



ABU DHABI GLOBAL MARKET  
سوق أبوظبي العالمي

# CONSULTATION PAPER NO. 2 OF 2016

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10 MAY 2016

**POLICY CONSULTATION ON A  
REGULATORY FRAMEWORK TO  
SUPPORT PARTICIPANTS DEPLOYING  
INNOVATIVE TECHNOLOGY WITHIN  
THE FINANCIAL SERVICES SECTOR**

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## INTRODUCTION

### WHY ARE WE ISSUING THIS PAPER?

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1. The Financial Services Regulatory Authority ("**FSRA**") of the Abu Dhabi Global Market ("**ADGM**") has issued this Consultation Paper to invite public feedback and comments on the proposal to establish a regulatory framework to support participants deploying innovative technology within the financial services sector.
2. Innovation in financial technology ("**FinTech**") allows the use of new technologies in the financial services industry to improve operational and customer engagement capabilities by leveraging analytics, data management and digital functions. Recognizing FinTech's potential to improve efficiency within financial markets and systems, international leading financial centres have made FinTech a priority in developing and positioning their financial sectors for the future.
3. To build a conducive FinTech environment in Abu Dhabi and the ADGM, and position the ADGM as the FinTech innovation hub in the GCC region, FSRA has worked closely with local and international stakeholders, with the following key objectives:
  - a. Develop innovative products, services and solutions to enhance the efficiency of our financial markets and systems, thereby improving consumer choice and experience;
  - b. Promote growth opportunities in Abu Dhabi's and ADGM's financial ecosystem<sup>1</sup>; and
  - c. Anchor FinTech knowledge and expertise in local banks and financial institutions to capitalize on emerging trends and manage risks.
4. As provision of financial services in ADGM is regulated under the Financial Services and Markets Regulations 2015 ("**FSMR**"), deployment of

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<sup>1</sup> Such as data analytics, payments, automated advice, funding platforms, mobile banking, cyber-security, risk management systems, etc.

innovative technology by participants within the financial services sector will therefore be subject to regulation. To address perceived high authorization entry barriers and provide assistance to start-up FinTech firms in navigating our regulatory requirements, FSRA will create a dedicated regulatory environment that caters to new business models in a fast-evolving landscape.

5. To achieve the objectives as stated in paragraph 3, FSRA is proposing to create a “Regulatory Laboratory” (“**RegLab**”), a tailored framework that provides a safe environment, within controlled boundaries, for businesses to test, develop and provide innovative FinTech products and services without immediately being subject to all the normal regulatory requirements. The RegLab will continue to promote systemic safety and safeguard consumers while fostering innovation and growth within the financial services sector.
6. FSRA would like to invite comments on the proposed RegLab. Our proposal will subsequently be effected through new regulations and rules, which FSRA will consult on after considering feedback from this consultation.

## **WHO SHOULD READ THIS PAPER?**

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7. The proposal in this Consultation Paper would be of interest to individuals, organisations and investors looking at developing innovative ways to provide financial services in ADGM / Abu Dhabi or otherwise doing business or activities in ADGM / Abu Dhabi and their professional advisors.

## **HOW TO PROVIDE COMMENTS**

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8. All comments should be in writing and sent to the address or email specified below. If sending your comments by email, please use the Consultation Paper number in the subject line. You may, if relevant, identify the organisation you represent in providing your comments. FSRA reserves the right to publish, including on its website, any comments you provide, unless you expressly request otherwise at the time of making

comments. Comments supported by reasoning and evidence will be given more weight by FSRA.

## **WHAT HAPPENS NEXT?**

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9. The deadline for providing comments on this proposal is **13 June 2016**. Once we receive your comments, we will consider whether any modifications are required to this proposal. FSRA will then proceed to draft the relevant regulations, rules and guidelines for public consultation. You should not act on this proposal until the relevant regulations and rules are issued. We will issue a notice on our website when the regulations and rules are issued.

## **COMMENTS TO BE ADDRESSED TO:**

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## REGULATORY FRAMEWORK TO SUPPORT FINTECH

### CRITICAL ELEMENTS OF A REGULATORY FRAMEWORK TO PROMOTE FINTECH INNOVATION AND DEVELOPMENT

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1. FSRA embarked on an extensive stakeholder engagement programme, both locally and internationally, in developing a tailored regulatory framework that addresses specific requirements and unique risks associated with FinTech innovation and development. Drawing on feedback from this engagement with stakeholders, we identified a number of critical elements that underpin a successful regulatory framework for a Fintech ecosystem:
  - a. Ease of regulatory compliance to test or deploy the new technologies within the financial services sector;
  - b. Certainty and speed in obtaining the relevant regulatory approvals to commence business; and
  - c. Operational cost efficiencies, including start-up costs and fixed overheads.
2. From FSRA's perspective, we seek to establish sound regulation of a high standard that promotes stable and sustainable development of the financial services sector while accommodating well-managed risk taking and innovation. New entrants with untested business models pose a threat to the safety and soundness of the financial system due to new risk exposures. Our challenge, therefore, is to address the risks of testing novel solutions on consumers in a manner that does not undermine the stability of our financial system. For any particular technology used, we recognize that the nature, benefits and risks can be very different. As such, there cannot be a "one-size-fits-all" approach.

### POLICY CONSIDERATIONS OF THE REGULATORY FRAMEWORK

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3. To provide confidence and certainty to FinTech participants to test and launch their solutions within controlled boundaries in a cost-effective

environment, the proposed regulatory framework is designed based on the following policy considerations:

- a. *The framework should not front-run innovation.* Introducing regulation prematurely risks stifling innovation and/or derailing the adoption of useful technology;
  - b. *The framework should be proportionate to the materiality of the risk posed.* Risk-based regulation that is proportionate to the materiality of the risk will be applied to FinTech participants. As failure is an inherent part of an innovation cycle, our objective is to create an environment to contain the risks to consumers and limit the impact of a failed experiment or solution ; and
  - c. *The framework should be nimble and flexible to cater to new business models.* The framework should facilitate time-to-market of new business models in a cost-efficient environment.
4. In light of the considerations, FSRA proposes to create a special-purpose **RegLab** tailored framework that caters to regulated activities carried out by FinTech participants, as detailed in the following paragraphs.

## KEY FEATURES OF THE REGULATORY LABORATORY

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### “Blank-Sheet” Approach

5. Under the RegLab, FSRA proposes to adopt a regulatory “blank-sheet” approach.
6. To ease the burden of regulatory compliance, we propose the approach of tailoring regulations to mitigate the specific risks associated with the FinTech application. FinTech participants authorised by the FSRA to carry on a regulated activity within the RegLab will **not** be subject to the standard regulations and rules that are applicable to those regulated activities under the FSMR. Instead, a customised set of rules may be selectively applied based on the risks identified for the FinTech business model. These rules may be adapted from existing regulations and rules under the FSMR, or newly drawn up depending on the specific business model and technology. To illustrate how the RegLab may operate, some examples are set out in the Box Section 1 overleaf.

**Box Section 1:**

Under the RegLab, FSRA will selectively apply rules based on the risks identified for FinTech application. Examples of the type and nature of rules or conditions that may be imposed under the RegLab to allow FinTech participants to test new products and services may include:

- Requiring appropriate disclosures to, and consent of clients willing to participate. In order for clients to make an informed decision, clear disclosures on the risks involved, regulatory safeguards they are foregoing under the targeted scope of the RegLab, and the possible outcomes at the end of the test is important. This approach is generally appropriate if the FinTech participant is testing with a group of professional clients;
- Limiting the impact or reach to consumers, e.g. prohibiting the handling of clients' money, restricting the clientele base, capping the size of investments, restricting the marketing channels, etc. This approach, in combination with appropriate disclosure requirements, could be considered if the FinTech firm is testing with a certain segment of retail clients with prior investment experience; and/or
- Appointing established financial institutions as sponsors to undertake responsibility for compliance assurance or resolution of any client issue if a test does not perform as expected. For example, the trial deployment of a robo-advisor may be excluded from Anti Money Laundering/Know Your Client due diligence if the consumer opens an investment account with a sponsor bank, which takes on the corresponding regulatory obligations.

### **Two-year validity period**

7. To mitigate the regulatory and reputational risks of admitting FinTech start-ups where the likelihood of failure is higher, the authorisation granted under the RegLab will have a validity period of two years.
8. During the two-year validity period, FSRA will actively engage the FinTech participant so as to stay abreast of, and support, the FinTech innovation and ensure the FinTech participant operates within the parameters and outcomes as set and agreed prior to the grant of authorisation under the RegLab.
9. At the end of two year validity period, or earlier if the size, scale or progress of the business warrants (e.g. the firm wants to launch its FinTech solution on the wider market), the FinTech participant will have to migrate to the full authorisation and supervisory regime under the FSMR. To this end, the FinTech participant will have to demonstrate to the FSRA that it has a sustainable business model to support the deployment of the FinTech solution, and that it continues to be fit and proper to operate as an authorised firm in the ADGM. Otherwise, it shall cease its activities. The two-year validity period of the authorisation granted under the Regulatory Lab may be extended by the FSRA in exceptional circumstances on a case-by-case basis.

### **Operational cost efficiency**

10. To achieve operational cost efficiency and reduce fixed overhead expenditure, such as office leases and working space, the FinTech participants registered in the ADGM may have the option to develop their FinTech solutions from office premises outside ADGM.
11. In this regard, FSRA will explore options to provide co-working space within ADGM and/or other innovation clusters where the concentration of interconnected businesses, suppliers, and associated institutions will help lower operating costs. In so far as the test activity is deemed a regulated activity under the FSMR, the FinTech participant shall conduct the live tests within ADGM.

### Dedicated online FinTech portal

12. FSRA will establish a FinTech online portal to provide dedicated support to FinTech participants in understanding FSRA’s regulatory framework and direct access to our expertise when seeking authorisation under the RegLab. Through the FinTech portal:
  - a. FinTech participants will have direct engagement with FSRA to help shape its regulatory business plan and testing scope that is risk-appropriate, with a view to preparing for authorisation under the RegLab; and
  - b. Emerging trends, opportunities and risks are identified, which will help FSRA in our policy review to enhance the RegLab, and promote development of the wider FinTech ecosystem in the ADGM and Abu Dhabi.

#### ISSUES FOR CONSIDERATION

##### QUESTION 1:

FSRA SEEKS COMMENTS ON THE PROPOSED REGULATORY LABORATORY, AND WHETHER THERE ARE OTHER ASPECTS THAT SHOULD BE INCLUDED IN THE FRAMEWORK TO SUPPORT THE FINTECH PARTICIPANT?

13. A possible scenario of how a FinTech participant may operate under the RegLab as highlighted in paragraphs 5 to 12 is set out in Box Section 2 overleaf.

**Box Section 2:**

From conception to testing of a FinTech deployment, a FinTech participant may go through the following steps / phases:

- The FinTech participant with a preliminary FinTech idea may initiate contact with the FSRA via the online portal to make general enquiries about the regulatory requirements and how they would apply to its business idea. FSRA will help the FinTech participant understand the regulatory framework, the FinTech ecosystem in which it operates, and the preparations needed as the FinTech participant develops its product / solution.
- Depending on the needs of the FinTech participant, FSRA may also refer the FinTech participant to initiate dialogue with relevant FinTech stakeholders in the ADGM / Abu Dhabi ecosystem. These stakeholders may be expert partners with which FSRA has entered into Memoranda of Understanding to collaborate on developing the FinTech ecosystem in ADGM / Abu Dhabi. These FinTech stakeholders may provide guidance on schemes that the FinTech participant may make use of to further develop its product, including appropriate accelerator / incubation programmes and co-working space.
- While developing its product/solution, the FinTech participant will consult and update FSRA on its progress regularly to ensure that its preparations in relation to testing the product on the RegLab are on track.
- When the FinTech project is in a sufficiently advanced stage of development to mount a live test, the FinTech participant may then apply for authorisation under the RegLab.
- On satisfying the authorisation criteria (see overleaf), the FinTech participant will have to register a commercial entity in ADGM. This may be in the form of an ADGM company, or a branch of a non-ADGM company. Any dealings and trials with clients in relation to the FinTech product are to be carried out by the authorised entity. The FinTech participant may, however, continue to develop and fine-tune its product (as part of the trial implementation) in a non-live environment from its existing work space, either within or outside the ADGM.
- By the end of the two years (or such other time-frame as may be agreed to by the FSRA), the authorised FinTech participant will have to migrate to the full authorisation regime under the FSMR, failing which it will have to cease all regulated activities. Depending on the commercial assessment of the FinTech participant, its exit strategies may vary. For example, the FinTech participant may just cease business at the end of the test, or it may transfer clients to other authorised financial institutions, which will take over the FinTech product.

## AUTHORISATION CRITERIA FOR FINTECH PARTICIPANTS UNDER THE REGULATORY LABORATORY

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14. It is envisaged that the RegLab would be applicable to FinTech start-ups or existing financial institutions which have a FinTech product or service that is untested, but would like to live-test it in a clearly demarcated environment with controlled scope and scale.
15. The RegLab is not intended to be a platform for financial institutions authorised under the FSMR to pilot or launch a FinTech solution to a wider market. For such financial institutions, FSRA may consider waiving certain regulatory requirements that may be inapplicable for a particular FinTech model, determined on a case-by-case basis.
16. To be authorised under the RegLab, FSRA proposes the following authorisation criteria:
  - a. The FinTech project should promote novel innovation<sup>2</sup>, in terms of the business application and deployment model of the technology;
  - b. The FinTech project has the potential to:
    - (i) promote significant growth, efficiency<sup>3</sup>, or competition<sup>4</sup> in the financial sector;
    - (ii) promote better risk management solutions and regulatory outcomes for the financial industry<sup>5</sup>; or

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<sup>2</sup> This criteria distinguishes Fintech that is novel, from Fintech that is relatively developed in the market for some time

<sup>3</sup> For example, the advent of robo-advisers that offer lower costs, simplicity and real-time portfolio analytics and monitoring; or leveraging on the application of blockchain technology and distributed databases to facilitate price discovery, smart contracts, settlement of financial transactions, etc. that may lead to safer/better products, and higher productivity and growth.

<sup>4</sup> For example, adopting an open banking platform via application programming interfaces (APIs) to unlock faster innovation in financial services; or setting up an information aggregator and distribution platform for insurance products.

<sup>5</sup> For example, a shared infrastructure for a Know-Your-Client database utility (industry-wide infrastructure to promote AML risk management); or a technological platform that allows more timely and proactive sharing of cyber intelligence among FIs to strengthen situational awareness and build cyber resilience.

- (iii) improve the choices and welfare of consumers<sup>6</sup>; and
- c. The FinTech project is in a sufficiently advanced stage of development to mount a live test. If the FinTech participant is at an early stage of product development, it will not be conducting regulated activities and hence will not need to be authorised under the FSMR.
17. In its application for authorisation under the RegLab, the FinTech participant will be required to:-
- a. Explain and demonstrate how it satisfies the authorisation criteria;
  - b. Set upfront the test parameters, milestones and outcomes;
  - c. Detail the safeguards that have been put in place, and demonstrate how they are appropriate to the FinTech proposition being tested, the risks that are posed and the type of consumers involved; and
  - d. Set out clearly a fair and proper exit strategy for consumers.

## ISSUES FOR CONSIDERATION

### QUESTION 2:

FSRA SEEKS COMMENTS ON THE PROPOSED AUTHORISATION CRITERIA FOR THE FINTECH PARTICIPANT TO BE AUTHORISED UNDER THE REGULATORY LABORATORY, AND WHETHER THERE ARE ALTERNATIVE OR ADDITIONAL CRITERIA TO BETTER ACHIEVE THE APPROPRIATE BALANCE BETWEEN FOSTERING INNOVATION AND MANAGING RISK?

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<sup>6</sup> For example, recent innovation in banking and payment applications have greatly enhanced the experience and convenience of the consumer by providing faster, cheaper and more reliable financial services on the move.