokens. This means that the issuance and dealing/trading in asset-back tokens are likely to have their bespoke regulations in the UAE (both inside and outside the FFZs) at some point in the not-too-far future.

However, although none of the regulators in the UAE (both inside and outside the FFZs) currently have in place regulations which expressly deal with asset-backed tokens, this does not mean that asset-backed tokens would not be allowed to be traded on a regulated exchange, at least in the FFZs. The current regulatory regimes in the FFZs, through the use of any needed waivers or rule modifications (or even the use of the DFSA's power under the law to deem asset-backed token as "securities"), can be even made to accommodate the establishment of token exchanges for the trading of asset-backed tokens.

This could officially usher in the era of generalized "tokenization" (which to an extent echoes securitization) where ownership of a broad range of assets can be represented on the blockchain using one of the existing standards, predominantly Ethereum (with ERC-20 poised to become one of the de-facto standards. Ethereum has become a popular cryptocurrency and blockchain system, where the ERC-20 is a technical standard for smart contracts which are used to issue asset-backed tokens on the Ethereum blockchain. We can already see tokens with a very rich variety of underlying assets being traded on blockchain-based exchanges. The underlying assets can include any type of ownership interests, from equity (company shares), bonds, to even ownership interest in real property - hopefully creating a much needed liquidity in that particular market.

Evidently, these are exciting times to be in the crypto-sphere which presents, along with its suite of novel and complex challenges, the unique opportunity to be looked at by history as a true pioneer.

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