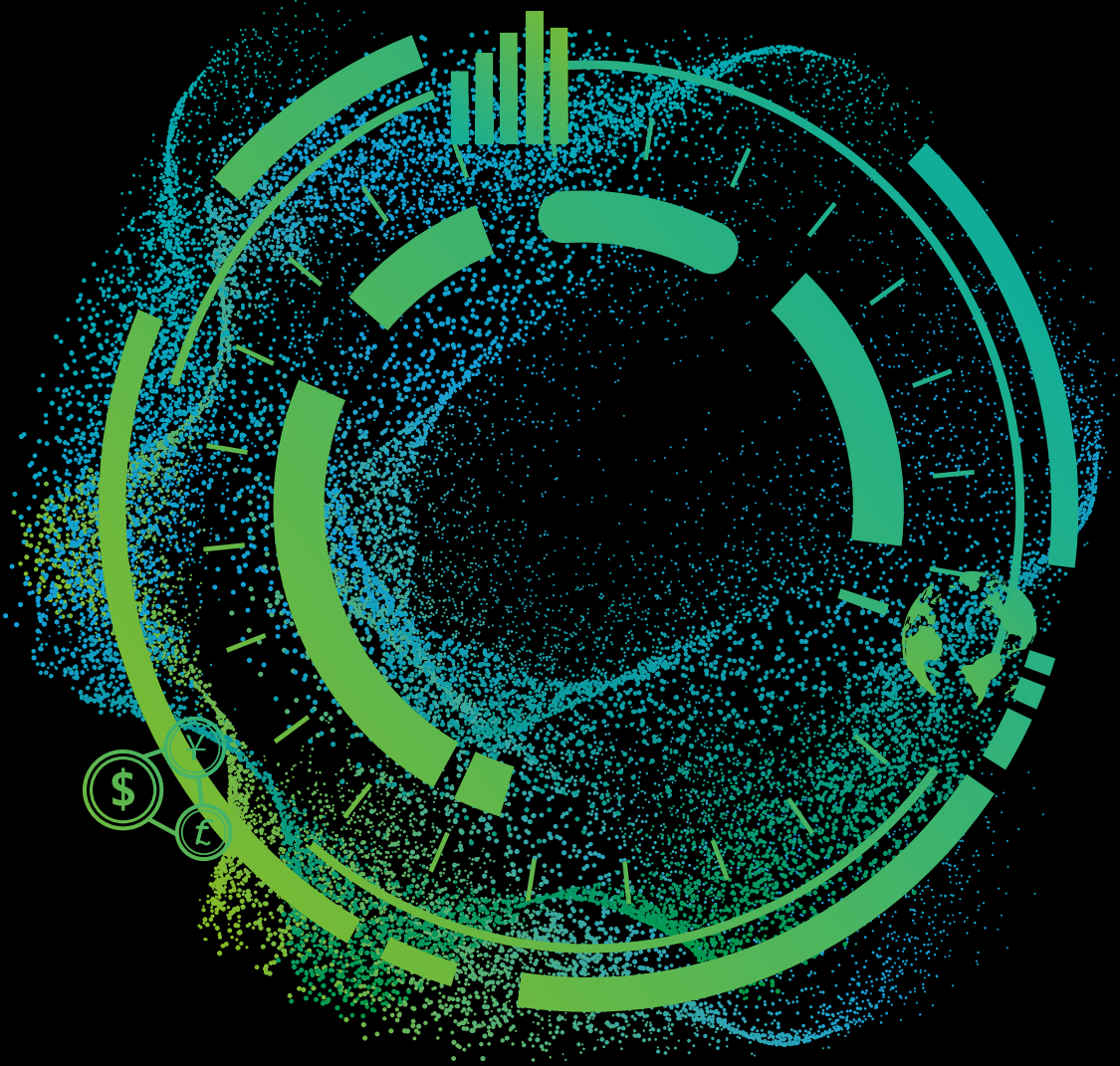


Deloitte.



Virtual Assets and the Existing Regulatory Landscape

February 2024



Introduction

The exponential growth of virtual assets globally necessitates an understanding of the surrounding regulatory landscape

Digital assets have gained immense popularity over the last few years, despite their volatile nature. The number of individuals globally that have invested in crypto-currency surpassed 300 million as of the end of 2022.

As the digital asset ecosystem continues to expand, with thousands of digital assets being offered globally, it has become imperative for governing bodies and regulators to develop the necessary framework and regulations that protect the vast consumer base from market manipulation and fraud, while allowing for reasonable growth of the industry.

Without proper guidelines and oversight mechanisms in place, the future of the digital asset marketplace remains precarious. It is important that regulators strike a balance between allowing innovation to thrive and restricting some of the more dangerous aspects of this new frontier of finance. Several regional regulators and global institutions have taken steps to establish a governing framework or guidance, which are discussed below:



European Union

Adopted the regulations published by the Markets in Crypto-assets (MiCA) in April 2023, to lead and supervise the issuance and provision of crypto-asset services and stable-coin.



Securities and Futures Commission – Hong Kong

Authorized a regime for cryptocurrency, which included licensing conditions and general terms and conditions for cryptocurrency platform operators.



Swiss Financial Market Supervisory Authority

Published guidance for payments on the blockchain, which considers FATF's recommendations and additional Anti-Money Laundering (AML) and Know Your Customer (KYC) considerations.



Monetary Authority of Singapore

Published legislations that establish a framework for payment systems and payment service providers, including digital payment token services.

Global institutions' guidance

Financial Action Task Force

- Published various guidance for regulators of crypto-asset service providers to consider in their development of a regulatory framework
- These include the "Revised FATF Standards on Virtual Assets and Virtual Asset Service Providers" and "Updated Guidance for a Risk-Based Approach to Virtual Assets and Virtual Asset Service Providers"

Financial Stability Board

- Published guidance on the regulation, supervision and oversight of crypto-asset activities and markets

Virtual assets are gaining popularity on a global level. In an increasingly uncertain environment around virtual asset supply, demand and investor sentiments, global players are comprehending the rising need for regulations.

Evolution of digital assets in the Middle East

Middle Eastern countries are acting to account for the growing presence of virtual assets by establishing strategies or frameworks to promote digital assets adoption

United Arab Emirates

The Virtual Assets Regulatory Authority (VARA) was established in March 2022 to develop a regulatory framework for the crypto-asset market across all zones in the Emirate of Dubai, including Special Development Zones and Free Zones (except DIFC). As the world's first independent regulator for virtual assets, VARA has published various regulations and handbooks for virtual asset service providers (indicated in the table to the right), which provide comprehensive coverage to overarching areas in the digital assets space.

Further, the "UAE Digital Economy Strategy" was launched in April 2022, which aims to expand the domestic digital economy by doubling its contribution to the gross domestic product within 10 years.

| | |
|----------------------|---|
| Compulsary rulebooks | <ul style="list-style-type: none"> · Company rulebook · Compliance & risk management · Technology and information rulebook · Market conduct rulebook |
| Activity-specific | <ul style="list-style-type: none"> · Advisory services rulebook · Broker-dealer services rulebook · Custody services rulebook · Exchange services rulebook · Lending and borrowing services rulebook · VA management and investment services rulebook · VA transfer and settlement services rulebook |
| Others | <ul style="list-style-type: none"> · Virtual asset issuance rulebook |

In February 2023, the Central Bank of the United Arab Emirates (CBUAE) also published guidance for licensed financial institutions regarding the risks related to virtual assets and virtual asset service providers (in terms of money laundering and terrorism financing).

Bahrain

The Central Bank of Bahrain (CBB) has issued comprehensive regulations to govern crypto-asset services locally, which arise out of the implementation of a regulatory sandbox in June 2017. Various crypto-currency related entities have entered the sandbox, thereby working closely with the CBB in testing and refining their technology-based innovative products, services and platforms, in a controlled virtual space without being immediately burdened by the usual regulatory and financial requirements.

Saudi Arabia

The Saudi Central Bank (SAMA) held a meeting with the Hong Kong Monetary Authority (HKMA) to strengthen the integration of financial services between the two countries, targeting tokenization and payments infrastructure agreements. The discussion included initiatives such as financial infrastructure development, open market operations, market connectivity and sustainable development. The central banks also signed a memorandum of understanding (MoU) to promote joint discussions on financial innovation.

Qatar

Qatar Central Bank (QCB) acknowledged the potential of Distributed Ledger Technology (DLT) through its inclusion in the FinTech strategy launched in 2023, in line with Qatar's National Vision (QNV) 2030. Several national initiatives indicate Qatar's willingness to adopt digital assets, such as the publication of the National Blockchain Blueprint and the development of a regime for digital assets. Local financial regulatory authorities have also published consultation papers for guidance from industry experts to build a "Digital Assets Regulatory Rules Framework".

The need for and adoption of digital currencies is gaining momentum within the region

Various countries within the Middle East are making strides towards Central Bank Digital Currencies (CBDCs) and taking the necessary steps to adhere to market developments with regards to digital currencies. Recent initiatives and developments include:



Project ABER

This project relates to a cross-border CBDC settlement network between the central banks of UAE and KSA, which was launched to explore the feasibility of a dual-issued digital currency for domestic and cross-border settlements.



A blockchain-based cross border payments service

The Central Bank of Bahrain collaborated with JP Morgan and Bank ABC (a local bank) to facilitate settlements with the bank's clients in US dollars between the United States and Bahrain through JP Morgan's Coin (JPM) systems.



Project mBridge

This project relates to a platform that was established to facilitate cross-border payments using a common platform based on Distributed Ledger Technology (DLT), the mBridge Ledger, which was developed by central banks to facilitate themselves in issuing and exchanging their respective central bank digital currencies (multi-CBDCs). UAE is one of the four countries that participated in this pilot program (which also included Hong Kong SAR, Mainland China and Thailand). It acts as an efficient, low cost and scalable platform that allows real-time cross-border arrangements. The pilot was conducted over the course of six weeks, wherein payment and foreign exchange (FX) payment versus payment (PvP) transactions were conducted by the central banks on behalf of their corporate clients using the CBDCs issued on the mBridge platform by their respective central banks.



UAE's digital currency development

The Central Bank of the United Arab Emirates launched its Central Bank Digital Currency Strategy, "The Digital Dirham". The strategy is among one of the nine initiatives under the Financial Infrastructure Transformation (FIT) program, which aims to transform UAE into a financial and digital payment hub. The first phase of the strategy, which is expected to be completed within a timeframe of 12 to 15 months, consists of the following three major pillars:

- The soft launch of mBridge to facilitate real value cross-border CBDC transactions for international trade settlement
- Proof-of-concept work for bilateral CBDC bridges with India (as one of UAE's top trading partners)
- Proof-of-concept work for domestic CBDC issuance covering wholesale and retail usage

The existing regulatory landscape

Prevailing regulatory frameworks encompass six fundamental themes



Client dealings: Close monitoring of AML/CFT activities

- **Account monitoring:** Monitoring transaction and account activity
- **Onboarding and KYC:** Completing account opening, KYC and due diligence requirements for applicants
- **AML validation:** Review of client activity and establishment of controls to combat ML/TF
- **Client rights:** Managing client agreements & communication and complying with client requests
- **Client funds:** Placement, handling and safeguarding of client funds
- **Marketing communications:** Appropriate advertisements or promotion relating to digital assets and activities



Digital asset trading: End-to-end digital asset workflows' framework establishment

- **Digital assets:** Identify the features, rules, restrictions, risks and processes related to crypto-assets (such as the selection and de-listing process)
- **Custodial arrangements:** Uphold the responsibility of client funds in case of custodial arrangements and disclosure of custodial arrangements
- **Complaint handling:** Establish elaborate procedures to cater to client complaints and maintain a record
- **Trading platform requirements:** Fulfills the requirements in terms of operations, trade execution mechanism, controls on trade requests, etc.



Business resilience: Due diligence, future-proofing and personnel guidelines

- **Business continuity, disaster recovery and contingency plans:** Safeguard the business in case of extreme events or disasters
- **Due diligence:** Fulfill requirements, in terms of clients, virtual assets, transactions above a threshold, suspicious transactions, etc.
- **Insurance:** Obtain an insurance policy for protection against unprecedented events
- **Employee dealings:** Appropriate restrictions on employees participating in crypto-trading on their own behalf or for related parties
- **Management requirements:** Ensure that management possesses the required capabilities (such as skill, knowledge, commitment, independence, etc.)



Monitoring and prevention: Establishment of safeguards and vigilance

- **Auditors:** Periodic internal and external audits
- **Data protection:** Protection of confidential data relating to clients, trades, and operational activities
- **Market abuse / market manipulation:** Monitoring, detection, prevention and reporting of any market abuse or manipulation
- **Monitoring and risk prevention:** Management, assessment and prevention of risks (such as operational risk, market risk, etc.)
- **Periodic reviews:** Regular internal reviews of existing policies and procedures and remediation of any deficiencies
- **Reconciliation:** Periodic reconciliation of account balances



Reporting and regulatory compliance

- **Conflicts of interest:** Identification, disclosure and prevention of any conflicts of interest
- **Disclosures:** Public disclosures regarding pricing policy, live prices and volume, fee structure, and any documentation for clients, etc.
- **Financial soundness:** Adherence to minimum capital, liquidity and reserve requirements
- **Insider trading:** Restrictions on trades by personnel in possession of material non-public information
- **Permitted trades:** Classification of the nature of permissible trades
- **Record keeping:** Record maintenance for all activities and client information for the regulator
- **Regulatory reporting and compliance:** Periodic reporting to the regulator, compliance and submission of regulatory reports
- **Reporting requirements:** Share periodic reports with clients



System readiness: Capabilities for business requirements

- **System capacity:** Ability to cater to large and unprecedented trade activity
- **System reliability:** System strength and ability to prevent or manage outages
- **System requirements:** Fulfills general requirements such as efficiency, surveillance, consistency, system testing and technology audits
- **System security and controls:** Maintenance of cybersecurity requirements and controls and monitoring of system-based activities

Regulators of digital asset service providers

Financial Stability Board's (FSB) endeavors to promote regulations in the digital assets space

The FSB has various publications highlighting the potential of digital assets to give rise to financial stability risks. In line with the G20's mandate, the FSB published a consultative paper in July 2023 that acts as a comprehensive and effective framework to guide regulators. The paper outlines its recommendations for regulators in terms of maintaining supervision and oversight of the digital assets market:



Crypto-asset oversight

Authorities require regulatory powers, tools, and adequate resources to oversee crypto-asset activities and markets.



Supervise activities, issuer and service providers

Authorities should regulate and supervise crypto-asset activities, issuers, and service providers in proportion to the financial stability risk they pose.



Domestic and international cooperation

Authorities should cooperate and communicate domestically and internationally to encourage consistency in regulation and supervision.



Comprehensive governance framework

Authorities should require crypto-asset issuers and service providers to establish a comprehensive governance framework that covers clear and direct lines of responsibility and accountability for the functions and activities they are conducting.



Effective risk management

Authorities must require crypto-asset service providers to have an effective risk management framework in place that comprehensively addresses all material risks associated with their activities.



Data collection, record-keeping and reporting

Authorities should require crypto-asset issuers and service providers to have robust frameworks for data collection, recording, and reporting and should be granted access to the data as needed.



Transparent disclosures

Authorities should require crypto-asset issuers and service providers to disclose comprehensive, clear, and transparent information to users and stakeholders regarding their operations, risk profiles, financial conditions, products and activities.



Identification of interconnections and dependencies

Authorities should identify and address financial stability risks arising from interconnections and interdependencies within and between the crypto-asset ecosystem and the wider financial system.



Supervision of multiple functions

Authorities should ensure that crypto-asset service providers with multiple functions are subject to comprehensive regulation, supervision, and oversight that address the risks of individual functions and those arising from the combination of functions.

The G20 took a few integral measures in September 2023:



Officially endorsed the recommendations published by the FSB



Asked that the FSB and other standard setting bodies promote the global implementation of these recommendations to avoid regulatory arbitrage



Commissioned a paper released by the International Monetary Fund (IMF) and FSB, which outlines the policy and regulatory recommendations that are required to address the risks associated with digital assets

"High-level Recommendations for the Regulation, Supervision and Oversight of Crypto-Asset Activities and Markets", July 2023, <https://www.fsb.org/wp-content/uploads/P170723-2.pdf>
 IMF-FSB Synthesis Paper: Policies for Crypto-Assets, September 2023, <https://www.fsb.org/wp-content/uploads/R070923-1.pdf>

Digital asset service providers

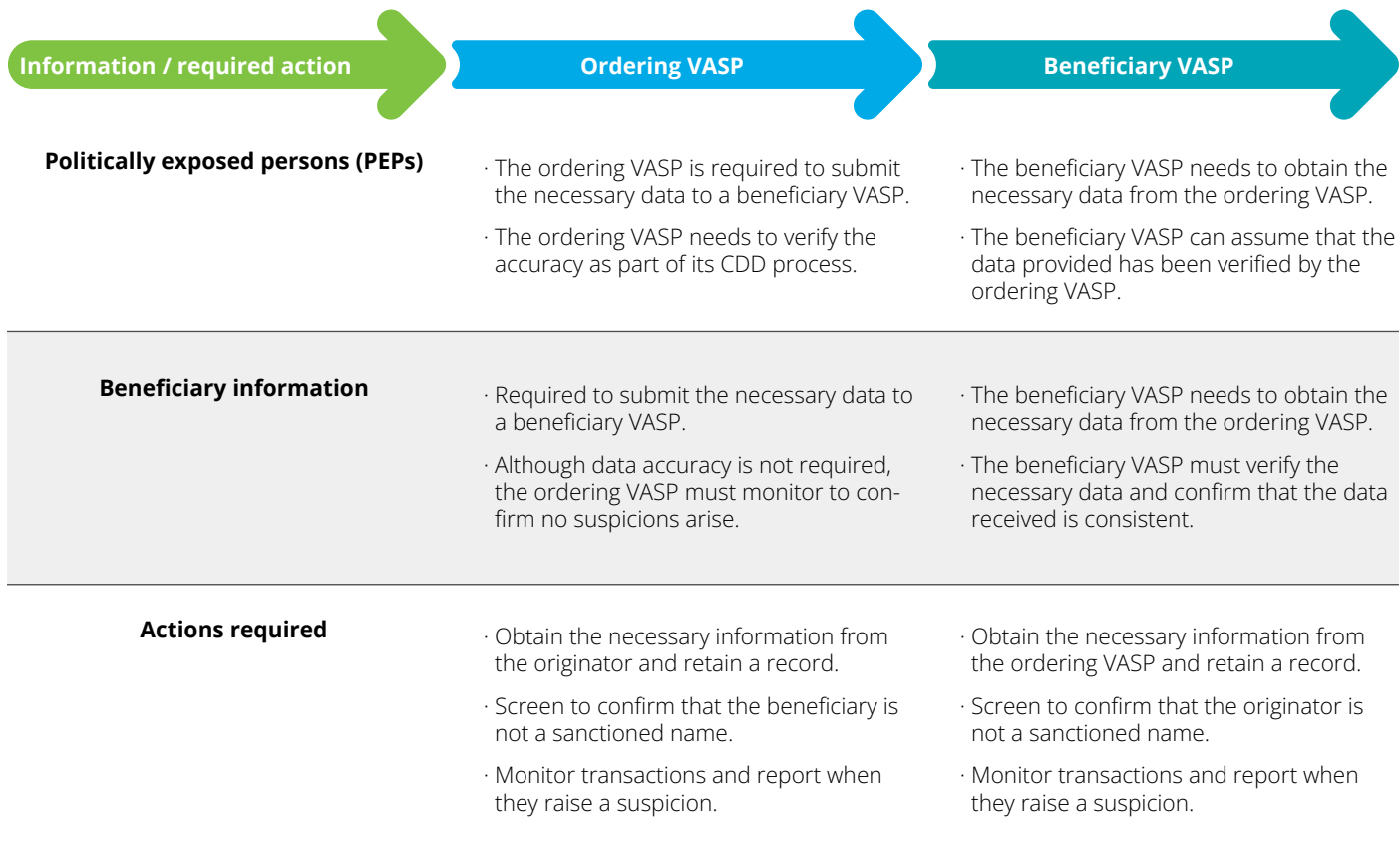
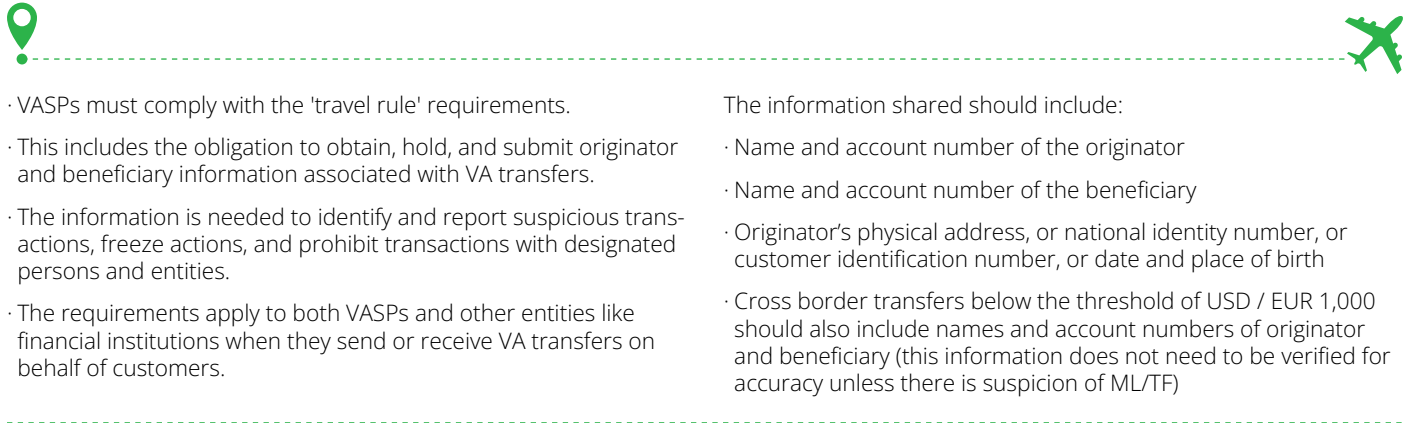
Financial Action Task Force’s (FATF) recommendations

The FATF has conducted a 12-month review (for 2020 and 2021) on the digital asset landscape and has also published guidance for regulators to apply a Risk-Based Approach (RBA) for the supervision of “Virtual Assets (VAs)” and “Virtual Asset Service Providers (VASPs)” (this terminology is in line with the guidance published by FATF). The core aspects of the recommendations made by FATF for application by regulators of VASPs are covered below:

| | |
|---|--|
| <p>Customer due diligence</p> | <ul style="list-style-type: none"> · Identify and verify customer identity using reliable source documents · Identify the beneficial owner · Understand the purpose and nature of the business relationship · Conduct ongoing due diligence and transaction scrutiny · Establish transactional thresholds for due diligence · Collect additional non-core identity information for verification · Mitigate ML/TF risks associated with the customer and their activities · Prepare a risk profile for customers or clusters (based on homogenous characteristics) to determine ongoing monitoring level · Create a list of “blacklisted wallet addresses” (where there are suspicions of ML/TF for addresses) and screen customer and counterparty addresses against them · Ongoing monitoring of transactions and updating risk profiles. |
| <p>Politically exposed persons (PEPs)</p> | <ul style="list-style-type: none"> · Take reasonable measures to identify whether a customer or beneficial owner is a domestic or international organization PEP and assess the risk of the business relationship. · Additional measures, including identifying the source of wealth and funds, must be taken for higher-risk business relationships with PEPs. |
| <p>Correspondent banking and other similar relationships</p> | <ul style="list-style-type: none"> · Correspondent banking involves ongoing, repetitive transactions, and VASPs should establish a control framework to assess the characteristics of their counterparty VASP relationships. · They should consider whether these relationships involve activities similar to correspondent banking and take into account their competent authorities' views on any high-risk counterparty VASP relationships. |
| <p>Internal controls and foreign branches and subsidiaries</p> | <ul style="list-style-type: none"> · Ensure oversight of the development and implementation of the RBA across the VASP sector. · Information sharing within the group, where relevant, regarding unusual transactions or activities. |
| <p>Suspicious transactions reporting (STR) and tipping off</p> | <ul style="list-style-type: none"> · VASPs and other obligated entities must have the ability to identify and flag any suspicious movements of funds or transactions related to virtual assets, regardless of whether the transactions or activities are fiat-to-fiat, virtual-to-virtual, fiat-to-virtual, or virtual-to-fiat. · They should have appropriate systems in place to scrutinize such transactions in a timely manner and determine if they are suspicious, with the goal of preventing involvement in illicit activities. |

“12 Month Review of Revised FATF Standards – Virtual Assets and VASPs”
 2020 (<https://www.fatf-gafi.org/en/publications/Fatfrecommendations/12-month-review-virtual-assets-vasps.html>)
 2021 (<https://www.fatf-gafi.org/en/publications/Fatfrecommendations/Second-12-month-review-virtual-assets-vasps.html>)

To prevent terrorism financing and other illegal activities, the FATF enforces the 'travel rule', which applies to VASPs in terms of VA transfers. The recommendation for wire transfers and the 'travel rule' is detailed in the illustration below, followed by a table which covers the information or required action for transfers:



Your go-to guide to the FATF's crypto Travel Rule, October 2022 (https://ciphertrace.com/wp-content/uploads/2022/10/CipherTrace_Travel-Rule-Guide_FINAL.pdf)

Our portfolio of digital asset services

Deloitte adds its core competencies within the digital assets space



Strategic Decision-Making Assistance

1. Strategic market and feasibility case studies for new geographies or segments
2. Strategic procurement and resource support
3. Digital asset lending and risk limit management
4. Strategic positioning competitive benchmark peer comparison
5. Assistance to launch funds and ETFs based on digital assets
6. Assistance with the set-up of digital assets treasury desks
7. Assisting the launch of stablecoins
8. Wallet management implementation for payment acceptance
9. Gift card reward management based on digital assets



Operational Readiness Journey

1. Digital asset operational readiness
2. Private key protocol design
3. Tokenization operational readiness and implementation
4. Crypto transaction support
5. Blockchain system transformation for settlements in digital assets
6. Digital asset payment solution assessment
7. Order management system (OMS) implementation support
8. Listing and delisting protocols
9. Cold and hot wallet management
10. System enhancement design and implementation
11. Virtual currency framework, design and implementation



Reporting and Validations

1. Enhancement of data quality and information disclosure
2. Index composite calculation validation
3. Trade execution review



Assistance for Regulators

1. Regulatory consultations
2. Regulatory frameworks
3. Central Bank Digital Currency (CBDC)
4. Monitoring framework for market surveillance

Our experts

Our digital asset community has a well-established global footprint



3

Global labs



33

Blockchain & digital assets' hubs



2000+

Professionals



400+

customers in 33 countries



13

industries



100+

developed use cases



40+

use cases in the last 6 months



Ed Moorby
Partner



Zulfiqar Patel
Partner
zupatel@deloitte.com



Mustafa Kanchwala
Director



Syed Sohaib Moid
Director
smoid@deloitte.com



Rajesh Mohan
Senior Manager
ramohan@deloitte.com



Tim Davis
Advisory Principle



Anastasia Traylor
Advisory Partner



Roy Ben Hur
Managing Director



Seth Connors
Advisory Senior Manager



Marta Garcia
Partner



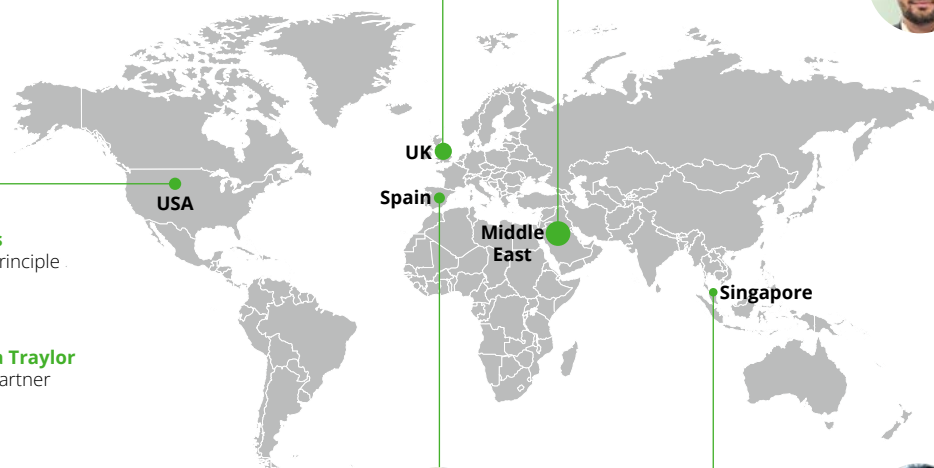
Carlos Navarro
Senior Manager



Chee Siong Chang
Director



Xueni Ng
Director



Deloitte.

This publication has been written in general terms and therefore cannot be relied on to cover specific situations; application of the principles set out will depend upon the particular circumstances involved and we recommend that you obtain professional advice before acting or refraining from acting on any of the contents of this publication.

Deloitte & Touche (M.E.) (DME) is an affiliated sublicensed partnership of Deloitte NSE LLP with no legal ownership to DTTL. Deloitte North South Europe LLP (NSE) is a licensed member firm of Deloitte Touche Tohmatsu Limited.

Deloitte refers to one or more of DTTL, its global network of member firms, and their related entities. DTTL (also referred to as "Deloitte Global") and each of its member firms are legally separate and independent entities. DTTL, NSE and DME do not provide services to clients. Please see www.deloitte.com/about to learn more.

Deloitte is a leading global provider of audit and assurance, consulting, financial advisory, risk advisory, tax and related services. Our network of member firms in more than 150 countries and territories, serves four out of five Fortune Global 500® companies. Learn how Deloitte's approximately 457,000 people make an impact that matters at www.deloitte.com.

DME would be pleased to advise readers on how to apply the principles set out in this publication to their specific circumstances. DME accepts no duty of care or liability for any loss occasioned to any person acting or refraining from action as a result of any material in this publication.

DME is a leading professional services organization established in the Middle East region with uninterrupted presence since 1926. DME's presence in the Middle East region is established through its affiliated independent legal entities, which are licensed to operate and to provide services under the applicable laws and regulations of the relevant country. DME's affiliates and related entities cannot obligate each other and/or DME, and when providing services, each affiliate and related entity engages directly and independently with its own clients and shall only be liable for its own acts or omissions and not those of any other affiliate.

DME provides services through 23 offices across 15 countries with more than 7,000 partners, directors and staff. It has also received numerous awards in the last few years such as the 2023 & 2022 Great Place to Work® in the UAE, the 2023 Great Place to Work® in the KSA, and the Middle East Tax Firm of the year.