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# **SHOULD CRYPOCURRENCIES BE REGULATED OR BANNED?**

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## **AN ANALYSIS OF THE REGULATORY STANCE ON CRYPTOCURRENCIES IN NIGERIA**

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The surge in conversations surrounding cryptocurrencies recently is not completely surprising as this class of assets which were of little to no value in 2009 when the world's first cryptocurrency "Bitcoin" was created<sup>1</sup>, are now estimated to be worth approximately \$36,000 per crypto-unit<sup>2</sup>. With the rapidly growing popularity of cryptocurrencies as a trading instrument across the world, a major point of interest and concern for most people in relation to cryptocurrencies is the mode of regulating them, especially in consideration of their unconventional nature. This article will provide an insight into the current regulatory stance on cryptocurrencies in Nigeria.

Cryptocurrencies are decentralized digital currencies which can be used in purchasing goods and services and can also be traded for profit making purposes. Being decentralized means that cryptocurrencies are not subject to supervision/management by a central bank, as with traditional currencies. Rather, cryptocurrency transactions are carried out through blockchain technology. Blockchain technology is a decentralized processing and recording platform which is shared and can be accessed by different computers simultaneously for the purpose of cryptocurrency related transactions. Furthermore, blockchain technology is mainly characterized as being a highly secure and transparent network which locks out any form of interference by third parties in the chain of events or transactions.

The decentralized nature of the cryptocurrency system is arguably its focal feature and has also been posited to be one of its major advantages. On the other hand, its decentralized nature has also been asserted as the reason why the regulation of cryptocurrencies may prove difficult. Nonetheless, the Securities and Exchange Commission's ("SEC") initial stance on cryptocurrency is worth considering. SEC communicated its foremost position on cryptocurrencies to the Nigerian public through a public notice dated 12 January 2017<sup>3</sup>.

In this notice, SEC cautioned the Nigerian public against trading and investing in cryptocurrencies and its basis for this was that the persons, companies and entities dealing in/offering same were not authorised by SEC or any other regulator to collect deposits from the public or provide financial services generally. SEC also categorically stated that there was no

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<sup>1</sup> Bitcoin in Numbers - Statistics and Facts about the cryptocurrency No.1 <https://btcmargintrading.com/bitcoin-in-numbers-statistics-and-facts-about-the-cryptocurrency-no-1/> Accessed on January 2021

<sup>2</sup> <https://markets.businessinsider.com/cryptocurrencies>

<sup>3</sup> Public Notice on Investments in Cryptocurrencies and other Virtual or Digital Currencies <https://sec.gov.ng/public-notice-on-investments-in-cryptocurrencies-and-other-virtual-or-digital-currencies/> Accessed on 29 January 2021

protection against financial losses available to Nigerian investors who deal in cryptocurrency. SEC dissociated itself from the cryptocurrency market and it led to a fair assumption by some that SEC had no interest in regulating cryptocurrencies. This was particularly interesting as 2017 was the year when the value of cryptocurrencies saw its most drastic increase<sup>4</sup>. However, SEC's position at that material period may have been borne out of the fact that at the time, cryptocurrencies were for a significant period mostly associated with illegalities such as fraud and terrorism funding.

The negative reputation of cryptocurrencies however lessened over time as they gained a reputation as profitable investments. Coincidentally, a major shift was witnessed in SEC's treatment of cryptocurrencies. On 14 September 2020, SEC published a public notice titled - Statement on Digital Assets and their Classification and Treatment<sup>5</sup> ("Statement"). SEC in this Statement informed the public that pursuant to the role conferred on it by section 13 of the Investment and Securities Act 2007 ("ISA" or "the Act") as apex regulator of all investments and securities, it would regulate all crypto-assets where they qualify as securities. Although digital assets were not specifically mentioned in the Act, the expansive nature of the word "all" used in describing the extent of SEC's regulatory oversight permitted the interpretation of "investments and securities" under its purview to cover both traditional and digital investments and securities.

SEC declared that all crypto-assets would be prima facie regarded as securities unless proven otherwise, thereby bringing all cryptocurrencies within its regulatory purview at the first instance. By this Statement, a burden had been placed on issuers and sponsors of cryptocurrencies to prove that their crypto-assets did not qualify as securities to warrant regulation by SEC. This burden of proof was to be discharged by an initial assessment filing to be made to SEC by said issuers and sponsors of cryptocurrency to enable SEC reach a decision on whether the said asset qualified as a security. Where SEC found that the crypto-asset qualified as a security, then the issuer or sponsor of same would be required to register with SEC. Similarly, all digital assets and blockchain related offerings (such as initial coin offerings) within Nigeria, whether by Nigerians or foreigners were subject to regulation.

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<sup>4</sup> 3 reasons why bitcoin has doubled in less than a month - and why experts think it won't repeat its 2017 crash <https://africa.businessinsider.com/markets/3-reasons-why-bitcoin-has-doubled-in-less-than-a-month-and-why-experts-think-it-wont/m0qjb5w> Accessed on 9 January 2021

<sup>5</sup> Statement on Digital Assets and their Classification and Treatment <https://sec.gov.ng/statement-on-digital-assets-and-their-classification-and-treatment/> Accessed on 29 January 2021

Before proceeding, it is important to consider SEC's definition of crypto-assets. According to SEC, a crypto-asset is "a digital representation of value that can be digitally traded and functions as: a medium of exchange; and/or a unit of account; and/or a store of value, which does not have legal tender status in any jurisdiction. A crypto-asset is neither issued nor guaranteed by any jurisdiction and fulfils the above functions only by agreement within the community of users of the crypto asset. The Commission notes that crypto assets are distinct from fiat currency and e-money".

A few observations from this portion of the Statement are as follows. Firstly, it is clear that SEC's intention was not to regulate all dealings with cryptocurrencies which could range from cryptocurrency trading to cryptocurrency mining (creating new cryptocurrencies), cryptocurrency investments and the use of cryptocurrencies as legal tender in exchange for goods and services. SEC's concern was only with crypto-assets which qualified as securities. However, the effect of SEC's Statement was that all persons and entities dealing with cryptocurrencies in any of the aforementioned capacities were required to undergo an initial assessment filing to prove that the assets they held were not securities. This approach appeared reasonable, as an attempt to regulate all spheres of cryptocurrency was not only impracticable in light of the decentralized nature of cryptocurrency dealings, but would also require the introduction and deployment of a significant amount of complex technologies and expertise. With regards to digital asset offerings which are essentially the crypto industry's equivalent of company public offerings, it remained to be seen how SEC would regulate offerings within Nigeria, as the offerings were carried out through blockchain technology, which was not within the control or regulatory purview of SEC nor any other individual or entity across the world.

Additionally, SEC provided that the following class of persons would be subject to its regulation:

- (i) Any individual or corporate entity whose activities involved blockchain related and virtual digital asset services such as reception, transmission and execution of orders on behalf of persons, portfolio management, investment advice and nominee services; and
- (ii) Issuers or sponsors of digital assets.

In relation to (ii), SEC had stated further that SEC may require foreign and non-residential issuers and sponsors to establish a branch office within Nigeria. An exception was however made for - foreigners and non-resident Nigerians from countries who had reciprocating agreements with Nigeria; and foreigners and non-resident Nigerians from any of the member countries of the International Organization of Securities Commissions; in respect of whom SEC conferred recognition status. We note however that SEC had not provided any insight as to the scope of this recognition status and the consequential benefits.

It appeared that the issues raised in SEC Statement would subsequently be codified into regulatory guidelines to be issued by SEC on the regulation of digital assets in Nigeria and consequent upon the issuance of same, would become of full force and effect. SEC had stated that when the guidelines come into effect, digital assets offerings which were in existence and operating prior to the issuance of the regulatory guideline would be granted a three (3) month period for the submission of their initial assessment filings and completion of registration process (where applicable).

A strong case had been made by cryptocurrency enthusiasts and experts within that sector on how clear and effective regulation of cryptocurrency investments could increase their viability and popularity and also, reduce their volatility thereby enabling cryptocurrencies to occupy a larger space in the global money economy. The proposed steps to be taken by SEC in relation to cryptocurrency regulation were commendable as it showed that the apex securities regulator understood the distinction between functional cryptocurrencies, such as bitcoin, which are not securities, and promises of cryptocurrencies, which may in some cases be securities. It was highly anticipated that the regulatory guidelines to be issued by SEC would proffer a clear and practical framework which would boost the confidence of investors in this rapidly emerging class of securities. A particularly anticipated provision of the proposed guidelines were the provisions on non-compliance.

For example, the UK has adopted an approach which seeks to regulate cryptocurrencies in relation to money laundering and terrorism funding. Thus, the UK Financial Conduct Authority (“FCA”) has placed a burden on UK cryptocurrency exchanges to be registered with FCA.

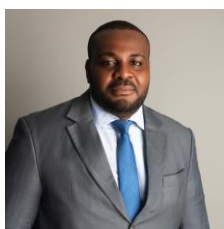
After what seemed like a giant stride towards Nigeria’s long over-due alignment with the growing cryptocurrency market and its corresponding benefits to the Nigerian economy, the Central

Bank of Nigeria (“CBN”) has now outrightly banned cryptocurrency activities in Nigeria. This is despite Nigeria’s recent surge as the second highest crypto destination in the world.<sup>6</sup> By the CBN’s circular dated 5 February 2021, CBN has banned financial institutions for facilitating the purchase of cryptocurrencies from the relevant exchanges. The reason behind CBN’s decision is apparently to curb illegal activities such as fraud and money laundering. Many have rightly criticised this move by CBN as being adverse to the Nigerian economy in consideration of the recent inclination of the Nigerian public to cryptocurrency investments and the consequent inflow of capital into the Nigerian economy. Although the central banks within many jurisdictions, such as the Central Bank of the European Union have acknowledged the possibility of cryptocurrencies being used for reprehensible activities, the approach in many jurisdictions is to regulate cryptocurrencies. Adequate regulations of cryptocurrency will in fact assist both the regulators and financial institutions in tracing and flagging illicit activities.

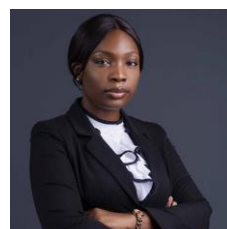
For example, the UK has adopted an approach which seeks to regulate cryptocurrencies in relation to money laundering and terrorism funding. Thus, the UK Financial Conduct Authority (“FCA”) has placed a burden on UK cryptocurrency exchanges to be registered with FCA. An integral part of the regulation is the implementation of effective Know Your Customer and Customer Due Diligence practices in a bid to protect customers and prevent illicit activities.

While the CBN is not and cannot be reasonably expected to sit back and allow illicit activities under the guise of crypto-trading and investments, a blanket ban of cryptocurrency trading is not only unfavourable to the Nigerian economy but also the citizenry at large. As such, it is posited that the regulatory approach earlier sought to be implemented by SEC is the more favourable way forward in conjunction with regulatory oversight by the CBN.

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<sup>6</sup> Nigeria ranks as world’s second- largest bitcoin trader after US <http://www.financialnigeria.com/nigeria-ranks-as-world-s-second-largest-bitcoin-trader-after-the-us-news-2282.html> Accessed on 5 February 2021