

THE SECURITIES AND
EXCHANGE COMMISSION'S
RULE ON ISSUANCE, OFFERING
PLATFORMS AND CUSTODY OF
DIGITAL ASSETS



Introduction

A cryptocurrency is a digital currency created and designed to work as a medium of exchange through a computer network that does not depend on any central authority, such as government or bank, to uphold or maintain it. As a result of this, government around the world, regulatory agencies, central banks and other financial institutions are working to understand the nature and meaning of digital currencies, and how individual investors or traders can make a great deal of money investing in this new space.

It is based on the above premise that the Central Bank of Nigeria (CBN) on 5 February 2021 announced in a circular that all local financial institutions in Nigeria are restricted from participating in trade of cryptocurrencies and other related transactions. The CBN further stated in a subsequent press release that this decision is not outlier as other central financial institutions around the world have done same. It further stated that the press release only reiterated the CBN's position which has been communicated to local financial institutions in preceding years.

SEC's Rule

The outcome of this CBN circular was that trading of cryptocurrencies became largely restricted and tedious as coin holders are restricted to trading through person-to-person platforms. It became trade by barter all over again. It is no news that the one of the world's largest cryptocurrency markets was set back by the development. The Securities and Exchange Commission (SEC), which a few months prior had announced that it will be proposing rules to regulate crypto tokens, announce that it will be putting same on hold.

The development brought with a lot of disgruntled feedback especially from crypto traders but one of the foremost questions raised was, **is cryptocurrency a currency to be regulated by CBN or an intangible asset to be regulated by SEC?**

The following are highlight of the new rule issued by SEC.

This question was answered over a year after when on the 13 May 2022, SEC published new set of rules in respect of the crypto market. Recall that before the CBN's blanket ban on cryptocurrency, SEC has been working on how to regulate and control the crypto market.

In SEC's new rule, it referred to cryptocurrency as “**Digital Assets**”. It went further to define the term digital assets as a digital token that represents assets such as a debt or equity claim on the issuer thereby, making digital asset the umbrella term under which all types of crypto assets fall.

Going by the above definition, it is clear that SEC has taken a position and from the definition of digital assets, the position is that cryptocurrency is not a currency but an intangible asset to be regulated by SEC.

Highlight of the SEC Rule

- ❖ All entities looking to offer any kind of crypto products and services in Nigeria or to Nigerians must now secure a virtual asset service provider (VASP) license.
- ❖ Anyone offering crypto or digital assets-related service in Nigeria is a VASP and be registered as such. In addition to being licenced VASP, any entity intending to operate in the categories such as Digital asset exchange (DAX), Digital assets custodians (DAC) and digital asset offering platform (DAOP) must obtain additional licence for it from SEC.
- ❖ The rules allows digital assets offering platforms to operate trust accounts with receiving banks for the maintenance of money received from investors.
- ❖ The SEC must also be notified before an exchange can cease trading operations. They are also not allowed to grant financial assistance to investors or employees to trade digital tokens.

- ❖ The digital asset service providers are mandated to file reports on digital asset details, risk and disaster management plans, and KYC policies.
- ❖ Security protocols must also be provided for investors.
- ❖ The digital asset service providers must submit to SEC for assessment details of the technology behind the project, detailed description of the systems architecture, description of the project and use of proceeds, information on market capitalization, anticipated growth, other technical details, the team, and advisors behind the project.
- ❖ SEC also sets limits on the investment amounts for retail users: 200 000 NGN per issue and no more than 2 million NGN within 12 months while no limit or restriction is put in place for qualified institutions and high net worth investors.

Categories of Digital Assets Service Providers

- Digital Asset Custodians (DACs): According to the SEC, “this means a person who provides the services of providing safekeeping, storing, holding or maintaining custody of virtual assets/digital tokens for another person’s account.” These are crypto wallets like Metamask and Trust Wallet. Crypto exchanges may fall into these categories too because they offer wallet services.
- Digital Assets Exchange (DAX): This is “an electronic platform which facilitates the trading of a virtual asset or digital asset.” They are simply crypto exchanges such as Binance and Quidax.
- Digital Assets Offering Platforms (DAOPs): These platforms enable the issuance of digital assets for fundraising purposes. They can also be called Initial Coin Offering platforms. You can liken it to a place where public companies offer their stocks for sale, such as the Nigeria Stock Exchange (NSE).

- Virtual Asset Service Provider: means any entity who conducts one or more of the following activities or operations for or on behalf of another person:
- i. exchange between virtual assets and fiat currencies;
 - ii. exchange between one or more forms of virtual assets;
 - iii. transfer of virtual assets;
 - iv. safekeeping and/or administration of virtual assets or instruments enabling control over virtual assets;
 - v. participation in and provision of financial services related to an issuer's offer and/or sale of a virtual asset.

Effects of SEC's Rule

Cryptocurrencies operate largely on anonymity and decentralisation. Cryptocurrencies were created to give pseudonymity to financial transactions. It is one of the reasons the generic name is cryptocurrency. Although, the SEC rules on exchanges signify a thorough understanding of how cryptocurrencies work which has helped the Commission develop measures to protect crypto traders from trading scam tokens and ensure the safety of their funds in exchanges. However, sharing data with the SEC could be a privacy concern for many especially where they rely on the anonymity of cryptocurrency. While the Commission can control what goes on in centralised exchanges, it is unaware of what people do on decentralised exchanges where know-your-customer (KYC) protocol is not required. Therefore, the rule mandating platforms within its scope to employ KYC protocol defeats a major cryptocurrency purpose.

The SEC rule allows for digital assets to be issued via ICO especially in cases where fund is being by crypto focused companies for new projects which are already approved by SEC after the submission of a white paper raised through. To achieve this end and going by the new SEC rule, if a company wants to raise funds by issuing tokens, it must do so on a platform that is registered and licensed as a VASP and DAOP. This process may be considered cumbersome by some people who are already in the crypto market.

In addition to the above, the SEC rule also set a hard cap for the funds to be raised by issuers. According to the Rule, an issuer can only raise twenty times the issuer's minimum shareholder capital (issuer's minimum shareholder capital is Five Hundred Million Naira (₦500,000,000)) within a 12-month period, subject to a ceiling of Ten Billion Naira (₦10,000,000,000) or any ceiling that the Commission may from time to time determine for any digital asset project as shown in the whitepaper.

Given the nature of these digital assets and how volatile they can be, it is a wonder what the impact of this ceiling will be. For this purpose, will digital assets be similar to stock or is it only for raising capital? If digital asset is similar to stock, it only translates that the digital asset will react to growth based on market forces. Then, investors' money can be equally susceptible to profit or loss, whichever may be.

Cryptocurrency in other Jurisdiction and SEC's Rule

While the SEC rules may seem novel, it is not as countries around the world have since seize control of their respective crypto markets. Take for instance, Malta, widely known as the Blockchain Island in the crypto world, has regulations in place controlling its crypto market. In Malta, crypto exchanges are legal. The Maltese government has in place a regulatory framework called Landmark Legislation for Cryptocurrencies since 2018. This law addressed Anti-Money Laundering/Combating the Financing of Terrorism concerns as well.

The Virtual Financial Assets Act (VFA) is another of the Maltese crypto regulation laws which establishes a regulatory regime for crypto exchanges, ICOs, Brokers, wallet providers, advisers, and asset managers. The Virtual Financial Assets Act (VFA) is another of the Maltese crypto regulation laws which establishes a regulatory regime for crypto exchanges, ICOs, Brokers, wallet providers, advisers, and asset managers.

The VFA regulations were further accompanied by the innovative Technology Arrangements and Services Act, establishing a regime for future registration and accountability of crypto service providers. The Maltese government also establishes the Malta Digital Innovation Authority (MDIA), which acts to create crypto policies, collaborates with other nations and organizations, and enforces ethical standards for the use of crypto and blockchain technology.





Similarly, in the USA, cryptocurrency exchanges are considered legal and falls under the regulatory scope of Bank Secrecy Act. And like SEC is proposing, this means that providers in the USA must register with Financial Crimes Enforcement Network (FinCEN), implement an Anti-Money Laundering/Combatting the Financing of Terrorism program, maintain appropriate records, and submit reports to the authorities. The USSEC, like its Nigerian counterpart, considers cryptocurrencies to be securities and applies securities laws comprehensively to digital wallets and exchanges.

Conclusion

Comparing the new development in Nigeria with the practices in the above stated countries, it is obvious that Nigeria is just catching up with modern practices. However, the SEC's new rule is a commendable headway in restoring the Nigerian crypto sector. It is believed that the new rules would provide the proper backdrop for a legal framework with which local financial institution and other related institutions within the sector may relate with cryptocurrency and other digital assets. It will also be commendable if the CBN can review its policy to accommodate and regulate the crypto-trade.

For more information

See [https://sec.gov.ng/wp-content/uploads/2022/05/Rules-on-Issuance-
Offering-and-Custody-of-Digital-Assets.pdf](https://sec.gov.ng/wp-content/uploads/2022/05/Rules-on-Issuance-Offering-and-Custody-of-Digital-Assets.pdf)

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