

AN EXAMINATION OF THE REGULATORY FRAMEWORK FOR DIGITAL ASSETS IN NIGERIA

Uchechukwu Esther Oloworaran*

Abstract

Modern economic expansion has been driven by technology which has promoted the viability of digital assets. This novel form of wealth holding; riding on evolving forms of virtual technology and artificial intelligence comes with a new wave of legal consequences. The approach by Nigerian regulatory institutions, namely the Securities and Exchange Commission and the Central Bank of Nigeria was first resistance; followed by restriction; and finally regulation. The inevitability of developing a decisive legal regime to equip stakeholders in digital and virtual investments and securities was immense; prompting the examination of the dynamics that have dictated the pace for regulation of digital assets in Nigeria. Utilising the doctrinal research method, the paper reviews the available legal framework on digital asset in Nigeria. The paper observes that digital asset transactions are poised to become a major market player in global economy, especially with improved technology. The paper finds that there appears to be extensive disjoints in the framework hitherto utilised which led to several anomalies and even fraud in the market. Assessing the adequacy of the relevant existing legal framework, the paper accentuates the necessity for better regulation by comparative lessons from other jurisdictions.

Keywords: Digital Assets, Digital Securities, Visual Assets, Online Investments, Securities and Exchange Commission

* LL.M, BL, doctoral candidate, Faculty of Law, Rivers State University, Port Harcourt and Executive Director, Institute of Human Capacity Development and Continuing Education, Port Harcourt.

1. Introduction

The generation, preservation and advancement of wealth are basic to societal growth. This is also true of access to assets and investment opportunities. Although wealth in its raw form of mineral resources and agricultural produce drove human civilisation for ages; in modern times, economic growth has evolved rapidly with scientific discoveries, industrial revolutions, technological advancements and most recently, the foray into artificial intelligence.¹ Expectedly therefore, economic empowerment has been propped on empirical adjustments to asset holdings and investment opportunities that are prevalent within a given period of time in which particular value is vested in such asset holding or investment.

The introduction of innovative wealth creation and investment platforms providing avenue for digital assets, ecommerce and similar businesses and investment opportunities that were hitherto unavailable became a core impute of technology to economy.² Howbeit, the legal consequences of these novel investment platforms are issues for much concern, as traditional legal frameworks used in regulating investment and security market may not be adequate for the protection of investors on digital platforms.³

Generally, once an asset can be legally quantified and its validity in trade considered sacrosanct, legal regime for regulations as to registration of platform, issuance, holding and trading in such asset becomes inevitable so as to prevent fraud and illegal dealings in the market as well as for the evaluation of applicable charges and taxes.

¹ R Vinuesa and Others, “The Role of Artificial Intelligence in Achieving the Sustainable Development Goals,” [2020] (11) *Nature Communications* 233.

² A Andal-Ancion, PA Cartwright, and GS Yip, “The Digital Transformation of Traditional Businesses,” [2003] (44) (4) *MIT Sloan Management Review* 34–41; A Bharadwaj and Others, “Digital Business Strategy: Toward a Next Generation of Insights,” [2013] (377) (2) *MIS Quarterly* 471–482; EM Solomon and A Van Klyton, “The impact of digital technology usage on economic growth in Africa,” [2020] (67) (3) *Utility Policy*

³ M Arntz, T Gregory and U Zierahn, “Revisiting the risk of automation,” [2017] *Economics Letters*, 159, 157–160; X Bai and Others, “On the Prevention of Fraud and Privacy Exposure in Process Information Flow,” [2012] (24) (3) *Journal on Computing* 416–432.

The first challenge that digital and visual assets portend for the Nigerian securities market is their reliability and sustainability. The response by the regulatory institutions then was to avoid regulating the sector. This was unsustainable as digital trading is such that allows direct interactions with investors, even where the public regulatory institutions have refused to regulate the sector. As such, the whims of the operators dictated the operations of the digital market place and resulted in flooding of the internet space within Nigeria with investment platforms that were unregistered, unregulated, unsecured and fraudulent.⁴

It was this state of affairs that propelled market regulators to deactivate every legal apparatus that could give credence to digital assets market and online investment in Nigeria.⁵ Not only were investors warned and advised not to invest on such platforms;⁶ banks were also instructed to deactivate every avenue for monetary transactions in respect of certain online investments.⁷

It must however be acknowledged that there are genuine and fundamental issues that informed this form of intervention. First, technological assurance of a secured, fraud free digital transaction appeared, as at then inchoate such that it was not safe for the public to invest in.⁸ Again, the fact that digital economy can only operate within a jurisdiction that have developed a relatively stable digital technology that can sustain the market and give investors a level playground with other investors across the globe, constituted a factor as at then. In addition, regulation in any novel field always involves extensive

⁴ BusinessDay News, “Rising Cyber Fraud in Nigeria and Banks' Losses,” <<https://businessday.ng/editorial/article/rising...>> accessed 23rd January 2024.

⁵ Alex-Adedipe, V Ojo and S Ngwu, “Nigeria: Understanding The Central Bank Of Nigeria Guidelines On The Operation Of Bank Accounts For Virtual Assets Service Providers In Nigeria,” <<https://www.mondaq.com/nigeria/fin-tech/1407908>> accessed 23rd January 2024.

⁶ *Ibid.*

⁷ CBN Circular FPR/DIR/GEN/06/010 to Banks and Other Financial Institutions on Virtual Currency Operations in Nigeria of 12th January 2017; CBN Letter BSD/DIR/PUB/LAB/014/001 to all Deposit Money Banks, Non-bank Financial Institutions and Other Financial Institutions of 5th February, 2021.

⁸ *Ibid.*

consultations, considerations and coordination, so as not to mislead the society.

Notwithstanding the issues highlighted above, regulation became inevitable owing to market indication that despite the warnings from the regulatory authorities as to the volatility of digital investment, many citizens were exposed to digital investment frauds, having been convinced either through advertisements, herding behaviours or other means to invest. The investors on these online platforms continued to be victims of an unprotected market, losing millions of naira at different times to several of such online investment platforms.⁹ Further, the state of technology within the country now makes it inevitable to regulate the market.

The regulatory institutions, essentially, the Security and Exchange Commission (SEC) and the Central Bank of Nigeria (CBN) therefore recognised that regulation is pivotal and have in recent years set in motion rules for operation in the digital assets field. The relevant statements, rules and regulations now form the basis upon which digital and virtual securities and investment is now pursued in Nigeria. This article is therefore driven by the need to interrogate the legal framework for the operation of digital investments and digital securities in Nigeria in order to determine its adequacy, efficacy and need for improvement. The article does this by analysing the available legal machinery and comparing same with international best practices in reaching conclusion on the relevant suggestions that would enhance a better digital assets market.

2. Thematic clarification

The use of the terms ‘digital investments’ and ‘digital securities’ has not been applied specifically to relate to a class or type of digital asset, rather, they have been applied in relation to both regulated and unregulated digital investments and securities within the Nigerian capital market. This is also true of the use of digital, virtual and crypto assets. However, the interchangeable use of these terms may not be

⁹O Ojo, “Investment Scam in Nigeria: The Legal Remedies,” <<https://www.mondaq.com/nigeria/white-collar-crime...>> accessed 23rd January 2024

appropriate without clarifications, accordingly, it is appropriate to clarify the contextual scope of the relevant terms to this paper.

2.1 Digital Investment

Investment is any purchase made for the purpose of retaining, improving or generating wealth. It is an asset or item procured with the aim of gaining income and value thereby. It has been described thus:

In an economic outlook, an investment is the purchase of goods that are not consumed today but are used in the future to generate wealth. In finance, an investment is a financial asset bought with the idea that the asset will provide income further or will later be sold at a higher cost price for a profit.¹⁰

Like any other digital activity, defining digital investment is tricky owing to the kinetic nature of digital technology as such definition could unnecessarily restrict the scope of digital investment. While it could be said that the field of digital investment is novel, it could also be noticed that activities within its precincts have evolved drastically within the very limited period of its evolution that some of the medium and expressions relevant at the inception of digital trading are either out of use or modified.¹¹ Accordingly, a detailed descriptive analysis of the term digital investment may be more apt to qualify the field, rather than a strict definition.

Digital investment may be viewed as investments domiciled in online platforms using digital tools in the purchase, sale, transfer and management of such investments or financially viable assets. It generally relates to the use of technology to harness investment opportunities generated and managed digitally. Digital investments presently utilises robo-advisors, algorithms and artificial intelligence to advice investors and also to aid in managing their portfolio

¹⁰ Investment, <<https://byjus.com/commerce/investment>>accessed 23rd January 2024.

¹¹ Li Ming and Others, “Modelling the Dynamics of the Value of Digital Financial Assets Using the Example of Bitcoin, Ethereum and Ripple,” <<https://www.researchgate.net>> accessed 23rd January 2024.

automatically.¹² Digital investment is dynamic and hence incorporates both traditional investments with modern investments in creating online market platforms for investors and investment managers.

Accordingly, once an investment can be effectively done online, it would be tagged digital investment; although this liberal description may not represent the technical use of the term. There are several forms of digital investments, which include but are not limited to stock trading; bond investing, crowdfunding; cryptocurrency trading; forex trading; robo-advisors; peer-to-peer lending; mutual funds and ETFs.

While some of these, like stock trading and bond investing, involve trading in shares of publicly traded companies or purchase of fixed-income securities issued by corporations or governments; others like crypto currency trading are purely based on trading in digital currencies such as Bitcoin, Ethereum, and Litecoin. To that extent, the former are digitalisation of the processes and procedures relating to traditional investments and securities trading, while the other is purely digital platforms for asset trading. Such digital platforms for asset trading are usually non liquidable investments and are digital representations of securities, made subject to traditional securities laws.¹³

2.2 Digital Securities

The word digital as used herein relates to electronic and computer technology. Securities as defined by the Investments and securities Act 2007 (ISA) (as amended),¹⁴ are debentures, stocks or bonds including rights attached thereto, issued or proposed to be issued by a government or by a corporate body. It also includes commodities

¹² A Furinto and Others “Financial and Digital Literacy Effects on Digital Investment Decision Mediated by Perceived Socio-economic Status,” [2023] <<https://doi.org/10.1051/e3sconf/202342602076> ICobar> assessed 23rd January 2024. 2023; T Koens, “The Future of Digital Assets: Trends, Challenges, and Opportunities,” <<https://www.ingwb.com/binaries/content/assets/...> > accessed 23rd January 2024; P Szwajdler, “Digital Assets and Inheritance Law: How to Create Fundamental Principles of Digital Succession System?” [2023] (31) (2) *International Journal of Law and Information Technology* 144–168.

¹³ SEC Statement on Digital Assets and Their Classification and Treatment of 11th September 2020 (The SEC Statement).

¹⁴ ISA, s 315.

futures, contracts, options and other derivatives. Securities are basically assets possessed with the aim of gaining a rise in value due to third party mechanisations.¹⁵ The ISA permits the transference of securities by any electronic means approved by the SEC and which may be deposited, kept or stored with any licensed depository or custodian company. Digital securities therefore are securities, stored, managed and transferable digitally. It is any security upon which transaction can be conducted digitally or by electronic means.

The use of digital securities is wide, and may encompass assets in form of electronically registered and transferable debt, equity, or asset such as investment contracts, shares of a corporation, debt security and the likes. The law was careful to identify the forms of digital investments and digital security to which regulations are presently applicable. By looking at the provisions of the extant regulations, one may deduce those regulated and in which form.

2.3 Digital Assets

It is generally understood that assets are specific items that directly provide or confer financial benefits, ownership rights and investment potentials on the owner or bearer. The development of regulatory framework on issues relating to assets and investment has always relied on the value of the assets and the validity of the investment based on tangibility until in recent times, when developments in technology have not only altered the fundamental dynamics of asset holding, but is poised to establish a novel framework for asset generation and management.

The International Financial Reporting Standards (IFRS) views asset as a resource controlled by the enterprise as a result of past events and from which future economic benefits are expected to flow to the enterprise.¹⁶ It could refer to loans receivable or other financial assets

¹⁵ CW Iheme “A Critical Review of the Current Laws on Secured Transactions in Nigeria, In: Towards Reforming the Legal Framework for Secured Transactions in Nigeria” [2016] <https://doi.org/10.1007/978-3-319-41836-0_2>accessed 23rd January 2024.

¹⁶CFI Team, “Types of Assets: Classifying Assets Based on Convertibility, Physical Existence and Usage,”

with an expected cash payment stream.¹⁷ Within that context, it includes but is not limited to receivables, mortgage loans and other debt instruments and receivables under non-financial contracts like service contract.¹⁸

As valuable possessions available for immediate use, there are various forms and types of assets.¹⁹ By accounting standards, assets are divided into various categories and can be used to assess an individual's or a company's net worth as against the liabilities; and could be classified using liquidity, tangibility, and identity function.²⁰ There are essentially six types of assets, although some assets may fall into more than one category. They are current, fixed, tangible, non-tangible, operating and non-operating assets,²¹ and each type of asset has economic value, ownership, and resources as features. Examples of current assets are cash and cash equivalents such as certificates of deposits, promissory notes, and prepaid expenses; mutual funds; money market account; marketable securities; accounts receivable; goods and products; and supplies.²² Capital market analysts and financial advisers have divided these assets into five classes namely: stock or equities; bonds or other fixed income investment; cash or cash equivalents such as money market funds; real estate or other tangible

<<https://corporatefinanceinstitute.com/resources/accounting/types-of-assets/>>
accessed on 3rd January 2004.

¹⁷ SEC Rules on Securitization, Definition of Terms A (iii).

¹⁸ *Ibid.*

¹⁹ SJ Williams, "Assets in Accounting: Reality Lost," [Dec 2003] (30)(2) *The Accounting Historical Journal* 133-172; FreshBooks, "Assets: Definition and Types," <<https://www.freshbooks.com/glossary/accounting/asset>> accessed on 3rd January 2004.

²⁰ CFI Team, "Types of Assets," <<https://corporatefinanceinstitute.com/resources/accounting/types-of-assets/>>
accessed on 3rd January 2004.

²¹ D Weidinger, "6 Types of Assets (With Definitions and Examples)," <<https://www.indeed.com/career-advice/career-development/types-of-assets>>
>accessed on 3rd January 2004.

²² CFI Team, "Types of Assets: Classifying Assets Based on Convertibility, Physical Existence and Usage," <<https://corporatefinanceinstitute.com/resources/accounting/types-of-assets/>> accessed on 3rd January 2004.

assets which offer protection against inflation; and forex, futures and other derivatives.²³

Digital assets have become a significant part of investment securities and capital market. This is because they represent real assets that can be bought, sold, stored and traded online; although they cannot be handled physically.²⁴ Digital asset means a digital token that represents assets such as a debt, or equity claim on the issuer.²⁵ For an asset to qualify as digital asset it must have potential to create value, transfer ownership through purchase, gifting or other means of passing right to someone else along with the value it can generate, and must be discoverable.²⁶ Digital assets are anything that can be stored and transmitted electronically through a computer or other digital device, and are associated with ownership or use rights.²⁷ Examples of such assets are cryptocurrencies and Non-Fungible Tokens (NFTs). It also includes digital tokens, and digital securities.

The basic characteristics of digital assets could be summarised into three. Firstly, digital assets are immutable. That is to say that once they are recorded on a blockchain, they cannot be altered or deleted and which provides security, durability and transparency for the asset. Secondly, they are decentralised. That is to say those assets are not controlled by any central authority or intermediary which gives investors direct control and ownership of the assets. Finally, they are programmable. This means that the asset can be programmed to perform specific functions, such as executing smart contracts or automated transactions thereby making the asset flexible, efficient and fit for purpose in use.

²³M Park, “Asset Class: Overview,” <<https://corporatefinanceinstitute.com/resources/wealth-management/asset-class/>> accessed on 3rd January 2004.

²⁴A Olaniyun, “SEC Statement on Digital Assets and Their Classification and Treatment,” Sept 2020 Newsletter <<https://www.sec.gov.ng/wp-content/uploads/2020/09/...>> PDF file> accessed on 3rd January 2004.

²⁵ SEC Nigeria, New Rules on Issuance, Offering Platforms and Custody of Digital Assets; Pt A, r 2.0.

²⁶Digital Assets, “Characteristic Properties of Digital Assets,” <<https://www.bitbon.space.chance>> accessed on 3rd January 2004.

²⁷J Frankefield, “Digital Assets,” <<https://www.investopedia.com/digital-asset-framework>> accessed on 3rd January 2004.

Digital assets may be used for investments; such as buying and holding of cryptocurrencies or digital securities; payment for goods and services; as utility to access a platforms or services; and as a reward for participation in a network or community. Digital assets could be securities, commodities or currency.

2.4 Virtual Assets

Virtual assets relate to assets that exist only in digital form and most often identified with games or social media platforms who create, and control the asset, and the value is determined by the demand within the platform or game. Basically, virtual assets could be identified by certain characteristics. Firstly, they are fungible. That is to say that they are interchangeable with other assets of the same type within the platform or game. Secondly, they are centralised; which is to say that they are controlled by the platform or game developers. Lastly, they provide limited ownership and control rights over the asset. This signifies that assets are subject to terms and conditions that limit ownership and transferability of the asset.

Virtual asset may be used for gaming to purchase in-game items or enhancing game play. They may also be used for social media platforms, where they serve such purposes as gifting virtual items to other users or unlocking premium features. Virtual assets are also used in the virtual market for real-world or virtual currency.

2.5 Crypto Asset

Crypto asset are assets that derive value from their use of cryptography, distributed ledger technology, consensus algorithm and smart contracts. It is a compound word deriving its meaning from ‘crypto’ meaning hidden to depict the secured technology by which ownership and usage is determined and ‘asset’ signifying the value of the crypto asset. It is a value storage system that vests in the owner the right to utilise the value obtained there from as medium of exchange, a unit of account and for business transaction purposes.

A major characteristic of crypto assets is independence from any central authorities such as governments, Central Banks or financial institutions and; they use distributed ledger such as blockchain and data base maintained by the participants of the network. The major

types of crypto assets include cryptocurrencies, utility tokens, security tokens, stablecoins, and non-fungible tokens (NFTs).

2.6 Distinguishing Between Digital, Virtual and Crypto Assets

The tendency to use digital asset, virtual asset and crypto asset interchangeably is always high; however, the terms do not have absolutely the same meaning. The accurate identification of the peculiarities of each of these assets helps in devising regulatory mechanisms that are appropriate and adequate for each of them, and also help investors in appreciating the nature and form of investment they are undertaking.

Digital asset is identified as asset that is stored and traded on a blockchain or other distributed ledger technology, such as NFTs, Utility tokens, and similar assets that are issued and tracked on the blockchain with or without intermediaries. On the other hand, virtual assets are store value that can be stored or transferred digitally, and may be utilised to make payment of investments; and does not necessarily involve blockchain technology. Crypto asset are assets that derive value from its use of cryptography and distributed ledger technology.

Admittedly, the use of the terms is overlapping and the distinction quite confusing as authors are uncertain as to what may be included in each of the groups. Moreover, every attempt by authors to attach distinctive and exclusive technical meaning to each of the terms has not only been elusive but devoid of universal appeal. Nonetheless, an effective understanding of the differences is important as it guides investors in understanding the working of the different forms of assets and also determines the value of each and the nature of regulations applicable.

3. Regulatory mechanisms

Granted that every new development in any field is always received with caution, the emergence of digital assets was also so received.²⁸

²⁸ M Iansiti and KR Lakhani, "The Truth About Blockchain," [2017] *Harvard Business Review* <<https://hbr.org/2017/01/the-truth-about-blockchain>> accessed on 3rd January 2004; W Mougayar, "The Business of Blockchain: Promise, Practice and

Prior to formal regulation of digital assets, the institutions relevant to the regulation of such assets had advised caution in the field.²⁹ However, the establishment of the Fintech Roadmap Committee in November 2018 by the Securities and Exchange Commission (SEC) for the primary aim of discovering the impact of Financial Technology (Fintech) on investments and securities in Nigeria led to the development of standardisation mechanisms.³⁰ This was also followed by the Central Bank of Nigeria adoption of Guidelines Relating to the Operations of Virtual Assets Service Providers.

Although the Investment and Security Act was passed in 2007, and could not have envisaged the developmental strides that technology has made on digital assets, SEC recognised the fact that there are ‘alternative investment opportunities’ associated with digital assets and that it should be regulated to ensure confidence in the market, protection of the investors and operators alike and to secure market integrity, transparency and continuity.³¹

3.1 Regulation under the SEC Regime

Regulation under the SEC regime has emphasised the classification of market participants, establishing a link between traditional investments and securities with the digital parallel so as to apply existing regulations to new assets and finally, the development of specific rules

Application of the Next Internet Technology,” [2016] <<https://techcrunch.com/2016/05/11/the-blockchain-is-the-newgoogle/>> accessed on 3rd January 2004; J Naughton, “Is Blockchain the Most Important IT Invention of Our Age?” [Jan 24, 2016] *The Guardian* <<https://www.theguardian.com/commentisfree/2016/jan/24/blockchain-bitcointechnology-most-important-tech-invention-of-our-age-sir-mark-walport>> accessed on 3rd January 2004; M Crosby et al., “BlockChain Technology: Beyond Bitcoin,” [2015] <<http://scet.berkeley.edu/wp-content/uploads/BlockchainPaper.pdf>> accessed on 3rd January 2004.; K Torpey, “Why the Bitcoin Blockchain Is the Biggest Thing Since the Internet,” [Apr. 19, 2016] <<http://www.nasdaq.com/article/why-the-bitcoinblockchain-is-the-biggest-thing-since-the-internet-cm608228>> accessed on 3rd January 2004.

²⁹The Central Bank of Nigeria Circular, 12 January 2017.

³⁰SEC Final Report of the Fintech Roadmap Committee of the Nigerian Capital Market.

³¹ The SEC Statement.

for the digital market.³² These have been achieved through the Investment and Security Act (ISA), the SEC Statement on Digital Assets and Their Classification and Treatment, (the SEC Statement), and the SEC New Rules on Issuance, Offering Platforms and Custody of Digital Assets (the Rules on Digital Assets).

3.1.1 Investment and Securities Act

By virtue of the ISA,³³ SEC is the apex regulatory organisation for the Nigerian capital market. This it does through an array of means, including the power to make rules and regulations.³⁴ The SEC Statement was the first major attempt at regulating digital investments and securities. One of the major preoccupations of the SEC Statement was the establishment of a nexus between ISA and digital investments. In doing this, the SEC Statement established a parallel between the provisions of ISA and the operational requirements of virtual assets.

3.3.2 The SEC Statement on Digital Assets and Their Classification and Treatment

The SEC Statement established standards as regards what is to be regulated, identity of who is to be regulated and the nature of regulation for classes of digital and virtual assets. This is done by establishing a primary nexus between digital assets and existing provisions of ISA.

The statement recognised that virtual crypto assets are securities, unless proven otherwise. The burden of establishing that the crypto assets proposed to be offered are not securities and therefore within the jurisdiction of the SEC is placed on the issuer or sponsor of the said assets. The said burden would only be satisfied by their compliance with initial assessment filing. Where upon initial assessment filing, SEC concludes that registration is necessary; with the exception in cases where the securities are not structured to be exclusively offered through crowdfunding portals or other exempt methods; then, the

³²*Ibid.*

³³ ISA, s 13.

³⁴*Ibid*, s 313.

issuer or sponsor must register the digital assets.³⁵ Registration as provided for by the statement is a two-prong approach determined by an initial assessment filing to satisfy the burden of proof and a filing for registration proper.

In addition, all Digital Assets Token Offering (DATOs), Initial Coin Offerings (ICOs), Security Token ICOs and other Blockchain-based offers of digital assets within Nigeria or by Nigerian issuers or sponsors or foreign issuers targeting Nigerian investors, are subject to regulation by SEC. Existing digital assets offerings prior to the implementation of the Regulatory Guidelines have three (3) months to either submit the initial assessment filing or documents for proper registration. The statement further recognised that the SEC will regulate crypto-token or crypto-coin investments when the character of the investments qualifies as securities transactions.

The SEC Statement further provided for the registration of persons, corporate or otherwise, whose activities involve any aspect of Blockchain-related and virtual digital asset services such as but not limited to reception, transmission and execution of orders on behalf of other persons, dealers on own account, portfolio management, investment advice, custodian or nominee services. Issuers or sponsors (start-ups or existing corporations) of virtual digital assets are also subject to the SEC's regulation. In addition, the SEC may require foreign or non-residential issuers or sponsors to establish a branch office within Nigeria. Foreign issuers or sponsors will be recognized by the SEC where a reciprocal agreement exists between Nigeria and the country of the foreign issuer or sponsor. Recognition status will also be accorded, where the country of the foreign issuer or sponsor is a member of the International Organization of Securities Commissions (IOSCO). This is to ensure that no unregistered entity operate in the market.

3.1.3 New Rules on Issuance, Offering Platforms and Custody of Digital Assets

The Rules on Digital Assets makes detailed provisions in respect of issuance of digital assets; registration of Digital Assets Offering

³⁵ The SEC Statement.

Platforms (DAOPs) and Digital Assets Custodians (DACs). It also deals with rules on Virtual Assets Service Providers (VASPs) as well as Digital Assets Exchange (DAX). The Rules is more detailed than the statement. It applies to all issuers seeking to raise capital through digital asset offerings and provides for their registration.

However, there are exemptions to the rules as to registration. Registration is not required when it is a securities structured to be exclusively offered through crowdfunding portals or intermediaries; or a judicial sale or sale by an executor, administrator or receiver in insolvency or bankruptcy. It also exempts sale by a pledged holder or mortgagee, selling to liquidate a *bona fide* debt and not for the purposes of avoiding the provision of the Rules. Also exempted is any isolated transaction in which any digital token is sold for the owner's account and such sale or offer for sale not being made in the course of repeated and successive transactions of like manner by such owner.

The Rules on Digital Assets further provides for registration requirements for DAOPs and VASPs. However, the registration requirements for VASPs exempted a technology service provider who merely provides the infrastructure, software or the system to a DAX; an operator of a communication infrastructure that merely enables orders to be routed to an Exchange and an operator of a financial portal that aggregates content and provides links to financial sites of service and information provider.

3.2 Regulation by the Central Bank of Nigeria

The rationale for considering CBN as a regulatory body stems from the fact that not all digital assets are securities. Digital assets could be commodities and currencies, which would not amount to securities in the real sense. Such digital assets may be tokens, coins, and other digital replacement of currencies that does not provide equity or debt claim on an Issuer. Again, banks and other financial houses whose legitimate transactions relate to currency and money transaction are under the regulation of the CBN and are always actively involved in the activities of those in the digital asset business.

The first major regulatory framework by the CBN was the information contained in CBN Circular to banks and other financial institutions in

respect of virtual currencies.³⁶ The major preoccupation of the Circular was to restrict cryptocurrency transactions. It directed financial institutions not to hold trade or transact in any form of cryptocurrency. It further directed that such financial institutions ensure that their existing customers who were into virtual currency exchange are possessed of the requisite anti-money laundering and combating terrorism financing controls put in place to enable them comply with customers' due diligence and transaction monitoring. Where there are suspicious transactions, they were to be reported immediately to the Nigerian Financial intelligence Unit (NFIU). The policies of the CBN could not be said to be consistent on the issue of crypto currencies as subsequent circular³⁷ appeared to have interdicted transactions in respect of cryptocurrency exchange by the directive to close down crypto related accounts immediately.

However, the most detailed provisions are contained in the Guidelines on the Operations of Bank Accounts for Virtual Assets Service Providers (the Regulatory Guidelines).³⁸ This guideline makes detailed provisions for standard requirements for banking business in relation to virtual asset providers in Nigeria. It provides for effective monitoring, guidance and risk management in respect of virtual asset providers. The Guidelines also applies to banks and all other financial institutions under the regulation of the CBN.

4. The Legal Implications of the Relevant Regime

One notable attribute of the framework for digital assets in Nigeria is the use of directives, letters, circulars, guidelines and rules in the provision of regulatory standards in the digital asset ecosystem. The functional capabilities of these forms of regulation even where effective could still lack the legal credence necessary for effective market operations. Even though a question of legitimacy may not arise

³⁶CBN Circular FPR/DIR/GEN/06/010 to Banks and Other Financial Institutions on Virtual Currency Operations in Nigeria of 12th January 2017.

³⁷CBN Directives, including Letter BSD/DIR/ PUB/LAB/014/001 to all Deposit Money Banks, Non-bank Financial Institutions and Other Financial Institutions of 5th February, 2021.

³⁸Guidelines FPR/DIR/PUB/CIR/002/003 on the Operations of Bank Accounts for Virtual Assets Service Providers.

over this form of regulations, that of legality would arise as to whether such directives, letters, circulars, guidelines and rules can create legally enforceable regulations.

It has been established that court can take judicial notice of rules, regulations and guidelines issued by the Central Bank of Nigeria.³⁹ However, there must be enabling statutory provisions upon which such rules and guidelines may be made. In *Access Bank Plc v Ogboja*,⁴⁰ the Supreme Court of Nigeria recognised that section 33(1) of the Central Bank Act, 2007 enables the Central Bank of Nigeria to issue guidelines to any person and any institution under its supervision. Accordingly, it has been recognised that where such guidelines are issued in pursuance to the enabling law, it shall be binding and enforceable.⁴¹

However, it has been held by the Court of Appeal⁴² that a bank cannot on the pretext that it is applying the directives in the Central Bank of Nigeria Guidelines vary the interest rate previously agreed on with its debtor. This is because such a step amounts to a breach of the legal transaction between the parties to which the Central Bank was not a party and even more so when there is nothing in the Guidelines suggesting that they would have retrospective effect on all existing agreements entered into before the issuance of the Guidelines. This decision appears restrictive to instances where there is a subsisting agreement between the bank and the customer, and where the guideline has no retrospective effect.

In *SEC v Kasumu*,⁴³ the Court of Appeal recognised that the extent and scope of power of SEC to make rules and regulations under section 258(1) of the ISA 1999 is with respect to anything required to be prescribed under the Act; and generally for carrying out the principles and objectives of the ISA. The court further clarified that whilst section 262(1) of the ISA provides for areas in which the SEC can make rules and regulations for the purpose of giving effect to the

³⁹*Karimu v Lagos State Government* (2012) 5 NWLR (Pt. 1294) 620; *Ogboja v Access Bank Plc* (2016) 2 NWLR (Pt. 1496) 291.

⁴⁰(2022) 1 NWLR (Pt. 1812) 547 at 575, para. G.

⁴¹*U.B.N. Ltd. v Ayoola* (1998) 11 NWLR (Pt. 573) 338 at 344-345, paras. H-C.

⁴²*I.D.S. Ltd. v A.I.B. Ltd.* (2002) 4 NWLR (Pt. 758) 660 at 690-691, paras. G-A.

⁴³(2009) 10 NWLR (Pt. 1150) 509.

provisions of the ISA, the provisions of sections 258(1) and 262(1) of the ISA can only be given effect to in respect of express provisions of the ISA. Where the Act makes no provisions on a particular issue, any rules made in that regard is invalid as it was not made to give effect to the provisions of the Act.

Upon the authorities above, one may conclude that SEC and CBN guidelines and rules on digital assets are effective to the extent that there are express provisions in enabling statute upon which the extant Guidelines and Rules are made. It would appear that SEC intends to regulate both public and private securities in the extant rules applicable to digital assets. However, there appears to be no express power under ISA for SEC to rely on in regulating private securities. Even though the extant rules and statements exempted certain transactions from regulation, where power to regulate certain activities in relation to digital assets is not donated under the enabling law; any rule or Guidelines made in that respect would be void.

In the celebrated decision in *Rise Vest Technology Limited v Central Bank of Nigeria*,⁴⁴ the court came to the conclusion that although the CBN is possessed of the powers to investigate any infraction, the infraction must relate to BOFIA or any other enactment administered by the regulator. The court held further that an infraction allegedly based on the circular of the CBN is illegal. The court held that:

The law is trite that any conduct that must be sanctioned must be expressly stated in a written law. Being unknown to law, circulars cannot create an offence because it was not shown to have been issued under an Order, Act, Law or Statute.

The implication of this decision is that circulars and statements may not constitute enforceable rules on issues of digital asset.

5. Comparative notes

⁴⁴ Unreported ruling of the Federal High Court, delivered on 18th October 2021 in Suit No: FHC/ABJ/CS/822/2021, per Taiwo J.

The legal regulation of digital assets is presently of universal appeal. Under the US laws, the American Securities and Exchange Commission's (ASEC) powers to regulate crypto currencies and digital assets in general has been termed inconsistent as there appears to be limited regulations covering the field.⁴⁵ However, the ASEC has at all times relied on its capacity to exercise legal oversight over all forms of digital assets; and has based on that taken legal steps at different times to regulate operators in the market.⁴⁶ Suffice to also state that ASEC's powers to regulate private securities have been a subject of much legal commentary.⁴⁷

The situation in Africa does not fare better. In *Wiseman Talent Ventures v Capital Markets Authority of Kenya*,⁴⁸ the issue of whether crypto currencies were regulated in Kenya fell for decision. The court held that:

[T]he absence of a specific regime does not ouster jurisdiction of the general regime of law as exemplified by the cited provisions of Capital Markets Act and the application of the Howey test outlined above. The interpretation of cryptocurrency as a security is because it is a scheme that involves an investment of money in a common enterprise with profits to come solely from efforts of others as illustrated by Howey test.⁴⁹

According to the court, the Capital Market Authority of Kenya is possessed with the authority under sections 2 and 11 of the Capital Markets Act of Kenya to regulate crypto currencies as securities. Although

⁴⁵ J Godoy, "What Makes a Crypto Asset a Security in the U.S.?" [June 7, 2023] *Reuters*.

⁴⁶ Bloomberg News, "SEC Sues Binance and CEO Zhao for Breaking US Securities Rules," [June 5 2022].

⁴⁷ AI Platt, "Gatekeeping" in the Dark: SEC Control over Private Securities Litigation Revisited," [2020] (72) (1) *Administrative Law Review* 27.

⁴⁸ (2019) eKallr.

⁴⁹ Investopedia, "Howey Test Definition: What It Means and Implications," <<https://www.investopedia.com/terms/h/howey-test.asp>> accessed 25th January 2024.

purposive, this decision appears not to be the universal view on crypto currency.

In Uganda, despite the recognition by writers that Crypto currencies are securities under Capital Markets Authority Act,⁵⁰ the only forms of regulation and restrictions have been by the Central Bank of Uganda. In *Silver Kayondo v Bank of Uganda*,⁵¹ the legality, rationality, and procedural propriety of a circular issued by the Bank of Uganda on April 29, 2022 to ban the liquidation of crypto assets in Uganda were the main issues for determination. It was the contention of the applicant that the circular exceeded the regulatory authority's powers. The Bank of Uganda contended that the circular was issued within the scope of the National Payment Systems Act, 2020, which granted it regulatory authority over payment systems. The court came to the conclusion that the regulation was legally issued.

The SEC Statements, Regulatory Guidelines and Rules on Digital Assets so far adopted in Nigeria by the regulatory institutions are based on the Financial Action Task Force (FATF) policies to protect the global financial system against money laundering, terrorist financing and the financing of proliferation of weapons of mass destruction. The adoption of these policies in some cases leave out some other critical policies articulated by the FATF, thereby creating unnecessary gaps in the regulations. For example, the definition of virtual assets under the Guidelines on Operation of Bank Accounts for Virtual Assets Service Providers⁵² excluded 'digital representations of fiat currencies, securities and other financial assets that are already covered elsewhere in the FATF recommendations. 'This reference is without significance as the said FATF recommendations were neither incorporated into the Regulatory Guidelines nor independently adopted. The implication of this is the reliance on inchoate legal rules to advance standardisation in the digital asset ecosystem.

⁵⁰Capital Markets Authority Act, section 1.

⁵¹ *Kayondo v Bank of Uganda* (Miscellaneous Cause No. 109 of 2022) [2023] UGHCCD 113 (24 April 2023) Media Neutral Citation. [2023] UGHCCD 113, <<https://ulii.org/ug/judgment/hc-civil-division-uganda/2023/113>> accessed 25th January 2024.

⁵²Regulatory Guidelines, para 4.0.

6. Conclusion

In the face of global dynamism in digital assets regulation, ignorance and non regulation would only promote malpractices, fraud and manipulations by operators. Despite the fact that regulating private securities and digital assets may not be easily achieved, the Regulatory Guidelines and other instruments presently put in place would play a pivotal role for setting standards, the breach of which sanctions can be imposed. It would also help in creating public awareness of the rights, obligations and liabilities of each class of key players in the digital assets ecosystem.

The recognition of digital asset by various laws as key to government revenue; control of money laundering and prevention of terrorism and fraud also make regulation inevitable. The Finance Act 2023⁵³ for example, introduced capital gains tax on profits made from disposal of digital assets. Also, the Money Laundering (Prohibition, Prevention, etc) Act 2022 recognises digital asset and also defines “financial institutions” to include Virtual Assets Service Providers (VASPs).⁵⁴ However, the inconsistencies and loopholes in the regulatory regimes highlighted in this paper could hinder the efficacy of the regulatory bodies in carrying out their statutory mandates.

7. Recommendations

This paper is of the view that there is the need for harmonisation of the available guidelines, rules and the statement by SEC so as to achieve regulatory clarity. Specifically, the need for express statutory provision sanctioning and expressly authorising SEC to regulate all forms of digital assets will go a long way in achieving market stability and fairness within the digital asset ecosystem.

The field of digital asset is evolving; thus leaving some forms of digital assets out of regulation in Nigeria. There is therefore the need to enhance the market transparency and integrity by adopting international best practices, while all efforts are made to bring all digital assets under regulation.

⁵³Finance Act 2023, s 2.

⁵⁴*Ibid.*, s 30.