REGULATING CRYPTOCURRENCY IN NIGERIA; THE RIGHT APPROACH

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1.0 INTRODUCTION

Technology continues to evolve as time counts. It is expected from the indication of things, that the Digital economy will gradually evolve into the main economy itself. Digital assets (Cryptocurrency) and the Blockchain sector has posited a major feature of this emerging economy. The decentralized nature of the Blockchain has the potential benefits of driving financial inclusion, eliminating fraud and corruption and allowing for efficient and quicker transactions. However, the benefits of the emerging sector to the economy is as gigantic as the accompanying risk involved, this may not have been a far-fetched reason for the initial lukewarmness of regulatory bodies around the world in granting a firm legal status to the emerging financial system. Nigeria was not an exception, with most financial regulators in the country issuing circulars against the risk of cryptocurrency. Despite the thick regulatory stiffness that has circled the crypto market, Nigeria reportedly ranks as the second largest holder of Bitcoin in the world[1], this shows its increasing popularity which has come to stay.

Recent trends and gradual global economic acceptance of cryptocurrencies have deemed it necessary for regulatory bodies to address the legal and economic implications of the growing sector. To this effect, SEC released a Classification statement on digital assets on Sept 14, 2020 [2]and a National Blockchain adoption strategy was also drafted for relevant stakeholders in the industry.[3] Predicated on this foregoing, this article seeks to explore the best possible approach by Nigerian financial authorities in the regulation of crypto assets. Towards this end, the first part of the article shall demystify the concept of cryptocurrency and its accompanying technologies. We will then examine the regulatory approach by Financial institutions in Nigeria with the intention of unmasking challenges. Finally, we will make a case for a brief comparative analysis with regulatory approaches in other jurisdictions in a bid to proffer recommendations.

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[1] Financial Nigeria, Nigeria ranks as world's second-largest bitcoin trader after the U.S, (18 Dec 2020, 04:22), financialnigeria.com, http://www.financialnigeria.com/nigeria-ranks-as-world-s-second-largest-bitcoin-trader-after-the-us-news-2282.html

[2] SEC Nigeria, Statement on Digital assets and their classification and Treatment, sec.gov.ng, (Sep 14,2020), https://sec.gov.ng/statement-on-digital-assets-and-their-classification-and-treatment/

[3] NITDA, National Blockhain adoption Strategy,

2.0 THE EMERGENCE OF CRYPTOCURRENCY

Who could be Satoshi Nakamoto?

It all started in 2009 when a paper called Bitcoin- a peer to peer Electronic cash system was posted to a mailing list discussion on cryptography. It was posted by someone calling themselves Satoshi Nakamoto, whose real identity remains a mystery till this day[4]. This indeed marked the beginning of Cryptocurrency, the talk of the town. Cryptocurrency is a medium of exchange created and stored electronically, using encryption techniques to control the creation of monetary units and to verify the transfer of funds. [5]

The definition of Cryptocurrency will be inchoate without referring to its underlying technologies. This is because cryptocurrencies are decentralized networks based on blockchain technology- a distributed ledger enforced by a disparate network of computers which eliminates third party interference in the execution of transactions and allows for costlier and effective transactions.[6] With the Blockchain technology, transactions of cryptocurrency can be made from one person to another. However, no physical currency moves under this transaction. All the currency exists as data on a global database (Blockchain) which ensures transactions are checked and verified by computers around the world[7]. Cryptocurrency could be interchangeably referred to as coin or tokens. A digital coin is usually native to a blockchain and can be used for payments, transfer of funds, and storage of value. Unlike digital coins that are created on their own blockchain, tokens generate on existing blockchain of specific digital coins. They could be security tokens, commodity tokens, payment tokens, utility tokens or application tokens. Most Security tokens usually assume features of traditional securities and are most likely to be regulated as an investment.

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[4] Bernard Marr, A Short History of Bitcoin and Crypto Currency Everyone Should Read, Forbes, (Dec 6, 2017,12:28am, EST), https://www.google.com/amp/s/www.forbes.com/sites/bernardmarr/2017/12/06/a-short-history-of-bitcoin-and-crypto-currency-everyone-should-read/amp/

[5] CCN, "Bitcoin Turns 9 and Has Evolved into a Global Currency Already", CCN, 31 Oct, 2017), https://www.ccn.com/bitcoin-turns-9-already-evolved-global-currency/

[6] . Jake Frankenfield, Cryptocurrency, Investopedia, (May 5, 2020) https://www.investopedia.com/terms/c/cryptocurrency.asp

[7] Aelex, Regulating Cryptocurrency and Initial coin offerings: The Nigerian Perspective (Part 1), Aelex, (July, 2020) https://www.aelex.com/regulating-cryptocurrency-and-initial-coin-offerings-the-nigerian-perspective/

3.0 REGULATORY RESPONSE TO THE RISE OF CRYPTOCURRENCY; PROSPECTS AND CHALLENGES

When the virtual currency system arrived, it was met with scepticism from financial bodies. Though aware of its increasing popularity, the feeble reception could be justified. Cryptocurrencies such as Bitcoin was severally linked with schemes in the underworld like the funding of terrorism and other criminal acts[8]. The suspicion further heightened when the popular Ponzi scheme, Mavrodi Mudial Moneybox (MMM) which swindled both the rich and poor in the unforgettable 2016 scam, announced its adoption of Bitcoin[9]. Following this, the CBN [10]and SEC [11]released circulars advising and warning the public on the risks of cryptocurrency, noting it was not a legal tender and was yet to be given regulatory backing. Financial institutions were also advised to exercise caution in the use of cryptocurrencies.

This position was short lived though, as the increased popularity in the usage of Fintech products and services necessitated the SEC to inaugurate a FinTech Roadmap Committee (the Committee) for the Nigerian Capital market (NCM) to look into the growths and prospects of the Nigerian FinTech Industry. One of the recommendations by the Committee was for SEC to provide a framework for the regulation of virtual assets. Among the recommendations was for Cryptocurrencies to be recognized as either commodities or security but not a legal tender. It was also highlighted that SEC develop a framework that will cater for Virtual Financial Assets, issue guidelines and standards for white papers and ICOs and even referred to the Malta ICO guide for the classification and taxonomy of tokens.[12]

Drawing inspiration from this, the SEC released a statement on the classification of digital assets. Consequently, the SEC will regulate crypto-token or crypto-coin

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[8] Olga Kharif, The Criminal Underworld Is Dropping Bitcoin for Another Currency, (Jan 2, 2018, 11.00am), Bloomberg,
https://www.bloomberg.com/news/articles/2018-01-02/criminal-underworld-is-dropping-bitcoin-for-another-currency

[9] Vanguard, "MMM prepares to return, dumps Naira for Bitcoin" (9 January 2017),
https://www.google.com/amp/s/www.vanguardngr.com/2017/01/mmm-prepares-to-return-dumps-naira-for-bitcoin/amp/

[10] CBN circular "Circular to banks and other financial institutions on virtual currency operations in Nigeria" (12 Jan, 2017),

[11] .SEC, "Public Notice on Investments in cryptocurrencies and other virtual or digital currencies", sec.gov.ng, (12 January 2017),
http://sec.gov.ng/public-notice-on-investments-in-cryptocurrencies-and-other-virtual-or-digital-currencies/

[12] The FinTech Roadmap Committee of the Nigerian Capital market, The Future of FinTech in Nigeria, (Aug 22, 2019),
https://sec.gov.ng/wp-content/uploads/2020/09/Report-of-the-FinTech-Roadmap-Committee-of-the-Nigerian-Capital-Market_-October-14-2019.pdf

investments when the character of the investment qualifies as securities transactions. The statement deems all virtual assets as securities until proved otherwise by the issuer or sponsor of the said assets. The Statement further classifies digital assets into four namely utility tokens, Security tokens, crypto assets and derivative and collective investment funds for crypto assets.[13] While it can be said that the statement proves a major victory for the crypto market which prior to the statement thrived on regulatory risks and market confusion. Can it be said that the SEC statement on Digital Assets served as a panacea to the already confused market or rather fuelled more confusion? This debate will mostly linger in the day to day operations of a legal practitioner. For instance, the classification is bereft of a proper guide to understand what may or may not constitute securities. There is the tendency of cryptocurrency platforms possessing virtual assets to be inaccurate in their classification in a bid to escape the overwhelming obligations inherent in regulations. In such a situation where a business that offers variety of coins is oblivious on how best to classify her assets, there will be need for strong legal insight to uncover its classification since the SEC statement is bereft on that point. What then will constitute securities under the classification of digital assets? By virtue of the investment and Securities Act (2007)[14] which covers securities transferred electronically, Security tokens can also be regulated by SEC. However, the vague clarity in classification is an issue that will need revisiting in the regulatory framework since the area is still novel in Nigeria and is scarcely covered by case laws. A standard test to ascertain what will amount to a security token is mostly applied in the United states and is usually referred to as the Howey Test,[15] drawing its origin from the U.S Supreme court case of Howey V SEC[16] which sets out what will constitute an investment contract in any transaction. Recently in the United States, the US SEC obtained an injunction to restrain Telegram from issuing over 1.7 billion of grams (her native cryptocurrency) on the grounds of unregistered securities. Telegram had argued that the coins were commodities and served as utilities to obtain services on her platform, however the US SEC was of a contrary opinion.[17] To avoid potential issues like this and avoid the bottlenecking of well-meaning initiatives in the crypto market, the anticipated regulatory framework should be crystal clear on the issue of defining what will amount to securities or not.

Next is to ascertain the role of other regulatory bodies in the regulation of secondary market operators and Cryptocurrency platforms, such centralized platforms will need

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[13] Supra 2
[14] Section 13(d) Investment and Securities Act 2007 (ISA 2007)
[15] Leeway Hertz, The Howey Test; Regulating the Blockchain tokens https://www.leewayhertz.com/howey-test/

[16] 328 US 293 (1946)
[17] U.S. Securities and Exchange Commission, SEC Halts Alleged $1.7 Billion Unregistered Digital Token Offering, (2020), https://www.sec.gov/news/press-release/2019-212

to keep strictly with licensing requirements as exchange platforms and uphold data privacy/policies and set strict standards like KYL and AML requirements which will help combat the likelihood of scams and the influx of Ponzi schemes.

It is important to note that the Cryptocurrency sector is only a dividend of the multifarious benefits of Blockchain industry. For any meaningful development in the sector, the source must be adequately fed. Most advanced cryptocurrency jurisdictions like Malta boasts of a well-defined framework of the Blockchain industry. Nigeria seems to be on the right track, with the NITDA presenting a National Blockchain draft.[18] If fully implemented and morphed into to a comprehensive regulation, the Crypto market in Nigeria will stand a lot to gain.

Overall, Nigeria is threading a good path in the journey to the realization of a full digital economy. as they say a journey to a thousand miles begins with a step. Nigeria has taken the vital steps but will need to learn from others who have gone ahead of the journey.

4.0 CRYPTOCURRENCY REGULATIONS; ANY LESSON FROM OTHER JURISDICTIONS

For any budding industry to be established, it is expected to go through phases of development. The Nigerian cryptocurrency regulatory system should take a cue and mirror the initiatives of successful Cryptocurrency jurisdictions to attain a well-established system. A perfect example to mirror is Malta, the world acclaimed blockchain island. Malta has taken a very progressive approach to cryptocurrencies, positioning herself as a global leader in crypto regulation[19]. To create an enabling environment for the emerging economy, Malta enacted three laws, these are the Malta Digital Innovation Authority Act, the Innovative Technological Arrangement and Services Act, and the Virtual Financial Assets Act[20]. These three Acts were intricately designed in a way that they would work seamlessly to create a triad that provides a comprehensive platform which the industry uses to ascertain the integrity of all Distribute Ledger Technology (DLT) software solutions and put together all the necessary safeguards for buyers[21]. The sector is well recognised worldwide that the Mediterranean archipelago earned the nickname "Blockchain Island"[22]. The interesting

[18] Supra 3

[19] Comply Advantage, Cryptocurrency Regulations in Malta, https://complyadvantage.com/knowledgebase/crypto-regulations/cryptocurrency-regulations-malta/

[20] CSB Group, Cryptocurrency Services in Malta, https://www.csbgroup.com/fintech/cryptocurrency-malta/

[21] CSB Group, Cryptocurrency Services in Malta, https://www.csbgroup.com/fintech/cryptocurrency-malta/

[22] https://www.google.com/amp/s/blog.okcoin.com/2020/01/21/malta-cryptocurrency-regulation-innovation-on-the-blockchain-island/amp/alta

thing to note about the Malta system is that it sets out a well-defined Financial Instruments Test to ascertain the classification of digital assets. This solves the incongruous interpretations in this aspect as visible in the Nigerian SEC statement.

The taxation of cryptocurrencies should also be looked into, for instance the American Inland Revenue Service (IRS) taxes crypto asset as properties as opposed to currencies.[23] In Malta, tokens are categorised into two; Financial tokens and Utility tokens, Financial tokens (securities) are usually taxed as income taxes while VAT is attached to utility tokens[24].

Furthermore, Nigeria should also update her anti money laundry requirements to cover Cryptocurrency transactions. For instance, the US FinCen[25] has proscribed firm guidelines for virtual currency exchange platforms and secondary market operators. The CBN, NITDA and other concerned financial institutions should also proscribe guidelines to reduce the possible volatilities associated with the crypto market.

4.0 RECOMMENDATIONS AND CONCLUSIONS

The regulatory response by the SEC to the emerging blockchain and cryptocurrency sector in Nigeria has been commendable, however much more needs to be done to advance the crypto market in Nigeria. The government should ensure that relevant stakeholders, blockchain experts, organisations and enthusiasts are consulted to give suggestions and clarity to regulatory issues. Also, the government should be careful not to over regulate the crypto market as this may stifle creativity and market initiatives. Nigeria needs to borrow a leaf from other jurisdictions in designing efficient regulatory frameworks for the crypto markets and decide how best it will suit the Nigerian context.

Authorities should also develop frameworks to manage the heavy risks and volatilities in cryptocurrency. It behoves regulators to know that risks are inherent parts of businesses and it is the job of regulators to manage it effectively.

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[23] Blockchain/Cryptocurrency Regulation 2021|USA, Global Legal Insights,https://www.globallegalinsights.com/practice-areas/blockchain-laws-and-regulations/usa

[24] Toshendra Kumar Sharma, Cryptocurrency Tax Regulations in Malta, Blockchain Council, https://www.google.com/amp/s/blog.okcoin.com/2020/01/21/malta-cryptocurrency-regulation-innovation-on-the-blockchain-island/amp/alta

[25] Financial Crime Enforcement Network of the United states of America (FinCen)