



ADOPTION OF DIGITAL ASSETS IN NIGERIA

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Introduction

Practically everyone has heard something about crypto: the currency, the hype, the phenomenal gains and inevitable crash that followed in 2022 on the back of industry turbulence (Multiple bankruptcies, poor controls, fraud and conflicting regulatory signalling). Attention is shifting (correctly) from a single use case to the underlying technology on which all crypto currency – blockchain.

Blockchain is a decentralized and distributed digital ledger technology ["DLT"] that is designed to record transactions across multiple computers in a secure and transparent manner. DLT comes in 2 main classification types – permissioned or permissionless.

- Public permissionless blockchains are open to anyone who wants to participate and no central authority governs the network.
- Permissioned blockchains are restricted and only accessible to a specific group of participants. Permission is required from a central entity who control the network.

TABLE 1: CHARACTERISTICS OF BLOCKCHAIN

	Public Permissionless	Private Permissioned
Advantages	Access Control	Y
	Independence	Y
	Performance	Y
	Scalability	
	Security	
	Transparency	Y
	Trust	Y
Disadvantages	Auditability	X
	Performance	X
	Scalability	X
	Security	X
	Transparency	
	Trust	X

While all cryptos reside on public blockchain resident, the technology is applicable to improve the efficiency of an ever-expanding range of processes and operations like

- Payment token and Digital coins (Currency that can be used for payment or as a store of value currency),
- Utility tokens (non-transferrable with no underlying value that gives a right to use a particular service)
- Security tokens that are backed by real assets and are regulated as traditional securities.

It creates significant revenue generation and cost efficiency opportunities to operators, investors, and issuers. As a result, Governments, regulatory bodies, and industry players have shown immense interest in exploring and adopting DLT for their operations.

For the purposes of the capital market application, we focus on the ability, to securitise and fractionalise real world illiquid assets.

In an earlier survey, Sophus Consultants reviewed the readiness and anticipation of the capital market community for blockchain technology. We now update with this review of the progress made in implementing a digital transformation. We identify some of the risks, opportunities, and challenges to a full on but inevitable revolution and offer a few suggestions to what we believe is a well-structured approach for the capital market in Nigeria.

We conclude that indeed the transformation has commenced and institutional interest is growing.

Financial and Capital market Adoption

DLT brings the power to share stakes in illiquid assets and secure ownership in the asset of business by providing a transparent, irrevocable record of identity, ownership or data in a single universally accepted ledger and the capital market ecosystem is exploring case applications to exploit this daily.

The use of blockchain technology reduces the need for middlemen and paperwork – creating cost savings all through the value chain.

Due to its decentralised structure, it is immutable, transparent and efficient. Automated smart contracts eliminate any human role in conducting transactions, thus eliminating any unfair deals and counterparty risk.

Many established financial-services companies have continued to research and develop digital asset capacity. Teams of 50-strong or more continue to research means to exploit the revenue generation and cost saving opportunities from DLT (see Table 2).

With the groundswell of knowledge and capacity has come greater experimentation and planned expansion of capabilities (often through partnerships). Other operators are opting to integrate the whole structure and become one-stop shops for asset tokenization and distribution.

USE CASES

Apart from developing currencies and stablecoin, some interesting use models have emerged such as

A Capital raise application

In most cases, regulation is being aligned to legacy market rules and structures and pointed to reducing market risk (e.g., by restricting distribution of tokenized assets to accredited investors only in the first instance). Regulators in Hong Kong, Japan, Switzerland, Singapore, the United Arab Emirates, and the United Kingdom have published guidelines that enhance the regulatory clarity for digital assets.

As early as September 2019, Santander announced the issuance of the first end-to-end bond valued at \$20million using the public Ethereum blockchain. The bond continues to exist only on blockchain and it created a critical first step towards a secondary market for mainstream security tokens across blockchain. The model also positioned Santander as a one stop shop as various bodies within the Santander group acted as tokenization agent, custodian of the cryptographic keys and dealer – reducing the number of intermediaries required! After this first issuance many other issue have followed.

B Democratising real estate

Tokenisation has significantly changed the game for real estate also. large assets can be fractionalised and democratised for smaller investors.

In 2018, Elevated Returns pioneered the tokenization of the St. Regis Resort Aspen, Colorado in an \$18 Million securitised token offering and listed on tZero. Since then, a wide range of real estate assets have been tokenised to seek more liquidity, transparency or wider investor spread.

Opportunities from DLT	Regulator	Asset owner	Investor
Improved capital efficiency • meaningful capital efficiencies. • Instant Tri-party repurchase agreements or money market fund redemptions. • Shorter settlement times • Interest savings	R	R C	R C
Democratization of access. • potential for improved liquidity • fractionalization of assets / division of ownership • streamlining operationally intensive manual processes bring smaller investor sizes	R	R C	R
Operational cost savings. • Asset programmability and Reduced intermediaries • Error proofing • System automation via smart contracts • Real time Automated portfolio rebalancing	C	C	R
Enhanced compliance, auditability, and transparency. • Asset issuers could automate compliance checks • 24/7 data availability& real time reporting • immutable recordkeeping, and real-time, auditable accounting through triple-entry bookkeeping	C	C	C
Cheaper and more nimble infrastructure. • open source and scalable • thousands of Web3 developers and billions of dollars' worth of venture capital invested • See public permissionless blockchains above	R C	C	R
• R - Revenue Opportunity • C - Cost efficiency			

TABLE 2: OPPORTUNITIES FROM DLT

C Private Equity

The potential to unlock liquidity, enhance transparency, and revolutionize investor access, presents a compelling option for private equity firms. Globally, more than 90% of companies with an annual turnover of US\$100 million or more are private. They are seizing the

opportunity to simplify complex investment portfolios and making them more flexible, easier to trade, and more accessible. This movement to embrace the new technology also aligns with the evolving demands of investors for greater flexibility and efficient capital deployment creation and financial inclusivity. (see Figure 1)

	issued \$16 million in exchange tradable Spice Tokens
	
	Opened part of its \$4 billion Health Care Strategic Growth Fund II ("HCSG II") to be tokenized on the Avalanche.
	First incubator worldwide to raise its own tokenized compliant securities offering (SCI)
	The open-ended fund is open to international investors and tradable on ADDX
	Fullerton Optimised Alpha Fund tokens reduced investment packets from \$200,000 to \$10,000

FIGURE 1: PRIVATE EQUITY TOKENISATION USE

D Privatisation

Some governments and financial institutions are exploring DLT and tokenization to significantly reshape and optimize privatization programs, making them more inclusive, efficient, and globally accessible. Tokenisation can fragment ownership of state-owned assets into digital tokens and make the security available to both citizenry and foreign investors. The tokens can be traded on digital platforms, facilitating easier and more liquid trading of ownership interests. Especially important to privatisation experience are 2 additional factors

- i) It can attract a global audience of investors. This can lead to increased competition during the privatization process and potentially drive up the value of the assets being privatized.
- ii) The security of the platform provides opportunity for a secure transparent and tamper-proof ledger.

E Exchanges and secondary trading

Stock exchanges have emerged as some of the more prominent users of DLT for activities like trading, settlement, and record-keeping. DLT is also being explored for a wider range of financial applications, including cross-border payments, remittances and trade finance.

At least 12 jurisdictions (see Figure 2) have commenced operation in some form and as the technology matures and gains wider acceptance, more securities exchanges are integrating blockchain solutions to enhance their operations and provide better services to market participants.

ADDX in Singapore is only one of such exchanges. So far it has listed 26 deals on its platform involving blue-chip names such as Investcorp, UOB, CGS-CIMB. It caters to asset classes like private equity, venture capital, private debt, real estate, hedge funds, funds with cryptocurrency exposure, and structured products.

We note very positively that Nigeria is not far behind.

The Nigeria Story

The Nigeria Securities and Exchange Commission ["SEC"] was quick to recognise three things,

- i) the high interest – especially among the young - to invest in crypto assets. Even though these were often from unregulated markets and abstract instruments.
- ii) The need for a clear regulatory environment to support orderly growth and protect investors
- iii) A strong dependency on capacity among professionals in the industry

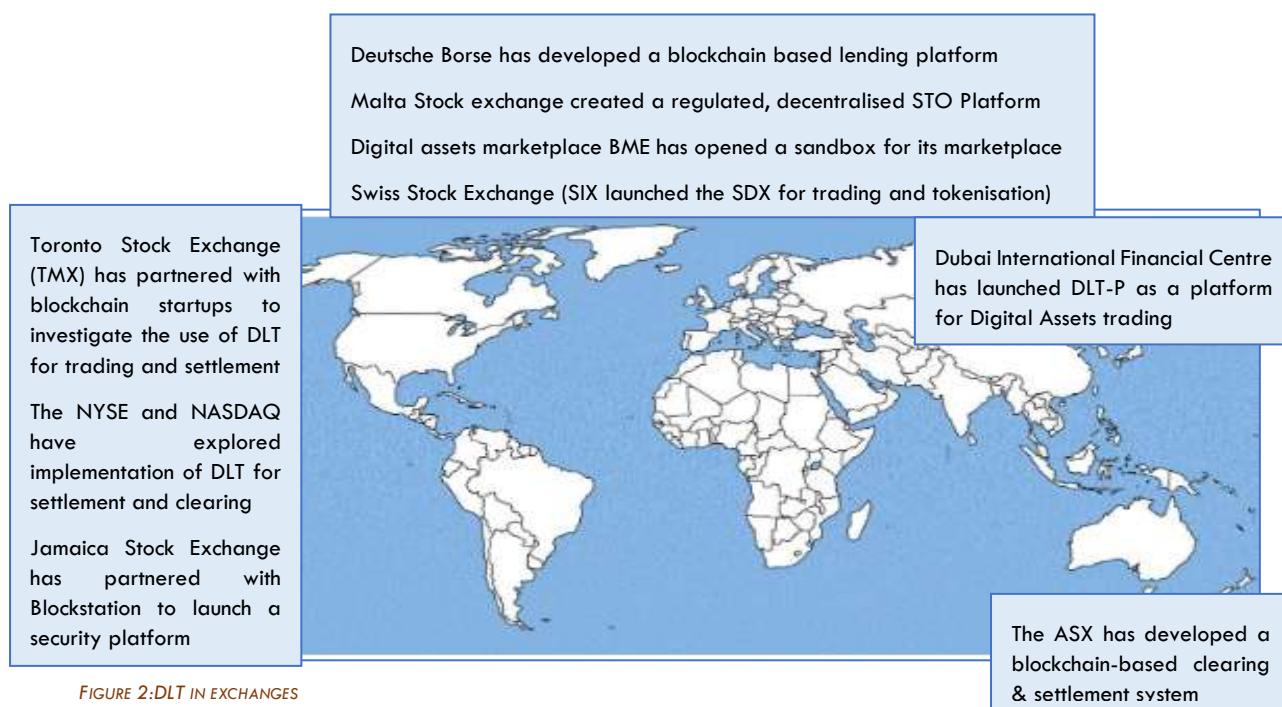
In 2020 SEC released Crowdfunding Regulations designed to enable MSMEs and

other entities that were not hitherto eligible to raise funds from the public market access the market for funding.

SEC in May 2022 then released rules for the regulation of digital assets to cover ICOs and STOs but specifically excluding the Cryptocurrencies like Bitcoin and Ether.

In April 2023, the SEC invited the first cohort of operators to apply to enter its regulatory incubation program. The first cohort was accepted to test out its structure in September 2023.

Various institutions including the Nigerian Capital Market Institute ["NCMI"] affiliated with the SEC have also commenced rolling out programs to build capacity among operators, investors, and issuers.



COMMENCEMENT OF REGULATORY INCUBATION

We applaud the commencement of regulatory incubation to test out FinTech innovation in the Nigerian capital market. This controlled innovation incubatory environment would provide a safe space for risk mitigation, standardisation of products processes and technology.

Operators in the core of the program will also generate critical insights that will allow the Regulator refine and improve efficiency of procedures while safeguarding clients and investors.

Most importantly, Regulatory Incubation will enable participants demonstrate the viability of the structure and instil confidence in its value proposition.

About Sophus

Sophus offers consulting services, guiding clients through regulatory compliance and legal aspects of their tokenization journey. As an interested party in the structuring of a Digital Assets market in Nigeria, we stay abreast of regulatory developments, ensuring that our clients can confidently navigate the dynamic digital asset regulation landscape.

We advise and work with our clients through the entire process flow - from planning, to regulatory compliance, structuring and technical implementation.

Contact us for further information of our services or consultation.

