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## Lending to SMEs Through the ADGM Made Easy

Recently, Abu Dhabi Global Market (**ADGM**), an international financial centre in Abu Dhabi, announced the launch of a new regulatory framework (the **Framework**) for operators of Private Financing Platforms (**PFPs**). PFPs will connect entities who are able to provide finance to start-ups, private enterprises and small medium enterprises (**SMEs**) in need of that finance.

The launch follows a public consultation process finalized by the Financial Services Regulatory Authority (the **FSRA**) on 16 August 2018 to introduce a tailored, risk-proportionate regulatory framework for transactions facilitated through a PFP in the ADGM.

SMEs make up 94 per cent of the companies operating in the UAE, contributing to 60 per cent of the UAE's GDP<sup>1</sup>. Yet SMEs continue to find it tougher than ever to access finance, in particular from banking institutions. Data provided by the Khalifa Fund shows that approximately 50-70 per cent of the SMEs applications for funding are rejected by conventional banks. Loans to SMEs account for just 4 per cent of the outstanding bank credit in the UAE.

It is doubtless to say that dramatic change in small business financing is required to allow for the essential growth of SMEs, and to bridge the existing funding gap, and who better to pave the way than the non-bank lenders with the help of regulators facilitating such leap.

### **BACKGROUND: Providing Credit as a regulated activity prior to the introduction of the Framework**

Under the laws of the ADGM, entering into a credit agreement with a person (as a borrower or a potential borrower), by way of business, in the ADGM is a regulated activity. Such regulated activity may only be carried out by a person who is authorized to carry out such activity by the Financial Services and Markets Regulations 2015 (the **FSMR**).



A credit agreement is defined broadly to cover all facilities extending monetary credit (on a funded or unfunded, bilateral or syndicated basis), including but not limited to, mortgage, overdraft, financial lease, letter of credit, financial guarantee, trade finance, transaction finance, project finance or asset finance.

Therefore, an entity lending to an SME from the ADGM will need to obtain the necessary license from the ADGM, if such lending is carried out by way of business. By way of business is described under ADGM law as: (a) engaging in the activity in a manner which constitutes the carrying on of a business; (b) holding oneself out as willing and able to engage in that activity; or (c) regularly soliciting other persons to engage in transactions constituting that activity.

It should be borne in mind that pursuant to ADGM law, any provisions of credit must not be in UAE dirhams.

### **KEY POINTS**

The Framework is a welcomed new addition to the existing lending regime - specifically opening the path for lenders/investors and SMEs alike.

The Framework will facilitate access by SMEs to new alternate sources of funding, as well as providing an opportunity to investors and lenders to finance such SMEs. Below are some of the key features of the Framework:

- PFPs are online platforms that enable SMEs to obtain financing from private and institutional investors.
- The Framework provides for authorization criteria that PFP applicants must satisfy to be authorized to undertake the regulated activity of operating a PFP. PFP operators generally do not provide financial advisory services to their clients.
- The FSRA intends to restrict lenders/investors and therefore their access to the Framework to primarily professional clients (i.e. those considered to be more sophisticated and able to make informed decisions on the instruments offered and the inherent risks associated with such transactions). Having said that, the FSRA will also allow retail clients to access PFPs on an exception only / case by case basis, subject to the PFP operator having appropriate safeguards.
- The borrower/investee must be a body corporate.
- A PFP Operator will fall within Prudential Category 4.

### **CONCLUDING REMARKS**

The Framework will allow financings to take place through the ADGM with a lesser regulatory burden and cost to the PFP Operators.

It should however be borne in mind that the regulatory scope of the ADGM only extends to those activities performed in or from the ADGM. Therefore, any regulated debt financing activities that are performed out of the ADGM but within the UAE would still be subject to the regulation of the Central Bank.



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<sup>1</sup> Source: <https://government.ae/en/information-and-services/business/crowdfunding>, <https://www.government.ae/en/information-and-services/business/crowdfunding/the-impact-of-smes-on-the-uae-economy>