

ARTICLE SERIES

REGULATION OF CRYPTOCURRENCY IN NIGERIA: A NEW WRINKLE

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1.0 BACKGROUND

Cryptocurrencies have largely received conflicting treatment by regulators in Nigeria. While the Central Bank of Nigeria (“CBN”) has increasingly been hostile towards cryptocurrencies, the Securities and Exchange Commission (“SEC”) has, for the most part, adopted an embrative approach.

For example, CBN has moved from:

i) merely warning that virtual currencies (cryptocurrencies) are not legal tenders and banks/institutions transacting in such currencies do so at their own risks in 2017;[1]

ii) warning “all and sundry” on the risks inherent in dealing with cryptocurrencies in 2018;[2] to

iii) outrightly prohibiting deposit money banks, non-bank financial institutions and other financial institutions (collectively referred to as “Regulated Entities”) from dealing in cryptocurrencies or facilitating payments for cryptocurrency exchanges in 2021. Regulated Entities were also required to identify and close the account of persons/entities transacting in or operating cryptocurrency exchanges.[3]

Conversely, in 2020, SEC indicated that it would regulate crypto-token or crypto-coin investments when the character of the investment qualifies as securities transaction. In fact, SEC stated that its position is that virtual assets are securities unless proven otherwise, and the burden to prove that crypto assets are not securities is placed on the issuer or sponsor of the assets.[4]

However, SEC took a form of backtrack following the CBN’s letter on cryptocurrencies. While SEC maintained that virtual assets (including cryptocurrencies) may have the full characteristics of investment as defined in the Investment and Securities Act (“ISA”) and trading in such assets falls under SEC’s regulatory purview (except proven otherwise), SEC conceded that, for the purpose of admittance into the SEC Regulatory Incubation Framework, the assessment of all persons (and products) affected by the CBN Circular of February 5, 2021 would be put on hold until such persons are able to operate bank accounts within the Nigerian banking system.[5]

Nevertheless, when SEC published the SEC Rules on Issuance, Offering and Custody of Digital Assets in May 2022 (“SEC Rules”),[6] it was generally understood that the SEC Rules will apply to cryptocurrencies as either digital assets[7] or virtual assets.[8]

[1] CBN, “Circular on virtual currency operations” available at <https://www.cbn.gov.ng/Out/2017/FPRD/AML%20January%202017%20Circular%20to%20FIs%20on%20Virtual%20Currency.pdf>

[2] CBN, “Press release on virtual currencies” available at <https://www.cbn.gov.ng/Out/2018/CCD/Press%20Release%20on%20Virtual%20Currencies.pdf>

[3] CBN, “Letter to Banks on Crypto” available at <https://www.cbn.gov.ng/Out/2021/CCD/Letter%20on%20Crypto.pdf>

[4] SEC, “SEC Statement on Digital Assets and their Classification and Treatment of September 11, 2020” available at https://sec.gov.ng/wp-content/uploads/2020/09/SEC-STATEMENT-ON-DIGITAL-ASSETS-AND-THEIR-CLASSIFICATION-AND-TREATMENT_11920.pdf

[5] SEC, “Press Release On Cryptocurrencies” available at <https://sec.gov.ng/press-release-on-cryptocurrencies/>

[6] Available at <https://sec.gov.ng/wp-content/uploads/2022/05/Rules-on-Issuance-Offering-and-Custody-of-Digital-Assets.pdf>

[7] Defined to mean a digital token that represents assets such as a debt or equity claim on the issuer.

[8] Defined to mean a digital representation of value that can be transferred, digitally traded and can be used for payment or investment purposes. It shall not include digital representations of fiat currencies, securities and other financial assets.

Although not yet operational, it was generally assumed that entities registered under the SEC framework will be exempted from the restriction imposed by the CBN's letter on cryptocurrencies and therefore able to operate accounts with Regulated Entities. However unconfirmed reports from Bloomberg[9] and other outlets (the "reports") assert that Dr. Lamido Yuguda, Director-General of the SEC (the "DG"), informed reporters in Lagos on Friday 25th November 2022 that the earlier referenced "understanding" is incorrect.

2.0 SEC'S POSITION; JUSTIFICATION AND IMPLICATIONS

It has been reported that SEC will not be considering cryptocurrencies in its push for digital assets, at least until regulators agree on standards that protect investors. The reports state that SEC will rather promote investment in "sensible digital assets" with investment protection.

It is reported that the DG explained that SEC was avoiding the digital currency as cryptocurrency exchanges do not yet have access to the banking platform that is needed to drive their trades in Nigeria. Another justification reported is that SEC is looking at digital assets that really protect investors; as it is in the business of protecting investors, not in the business of speculation.

In essence, SEC seeks to reject the registration of cryptocurrency as digital assets because, in SEC's opinion, cryptocurrency activities infringe public policy and are injurious to investors.[10] Nevertheless, it was also reported that SEC is open to exploring blockchain technology to advance virtual and traditional investment products. It was reported that SEC may promote crypto as the digital assets market undergoes development.

If the reports are accurate, the immediate implication of the reports is that the SEC Rules do not apply to cryptocurrencies. Consequently, the assumption that entities registered under the SEC framework will be exempted from the restriction imposed by the CBN's letter on cryptocurrencies has been displaced. As such, entities in the crypto space are forced to maintain their operations using peer-to-peer mechanisms and other systems that keep them safe from the repercussions of the extant CBN position.

However, we wish to stress that the veracity of the reports are unconfirmed. Indeed, contacts within the SEC appear unaware of any such change/directive concerning acceptance of cryptocurrencies as digital/virtual assets.

[10] Rule 5.03 SEC Rules provides that: The Commission may reject an application for registration of digital assets if in its opinion, the proposed activity infringes public policy, is injurious to investors or violates any of the laws, rules and regulations implemented by the Commission.

3.0 OUR THOUGHTS

Notwithstanding the torrid effect of the Luna implosion, [11] the 3AC collapse,[12] the bankruptcy of FTX[13] and attendant significant financial loss each of these catastrophes caused, the global cryptocurrency market cap today stands at \$855 Billion.[14] This suggests that, despite the actions of bad faith actors and inactions of regulators, investors will remain in the crypto space. Consequently, it is unsurprising that regulators all over the world are now actively seeking to regulate the cryptocurrency space, even hitherto unregulated cryptocurrency operations.[15]

Concerning the Nigerian perspective, it appears that even though cryptocurrencies may ordinarily be deemed digital assets or virtual assets as defined under the SEC Rules and therefore subject to SEC's regulatory purview, SEC has chosen to toe the line of the CBN by not regulating cryptocurrencies and maintaining that they infringe public policy and are injurious to investors.[16]

In addition to flying in the face of world trend and investor needs, from the earlier referenced reports, the justification for this stance are concerning.

For example, the reports state that one of the reasons for SEC's stance is that cryptocurrency exchanges do not have access to banking platforms, but this is a classic case of the chicken and the egg. Prior to the reports, the understanding was that entities registered by SEC will have access to banking platforms and therefore this will be a non-issue.

The same principle applies to the claim that SEC will not accept cryptocurrencies until regulators agree on standards that protect investors. However, the SEC had by the SEC Rules, set standards for people seeking to issue cryptocurrencies as digital or virtual assets and the onus should then be on other regulators to set standards for the operation of cryptocurrencies under their respective regulatory purview. Indeed, this was the impression given by the SEC itself in its earlier referenced press statement of February 2021.[17]

Similarly, the idea that SEC is not interested in cryptocurrencies because it is looking at digital assets that really protect investors is concerning. One of the key functions of SEC is acting in the public interest having regard to the protection of investors and the maintenance of fair and orderly markets.[18]

[11] Bloomberg, "The Big Take: What Caused Terra, Luna's \$60 Billion Implosion" available at <https://www.bloomberg.com/news/newsletters/2022-05-16/the-big-take-what-caused-terra-luna-s-60-billion-implosion>

[12] CoinTelegraph, "3AC: A \$10B hedge fund gone bust with founders on the run" available at <https://www.cnbc.com/2022/07/11/how-the-fall-of-three-arrows-or-3ac-dragged-down-crypto-investors.html>

[13] BBC, "FTX crypto exchange owes biggest creditors \$3.1bn" available at <https://www.bbc.com/news/business-63697459>

[14] CoinGecko, "Global Cryptocurrency Market Cap Charts" available at <https://www.coingecko.com/en/global-charts#:~:text=The%20global%20cryptocurrency%20market%20cap,a%20Bitcoin%20dominance%20of%2036.46%25>. Accessed 28 November 2022

[15] For instance, the United States Securities and Exchange Commission ("US SEC"), until recently, only attempted to regulate issuers of cryptocurrencies at the Initial Coin Offering ("ICO") stage. However, the US SEC recently took regulatory control over entities that had issued cryptocurrency assets as far back as 2016. This extension was challenged in SEC v. LBRY, Inc., No. 1:21-cv-00260-PB (D.N.H. filed Mar. 29, 2021) but the Courts noted that it is within US SEC's purview to regulate all issuance of securities whether or not they are at the ICO stage.

[16] The CBN in justifying its stance on cryptocurrencies noted that: (a) cryptocurrencies, being issued by unlicensed and unregulated entities, goes against the key mandates of the CBN; (b) cryptocurrencies are well-suited for conducting illegal activities; (c) cryptocurrencies are used as speculative assets rather than as means of payment; (d) cryptocurrencies do not have any intrinsic value and do not generate returns by themselves; and (d) the stance is protect the financial system and the generality of Nigerians (including the youth population) from the risks inherent in crypto assets transactions. See "CBN Press Release Crypto" available at <https://www.cbn.gov.ng/Out/2021/CCD/CBN%20Press%20Release%20Crypto%2007022021.pdf>

[17] See footnote 5 above

[18] Section 13(k) Investment and Securities Act ("ISA"). See also Section 13(n) ISA which requires the SEC to protect the integrity of the securities market against all forms of abuses including insider dealing; Section 13(aa) which requires the SEC to prevent fraudulent and unfair trade practices relating to the securities industry

While we note that SEC has not given its official position on this matter, we urge it to carefully consider the realities of investors and risks inherent in cryptocurrencies. Refusing to regulate entities in the cryptocurrency space will not protect investors; rather it will expose investors to even more risks.

SEC is urged to permit the registration of cryptocurrencies as digital or virtual assets under the SEC Rules and work alongside other regulators to agree upon standards for all entities in the cryptocurrency space. We should be pushing for anticipatory regulation and not outright prohibition.

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