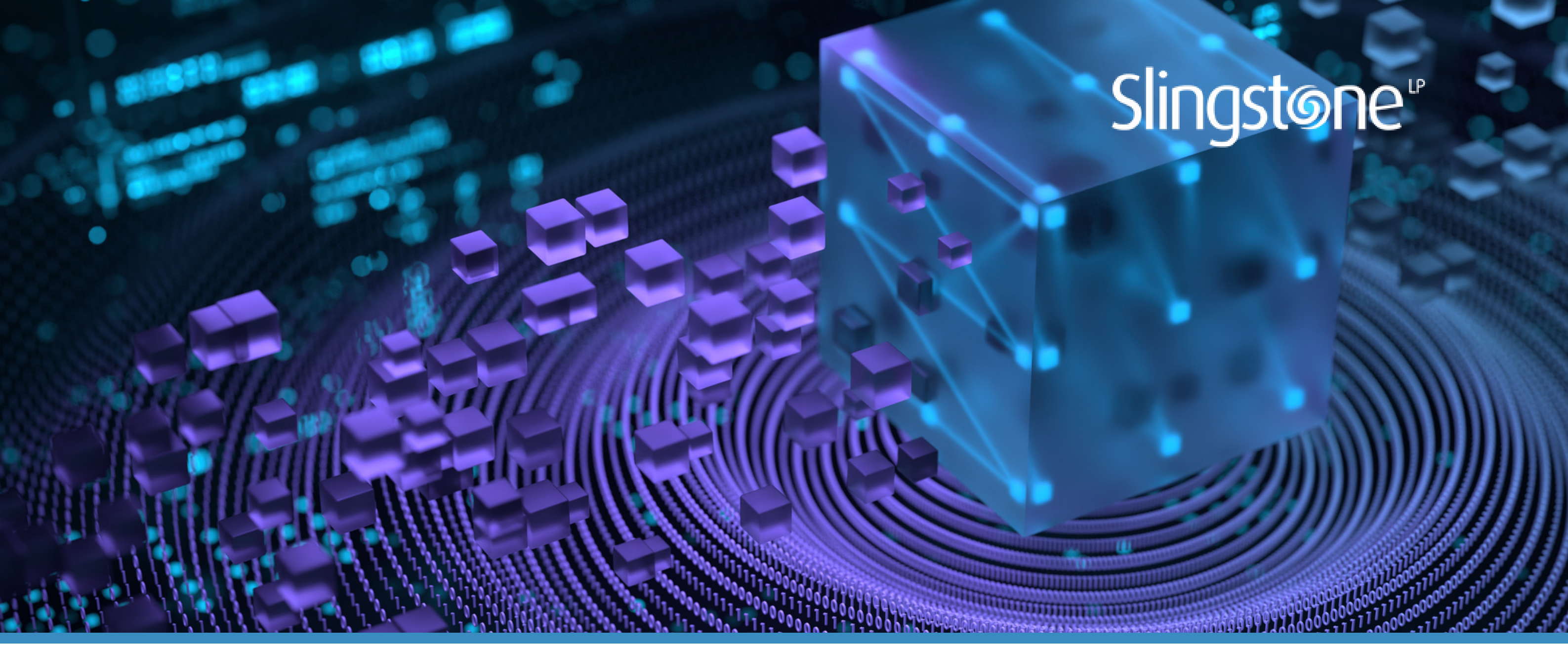

Impact Analysis Of CBN's New Regulatory Guidelines On Banking Virtual Assets Service Providers

Introduction

In a significant policy shift at the close of 2023, the Central Bank of Nigeria (CBN) reversed its two-year restriction on cryptocurrency transactions, announcing the "Guidelines on Operations of Bank Accounts for Virtual Assets Service Providers (VASPs)" on 23rd December 2023. CBN's regulatory posture prior to the new Guidelines actively discouraged investments in virtual assets, reflecting global regulatory uncertainties regarding the digital assets economy, potential systemic risks to the financial system and the challenge of ensuring market transparency, integrity and protecting investor and consumers. While global regulatory practices are still evolving and have not been fully tested and analyzed, CBN's new policy shift aligns with the progressing global experiment to address some of the regulatory and policy supervision issues relating to virtual assets transactions. Coupled with Securities and Exchange Commission's ground setting Rules Rules on Issuance, Offering Platforms and Custody of Digital Assets made on May 11, 2022, the new Guidelines expand the territory for virtual assets transactions within the Nigerian fintech regulatory landscape.

Under the new Guidelines, regulated financial institutions are now permitted to open accounts specifically designated for the purpose of virtual or digital assets. Financial institutions can provide designated settlement accounts and settlement services, and act as channels for forex inflows and trade for licensed VASPs involved in various virtual asset transactions. The eligible entities under the Guidelines are commercial banks, Payments Service Providers involved in settlement for third parties and all entities registered by the Securities and Exchange Commission (SEC) to provide digital or virtual assets services. These include: Digital Assets Custodians, Digital Assets Offering Platforms, Digital Assets Exchanges (DAX), DAX Operators and other entities as CBN may designate from time to time. Here, we present an overview of the Guidelines and some of the anticipated changes to the rapidly evolving digital assets economy.

Some Key Provisions

The Guidelines focus on setting minimum standards for banking relationships and account openings for VASPs in Nigeria, aiming to improve risk management practices in the banking industry. Key provisions include:

Enhanced Know-Your-Customer (KYC) Requirements for Opening Designated Accounts

The Guidelines prescribe enhanced due diligence requirements for opening designated accounts. In addition to corporate documents evidencing the legal existence, status, shareholding and directorship of the company, the Guidelines require evidence of a valid license issued by the Securities and Exchange Commission (SEC) to engage in the business, Certificate of Capital Importation (where there is foreign direct investment inflow either as equity or debt), AML/CFT and CPF Policy of the entity, and the approval of senior management of the Financial Institutions ("FI"). FIs are required to apply CDD (Consumer Due Diligence) requirements to all designated accounts based on materiality and risk. Also, a designated account must be strictly used for virtual/digital assets transactions only.

Ongoing Reporting Obligations by Regulated Financial Institutions:

FIs are responsible for monitoring designated accounts, and conducting continuing due diligence on existing relationships. FIs are required to keep information on the volume and value of transactions carried out on each designated account. Their obligations include: taking necessary measures for continuous verification, validation of address and documentation

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requirements, conducting onsite visits to ensure that the account is being operated strictly according to the Guidelines and relevant laws; investigating complex and suspicious transactions and reporting to the Nigerian Financial Intelligence Unit (NFIU) or keeping records of investigations regarding unusual transactions where the transactions were not reported to NFIU.

AML/CFT and CPF Safeguard:

Financial Institutions banking Virtual Assets Service Providers must implement necessary risk management measures to determine potential, actual or past infractions of existing regulations and laws on Anti-Money Laundering (AML), Combating the Financing of Terrorism (CFT), and Counter Proliferation Financing (CPF). or prevent designated accounts from money laundering, terrorist financing, and other financial crimes.

Operational and Transactional Limits:

FIs have discretion in setting transaction limits and account balances for VASPs and the limits may vary based on the VASP's risk profile, customer type, and transaction volume.

Operational Processes for Designated Settlement Accounts:

By the Guidelines, VASPs may open designated settlement accounts with banks for specific transactions. These accounts will be subject to additional scrutiny and monitoring by the CBN. FIs may restrict certain transactions from VASP settlement accounts, such as cash deposits and withdrawals. VASPs must maintain accurate and detailed records of all transactions involving settlement accounts. The Guidelines specify that Transactions on the VASPs platform shall only be in Naira amongst other rules.

In all, the Guidelines emphasize the importance of record-keeping and data retention for VASPs which will improve transparency and accountability, thereby mitigating risks associated with cryptocurrency and virtual asset transactions. In addition, the Guidelines will increase compliance costs for VASPs and consequently limit their operational flexibility.

Anticipating Changes in the Nigerian Digital Assets Market

Under the revised guidelines, banks can now provide services to licensed VASPs, fostering increased adoption of virtual assets in Nigeria. However, it's crucial to note that cryptocurrencies still lack legal tender status, and banks are prohibited from direct holding, trading, or transacting in them. Anticipated ramifications include:

These regulatory changes are anticipated to have several ramifications:

Increased Adoption:

The revised Guidelines may stimulate greater adoption of virtual assets in Nigeria by providing a regulated framework for transactions involving cryptocurrencies. The revised guidelines provides a regulatory clarity which is anticipated to increase confidence among investors and users in the Nigerian virtual assets market. As the market becomes more formalized, the risk perception associated with crypto transactions may decrease, encouraging a broader spectrum of investors to engage in virtual asset activities.

Global Crypto Exchange Engagement:

With the introduction of the CBN's regulatory framework, global crypto exchange companies might find the Nigerian market more attractive, encouraging increased participation and investment.

Formalized Virtual Assets Market:

The guidelines are a step towards formalizing the virtual assets market in Nigeria. Over time, this is expected to enhance market dynamics by providing a structured environment for virtual asset service providers to operate. This, in turn, may lead to the development of standardized practices, increased security measures, and improved investor protection, fostering a healthier and more sustainable virtual assets ecosystem especially as more regulations emerge on various aspects of the digital market.

Increased Fintech Innovation:

The regulatory adjustments could spur innovation in the fintech space, fostering the development of new virtual asset service offerings, including those related to international payments and remittances.

These regulatory changes signify a noteworthy shift in the CBN's stance on virtual assets, transitioning from a ban to a more nuanced regulatory framework. This approach aims to manage associated risks while acknowledging the potential benefits of cryptocurrency transactions. The impact of these changes on the crypto landscape in Nigeria and their contribution to the growth of the virtual assets market must be closely monitored.

Nurturing Fintech Growth:

Despite historical restrictions, the Nigerian virtual assets economy has thrived, and the guidelines are poised to nurture further growth. Fintech companies operating in the crypto space are likely to experience increased legitimacy and may find it easier to access financial services, thereby expanding their operations.

Against the Odds - Nigeria's Growing Virtual Assets Economy

Despite previous restrictions, the Nigerian digital assets market continues to grow. The growing list of crypto exchanges in Nigeria underscores the country's vibrant crypto ecosystem. While successful Initial Coin Offering (ICO) are not prevalent, there were notable instances of significant fundraise by VASPs in Nigeria including reported examples of SureRemit and Afro raising $7 million and $12 million respectively for addressing cross-border remittance challenges through blockchain. These cases, though rare, showcase the potential for ICOs. VASPs can potentially facilitate ICOs by offering custody, transaction settlement, or token listing services.

Remarks

The CBN's focus on regulating VASPs banking through the guidelines suggests a potential avenue for future regulations, bringing more clarity and legitimacy to the various operational aspects of the digital assets market and addressing a whole range of safety, governance, monitoring and policy supervision issues. The CBN's regulatory guidelines mark a significant milestone in shaping the trajectory of virtual assets in Nigeria. The impact is multidimensional, affecting market dynamics, fostering innovation, and potentially influencing the landscape of ICOs. The continued evolution of Nigeria's virtual assets economy will be closely monitored, with the guidelines serving as further building block for future developments in the digital assets economy.

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