

27 June 2024

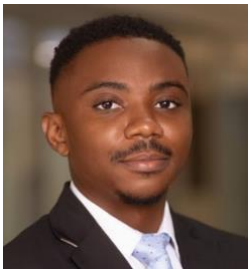
Key contacts



Zelda Akindede
Partner,
Finance and Fintech
zelda.akindele@templars-law.com



Victor Sameria
Senior Associate,
Finance and Fintech
victor.sameria@templars-law.com



Joshua Chizoma
Associate,
Finance and Fintech
joshua.chizoma@templars-law.com

Client Alert

The SEC's Incubation Program for Virtual Asset Service Providers – A Temporary Fix

Introduction

On Friday 21 June 2024, the Securities and Exchange Commission (SEC) released a circular (the "**SEC Circular**") notifying the general public of a special window for the onboarding of Virtual Assets Service Providers ("**VASPs**") through what it refers to as an Accelerated Regulatory Incubation Programme (the "**Programme**" or "**ARIP**"). The ARIP is to be used whilst it finalises the proposed amendments to the SEC Rules on Issuance, Offering Platforms and Custody of Digital Assets dated 11 May 2022 (the "**SEC Digital Asset Rules**").

VASPs desirous of being onboarded onto ARIP are expected to comply with the Framework on ARIP for the onboarding of VASPs and other Digital Investments Service Providers (DISPs) (the "**ARIP Framework**").

This client alert provides insight to the SEC Circular, ARIP Framework and the wider implications of the foregoing on both domestic and international VASPs.

Key Aspects of The Circular and Arip Framework

- **Scope of Application**

By the Circular, all operating and prospective VASPs are required to complete the ARIP application process. To this extent, being onboarded to the Programme does not appear to be optional as the scope of application of the ARIP Framework has been drafted quite broadly to include VASPs and token issuers that carry on business activities in Nigeria or offer services to the Nigerian consumers.

In this regard, the ARIP Framework specifically provides that it applies to (a) persons carrying on and providing virtual asset services to Nigerians irrespective of the physical location from which the activities are carried out and (b) foreign or non-residential operators that actively target Nigerian investors directly or through their agents, through promotions, publications in Nigeria or direct e-mails to Nigerian addresses.

This broad scope creates a potential challenge to the continued ability of non-Nigerian VASPs to rely on the principle of reverse solicitation (which allows offshore service providers to serve individuals of a particular country if the products and services have been requested at the individual's own exclusive initiative) to provide their services on an offshore basis without establishing a local entity or obtaining any in-country authorisation.

At the very minimum, offshore VASPs will need to evaluate the scope of the ARIP Framework and the extent to which it impacts on their reliance on reverse solicitation.

- **Eligibility Requirements**

The ARIP Framework specifies a minimum of three key requirements for entities seeking to be onboarded onto the Programme Firstly, an eligible applicant (defined as an entity that has undergone an initial assessment process and is cleared to submit an application into the ARIP) must be incorporated and have a physical office in Nigeria and its Chief Executive Officer/Managing Director or its equivalent must be resident in Nigeria.

The foregoing may have operational and other implications for VASPs given the requirement for their CEOs / MDs to be resident in Nigeria. Though not expressly stated in the ARIP Framework, we would expect this requirement to be in relation to the relevant Nigerian subsidiary of the VASP or at least the senior executive in charge of decision making for their Nigerian operations irrespective of designation. It is also not entirely clear if only Nigerian entities can apply to be onboarded to the Programme given that most of the application requirements are specific to Nigerian entities.¹

Secondly, there is a requirement for an eligible applicant to be undertaking investments and securities business and finally, the entity must be seeking registration or have pending virtual asset related registration applications with the SEC.

- **Application Stages**

The application process is divided into two phases – the Initial Assessment Phase and an Application Phase. This means an eligible applicant is first required to complete an initial assessment form for the SEC's review and may only proceed with the Application Phase upon being notified by the SEC of their approved eligibility status.

The SEC will grant an approval-in-principle (AIP) to eligible applicants that make it through the Application Phase. It is expected that the AIP will set out the terms and conditions upon which successful applicants can operate within the Programme for a specified period of time.

- **Key Application Requirements**

Some of the key application requirements include the requirement for applicants to (a) complete ARIP applications through a registered solicitor or adviser (b) obtain a "no objection" or approval letter from other relevant regulators, where the applicant

¹ Section 5 of the ARIP Framework provides that it applies to foreign or non-residential operators.

is regulated by another sectorial regulator e.g., the Central Bank of Nigeria (CBN) (c) provide evidence of registration with the Nigerian Financial Intelligence Unit (NFIU).

The ARIP Framework further provides for additional application requirements aimed at extracting the highest levels of compliance commitment from eligible applicants.

- **Financial Requirements**

In addition to any other financial requirements that may be imposed by the SEC from time to time, ARIP applicants are expected to (a) pay a non-refundable processing fee of N2,000,000.00 (Two Million Naira, only) (b) show evidence of required shareholder fund² (c) current Fidelity Bond covering at least 25% of the required shareholder fund.

- **Records and Reporting Requirements**

The ARIP Framework seeks to give the SEC access to any information considered necessary in discharging its responsibilities as a regulator.

Some of the reporting requirements include weekly and monthly trading statistics, quarterly financials, incident reports and gives the SEC the power to undertake onsite and off-site inspection, audit and monitoring and such periodic reports and returns as may be specified by the SEC.

Increased regulator visibility of digital asset transactions in Nigeria has long been expected and comes as no surprise, particularly given the recent request from the Nigerian Government for crypto exchanges to disclose user data and other information regarding their operations in Nigeria.

- **Operational Controls and Restrictions**

As expected with any regulatory incubation programme, the ARIP is not without operational restrictions. ARIP participants are expected to put in place appropriate safeguards and risk mitigation measures to protect customers and comply with the various Nigerian anti-money laundering (AML) and counter-terrorist financing (CFT) laws.

Most of all, ARIP participants are required not to grow their customer base by more than 10% from point of entry into the ARIP which presents a significant limitation on customer acquisition.

- **Timeline for Compliance**

The Circular sets the timeline for compliance at 30 days from the date of the Circular. In other words, eligible applicants must submit an application by 21 July 2024.

- **Consequences of Non-Compliance**

The Circular provides that the SEC will commence enforcement action against any operating VASP that fails to comply with the directives set out in the Circular. In this regard, the ARIP Framework provides for a penalty of not less than N5,000,000 (Five Million Naira) at the first instance and a further N200,000 (Two Hundred Thousand Naira) for every day of default.

² It is not entirely clear as at the date of this publication, if the shareholder fund requirements will be based on the SEC Digital Asset Rules or set by the SEC on a case-by-case basis.

There is an additional penalty at the discretion of the SEC but in an amount no less than N20,000,000 (Twenty Million Naira) for VASPs and N10,000,000 (Ten Million Naira) for digital investments platforms including crypto brokers/dealers, advisers, market makers for operating without due authorization or registration by the SEC.

Other administrative sanctions may also apply depending on the severity of the violation(s).

Conclusion

The ARIP Framework presents a temporary licensing fix for the digital investments ecosystem including the cryptocurrency regulatory landscape in Nigeria which has been in regulatory limbo for the past two years due to a number of factors including the lack of clarity as to the interplay between the SEC Digital Asset Rules and regulatory actions of the CBN, and more recently, the Office of the National Security Adviser (NSA) and the Economic and Financial Crimes Commission (EFCC) against cryptocurrency exchanges.

At the expiration of the period specified in an applicant's AIP, every participant is expected to seamlessly transition to registration by obtaining the relevant licenses under the SEC Digital Asset Rules or the amended rules to be released by the SEC.