Whether digital and virtual assets are, or need to be, regulated in Nigeria has been quite controversial in recent times. There have been various but uncoordinated approach on the issues by key regulatory bodies – most of which was geared towards getting people not to trade in the class of assets. The reluctance of regulators to publicly encourage the investment or participation in digital and virtual assets was evidenced in the position of the Securities and Exchange Commission (“SEC”) prior to September 2021. The initial indication of the SEC’s interest in regulating digital assets was indicated in its statement of 14th September 2020. The Central Bank of Nigeria’s (“CBN”) prohibition, in February 2021, of financial institution regulated by the CBN from dealing in cryptocurrencies or facilitating payments for cryptocurrency exchanges dealt a huge blow to the SEC’s regulatory effort. Apparently undaunted by the CBN’s prohibition, the SEC’s finally published new regulations titled “Rules on Issuance, Offering Platforms and Custody of Digital Assets” (the “Rules”) on 11th May, 2022. The publication of the Rules is a welcome development which has, as expected, generated significant buzz about various innovations that would thrive in the Nigerian digital and virtual assets.

The Rules are meant to address various aspects of dealings in digital and virtual assets and divided into five parts:

(a) Part A: Rules on Issuance of Digital Assets as Securities;

(b) Part B: Rules on Registration Requirements for Digital Asset Offering Platforms;

(c) Part C: Rules on Registration Requirements for Digital Asset Custodians;

(d) Part D: Rules on Virtual Assets Service Providers; and

(e) Part E: Rules on Digital Assets Exchange.

These various parts of the Rules set out the approval process for Issuers looking to raise funds in through the capital market by offering digital assets such as tokens to the public, digital assets offering platforms (“DAOP”), digital assets custodians (“DAC”), virtual assets service providers (“VASP”), and digital asset exchanges (“DAX”).
In the course of a 5-part series, Udo Udoma & Belo-Osagie will provide a review of the provisions and requirements of the Rules and highlight the key changes that have been introduced into the SEC’s regulations pursuant to the Rules. In this first part of the series, we will discuss the rules relating to the issuance of digital assets as securities.

**Issuance of Digital Assets as Securities**

Part A of the Rules applies to issuers seeking to raise capital through digital assets offerings. This follows the definition of digital assets in the Rules as “a digital token that represents assets such as debt or equity claim on the issuer”. Under the Rules, where digital asset Offerings (such as Initial Coin Offerings (“ICOs”)) are issued to the general public, investors can pay for such tokens with cash, cryptocurrencies and other assets. Such tokens, before they are issued to the public for purchase, must be registered with the SEC. What this means is that companies looking to issue security tokens are required to comply with the requirements of the Rules.

**Who can issue Digital Assets Securities to the public in Nigeria?**

The SEC stated in the Rules that they are in addition to any requirements for the issuance of securities provided for under securities laws or any other rules issued by the SEC. Under the Investments and Securities Act 2007 and the Companies and Allied Matters Act 2020, only public liability companies are permitted to issues securities to members of the public. The effect of this is that the issuers of digital assets will need to be public limited liability companies. Private companies will be unable to do that. Foreign companies also wishing to offer digital assets tokens as securities to the public in Nigeria must also register same with the SEC and, in seeking to do that, must comply with any other SEC regulations on offering of securities in Nigeria by foreign entities. Some of these requirements include:

A. filing of an application accompanied by a draft prospectus; and
B. making a sworn declaration that all material facts has been disclosed in the offer document.

**Application Process**

The Rules require any Promoter, entity or business proposing to conduct digital asset offerings within Nigeria, or targeting Nigerians, to first submit an initial assessment form and a draft whitepaper to the SEC. These documents are required to contain, among other things, comprehensive information on the sustainability and scalability of the token and how the digital asset offering will benefit investors and deepen the market; detailed description of the Digital Asset, the risks associated with investing, the lock up period (if any), the bonuses, profits, rights and privileges (monetary and non-monetary) to the buyer of the token, the value of each token, its technology and system architecture; legal opinion on whether or not the tokens to be sold through the Initial digital asset offering are securities, including sufficient justifications; and the minimum amount (“Soft Cap”) and Maximum amount (“Hard Cap”) of capital intended to be raised.
SEC’s Review

The SEC will review the initial assessment form and a draft whitepaper and inform the issuer within 35 days from the receipt of the documents on whether the digital asset to be offered is a security. Where confirms that it is a security, the issuer shall apply to the SEC to register the security.

Where the SEC confirms that the digital token being issued is a security, the issuer shall file an application for the registration of the digital assets which the SEC may accept or deny the application. The application is required to include a registration Statement containing the name, ticker, and price of the tokens and the number of tokens to be sold and the registration fees; Solicitor’s opinion confirming that all applicable permits and licences for the issuance and transfer of the securities has been obtained; and evidence of payment of applicable fees. Upon review of the application for registration, if the SEC is satisfied with the application, it will register the digital assets securities.

Protection of Investors

One fundamental responsibility of the SEC is the protection of investors. As a result, in its bid to protect investors and ensure that the directors and senior management of an issuer are fully invested in the digital asset Offering, the Rules require that the issuer’s directors and senior management should own an aggregate of at least 50% equity in the Issuer on the date of the issuance of the digital assets. While the issuer’s directors and senior management who own more than 50% of equity in the Issuer may sell, assign or transfer their equity holding upon commencement of the issuance of the tokens, they are not permitted to transfer more than 50% of their respective holdings until the issuance is completed.

Investment Limit

The SEC requires that the maximum amount of funds an issuer will be permitted to raise shall not be more than twenty times the issuer’s shareholders’ funds. Notwithstanding this threshold, the SEC prescribed a ceiling of NGN10 billion or any other ceiling that the SEC may determine from time to time within any continuous 12-month period. Where the funds raised are below the Soft Cap (which is a minimum of fund needed and aimed by the project to proceed as planned), it means the offering is unsuccessful and the issuer shall refund all monies to the token holders within 5 days of the offer closing date.

Regarding investors themselves, a retail investor is only permitted to invest a maximum of NGN200,000 in a digital asset offering with a total investment limit not exceeding NGN2 million within a 12-month period. There is, however, no limit for Institutional investors.

Exemptions to Registration

The SEC exempted some sale of digital assets in the form of securities from registration and these are securities structured to be exclusively offered through crowdfunding portals or intermediaries; a judicial sale or sale by an executor, administrator or receiver in insolvency or bankruptcy; where the sale is by a pledged holder or mortgagee, selling to liquidate a bona fide debt and not for the purposes of avoiding the provision of these rules; and an 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.
Conclusion

As you would have seen above, Part A of the Rules focuses on the issuance of digital assets which can be classified as debt or equity in the issuer of the digital assets. Nigerian and foreign issuers wishing to issue Digital Assets tokens as securities to the public in Nigeria are now required to register those Digital Assets are to register with the SEC. There is also emphasis on promoters of issuers having ‘skin in the game’, to ensure that investors are protected. It is currently not clear how this Part of the Rules will apply in light of the CBN Circular that prohibits financial institutions under its regulatory purview from engaging in or facilitating payments for transactions involving cryptocurrencies and virtual assets. This is so considering that issuers will be required to operate bank accounts to show that they have the requisite funds, receive payments for subscriptions and for their business. This will be difficult if the CBN does not relax the prohibition. The CBN’s prohibition will be a major draw back to the implementation of the Rules.

The Rules are fairly new and issues may arise in the course of implementation which the SEC will be required to address. We hope that the implementation of the Rules will achieve the SEC’s objective and that it would deepen transactions in digital assets in Nigeria.

This update is for general information purposes only and does not constitute legal advice. If you have any questions or require any assistance or clarification on how this update could apply to you or your business or require litigation advice on any aspect of the Nigerian laws, please contact uubo@uubo.org.