Forbes Middle East

The Crypto Grey Zone

While innovations involving blockchain are hurtling forward, when it comes to cryptocurrencies such as Bitcoin, regulators in the region—and globally—are still playing catch up.

Though most people associate cryptocurrencies with Bitcoin, hundreds of new coins were launched in 2017, meaning that the universe of cryptocurrencies is quickly expanding. Meanwhile, blockchains—tamper-proof digital ledgers—are being heralded for their transformational potential, both by governments and by the private sector, in verticals including banking, healthcare and real estate.

Governments in the GCC have been quick to see the potential of blockchains—most notably Dubai, which is aiming to have 50% of government transactions take place on a blockchain platform by 2021. But while embracing blockchains, governments have been warier of cryptocurrencies such as Bitcoin, LiteCoin, or Ether. Saudi Arabia's central bank recently warned that virtual currencies are not legal in the kingdom, and Kuwait has a similar view; in the U.A.E. a lack of clarity means that some companies may be operating in what Adil Shafi, a partner at AC&H, a law firm, terms a "grey area".

Currently it is not illegal to own cryptocurrencies in the U.A.E., although they can't be used as legal tender says Tobias Young, head of product development and strategy at the Dubai Gold & Commodities Exchange (DGCX). "You can buy it, sell it, hold it, trade it, store it, but you can't go into your local shop and buy a loaf of bread and pay with a cryptocurrency."

Yet the situation may be murkier for commercial entities, such as banks operating in highly regulated environments. In the U.A.E. the central bank has given seemingly differing statements on the legality or definition of cryptocurrencies; some banks have decided unilaterally to block payments from customer accounts to cryptocurrency trading platforms.

Indeed, authorities around the world, including the U.S., are grappling with the question of how to respond to cryptocurrencies. The breadth and complexity of cryptocurrencies—new coins are launched every week—also makes the job more difficult for regulators says Young. A single cryptocurrency can have a number of features synonymous with traditionally distinct asset classes, including physical cash, commodities, equities and bonds.

Some want new rules for cryptos, while others believe that cryptos can be approached through existing regulations. Ola Doudin, founder of BitOasis, says that "the uniqueness of the technology requires new regulations to be tailored for the industry and the potential disruption it may lead across multiple verticals, rather than simply adapting existing financial services regulations to the digital assets and blockchain space."

Jan Grabski, director of enterprise scaling at ConsenSys, a blockchain company that is advising the Dubai Government on its blockchain strategy, believes that the safest way forward is to start by clarifying existing regulation, noting that even newly-written legislation runs “a very high risk of being outdated once it comes into effect”. Internationally, Switzerland and Malta have taken an approach of working to clarify existing rules, he says. “It is not necessarily the lack of regulations that can hinder progress, it is the lack of an official interpretation of existing regulations, that makes it difficult to know which way to move when a company is trying to innovate,” says Grabski.

The U.A.E. may be in a position to take the lead globally, with new regulations on the horizon: in September, the U.A.E.’s Securities and Commodities Authority (SCA) said that it has approved a plan to recognize digital tokens as securities, which will eventually be published in the official Gazette.

Facing Uncertainty

In the meantime, uncertainty is causing some entrepreneurs and corporations to pause. A recent global survey on blockchain by PwC found that regulatory uncertainty was the second biggest barrier for U.A.E. companies considering blockchain initiatives, and the number one concern globally (the biggest issue for U.A.E. companies was trust).

The issue is more acute for entrepreneurs wanting to provide cryptocurrency services across the GCC. Omar Kassim, founder of e-commerce platform JadoPado, which was sold to Noon.com in 2017, announced in September in a blog post that he was “parking” plans to open a crypto exchange and over-the-counter play, blaming “a myriad of regulatory and banking challenges in a number of the markets that we were looking to target.”

Within the Middle East, it’s the financial services sector—including cryptocurrency-related businesses such as exchanges and funds—that has the most concern about regulatory uncertainty, says Matthew White, head of digital trust at PwC Middle East. Meanwhile, the uncertainty for banks can affect corporations in other business sectors that might be considering activity in the crypto space, since they have to weigh up whether such activity could impact their existing banking relationships, says White.

And while banks themselves are expected to be some of the key innovators in adopting blockchain solutions, regulatory uncertainty may be discouraging experiments and development. Some blockchains, such as Ethereum, require users to pay with utility tokens to host their applications on it. In practice, that means a bank will have to own crypto commodities, something that they are wary about, even if the actual value of these tokens is “probably closer to pocket change than to any significant value,” says Grabski.

Finally, with Initial Coin Offerings (ICOs) having become the go-to method for startups to raise funds in the blockchain space, a lack of regulations may also discourage innovative companies from setting up shop in the U.A.E., believes Grabski. “Companies that are looking to innovate heavily and raise millions or tens of millions and sometimes hundreds of millions of dollars in capital, because some of these projects are extremely ambitious, need to operate in a place that gives them access to that capital.”

Not Fazed

Last year OneGram garnered global headlines for its cryptocurrency, with each coin backed by one gram of gold. The company has managed to sell close to five million of its OneGramCoins (OGC), an amount worth well in excess of $100 million, says OneGram’s founder, Ibrahim Mohammed. Though the initial sale price was $45—equivalent to the price of a gram of gold plus 10%—that price has since skyrocketed to nearly $150. “Early ICO participants had an absolute steal on the coin,” says Mohammed.

Despite local and international media reports at the time of their ICO describing OneGram as “Dubai-based”, in reality the company has a presence in 12 countries around the world, and any payments that U.A.E.-based individuals made for OGC were sent to off-shore accounts rather than received by local banks, says Mohammed. One other company spoken to, Relam Investments, which is conducting an ICO, described a similar model of off-shore licensing and bank accounts. “It’s always off-shore,” says Mohammed. “Funds in these kinds of things are always received in what you would call ‘cooperative jurisdictions’.”

It will come as no surprise that ICOs have their critics. DGCX’s Young describes ICOs as unregulated Initial Public Offerings (IPOs). “You may hold a token but it’s not necessarily backed by anything.” Unlike with an IPO, most coin holders do not receive a dividend, he says. In February, the SCA in a public statement, warned that some ICOs may be subject to risk of fraud, and, given that companies may be operating off-shore, “following the money in the event of a collapse of the ICO as well as recovering invested funds may prove extremely difficult in practice.”

Mohammed of OneGram says he’s welcoming of new regulations, noting that the company already has anti-money laundering protections and know-your-customer protocols in place, while it plans to release an external audit report on its gold by March next year. “A lot of the industry doesn’t want regulations, [but] we are one of the supporters of regulation. We would like to see it, but I think that regulators need to figure out how they are going to do it.”

Regulations Arrive—Off-shore

So far it is freezones in the U.A.E. that have been the first movers. The Dubai Multi Commodities Centre (DMCC) offers licenses for various activities, including the buying and selling of crypto-commodities. In February, Regal Assets, a vaulting company with extensive experience in North America became the first company to be issued a crypto trading license in the Middle East.

That meant Regal could begin offering cold storage of Bitcoins and other cryptocurrencies in the highly secure DMCC vault in the base of the Almas Tower—something which it can’t yet offer in the U.S. or Canada because of regulations there, says Amine Rahal, the company’s marketing manager. Given that nearly $2 billion worth of cryptocurrency was lost through either hacking or theft in 2018 alone, the service has proven popular, says Rahal, with customers from the U.A.E., wider Middle East, and even Singapore and South Korea travelling to Dubai to set up their storage accounts. “People are interested in dealing with the company that actually has a license as opposed to many companies in this business [globally] that are just operating in a grey zone,” says Rahal.

In June, the Abu Dhabi Global Market (ADGM) launched a crypto asset regulatory framework. Richard Teng, CEO, of the ADGM Financial Services Regulatory Authority, said that they were positioning ADGM “as a destination of choice for crypto asset players.” The move seems to have sparked interest: PwC has been approached for advice by a number of interested companies, says White, including existing financial service companies interested in offering a crypto fund as well as established international crypto exchanges. At the same time, the hefty fees at the ADGM mean that it’s unlikely to be viable for many startups, while at the same time it’s uncertain what stance local banks will take to companies even if they do have a freezone license, says Shafi.

Many in the industry are hoping that comprehensive on-shore regulations from the SCA will have a broader impact. Doudin believes the announcement is great news for the FinTech industry locally and regionally, saying that the industry needs sound and business-friendly regulations to grow. “Regulators have to be aware and careful as they issue new laws; they need to make sure they understand the technology and its potential to avoid stifling innovation in an industry that is still young and fast developing.”

Investors are also in need of the protection. Though Bitcoin is currently tracking at around $6,450, down from its high of $20,000 at the start of the year, White says his personal view is that the global coin market is headed for a big wipeout, predicting that “the crypto bubble will burst quite spectacularly”. Major losses could see many investors turn away from the sector, he suggests. “I think then you would actually need regulations to rebuild investor confidence,” he says.

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