

OVERVIEW OF THE SEC FRAMEWORK ON ACCELERATED REGULATORY INCUBATION PROGRAM

FOR THE ONBOARDING OF VIRTUAL ASSETS
SERVICE PROVIDERS AND OTHER DIGITAL
INVESTMENTS SERVICE PROVIDERS

AELEX

LEGAL PRACTITIONERS & ARBITRATORS

Introduction

The Securities and Exchange Commission (“SEC/Commission”) has issued a Framework on Accelerated Regulatory Incubation Program for the Onboarding of Virtual Assets Service Providers and other Digital Investments Service Providers (“ARIP Framework”), to facilitate the onboarding of qualified entities into the Commission’s Accelerated Regulatory Incubation Program (“ARIP”), provide guidance to the entities on the Commission’s regulatory demands before they become fully operational in the capital market, and enable the Commission to further understand the digital assets business models for effective regulation.¹

The ARIP Framework is the most recent development in virtual/digital assets regulation in Nigeria and follows the SEC’s New Rules on Issuance, Offering Platforms and Custody of Digital Assets (“Digital Assets Rules”), CBN’s Guidelines on Operations of Bank Accounts for Virtual Assets Service Providers (“VASP Guidelines”) and the Proposed Major Amendment to the Commission’s Rules on Issuance, Offering Platforms and Custody of Digital Assets.

The ARIP Framework has significant implications for the registration and licensing process for Virtual Assets Service Providers (“VASPs”) and other Digital Investments Service Providers (“DISPs”).

The ARIP Framework was released via a Circular on the SEC website² (the SEC Circular/Circular), which mandates all operating and prospective VASPs to complete the application process no later than 30 days from 21 June 2024.

This article examines the key provisions of the ARIP Framework and their implications for virtual assets and digital investments regulation in Nigeria.

1. Section II, ARIP Framework.

2. <https://sec.gov.ng/framework-on-accelerated-regulatory-incubation-program-arip-for-the-onboarding-of-virtual-assets-service-providers-vasps/>

Applicability and Eligibility

The ARIP Framework applies to VASPs and DISPs seeking registration from the Commission.³ VASPs are as defined in the existing SEC Rules and include entities involved in exchange between virtual assets and fiat currencies; exchange between one or more forms of virtual assets; transfer of virtual assets; safekeeping and/or administration of virtual assets or instruments enabling control over virtual assets; and participation in and provision of financial services related to an issuer's offer and/or sale of a virtual asset.⁴

The ARIP Framework does not expressly define DISPs; however, it defines digital investment service as any investment service accessed and delivered through a digital channel while it defines digital investment platform as any platform that facilitates digital investment services.⁵ Accordingly, DISPs may be defined as entities carrying out digital investment services or operating a digital investment platform.

In order to be eligible for admission into the ARIP, an entity must:

1. Be incorporated and have an office in Nigeria with its Chief Executive Officer/Managing Director or its equivalent resident in Nigeria;
2. Be performing investments and securities business; and
3. Be seeking registration or have pending virtual assets related applications with the Commission.

3. Section IV, ARIP Framework.

4. Paragraph 3.0, of the Commission's Rules on Issuance, Offering Platforms and Custody of Digital Assets.

5. Section III, ARIP Framework.

Operation of the ARIP

As a preliminary step for admission into the ARIP, applicants are required to undergo an Initial Assessment Phase, completed through submission of the Initial Assessment Form via the SEC ePortal. Upon receipt, the Commission will review the submission and notify the applicant of its eligibility status for the ARIP. The Commission may defer approval or reject applications with justification, to ensure orderliness of the capital market. Applicants deemed eligible by the Commission may proceed to apply to the ARIP. Where an applicant is admitted into the ARIP, the Commission shall issue an Approval-in-Principle to the ARIP participant, enabling the entity to operate in accordance with the laws.⁶

At the expiration of ARIP period, which shall last for as long as the Commission determines, participants are expected to seamlessly transition to registration under the Digital Assets Rules. However, the Commission may issue a denial of permission for the participant to operate in Nigeria under prevailing Rules and Regulations.⁷

Documentation and Fees

Applications to ARIP shall be filed by the applicant through a registered solicitor or adviser,⁸ and attract a non-refundable processing fee of N2,000,000 (two million Naira).⁹ The application shall be accompanied by several documents, including:

- a. Sworn undertakings regarding the accuracy of information provided to the Commission; status of the applicant as a valid going concern; quality, experience, track record and integrity of the Applicant's management, etc.
- b. Operational Plan and a Business Model which has a clear or unique value proposition or will contribute to the overall development of the capital market.
- c. The Rules of the entity it seeks to operate, which makes satisfactory provisions for protection of investors and public interest, proper functioning of the entity, fairness and transparency, management of conflict of interest that may arise, etc.

6. Section VI, ARIP Framework.

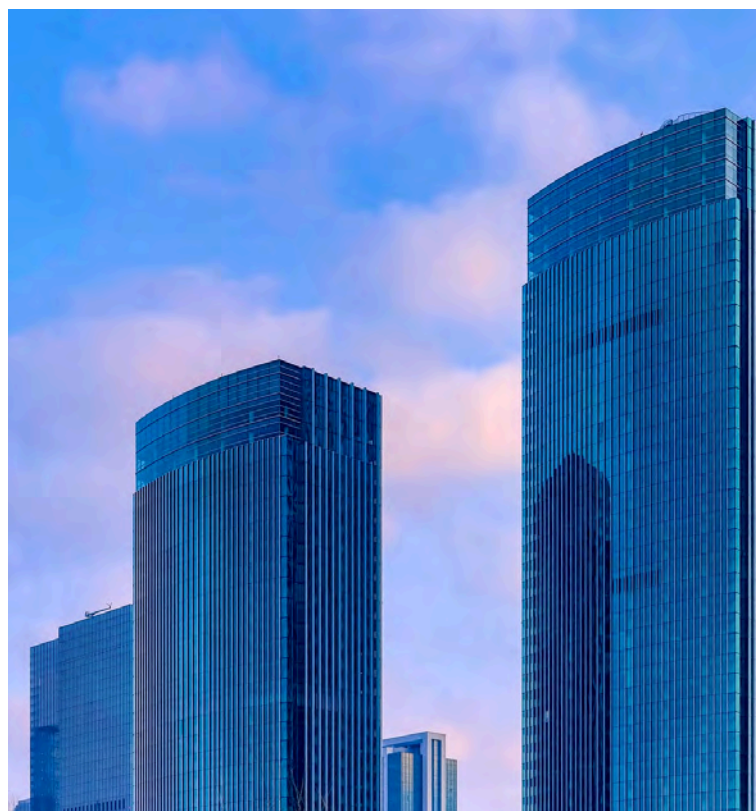
7. Paragraph 37, ARIP Framework.

8. Section VII, ARIP Framework.

9. Paragraph 20(a), ARIP Framework.

- d. Letter of no objection or approval letter, where the applicant is regulated by another sectoral regulator.
- e. Form SEC 2 & 2D (minimum of 4 sponsored individuals who shall be principal officers including Managing Director and Compliance Officers).
- f. Duly certified Corporate Affairs Commission documents (Certificate of Incorporation, Memorandum and Articles of Association, Statement of Share Capital, etc).
- g. Latest audited accounts or audited statement of affairs in the case of a new company.
- h. Tax Identification Number and Clearance Certificate.
- i. Valid means of identification (including BVN and NIN) of the sponsored individuals.
- j. Evidence of registration with the Nigerian Financial Intelligence Unit.
- k. Evidence of required shareholder fund.
- l. Current Fidelity Bond covering at least 25% of the required shareholder fund.

Applicants have a responsibility to protect their intellectual property and shall clearly mark 'confidential' on all intended non-public information submitted to the Commission or shared in connection with the ARIP. In turn, the Commission shall treat all 'confidential' information received from an applicant and/or participant in connection with the ARIP as such, and shall not disclose such information to third-parties unless required to do so by law or allowed in writing by an applicant and/or participant.¹⁰



10. Section XV, ARIP Framework.

Operation of the ARIP

The ARIP Framework imposes reporting obligations on ARIP participants and requires participants to submit the following to the Commission:

- a. Weekly and monthly trading statistics (where applicable) and all reporting requirements.

Quarterly financials as well as compliance reports to demonstrate compliance with conditions imposed by the Commission.

- b. Key issues arising from misconduct, fraud or operational incident reports and, if any, measures taken by the participant to address such incidents.
- c. Actions or steps taken to address customer complaints, emergent risks or other issues relevant to the Commission's assessment of applicable regulatory requirements.¹¹

Furthermore, ARIP participants shall be subject to the Commission's onsite and offsite inspection, audit, monitoring and shall make their premises, systems, books and records readily available to the Commission, or its officers or any person appointed by the Commission for inspection, audit and other supervisory purposes.

Controls and Restrictions

ARIP participants shall incorporate safety measures to identify and manage potential risks and mitigate the consequences of failure, such as undisclosed risk of financial loss or other undisclosed risks to customers, investors and market participants.¹² Specifically, the controls shall require compliance with applicable rules and regulations regarding the prevention of money laundering, including travel rules, counter-terrorism financing, counter-proliferation financing and other illicit activities as contained in the AML/CFT/CPF laws.

11. Section IX, ARIP Framework.

12. Section X, ARIP Framework.

Enrolment in the ARIP imposes restrictions on the participants to:

- a. Not conduct any other securities and/or investment business except as presented to the Commission.
- b. Not carry out promotional activities such as any notice, circular, letter or other written or electronic medium of communication either publicly or privately.
- c. Not provide information that is incomplete, untrue or misleading.
- d. Not grow their customer base by more than 10% from the point of entry into the ARIP.

Termination, Suspension and Removal from the ARIP

The Commission may terminate, suspend or remove a participant from the ARIP if at any time the participant:¹³

- a. Is found no longer fit to participate in the process.
- b. Has breached any restrictions or conditions imposed on the participant.

- c. Has breached the Investment and Securities Act, the SEC's Rules and Regulations or other relevant law.
- d. Deviates from its Operational Plan. Fails to implement any required safety measure or controls.
- f. Submits false, misleading or inaccurate information, or has concealed or failed to disclose material facts in the application.
- g. Is undergoing or has gone into liquidation.
- h. Breached data security and confidentiality requirements.
- i. Carries on business in a manner detrimental to customers, investors or the public at large.
- j. Fails to effectively address any defects, flaws or vulnerabilities in the product, service or solution which gives rise to recurring service disruptions or fraud incidents.

Any decision by the Commission to terminate, suspend or withdraw approval to participate in the ARIP shall be in writing, stating the reasons for terminating or withdrawing the approval. Also, prior to making this decision, the Commission shall give the applicant an opportunity to be heard.¹⁴

13. Paragraph XI, ARIP Framework.

14. Paragraph 35, ARIP Framework.

Penalties and Sanctions

ARIP participants who fail to comply with any of the stipulated requirements shall be liable to 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.¹⁵ Other administrative sanctions as provided in the Commission's Rules and Regulations may also apply depending on the severity of the violations.

In addition, commercialized VASPs operating, trading, offering and custody platforms without due authorization or registration by the Commission shall immediately be liable to a penalty of not less than N20,000,000 (twenty million Naira) while other digital investments platforms including crypto brokers/dealers, advisers, market makers etc. operating without due authorization or registration by the Commission shall immediately be liable to a penalty of not less than N10,000,000 (ten million Naira).

Notable Points on the ARIP Framework

Mandatory Application of the ARIP Framework

While incubation programs are generally optional, the ARIP appears to be mandatory for all VASPs. The penalty for non-compliance for commercialized VASPs suggest that all VASPs must register under the ARIP Framework to avoid sanctions. Additionally, the SEC Circular directing ALL operating and prospective VASPs to complete the application process no later than 30 days from the date of the Circular, or face enforcement action, supports this interpretation. Consequently, it seems that all VASPs in Nigeria and eligible foreign VASPs are required to register under the ARIP.

Limited Timeline for Submission of Application into the ARIP

The circular issuing the ARIP Framework mandates all applicants to submit their applications within 30 days from the date of the circular – by June 21, 2024.

15. Section XIV, ARIP Framework.

As the ARIP Framework requires the submission of application by all VASPs, including those who had submitted their application under the SEC Regulatory Innovation Program and potential applicants, this timeline may pose a challenge for completion of the application, especially for potential applicants.

This is considering the documentary requirements and the need for VASPs to have shareholders' funds of 500 million naira unimpaired by losses. Although some of these requirements were outlined in the Digital Assets Rules, based on its non-operational status, some VASPs may not have developed the capacity to meet them.

VASPs are encouraged to commence the application process within the specified timeline, and if possible, seek an extension from the SEC if they are unable to fulfill the requirements before the deadline.

However, it is possible that the stated timeline is intended to streamline the number of ARIP participants in line with the SECs objective to maintain orderliness in the capital market. If this is the case, extensions may not be granted.

Rejection of Applications by the SEC

Based on the ARIP Framework, the SEC may defer approval or reject applications "to ensure the orderliness of the capital market". It is unclear what the SEC means by this phrase and what will warrant a refusal of an application to preserve the "orderliness of the capital market", which may be unrelated to the applicant's failure to meet the requirements for acceptance into the ARIP. Also, it is uncertain the effect of the rejection on such businesses and their eligibility to apply for a licence when the Digital Assets Rules are issued.

Limitation on Onboarding of Customers

As noted, participants in the ARIP are restricted from growing their customer base beyond 10% from the point of entry into the ARIP. The limitation on the participants for onboarding new customers during the ARIP and the fact that there is no definite timeline for the ARIP or the issuance of the Digital Assets Rules, may negatively affect businesses. It has been reported that Nigeria has the second highest adoption of cryptocurrency as there has been continuous surge in the cryptocurrency space.¹⁶

16. <https://www.reuters.com/technology/nigeria-crypto-usage-growing-further-report-says-2023-09-19/>

The data on cryptocurrency adoption would presume a high customer onboarding percentage, which may exceed the current threshold in the ARIP. Participation in the ARIP may therefore automatically stifle the growth of the businesses, pending the issuance of the substantive rules.

Also, it appears the limitation only contemplates VASPs with existing customer base, and does not provide a customer threshold for prospective VASPs who are yet to onboard customers, and which the ARIP Framework also applies to. The Commission may need to provide some guidance on this.

Exit Plan of VASPs

The ARIP Framework requires applicants to submit an operational plan which should include an exit plan if registration is not achieved. This provision implicitly reflects the current regulatory stance on VASPs: they must either comply with the regulatory regime or cease operations entirely.

ARIP and The Central Bank of Nigeria's Guidelines on Operations of Bank Accounts for Virtual Assets Service Providers ('the Guidelines')

Under the Guidelines, financial institutions can open bank accounts for VASPs if they provide evidence of a valid SEC licence to engage in the business of VASP/DAX/DAOP, among other requirements. This raises the question of whether VASPs accepted into the ARIP will be able to open and operate bank accounts pursuant to the Guidelines. Additionally, given the recent CBN stance towards crypto platforms, it remains to be seen whether the Guidelines will be operationalised for this purpose.

Conclusion

Despite some of the challenges highlighted, the ARIP Framework is a welcome development for Nigeria's digital and virtual assets regulatory landscape, especially given the recent uncertainties surrounding cryptocurrency businesses operating in the country. It addresses the challenge posed by the delay in operationalising the Digital Assets Rules and provides a clear path to eventual registration for companies in the sector, while creating an environment for the Commission to approach regulation in a controlled and safe manner.



Authors



**Tiwalola
Osazuwa**

Partner

tosazuwa@aelex.com



**Peretimi
Akinmodun**

Senior Associate

pakinmodun@aelex.com



**Mubaraq
Popoola**

Associate

mpopoola@aelex.com



LEGAL PRACTITIONERS & ARBITRATORS

LAGOS, NIGERIA

4th Floor, Marble House
1, Kingsway Road, Falomo
Ikoyi, Lagos

Telephone: +234(0)201 279336-9

Facsimile: (+ 234 1) 2692072; 4617092

E-mail: lagos@aelex.com

ABUJA, NIGERIA

4th Floor, Adamawa Plaza
1st Avenue, off Shehu Shagari Way,
Central Business Area,
FCT Abuja, Nigeria.

Telephone: (+234 9) 8704187, 6723568,
07098808416

Facsimile: (+234 9) 5230276

E-mail: abuja@aelex.com

PORT HARCOURT, NIGERIA

2nd Floor, Right Wing UPDC Building 26,
Aba Road P.O. Box 12636, Port Harcourt
Rivers State, Nigeria.

Telephone: (+234 84) 464514, 464515,
574628, 574636

Facsimile: (+234 84) 464516, 574628

E-mail: portharcourt@aelex.com

ACCRA, GHANA

Suite C, Casa Maria, 28 Angola Road, Kuku
Hill, Osu GP Address 080-3525 Accra,
Ghana

Telephone: (+233-302) 224828, 224845

Facsimile: (+233-302) 224824

E-mail: accra@aelex.com