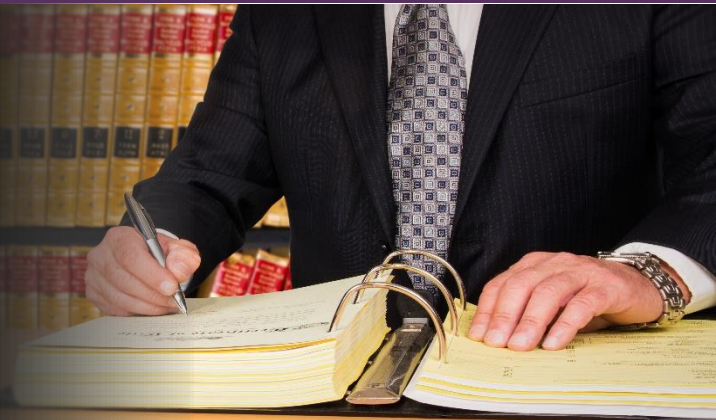


The DFSA's Crowdfunding Regulations

Corporate Finance



Introduction

The Dubai Financial Services Authority (the “DFSA”) recently introduced a new legal framework regarding crowdfunding (the “Regulations”): the aim of the Regulations is to drive growth in the financial technology (the “FinTech”) industry by ensuring clear governance and requisite protection for the parties involved. The development recognises the increasing significance of crowdfunding as a finance mechanism for small and medium sized enterprises, which are key contributors to the United Arab Emirates’ (the “UAE”) economy. Through the Regulations, the UAE is the first GCC country to undertake the initiative of regulating crowdfunding arrangements.

The Regulations are part of the DFSA Conduct of Business (COB) Module under section 11, and govern both a loan crowdfunding platform, where the person providing the funds enters into a loan agreement with the person to whom the funding is provided, and an investment crowdfunding platform, where the person providing the funding purchases an investment (share, debenture or sukuk) from the person to whom the funding is provided. Although, the Regulations mainly apply to both types of crowdfunding platforms, there are certain specific provisions, which apply to only one type of crowdfunding platform.

Risk Disclosure

One of the first general regulations set out by the DFSA is the obligation of the operator of a crowdfunding platform to disclose the risks that a lender or investor may be exposed to when engaged in funding. The DFSA sets out four express statements that need to be included on the operator’s website, these include:

- 1) The lender or investor may lose all or part of their money or may experience delays in being paid;
- 2) Borrowers or issuers on the platform may include new businesses and, as many new businesses fail, a loan to such a borrower or an investment with such an issuer may involve high risks;
- 3) The lender may not be able to transfer their loan, or the investor may not be able to sell their Investment, when they wish to, or at all; and
- 4) If for any reason the operator ceases to carry on its business, the lender or investor may lose their money, incur costs or experience delays in being paid.

Moreover, in order to allow potential lenders and investors to assess the risk with lending and investing using the platform, the DFSA requires operators to disclose default rates of loans entered into on the platform and failure rates in relation to issuers where they default on payments, become insolvent, are wound up or cease to carry on business.

Service Disclosure

The operator is also under an obligation to disclose information about its operating model. This provides both lender/investors and borrowers/issuers with an understanding of the crowdfunding platform in terms of how the platform functions, how and by whom the operator is remunerated for the service, the eligibility criteria for both borrowers/issuers and lenders/investors that use the service, and any limits on the amounts of loans or investments that may be sought by a borrower/issuer or limits on the funds provided by a lender/investor.

The extensive list of specific information that needs to be disclosed by the operator also includes the steps to be taken by the operator in the event that there is a material

change in a borrower's/issuer's circumstances and the rights of each party in that situation; information on any arrangements for facilitating the transfer of loans or the sale of investments, the conditions for using them and any risks involved; and details on the measures implemented to ensure that the platform is not used for money-laundering.

Due Diligence

The Regulations require a certain amount of due diligence to be carried out on the borrowers and issuers; the purpose of these checks is to ensure that the business carried out by the borrower or issuer is lawful in the place where it is carried out.

The Regulations stipulate that an operator is not permitted to allow a borrower or issuer to use its service unless it is a body corporate. In addition, the Regulations stipulate the minimum steps to be undertaken by the operator when conducting due diligence on the borrower/issuer. These due diligence steps include verifying the borrower's/issuer's identity, which include the details of its incorporation and registration, as well as the identity of its directors, the borrower's/issuer's financial strength, credit history, and the valuation of the business amongst other considerations.

In addition to the due diligence, the operator is also obliged to disclose information about each borrower/issuer on its website. Once again the DFSA provides the minimum information which needs to be provided; this includes the full name of the borrower/issuers, its directors and officers, a description about the business of the borrower or issuer, the most recent financial statements of the borrower, the results of the due diligence carried out by the operator, and a detailed description of the proposal for which it is seeking funding. The proposal should include the details about the total amount of funding sought, how the funds will be used and what will happen if the target level of funding has either not been met or has been exceeded. Also, in relation to a loan or debenture, the duration of the loan or debenture, details of interest payable and any other rights attaching to the loan or debenture need to be included, and in respect of a share issue, any rights attaching to the share, such as dividend, voting or pre-emption rights must be set out.

Additional Obligations

The Regulations prohibit operators, borrowers and issuers from advertising specific lending or investment proposals to those who are not existing clients of the operator. In such an event, it is possible that advertising an investment proposal to non-clients may constitute "an offer of securities to the public" under the DFSA laws, which may result in the onerous requirement of a prospectus. Nevertheless, the Regulations do not prevent an operator from generally advertising its crowdfunding services to potential clients.

In addition, there is an express set of requirements which the operator must comply with if there is a material

change affecting a borrower/issuer, either during the commitment period or later. In such a case, a material change might include a change in the management, control or structure of the business, any changes in relation to its assets, or a default in respect of any other obligation. The main steps include notifying the lender/investors and requiring the lenders/investors to reconfirm their commitment or informing them whether their rights have been affected.

It is important to note that the DFSA considers a material change to occur in a very limited number of cases. This is because all relevant information about the borrower or issuer would have been reviewed by the operator as part of the due diligence.

Some of the other obligations on the operator include: taking reasonable steps to restrict borrowers and issuers from seeking funding from other crowdfunding platforms during the commitment period; ensuring that all lenders and investors who use its service are treated equally; and taking reasonable steps to ensure that the operator's own staff members do not use the platform as neither the lenders/investors nor as the borrowers/issuers.

Conclusion

As a result of the DFSA Regulations, crowdfunding activities which were previously carried out through interim arrangements, are now formally regulated. The DFSA's efforts to implement such regulations is a reflection of the UAE Government's National Innovation Strategy which seeks to create an innovation-friendly ecosystem for FinTech businesses, and small and medium sized enterprises generally.

The information mentioned in this article is current at the date of publication of this article and available from public sources. Nothing in this article constitutes legal advice and should not be construed as any form of advice.

For further information and assistance with any aspect of the DIFC and DFSA regulatory framework and licensing process, please do not hesitate to contact us.

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