

# Aurora

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## **A SYNOPSIS OF THE NIGERIAN SECURITIES AND EXCHANGE COMMISSION RULES ON ISSUANCE, OFFERING PLATFORMS AND CUSTODY OF DIGITAL ASSETS.**

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**INSIDE TOLG ADVISORS**

## INTRODUCTION

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On Friday May 15, 2022, the Nigerian Securities and Exchange Commission (SEC) released its new rules on issuance, offering platforms and custody of digital assets (the "Rules") for crypto and digital asset service providers. The Rules provide for new licence requirements for platforms that deal with digital assets, classification of such platforms and guidelines for the operation of such platforms.

In the wake of the Central Bank of Nigeria's circular in February 2021, prohibiting banks and other financial institutions from undertaking cryptocurrency transactions, facilitating payments or settlement for cryptocurrency transactions, the Rules are a welcome and timely development as the cryptocurrency market continues to experience an upward progression with the shift of transactions to peer-to-peer platforms. The Rules apply to all issuers seeking to raise capital via any form of digital asset offerings and other market participants within the digital assets value chain.

## DIGITAL ASSETS AS SECURITIES

According to the Rules, a digital asset is a digital token that represents assets such as a debt or equity claim on the issuer of such asset. The Rules recognize cryptocurrencies/crypto-assets, utility tokens, non-security tokens, digital currencies (which are not recognized legal tender), non-fungible tokens and other forms of digital token as digital assets. It further recognizes all/any derivatives or collective investment funds backed by underlying digital asset or any other form of digital token which represents a debt or equity interest or participation as securities over which SEC exercises regulatory oversight. Essentially, a virtual asset is any digital representation of value that can be transferred, digitally traded, or utilized for payment or investment purposes.





## PARTICIPANTS IN THE DIGITAL ASSETS ECOSYSTEM

The rules identify the underlisted as the key players in the digital assets marketplace and therefore prescribes the procedure for registration and guidelines for their operations as capital markets operators:

- i. Digital Assets Offering Platforms (DAOPs).
- ii. Digital Asset Custodians (DACs).
- iii. Virtual Assets Service Providers (VASPs).
- iv. Digital Assets Exchange (DAX).



## PARTICIPANTS IN THE DIGITAL ASSETS ECOSYSTEM

The Rules require an issuer who seeks to offer digital assets to the public to first register the securities on a licensed Digital Operating Platform and to facilitate the issuance via the same platform. The DAOP operates as a self-regulatory organization like the exchanges and capital trade points in the broader capital market. It is required that all Digital Asset Offering Platforms be licensed by SEC (registration shall require the submission of an application in prescribed form and payment of incidental registration fees) and operated in full compliance with the rules and regulations of SEC. The Rules impose strict governance principles on DAOPs operating in Nigeria to ensure that the integrity of the market is preserved at all times. These include:

- i. Conduct of due diligence and critical assessment of all issuers and the proposed issuer to validate same as meeting the required criteria for issuance to the public;
- ii. Ensuring the issuer's compliance with the terms of the white paper (submitted in respect of the issuance) and all applicable SEC Rules.
- iii. Ensuring that the platform is operated in an orderly, fair, and transparent manner; Ensure transparency with investors by making the white paper accessible to the public.
- iv. Establish and maintain relevant policies and procedures including reporting, whistleblowing, compliance and risk mitigation policies;
- v. Keeping custody of and ensuring the safekeeping of investors' monies virtual assets/digital tokens by establishing and maintaining trust accounts administered by a trustee or a Central Securities Depository registered by SEC;
- vi. Maintain a register of initial token holders; and
- vii. Ensuring the safekeeping of digital assets of investors and pursuant to this, appoint a Digital Asset Custodian registered with SEC. Where the DAOP chooses to hold the digital assets in its own custody services, it shall be required to satisfy the full requirements of a Digital Asset Custodian. The Rules further prescribe that no DOAP shall discontinue/cease operations, without first giving a prior notice to SEC who may impose any conditions for the cessation of the operations of the DAOP. Winding up the operations of the DOAP will only take effect upon the satisfaction of SEC that all requirements stated in the Rules, the Investment and Securities Act 2007, relevant guidelines issued by SEC and any other relevant laws or requirements, have been fulfilled by the DOAP.



## II. DIGITAL ASSET CUSTODIANS (DACs)

A Digital Asset Custodian is any entity which provides the services of safekeeping, storing, holding or maintaining custody of virtual assets/digital tokens for the account of another person. Similar to a licensed custodian in the wider capital market, a digital assets custodian is expected to have a clear understanding of the Digital Assets Market place and the procedure for holding custody of or transferring legal title in and over the related asset. Any custodian holding assets to be issued under a SEC approved digital asset offering is required to be licensed by SEC upon submission of an application in the prescribed form and to satisfy SEC's prescribed eligibility requirements. It is interesting to note that foreign custodians may serve as Digital Assets Custodian, provided they meet the eligibility criteria prescribed in the Rules. Similar to the DAOP, the Rules impose strict governance principles on DACs operating in Nigeria to ensure that the integrity of the market is preserved:

- a. Establishment of a risk management framework to identify, assess, monitor, control and report all material risks to which the assets in the custody of the custodian could be exposed to;
- b. Ensuring the safe custody of assets and compliance with all relevant laws, regulations and guidelines including but not limited to Anti-Money Laundering/Combating the Financing of Terrorism/Proliferation Financing laws and regulations (AML/CFT/PF);
- c. Where there is a conflict of interest between the interests of the DAC and the investors, the DAC shall be required to give priority to the interest of the investors;
- d. Facilitation of the performance of periodic internal audits on the operations of the DAC;
- e. Safeguard of the rights and interests of investors in the digital assets. To this end, SEC imposes a duty on DACs to establish and maintain a secured storage medium for investors' digital assets; and

Protection of the data privacy of investors in relation to their digital assets. Where a DAC intends to cease its operations, it is required to give prior notice to SEC who may impose any condition for the cessation of the operations of the DACs. The winding up of the operations of the DACs will only take effect upon satisfaction of relevant requirement prescribed in the ISA2007, these Rules, relevant guidelines issued by SEC and any other relevant laws or requirements, have been fulfilled by the DACs.

### III. VIRTUAL ASSET SERVICE PROVIDERS(VASPS)

Anyone offering crypto or digital assets-related service in Nigeria is a VASP. A Virtual Asset Service Provider is any entity which conducts any of the following activities: exchange between virtual assets and the applicable fiat currency; exchange between one or more forms of virtual assets; transfer of virtual assets; safekeeping and/or administration of virtual assets or instruments enabling control over virtual assets; and participation in and provision of financial services related to an issuer's offer and/or sale of a virtual asset. Virtual Asset Service Providers are therefore a broad categorization of service providers within the Digital Assets Offering value chain including financial advisers. The categorization of VASPs is further broken down into:

Digital Assets Offering Platforms (DAOPs): These platforms enable the issuance of digital assets for fundraising purposes, otherwise referred to as initial coin offering platforms. You can liken it to a place where public companies offer their stocks for sale, such as the Nigerian Exchange Group (NGX).

Digital Asset Custodians (DACs): According to SEC, this means "a person who provides the services of 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 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.

The Rules do not mention any monetary requirement for the registration of VASPs, but there are several strict governance obligations imposed on Virtual Assets Service Providers including:

- mandatory compliance with all SEC rules and regulations;
- taking active measures to protect consumers;
- complying with all extant AML/CFT measures;
- transparency;
- extensive reporting requirements;
- maintaining accurate records; and
- providing SEC access to its registers upon request.

Similar to all other participants; every virtual asset service provider is required to be registered with SEC by submitting an application in the prescribed form upon the satisfaction of the requirements of SEC.



## IV. DIGITAL ASSETS EXCHANGE (DAX)

A Digital Asset Exchange is an electronic platform which facilitates the trading of a virtual or digital asset. Before an entity can operate as a DAX operator, it must procure its registration with SEC by submitting an application to SEC in the prescribed form and make payment for the prescribed fees. In addition, every digital asset exchange shall have a minimum share capital of N500,000,000 (Five Hundred Million Naira) and the current fidelity bond covering at least 25% of its share capital; and any additional financial requirement imposed by SEC from time to time.

Special Provisions relating to Digital Assets Exchange include the following:

SEC makes it mandatory for all DAX operators to obtain a permission from SEC before facilitating the trade of any virtual or digital assets on its Exchange.

In order to ensure transparency, all DAX operators are required to make publicly available, all information relating to the trading of assets.

SEC prohibits DAX operators from providing direct or indirect financial assistance to investors to investor trade in virtual assets on its platform, irrespective of the relationship between such investor and the DAX operator.

DAX operators are required to submit periodic reports covering compliance, trading statistics and financial statements to SEC.

Every exchange serving Nigerians must be duly certified by the Corporate Affairs Commission (CAC). This means exchanges such as Binance and Paxful will have to be registered with the CAC. Every exchange will also have a SEC-approved board. The appointment of CEOs and other principal officers in exchanges is also subject to the approval of SEC.

## PROCEDURE FOR UNDERTAKING A DIGITAL ASSET OFFERING

Before any digital asset offering can be undertaken within the Nigerian Market, it is required to be approved by SEC. The Issuer who shall be a SEC licensed operator shall submit an initial assessment filing to SEC which shall be reviewed within 30 days of submission. Upon satisfaction of the offering requirements as prescribed in the Rules, SEC shall grant its approval to the issuer to proceed with registration; following which, the issuer shall be required to submit a formal application for the registration of the digital assets intended to be offered to the public as securities. It is important to note that whilst there is no restriction on investment amount for qualified institutional and high net worth investors, SEC has cautiously limited the initial investment amount for retail investors to a maximum of N200,000.00 (Two Hundred Thousand Naira only) per issuer with a total investment limit not exceeding N2,000,000.00 (Two Million Naira only) within a 12-month period. Furthermore, the Rules preclude any issuer undertaking an initial digital asset offering from raising more than a maximum aggregate of N10Billion. The issuer is further-on required to demonstrate that the gross proceeds from the Issue shall be sufficient to meet the disclosed use of proceeds requirement. Therefore, where the proceeds of an offering falls below the soft cap indicated in the white paper, SEC shall not approve the allotment of securities. Following the closing of the offer, the Issuer shall be directed to refund all monies to the investors within 5 days thereof and the issue shall be deemed to be unsuccessful.

## CONCLUSION

The publication of the new rules represents a positive shift which is expected to bolster market confidence, establish standards of operations and encourage ethical practices that will protect the investor community whilst entrenching fair market practices. The Rules indicate a thorough comprehension by SEC of how cryptocurrencies work, as they delineate preemptive measures developed to protect crypto traders from trading scam tokens and ensure the safety of their funds in exchanges. However, the requirement of sharing data with SEC could raise privacy concerns for many practitioners, as cryptocurrencies were essentially created to afford participants some pseudonymity in their transactions.

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