



Cryptocurrency: Strengthening digital currency regulations in Nigeria

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Abstract

The widespread use of digital currency as an alternative method of payment and an investment tool has led to a growing digital ecosystem over the years. The use of digital currency however has come with perceived threat to the financial sector. Governments around the world are behind the curve, continuing to wrestle with how to develop effective public policy measures to regulate its adoption and use. Thus, this paper will explore the current regulatory framework on digital currency in Nigeria, with major focus on ways these regulations can be strengthened.

Keywords: digital currency, cryptocurrency regulation, crypto investment, Nigeria

Introduction

In recent years, the global financial landscape has experienced a rapid shift towards digital currencies, with Cryptocurrency emerging as a prominent player in this sphere. However, this trend has not been without its challenges, as some governments have expressed concerns about the potential risks associated with digital currencies, such as money laundering and terrorism financing. Nigeria is among the countries that have expressed such concerns, with the Central Bank of Nigeria (CBN) issuing a ban on Cryptocurrency in February 2021. This move was prompted by a series of circulars issued by the CBN, the Securities and Exchange Commission (SEC), and the Nigeria Deposit Insurance Corporation (NDIC) between 2017 and 2020, which highlighted the risks associated with Cryptocurrency (Christopher, 2021; Premium Times, 2021).

Despite the ban, Cryptocurrency has continued to thrive in Nigeria, with the country emerging as one of the largest Cryptocurrency markets in the world, accounting for transactions worth US\$566 million in just five years (Larnyoh, 2021). This remarkable growth can be attributed to the resilience and adaptability of Cryptocurrency users in Nigeria, who have found alternative ways to invest and transact in digital currencies. The ban has had little to no effect on the widespread adoption of Cryptocurrency in the country, suggesting that the Nigerian government's efforts to curb the use of digital currencies may be in vain.

This is further evidenced by the growing trend among governments around the world to embrace Cryptocurrency and other digital currencies, recognizing their potential benefits as well as their risks. Many countries are exploring ways to regulate and incorporate digital currencies into their existing financial systems, while central banks are increasingly considering the creation of digital versions of fiat currency, known as Central Bank Digital Currencies (CBDCs). In Nigeria, President Muhammadu Buhari launched the E-Naira, Africa's first CBDC, in October 2021 (Erezi, 2021). This move indicates that the Nigerian government has acknowledged the limitations of its

previous approach and is now seeking to work with stakeholders to better understand and regulate digital currencies.

Therefore, this paper argues that a ban on Cryptocurrency in Nigeria may not be an effective strategy for mitigating the risks associated with digital currencies. Instead, it may be more beneficial to adopt a more proactive approach that seeks to regulate and harness the potential benefits of Cryptocurrency while mitigating its risks. The paper will explore the challenges and opportunities associated with this approach, drawing on relevant literature and case studies from other countries. Ultimately, the aim of this paper is to contribute to the ongoing debate on the future of digital currencies in Nigeria and beyond, providing insights and recommendations that can inform policy and practice in this field.

An Overview of Digital Currency and Cryptocurrency

Digital currency represents a modern and transformative evolution of currency, money, and money-like assets, as they are primarily managed, stored or exchanged through digital computer systems, especially over the internet (Huang & Mayer, 2022). As most experts have noted, digital currencies have disrupted the traditional notion of currency and money management by allowing for quick, cost-efficient, and secure transactions across borders, with cryptocurrency being one of the most revolutionary forms of digital currency (Li et al., 2019).

Cryptocurrency, virtual currency, and central bank digital currency are some of the most prominent types of digital currency (Belke & Beretta, 2020). While digital currencies share many properties with traditional currencies, they do not exist in a physical form like currencies with printed banknotes or minted coins, enabling nearly instantaneous transactions over the internet while reducing the cost associated with distributing notes and coins. This unique feature also facilitates the transfer of ownership across governmental borders.

Digital currency can be either centralized or decentralized (Li et al., 2019). Centralized digital currencies are controlled by a central point of authority, such as a bank, while decentralized currencies are governed through predetermined or democratic agreements. Central Bank Digital Currency is a classic example of centralized digital currency, while cryptocurrency is an excellent example of decentralized digital currency.

Cryptocurrency, in particular, is a digital asset designed to function as a medium of exchange where individual coin ownership records are stored in a ledger typically known as a Blockchain, which is a computerized database that uses strong cryptography to secure transaction records, control the creation of additional coins, and verify the transfer of coin ownership (Singh, 2022). The units of cryptocurrency are created through mining, which involves using computer power to solve complex math problems that generate coins. Additionally, users can purchase these currencies from brokers and store or spend them using cryptographic wallets (Singh, 2022).

Cryptocurrency, a form of digital currency, is an enigmatic and decentralized payment network that operates outside the bounds of traditional monetary institutions (Mohsin, 2022; Singh, 2022). Unlike conventional paper currencies, cryptocurrencies like Bitcoin, Ethereum, Ripple, Litecoin, and Doge exist purely in digital form, with their value driven by a multitude of factors including market demand, competition, news development, and regulatory measures.

One of the key features that make cryptocurrency attractive to users is its versatility (Li et al., 2019; Mohsin, 2022; Singh, 2022). Digital currencies are used extensively for online trading, cross-border transactions, and online payments, among other things. In Nigeria, for instance, many people turn to cryptocurrencies like Bitcoin to carry out foreign transactions in light of the country's stringent foreign exchange laws (Olisah, 2021). The decentralized nature of digital currencies means that they can be used for inter-border transfers without the involvement of financial institutions, which makes them highly appealing to Nigerians.

Another benefit of cryptocurrency is that it can be used as an investment tool or a store of wealth (Kayal & Rohilla, 2021). With the Nigerian naira continually losing its value, people in Nigeria use cryptocurrencies as a way to hedge against inflation.

Nonetheless, it is worth noting that cryptocurrencies have also been used for nefarious activities such as money laundering (Trozze et al., 2022). Investment schemes surrounding digital currencies have also made them vulnerable to theft and fraud (Trozze et al., 2022).

One of the most remarkable features of cryptocurrency is that it is powered by blockchain technology, which ensures that no single third party is in control of the transactions and data stored on the distributed ledger (Singh, 2022). This peer-to-peer payment network allows individuals to share information with one another without the need for a middleman. However, the downside of this technology is that it circumvents the control that central banks have over money supply. Cryptocurrencies' potential to undermine state ability to track currency movement has propelled the Nigerian government to curtail their use, with some officials labeling them a direct threat to national security and the stability of the global financial system (Ofili et al., 2022).

While the emergence of digital currencies has transformed online transactions, their use comes with inherent risks. Therefore, regulating the adoption and use of cryptocurrencies is essential to minimize the risks associated with their use.

The Current Regulatory Framework on Digital Currency in Nigeria

In Nigeria, the treatment of digital currencies and assets remains a contentious issue due to the lack of a uniform legal and regulatory framework. The Central Bank of Nigeria (CBN) and the Securities and Exchange Commission, Nigeria (SEC) both assert overlapping jurisdictions over market participants transacting in digital currencies or other digital assets, leading to a state of legal ambiguity (Ofili et al., 2022).

Under both the Central Bank Act 2007 (Section 2) and the Banking & Other Financial Institutions Act 2020 (Sections 1 & 2), the banking sector in Nigeria is primarily regulated by the CBN. Hence, all forms of financial institutions come within the regulatory purview of the Bank. In 2017, the CBN declared that the use of cryptocurrencies in Nigeria is a direct contravention of existing law and directed the closure of all accounts owned by individuals or entities transacting in or operating cryptocurrency exchanges in Nigeria (Central Bank of Nigeria, 2017). Based on the present circular (rule) by CBN, all banks and financial institutions in Nigeria are required to refrain from using, holding, trading, or transacting in any way with digital currencies. CBN has defined cryptocurrencies as "digital or virtual currencies issued by largely anonymous entities and secured by cryptography," and explained cryptography as "a method of encrypting and hiding codes that prevent oversight, accountability, and regulation." (Central Bank of Nigeria, 2021b) The CBN further emphasized that digital currency is not legal tender in Nigeria, and the use of digital currencies issued by unregulated and unlicensed entities is a direct contravention of its mandate as the statutory issuer of legal tender in Nigeria (Central Bank of Nigeria, 2021a).

In contrast, the Securities and Exchange Commission (SEC) has taken a more nuanced approach, classifying digital cryptoassets and cryptocurrencies as securities falling under its regulatory purview (Securities and Exchange Commission, 2020; Securities and Exchange Commission, 2021). The Securities and Exchange Commission (2021) has emphasized that all digital asset token offerings, initial coin offerings, and other blockchain-based offers of digital assets within Nigeria, by Nigerian issuers or sponsors, or foreign issuers targeting Nigerian investors, shall be subject to regulation by the SEC. While the SEC has suspended the admission of affected individuals to its Regulatory Incubation program in line with the CBN's directive, it has maintained its position to take a three-pronged approach to regulate innovation in the cryptocurrency sector, including safety, market deepening, and providing solutions to problems that will guide its regulations, strategy, and interactions with innovators seeking legitimacy and relevance in this emerging industry (Mojeed, 2021).

Despite the SEC's efforts to regulate the cryptocurrency sector, the law in Nigeria, including the Investment and Securities Act and the SEC Rules, does not provide for the regulation of digital currencies in Nigeria (Olujobi & Bonyah, 2022). The SEC has indicated that it will regulate virtual assets when the character of the investment qualifies

as securities. The SEC requires any person whose activities involve any aspect of blockchain-related and virtual digital assets services, including but not limited to reception, transmission and execution of orders on behalf of other persons, dealers on their own account, portfolio management, investment advice, custodian or nominee services, to be registered with the SEC.

One of the arguments against the adoption of digital currencies is that they facilitate money laundering. However, the main legislation governing money laundering in Nigeria, the Money Laundering (Prohibition) Act 2011 (as amended), and the regulations released by the CBN and SEC to regulate financial institutions under their purview, do not directly address the use of digital currencies for money laundering activities.

The lack of a harmonized regulatory framework has resulted in legal ambiguity for market participants. The SEC's approach, which emphasizes market deepening, safety, and innovation, provides more room for digital currency innovation in Nigeria. On the other hand, the CBN's restrictive stance on digital currencies may hinder innovation in the sector. However, the CBN's concerns about money laundering cannot be ignored, and there is a need for a regulatory framework that balances innovation and regulation.

It is thus imperative that the Nigerian government adopt a proactive stance in addressing the regulatory challenges posed by the incorporation of digital currencies into the financial landscape. One potential avenue for addressing the regulatory challenges presented by digital currencies would be the incorporation of digital currency-specific provisions into extant anti-money laundering laws and regulations. By doing so, regulatory authorities would be empowered to monitor and regulate digital currency transactions with a view to preventing the use of these instruments for illicit financial activities such as money laundering.

In light of the foregoing, it is clear that the incorporation of digital currencies into the financial ecosystem has brought with it a range of regulatory challenges that require urgent attention. As Nigeria continues to explore the potential of these novel instruments to enhance efficiency and promote financial inclusion, it is crucial that regulatory authorities take a proactive approach towards addressing the regulatory gaps and inconsistencies that currently exist. To this end, the inclusion of digital currency-specific provisions within anti-money laundering laws and regulations would be a crucial step towards mitigating the potential for these instruments to be exploited for the perpetration of illicit financial activities such as money laundering.

Recommendations on How Regulators can Strengthen Digital Currency Regulations.

The ever-evolving world of digital currencies, cryptocurrencies, and digital cryptoassets poses a unique challenge to regulators worldwide. In Nigeria, the Securities and Exchange Commission (SEC) has taken a proactive stance, issuing a statement on the 14th of September 2020, which asserts that digital currencies and cryptoassets are securities falling within its regulatory purview. This stance was further reiterated in a press release dated 11th February 2021, cementing the SEC's authority to regulate these emerging markets. To ensure that the current regulatory framework is strengthened, we recommend the following measures be taken.

First and foremost, the SEC should consider amending the Investment and Securities Act and the Regulations to cover the hitherto unregulated digital currencies and Crypto Assets Market. Estonia has already taken this step, amending its Money Laundering Act and Terrorism Financing Prevention Act to bring Crypto Wallets and Exchanges under its regulatory regime (Sav, 2022). Nigeria should follow suit, and the SEC should take the necessary steps to bring digital currencies and cryptoassets within its regulatory ambit.

In addition, the SEC may seek the enactment of bespoke legislation specifically targeting all aspects of the Crypto Assets Market and digital currencies generally, thereby providing a comprehensive regime of regulation that can address the peculiarities of the market. Malta has already taken this approach, enacting the Virtual Financial Assets Act (Buttigieg & Efthymiopoulos, 2018). It is, therefore, recommended that the SEC urgently enact new regulations for digital currencies and the Crypto Assets Market under its existing powers in Sections 13 and 313 of the Investment and Securities Act.

One of the most critical aspects of regulating digital currencies and cryptoassets is the classification of these assets. Whatever regulations the SEC enacts must define the type of crypto assets that fall within its regulatory ambit. Global best practices tend to classify crypto assets into three functional models: assets that are investment tools (Security Tokens), assets that operate as a medium of exchange (Payment Tokens), and assets that give a right to participate in digital resources (Utility Tokens). According to the SEC's statutory jurisdiction, Security Tokens could fall within the definition of Collective Investment Schemes and Securities (i.e., under subsection (d)) in Sections 13 (a) and 315 of the Investment and Securities Act. However, Payment Tokens and Utility Tokens, which have no aspect that can be deemed an investment tool or security, should not fall under the regulatory jurisdiction of the SEC.

Additionally, it is crucial for the regulatory body or bodies in Nigeria responsible for digital assets to reach a consensus with the authorities of other countries. As digital transactions cut across different jurisdictions, harmonization of the law is critical to ensure a proper regulatory regime. The consensus should be aimed at creating rules that would solve jurisdictional problems in digital transactions, and these rules should be of general application.

Finally, the National Assembly must take bold steps to strengthen the current regulatory framework for digital currencies and cryptoassets in Nigeria. By amending the Investment and Securities Act and the Regulations and the enactment of bespoke legislation, the National Assembly can create a comprehensive legal regime or framework that can address the peculiarities of the market. Classifying crypto assets and harmonizing laws with authorities of other countries will also go a long way in regulating the digital assets market. It is time for Nigeria to take a leadership role in this ever-evolving market and ensure that the digital currency and cryptoasset industry operates within a robust regulatory framework.

Conclusion

As the global financial landscape undergoes a digital revolution, governments worldwide are turning to digital currencies to keep pace with the changing tide. In light of these developments, it is imperative that Nigeria's financial regulatory bodies take the lead in building a robust financial

system and regulatory framework that embraces this contemporary technology. While the use of digital currencies carries the potential for abuse, it would be imprudent to reject the technology outright. Rather, the key lies in establishing rigorous regulations that can effectively mitigate the risks of misuse.

To this end, Nigeria's regulatory bodies, including the Central Bank of Nigeria (CBN) and the Securities and Exchange Commission (SEC), are currently engaged in ongoing efforts to establish a unified regulatory framework for virtual currencies in the country. By working in concert, these regulatory authorities can leverage their respective areas of expertise to create a regulatory framework that balances innovation with stability.

Given the complexity of the digital currency landscape, such a regulatory framework must be comprehensive, encompassing all relevant aspects of the technology and its use. From transaction processing and recordkeeping to risk management and fraud prevention, the framework must be designed to ensure that digital currencies can be used safely and securely by all stakeholders.

It is worth noting that the regulatory framework must be agile and responsive to evolving market dynamics. As the technology and its applications continue to evolve, so too must the regulatory framework be governing its use. With this in mind, the CBN, SEC, and other regulators must remain vigilant and continuously reassess their regulatory approach to ensure that it remains fit for purpose.

Ultimately, the establishment of a harmonized regulatory framework for the treatment and use of digital currencies in Nigeria will be a watershed moment in the country's financial history. By embracing this innovative technology, Nigeria can position itself as a leader in the digital currency space, driving economic growth and financial inclusion while mitigating the risks associated with its use. With a clear-eyed focus on regulatory excellence, Nigeria's financial regulatory agencies can unlock the full potential of digital currencies, paving the way for a more prosperous and inclusive future for all Nigerians.

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