

SEC NEW RULES ON THE ISSUANCE, OFFERING PLATFORMS AND CUSTODY OF DIGITAL ASSETS – WHAT YOU NEED TO KNOW

In our Series 3 of these updates <https://www.uubo.org/media/2454/series-3-the-new-sec-rule-on-the-issuance-of-digital-assets-and-the-implications.pdf>, we had looked at the Securities and Exchange Commission's ("SEC") requirements in relation to Digital Assets Custodians. In this current series, we will consider the SEC's Rules on Virtual Assets Services Providers (VASPs) ("VASP Rules"). The SEC describes a VASP in the VASP Rules as an entity which conducts any of the following activities or operations for or on behalf of another person:

- (a) exchange between virtual assets and fiat currencies;
- (b) exchange between one or more forms of virtual assets;
- (c) transfer of virtual assets;
- (d) safekeeping and/or administration of virtual assets or instruments enabling control over virtual assets; and
- (e) participation in and provision of financial services related to an issuer's offer and/or sale of a virtual asset. Any corporate entity which provides any of these services in Nigeria is a VASP and is required to obtain a licence from the SEC in order to lawfully operate in the country.

Applicability

Unlike the other Parts of the Rules that only apply to specific activities (please refer to Series 1 to 3 of these updates), the VASP Rules have a wider applicability. The VASP Rules apply to:

- (a) all platforms that facilitate trading, exchange and transfer of virtual assets;
- (b) persons whose activities involve any aspect of Distributed Ledger Technology ("DLT") and virtual digital services such as the reception, transmission and execution of orders on behalf of other person dealers on own account, portfolio management, investment advice, custodian or nominee services, etc.;

- (c) foreign or non-residential issuers or sponsors of virtual or digital assets; and
- (d) foreign or non-resident operators that actively target Nigerian investors directly or through their agents by promotions, publications in Nigeria or direct e-mails to Nigerian addresses.

Notwithstanding the wide scope of the VASP Rules, the rules do not apply to:

- (i) a technology service provider which merely provides the infrastructure, software or the system to a Digital Asset Exchange (“DAX”);
- (ii) an operator of a communication infrastructure that merely enables orders to be routed to an Exchange; and
- (iii) an operator of a financial portal that aggregates content and provides links to financial sites of service and information provider

Differentiation between virtual Assets and Digital Assets

The VASP Rules distinguishes between what is classified as a Virtual Asset and a Digital Asset. It defines a “Virtual Asset” as a digital representation of value that can be transferred, digitally traded and can be used for payment or investment purposes excluding digital representations of fiat currencies, securities and other digital assets while “Digital Asset” is defined to mean a digital token that represents assets such as a debt or equity claim on the issuer. By this definition, any electronic representation of a fiat currency (such as the e-Naira) will not be deemed to be a virtual asset. In addition, the definition excludes Digital Assets from being classified as Virtual Assets because Digital Assets are securities as defined the VASP Rules. What this means is that any digital token which is issued to represent a person’s interest in another class of assets (such as fiat currency, equity, debit or virtual assets) will be classified as digital asset and not virtual assets.

Incorporation of an Entity and Corporate Office

The SEC requires that a VASP must be a body corporate (unless the SEC specifies otherwise) and must have an office in Nigeria managed by a director of the company.

Waiver by the SEC

The VASP Rules empowers the SEC to grant an exemption from, or to vary, the requirements of the VASP Rules in relation to a VASP, provided the SEC satisfied, before such grant, that:

- (a) such a variation is not contrary to the intended purpose of the relevant requirements of the VASP Rules; or
- (b) there are mitigating factors justifying an exemption or variation.

It is noteworthy that the provisions which empower the SEC to vary or waive the requirements of the VASP Rules also provide that applicants are entitled to make a case to the SEC on why a particular requirement of the rules should not be complied with. This could provide a good opportunity for an entity interested in operating as a VASP in Nigeria to apply to the SEC to seek an exemption from any of the requirements of the VASP Rules which it deems should not be applicable. We hope that the SEC would exercise this discretionary power to vary the requirements of the rules judiciously in the interest of deepening participation in the market by operators.

Requirements for Registration

A VASP is required to be a corporate body to be registered with the SEC under the VASP Rules. The application to the SEC for registration should be accompanied with certain prescribed documents and information which include:

- (a) a sworn undertaking that
 - (i) the applicant will be able to operate a fair, orderly and transparent market when it comes to the securities and derivatives that are offered or traded on its platform;
 - (ii) the applicant will adhere to the provisions of the VASP rules as established by SEC; and
 - (iii) the information or document submitted to the SEC by the applicant is true and not misleading;
- (b) evidence that the applicant is not in the process of being wound up;
- (c) evidence that the applicant will be able to manage risks associated with its business and operation including demonstrating the processes and contingency arrangement in the event the applicant is unable to carry out its operations;
- (d) evidence that the applicant has sufficient financial, human and other resources for the operation of the Exchange; and
- (e) evidence that the applicant has appropriate security arrangements which include maintaining a secured environment pursuant to the SEC's Technology Risk Management Guidelines, as applicable.

Furthermore, an applicant must submit a business model which has a clear or unique value proposition that will contribute to the overall development of the capital market and the rules of the entity it seeks to operate and make satisfactory provisions

- (i) for the protection of investors and public interest;
- (ii) to ensure proper functioning of the entity to promote fairness and transparency;
- (iii) to manage any conflict of interest that may arise;
- (iv) to promote fair treatment of its users or any person who subscribes for its services;
- (v) to promote fair treatment of any person who is hosted, or applies to be hosted, on its platform;
- (vi) to ensure proper regulation and supervision of its users, or any person utilising or accessing its platform, including suspension and expulsion of such users or persons; and
- (vii) to provide an avenue of appeal against the decision of the VASP.

Where an applicant is regulated by another sector regulator, the applicant must also submit to the SEC a no-objection or approval letter from the relevant sector regulator as part of the application documents to be submitted to the SEC.

Obligations of a VASP

The VASP Rules impose various obligations on a VASP which include the obligation to: ensure and monitor compliance of its rules, ensure its users are treated fairly, ensure that all its disclosures are accurate, clear and not misleading, obtain and retain self-declared risk acknowledgement forms from its users prior to them investing in an Exchange; provide a conspicuous disclaimer on the platform informing investors that any loss resulting from the investors trading or investment through the Exchange is not covered by any protection fund; ensure that all fees and charges payable are fair, reasonable and transparent; provide the SEC access to the platform and any register required to be maintained under these Rules and disclose any other information as the SEC may require, and notify the SEC of the occurrence of any event which would trigger the activation or execution of the business continuity plan, in such form and manner as may be specified by the SEC.

In the event of any system error, failure or malfunction, a VASP shall take all necessary and immediate appropriate actions to mitigate any potential losses, and immediately notify the SEC of the system error, failure or malfunction.

Conclusion

The VASP Rules do not state the fees and timeline for registration with the SEC as a VASP. As we have indicated above regarding applicability of the VASP Rules, persons whose activities involve the safekeeping and/or administration of virtual assets or instruments enabling control over virtual assets are required to register as VASP. This is similar to the roles of Digital Assets Custodians ("DAC"). It is currently unclear whether registration as a DAC would be sufficient or whether an entity registered as a DAC will also need to obtain a VASP licence before it can act as a custodian for both virtual assets and digital assets. In our view, this issue will only arise if a DAC intends to have safe custody of both digital assets and virtual assets. This issue of whether a registered DAC will also need to obtain a VASP licence to keep safe custody of both virtual assets and digital assets will need to be clarified by the SEC; and we hope that would be done soon. On the other hand, a DAC can carry on the business of the safe custody of only digital assets without any concerns about whether it will also need a VASP licence. This is because the VASP Rules excludes digital assets from the definition of what constitutes virtual assets.

Lastly, and more importantly, it is still uncertain how this Part of the Rules will apply in light of the Central Bank of Nigeria ("CBN") prohibition of financial institutions under its regulatory purview from engaging in or facilitating payments for transactions involving cryptocurrencies considering that VASPs will be required to operate a bank account for their business and to settle transactions. We hope that a middle ground is arrived at on this issue between the SEC and the CBN soon in the interest of the market. Otherwise, interested parties may have no incentive to register with the SEC under the Rules as they will have no means to settle transactions without the involvement of financial institutions regulated by the CBN.