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Client Alert
Commentary

Latham & Watkins Emerging Companies Practice June 5, 2017 | Number 2151

How to Set Up a Fintech Business in the UAE – Part 1: Onshore Financial Service Regulation and Licensing

UAE-based fintech companies should understand the applicable onshore regulations — many of which are new and largely untested — when providing specific services.

Key Points:

- UAE fintech companies need sophisticated legal and regulatory guidance as they continue to drive the MENA region's increased activity in the sector.
- Part 1 of this three-part *Client Alert* series highlights the onshore regulations that fintech companies face when providing digital banking, digital money exchange, digital payments, cryptocurrency, crowdfunding or robo-advisory services in the UAE.

A recent "State of Fintech in MENA" report by Wamda Research Lab and Payfort predicts that by 2020 there will be 250 fintech startups in the GCC. The same report notes that, as of 2015, 30% of fintech startups in the MENA region were based in the UAE. Looking ahead, the UAE is driving the fintech surge across the region

In light of this trend, this Latham & Watkins three-part *Client Alert* series will provide high-level guidance for individuals and organizations that are considering establishing a fintech company in the UAE. Part 1 discusses onshore regulation and licensing requirements for fintech companies. Part 2 will address how to conduct business in the UAE, with a focus on distinguishing between "onshore" (*i.e.*, incorporated and licensed outside a free zone in the UAE) and "offshore" (*i.e.*, incorporated and licensed inside a free zone) entities as well as the impact of this distinction on how an entity conducts business in the region. Finally, Part 3 will set out additional considerations relevant to operating a fintech business in the UAE, whether onshore or offshore.

Onshore Financial Service Regulations

Fintech is a regulated sector. Accordingly, new companies looking to break into UAE fintech as well as established financial service providers looking to deploy new technology must understand the regulatory environment in which they operate.

Sources of Regulation

Beyond the basic requirements of UAE law compliance, a fintech company faces differing types and levels of regulation depending on both the services the company seeks to provide and the jurisdictions (onshore or offshore free zones) in which it seeks to operate.

This *Client Alert* focuses on the onshore regulations applicable to the provision of the following types of services:

- Digital banking
- Digital money exchange
- Digital payments
- Bitcoin and other cryptocurrencies
- Crowdfunding
- Robo-advisory activities

Part 2 of this series will consider additional regulatory requirements that may be imposed if a fintech company chooses to set itself up in a free zone.

Digital Banking

The principal regulation that governs banking in the UAE is Federal Law No. 10 of 1980 (the Banking Law) concerning the UAE Central Bank (the Central Bank), the monetary system and the organization of banking. The Central Bank, which was established in 1980 under the Banking Law, regulates commercial banks and other financial institutions in the UAE. Islamic banks, finance companies, and investment companies are also regulated by the Central Bank under Federal Law No. 6 of 1985 concerning Islamic banks, financial institutions and investment companies.

All commercial banks and financial institutions regulated by the Banking Law must obtain a license from the Central Bank before commencing operations in the UAE. Such entities must also comply with the requirements set out in applicable regulations that the Central Bank issues from time to time. For example, investment companies and banks must comply with the requirements set out in Central Board of Directors' Resolution No. 164/8/94 concerning the regulation of investment companies and banking, financial and investment consultation establishments or companies. While the Central Bank serves as the principal regulatory authority of banks and financial institutions in the UAE, such entities are also subject to additional requirements under UAE law, including Federal Law No. 2 of 2015 concerning commercial companies in the UAE (the Companies Law). The Companies Law requires all commercial banks (other than branches of foreign banks) to be incorporated as public joint-stock companies.

Digital Money Exchange and Transfer

In January 2014, the Central Bank issued Regulations concerning the Licensing and Monitoring of Exchange Business (the Exchange Business Regulations), with the objective of enhancing the regulation of exchange businesses, supporting the geographical expansion of exchange businesses and facilitating the provision of exchange services throughout the UAE. The Exchange Business Regulations define exchange businesses as (i) dealing in sale and purchase of foreign currencies and travellers' cheques; (ii) executing remittance operations in local and foreign currencies; (iii) paying employees' salaries through an established link to the UAE Wages Protection System; and (iv) other businesses licensed by the Central Bank. Pursuant to the Exchange Business Regulations, no person or entity may carry out an exchange business in the UAE without obtaining a license from the Central Bank. Commercial banks, as defined in the Banking Law, are exempt from this requirement.

To obtain and maintain a license under the Exchange Business Regulations:

- The applicant must meet the paid-up capital requirements stipulated in the Exchange Business Regulations. The paid-up capital requirements vary depending on the type of exchange business that the applicant intends to carry out.

- In the case of individual applicants, the applicant must be a UAE national who is at least 21 years old with full mental capacity and, in the case of corporate applicants, at least 60% of the shares in the corporate entity must be held by UAE nationals.

- The applicant must meet the “personal reliability” and “professional qualifications” requirements stipulated in the Exchange Business Regulations. In the case of corporate applicants, the Central Bank will consider any matters relating to another entity within the same group as the applicant or regarding any manager or controller thereof as concerns personal reliability or professional qualifications.

Upon obtaining the license, the licensed person may not transfer ownership of the license, for remuneration or otherwise, to any third party. If such person holds the position of Chief Executive Officer of the relevant exchange business, he or she shall not be entitled to hold a similar position at another establishment. The licensed person must also comply with the continuing obligations under Article 9 of the Exchange Business Regulations.

Digital Payments

On 1 January 2017, the Central Bank issued the Regulatory Framework for Stored Values and Electronic Payment Systems (the Electronic Payment Regulation). The Electronic Payment Regulation regulates applicable payment service providers, including banks, payment networks, telecommunications companies, government entities and non-issuing commercial entities. Under the Electronic Payment Regulation, such providers must maintain the necessary licenses as well as governance and operational controls to ensure the integrity of the payments system and provide a minimum level of consumer protection and clarity on consumer rights. Given that the Electronic Payment Regulation is still new and largely untested, investors looking to set up digital payments businesses in the UAE may need to seek further guidance from the Central Bank regarding their obligations under the new regulation. Investors should also seek advice from legal counsel to facilitate discussions with the Central Bank.

To read more about the Electronic Payment Regulation, please see the Latham *Client Alert* “United Arab Emirates – the New Digital Payments Regulatory Landscape.”

Bitcoin and Other Cryptocurrencies

Although the Electronic Payment Regulation expressly stated that all virtual currencies (and any transactions thereof) are prohibited, on 1 February 2017, the Governor of the Central Bank, His Excellency Mubarak Rashed Khamis Al Mansouri, issued a statement to Gulf News saying that “these regulations do not cover virtual currency” and “these regulations do not apply to bitcoin or other cryptocurrencies, currency exchanges, or underlying technology such as Blockchain.” He further added that the Central Bank is reviewing virtual currencies and will issue new regulations as appropriate. Until such regulations are issued, businesses that treat bitcoin as a currency that can be used as a form of payment in the UAE or currency remittances from the UAE should proceed cautiously and seek further guidance as to whether or not the new Electronic Payment Regulation affects (or prohibits) their services.

To read more about the legal status of bitcoin in the UAE, please see Latham's blog post, "The Legal Status of Bitcoin in the United Arab Emirates."

Crowdfunding

While debt-based crowdfunding in the Dubai International Financial Centre (DIFC) is permitted, crowdfunding onshore in the UAE is not currently specifically regulated. That said, certain existing UAE laws and regulations may apply to a crowdfunding platform depending on whether the platform promotes the equity, debt, donations or rewards model, described in turn below.

Equity Model

An equity-based crowdfunding platform involves the undertaking of financial activities. Either the Central Bank or the Securities and Commodities Authority (SCA) principally regulates such activities in the UAE, depending on the exact nature of the activity.

An equity-based crowdfunding platform's offer of ownership of shares in a company to investors in exchange for capital may constitute an offer of securities to the public and therefore require the SCA's prior approval in accordance with the Companies Law.

The Companies Law expressly stipulates that companies other than public joint-stock companies are prohibited from making any advertisements or marketing the subscription of shares to the public without obtaining the SCA's prior approval. This prohibition applies to companies whether they are incorporated onshore or in free zones.

Debt Model

Either the Central Bank or the SCA may also regulate a debt-based crowdfunding platform, depending on the nature of the platform's activity.

A typical debt-based crowdfunding/peer-to-peer lending platform —whereby lenders provide unsecured loans to borrowers in return for the full principal amount and interest at the maturity date — may require prior approval from the Central Bank in order to operate. The Central Bank has issued a number of regulations with respect to financial activities relating to the granting of loans including the Central Bank Board of Directors' Resolution No. 126/5/95 and Resolution No. 153/5/97 regarding the regulation of financial and monetary intermediaries, which prohibits intermediaries from conducting financial and monetary brokerage activities in the UAE without the Central Bank's prior approval.

By contrast, a debt-based crowdfunding platform — that offers a pooled investment into a fund that then lends to or purchases debt securities from a company — may constitute fund formation lending and securities offering activities, and therefore require approval from both the Central Bank and the SCA.

In addition, debt-based crowdfunding platforms must ensure they do not risk contravention of UAE Federal Law No. 3 of 1987 concerning the Penal Code, which prohibits individuals from granting loans with usury rates of interest based on Shari'ah law. One way to demonstrate Shari'ah compliance is to obtain certification from the Shariyah Review Bureau as being Shari'ah compliant. In the UAE, Islamic banks are underserving the SME market and so the potential for Shari'ah compliant tech start-ups to act as a lending platform for SMEs remains high.

Donations and Rewards Models

When crowdfunding involves funders donating money for no return, investors will need to be aware of the issues that compliance with UAE charity and fundraising regulations raises. In essence, both corporate entities and individuals are prohibited from raising funds without obtaining the relevant license applicable in the Emirate in which funds are raised. In Dubai, for example, Decree No. 9 of 2015 (the Fundraising Decree) prohibits fundraising, the authorization of fundraising and the advertisement of fundraising in Dubai unless the Islamic Affairs & Charitable Activities Department provides prior written approval. Any kind of fundraising activity connected with donations or charitable causes would therefore fall within the scope of the Fundraising Decree. The Fundraising Decree is strictly enforced in Dubai and has led to criminal charges being brought against individuals who have used social media to promote crowdfunding campaigns for charitable purposes.

When investors solicit funds in return for a reward, they must ensure that the rewards offered are not excessively disproportionate to the amount of funds raised. Otherwise, investors risk being deemed to have engaged in fundraising activities in contravention of the UAE charity and fundraising regulations.

Robo-advisory Activities

Robo-advisors, also known as automated investment advisors, provide financial advice or portfolio management online. Investors looking to set up investment management platforms need to consider whether or not the SCA Board of Directors' Decision No. 1 of 2014 Concerning the Regulations on Investment Management (the Investment Management Regulations) will apply.

Under the Investment Management Regulations, entities carrying out investment and fund management activities in the UAE must obtain a license from the SCA. The Investment Management Regulations also apply to DIFC incorporated entities that the Dubai Financial Services Authority (DFSA) licenses. However, a DIFC entity applying for an SCA investment management license will need to establish an onshore office in order to operate under that license. In addition, the UAE Insurance Authority may need to regulate online platforms that practice insurance brokerage activities. Given the regulatory uncertainty surrounding robo-advisory activities, investors should seek guidance from the relevant regulatory authorities with respect to the applicable licensing requirements as soon as possible.

Conclusion

Understanding and complying with the relevant onshore financial services regulations is a key challenge for fintech companies as they establish themselves in any jurisdiction, and the UAE is no exception. Navigating such regulations is difficult, but is possible and fintech companies should seek to prioritize discussions with relevant regulators early on to ensure that they can legally launch and conduct business in this region.

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:

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