THE CBN LETTER ON CRYPTOCURRENCY: YOUR FAQS ANSWERED

Nigerians reportedly traded more than US$400m worth of cryptocurrency on local crypto exchange platforms in 2020,[1] and with a global market valuation of about US$1 trillion,[2] cryptocurrency transactions in Nigeria have been on the rise for the last 12 months with no deceleration in sight, until Friday 5th February 2021 when the Central Bank of Nigeria ("**CBN**") directed all deposit money banks and financial institutions to immediately close bank accounts belonging to persons and/or entities transacting in cryptocurrency or operating cryptocurrency exchanges.

The CBN letter dated 5 February 2021 (the "**CBN Letter**") was addressed to banks, non-bank financial institutions and financial institutions, but given the subject matter and scope, it also impacts on the operations of cryptocurrency platforms in Nigeria. In response to the market reactions to the CBN Letter, the CBN published a press release dated 7 February 2021 (the "**Press Release**").

Unsurprisingly, between the CBN Letter and the rapidly issued Press Release, the market has many questions, and in this FinTech Market Update, we address some of the more pertinent Frequently Asked Questions.

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[1] <https://techpoint.africa/2021/01/06/nigerians-traded-more-than-400m-worth-crypto-2020/> accessed 7 February 2021
[2] <https://qz.com/1954555/all-the-worlds-crypto-is-now-worth-more-than-1 trillion/#:~:text=A%20week%20into%20the%20new,only%20to%20around%20%24260%20billion> Accessed 7 February 2021

01 WHAT DOES THE LETTER SAY?

The brief CBN Letter reminds all regulated financial institutions (including deposit money banks, non-bank financial institutions and financial institutions) that dealing in cryptocurrencies or facilitating payments for cryptocurrency exchanges is prohibited.

Deposit money banks and financial institutions are now required to identify bank accounts belonging to persons and/or entities transacting in cryptocurrency or operating cryptocurrency exchanges and close such bank accounts.

This effectively means that all customer accounts actively involved in cryptocurrency transactions must be closed. It is not entirely clear if the account closure directive will affect every single bank customer with any previous history of cryptocurrency transaction, irrespective of timing of that transaction, transaction size or whether there was one or a series of transactions. What is clear though, is that bank accounts belonging to cryptocurrency exchanges or custodians will certainly be closed.

02 WHEN DOES THE LETTER TAKE EFFECT?

The CBN Letter takes immediate effect. Therefore, all regulated financial institutions are expected to comply promptly upon receipt of the CBN Letter.

03 IS IT NOW ILLEGAL TO TRADE, INVEST OR OTHERWISE DEAL WITH CRYPTOCURRENCIES IN NIGERIA?

Whilst there had previously been no definitive statement from the CBN that trading or investing in cryptocurrency was illegal (other than a warning to the public of the risks associated with crypto transactions), it is prohibited for regulated financial institutions to trade in, facilitate and or transact in any form of cryptocurrencies, and the practical effect of this is that it is no longer permissible to facilitate any trades or payments in connection with cryptocurrencies through the Nigerian banking system.

In addition to the practical effect, we note that the Press Release expressly states that the use of cryptocurrencies in Nigeria is a direct contravention of existing law.

Moving forward, banks will have to closely monitor customer bank accounts and take action in line with the directives of the CBN.

04 CAN I ADD MONEY TO MY CRYPTO WALLET USING A NIGERIAN BANK CARD?

From the terms of the CBN Letter, this will no longer be permissible, as such transactions would be emanating from or connected to a Nigerian bank account.
By the directions of the CBN Letter, Nigerian bank accounts, bank cards and any other banking tool issued by a Nigerian bank can no longer be used in facilitating payments related to cryptocurrency.

05 ARE THERE PENALTIES FOR NON-COMPLIANCE?

Breach of the CBN directives set out in the Letter will attract severe regulatory sanctions which could range from imposition of a fine to revocation of license in extreme cases.

Although the CBN Letter is addressed to regulated financial institutions, and the severe regulatory sanctions will be directed at them, the only sanction noted at this stage for individuals/business entities will be closure of their bank accounts. However, in the event that an individual/business entity has multiple bank accounts closed for this reason, regulatory scrutiny should be expected.

06 DOES THE CBN LETTER OVERRIDE THE SEC STATEMENT ON DIGITAL ASSETS?

The Securities and Exchange Commission (the "**SEC**") had previously issued a Statement dated 14 September 2020 to the effect that unless otherwise demonstrated, virtual crypto assets will be treated as securities (*see our newsletter on the SEC Statement*).

The CBN and the SEC are both independent regulators, therefore whilst it is unlikely that the CBN Letter would override the position of the SEC, there is some regulatory overlap between the two which can sometimes result in conflicting messages to the market and this is one such occasions.

For example, the SEC Statement provides that any person, (individual or corporate) whose activities are blockchain-related and involves the offering of digital asset services, will be required to be registered with the SEC and comply with the regulatory guidelines of the SEC.

Therefore, if in fact an entity has gone through the process of registration with the SEC, does that mean such entity will be allowed to operate a Nigerian bank account for cryptocurrency transactions? This is one of the many unanswered questions that the regulators must provide guidance on.

In the immediate future, both regulators will need to collaborate closely to provide further guidance on how the SEC Statement will be implemented in view of the CBN's Letter.

07 CAN THE CBN EFFECTIVELY BAN CRYPTOCURRENCY SIMPLY BY ISSUING A LETTER – IS SOME FORM OF LEGISLATION NOT REQUIRED?

Not necessarily. As the apex banking regulator in Nigeria, the CBN is statutorily empowered by virtue of the Banks and Other Financial Institutions Act 2020 and the Central Bank of Nigeria Act 2007 to make rules and regulations for the operation and control of all financial institutions under its regulatory purview and supervision.

08 WHY DOES THE CBN CONSIDER CRYPTOCURRENCY SO RISKY?

The CBN has cited the need to protect the integrity of the Nigerian financial system as one of the reasons for its regulatory actions.

In a circular dated 12 January 2017 (the "**First Circular**"), the CBN expressed concern over the fact that cryptocurrency transactions are untraceable and anonymous, making them susceptible to abuse by criminals, especially in money laundering and financing of terrorism.

09 HAS THERE BEEN ANY OFFICIAL CBN RESPONSE TO THE MARKET REACTION SINCE THE LETTER WAS PUBLISHED?

Yes. The CBN has, via the Press Release, provided responses to the overwhelming market reaction prompted by the Letter.

In its response, the CBN cited the following reasons as justifications for its position:

- As cryptocurrencies are issued by unregulated and unlicensed entities, their use in Nigeria goes against the key mandates of the CBN as the issuer of legal tender in Nigeria by virtue of the CBN Act 2007. Therefore, the use of cryptocurrencies in Nigeria is a direct contravention of existing law.

- The increasing use of cryptocurrencies to perpetrate and conceal illegal activities including money laundering, terrorism financing, purchase of small arms and light weapons, tax evasion and more recently, the use of cryptocurrencies to purchase hard and illegal drugs on the darknet.

- The need to protect the financial system and the generality of Nigerians (including the youth population) from the risks inherent in crypto assets transactions, which have escalated in recent times, with dire consequences for the integrity of the financial system and financial stability.

- Unlike fiat money which is accompanied by the full faith and comfort of a country or Central Bank, cryptocurrencies do not have any intrinsic value and do not generate returns by themselves. Therefore, cryptocurrencies have become more widely used as speculative assets rather than as means of payment, thus explaining the significant volatility and variability in their prices.

10 IS THE CBN LETTER AIMED AT PROTECTING FIAT CURRENCY?

Going by the Press Release, the CBN has stated that the fact that cryptocurrencies are issued by unregulated and unlicensed entities goes against its key mandate as the issuer of legal tender in Nigeria. More so, unlike fiat money, the use of cryptography by cryptocurrencies prevent oversight, accountability and regulation.

On this basis, it seems reasonable to conclude that the CBN Letter is, at least in part, part of a drive to maintain the position of fiat currency.

Analysis

The CBN has argued that it did not place any new restrictions on cryptocurrencies, given that all banks in the country had earlier been forbidden, through the First Circular not to use, hold, trade and/or transact in cryptocurrencies. Thus, the Letter only reminded regulated financial institutions of an already existing prohibition. All fair, however, the market understanding was that the First Circular was only in relation to the ability of banks and other financial institutions to hold and trade cryptocurrencies on their own account or through their banking platforms. The profuse market reaction therefore stems from a belief that the CBN Letter represents a new and further step in the prohibition of crypto transactions, by extending the prohibition to any trades facilitated by payments through the Nigerian banking system.

The CBN further argued that in any case, its position on cryptocurrencies is not an outlier as many countries, central banks, international financial institutions have since adopted the same position. Many in the market would disagree with this position though, as the EU recently proposed a full regulatory framework for cryptocurrencies whilst two new Bills are under consideration by lawmakers in the US - the Digital Commodity Exchange Act, and the Securities Clarity Act.

In spite of the justifications put forward by the CBN, there are mounting concerns that the position of the CBN will stifle innovation and significantly restrict the operations of cryptocurrency businesses in Nigeria. The pertinent question then becomes whether the market will consider the risks identified in the Press Release as sufficient justifications to prohibit what is considered by many to be a burgeoning economic activity.

In the same manner in which nature abhors a vacuum, we have seen that technology is constantly innovating and usually at a rate faster than regulation can match. It would therefore not come as a surprise if, in the near future, we see cryptocurrency transactions evolve to avoid regulatory barriers altogether. In the meantime, the CBN and SEC should, as a matter of urgency align their policies on cryptocurrency and provide the market with much needed clarity.

Key Contacts

Zelda Akindele
Partner
zelda.akindele@templars-law.com

Victor Sameria
Associate
victor.sameria@templars-law.com