

APPRAISAL OF THE LEGAL NATURE OF DIGITAL ASSETS: THE WAY FORWARD

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Abstract

The growing adoption of the digital asset market has brought to light concerns about issues related to data privacy and security, financial stability and systemic risk, money laundering and criminal activity, national risk, the exercise of human rights, and financial inclusion. It is beneficial to conceptualize digital assets for legal and regulatory reasons. This is due to the requirement that the content of digital assets and associated actions be under control, not just their appearance. As a result, the conception of these assets is based on the concept of Asset form, or conventional instruments portrayed in digital form. Digital ledger technologies are the underlying technology. The question amongst others is whether there is a global legislation regulating financial technologies and digital assets? In a bid to answer the foregoing question, the researcher adopted the doctrinal method of research which entails the use of books, journals, articles, statutes, case laws and materials. This article found that the legal nature of digital asset is largely unsettled. It also found that although few municipal and regional legislations exist, they have not been able to address the issues arising from the operations of digital assets, not to talk of countries that have no such legal framework for the regulations of digital assets. Since there isn't any widely accepted international law on digital assets, digital assets are not yet classified using a standard method. This presents a problem for the management and control of digital assets, which are commonly encountered in international, multi-jurisdictional contexts. In view of the volatility observed in the cryptocurrency and digital asset markets, which includes recent cases of egregious fraud and unviable business models, this article recommended a more standardized and stringent regulatory framework to guarantee the operations and interoperations of digital within and across countries of the world.

Keywords: Digital, Assets, Digital Assets, Legal

1.0 Introduction

The inventions of digital technologies and the innovation of the digital age has caused a paradigm shift in culture, economies, work, health, education, investing and everything seems to have become smarter.¹ More so, the innovation in the global financial markets driven by three emerging economic phenomena—blockchain technology,² fintech,³ and crypto assets, (otherwise called "digital

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¹Omobolanle Adekoya and Elizabeth Ekpo 'Digital Assests- an emerging trend in capital markets, 2022, pwc, 2.

² Blockchain is "a cryptographically-secured digital ledger, and a blockchain's protocol is the software that governs rules, operations, and communications between computers interacting with the blockchain." Simply Vital Health, Inc., Exchange Act Release No. 10671, at 2 (Aug. 12, 2019), <<https://www.sec.gov/litigation/admin/2019/33-10671.pdf>>. A "distributed ledger" (which is the underlying feature of "distributed ledger technology" or "DLT") can be described as "a large, decentralized database that is maintained on a network of computers rather than a single server, and that is updated in real-time". Hilary J. Allen, *Bitcoin?*, 76 MD. L. REV. 877, 886 (2017).

³ "Fintech" refers to the integration of financial services and technology. See, e.g., Chris Brummer & Yesha Yadav, 'Fintech and the Innovation Trilemma', 107 GEO. L.J. 235, 241 n.18 (2019) (defining the "broad definition of fintech" as "the use of digital technologies in finance"); U.S. GOVERNMENT ACCOUNTABILITY OFFICE, FINANCIAL TECHNOLOGY: INFORMATION ON SUBSECTORS AND REGULATORY OVERSIGHT 1 (2017), <<https://www.gao.gov/assets/690/684187.pdf>> (noting that "[f]intech products and services include small business financing, education refinancing, mobile wallets, virtual currencies, and platforms to connect investors and start-ups").

assets")⁴—have spread throughout the world.⁵ According to the Securities and Exchange Commission, the term ‘digital asset’ refers to an asset that is issued and/or transferred using distributed ledger or blockchain technology (‘distributed ledger technology’), including, but not limited to, so-called ‘virtual currencies,’ ‘coins,’ and ‘tokens.’⁶ Other numerous definitions of digital assets are abound. It could mean cryptocurrencies and other virtual coins and tokens...;⁷ it could mean asset issued and transferred using distributed ledger or blockchain technologies;⁸ it could also mean an electronic record in which an individual has a right or interest.⁹

2.0 Legal framework for digital assets and its challenges

The fact is that if the legal system cooperates with the technological components of such digital asset systems, it can strengthen the overall robustness of digital asset environments—which also depend on social elements—as part of a larger social framework.¹⁰

It is most unfortunate to note that concerns about issues related to data privacy and security, financial stability and systemic risk, money laundering and criminal activity, national risk, the exercise of human rights, and financial inclusion have been raised by the growing adoption of the digital asset market. The aforementioned advancements have intensified the necessity for both domestic and international legal frameworks and regulations that govern the conduct of market participants in digital assets.¹¹ At the present there is either dearth of legislations or insufficient legislations regulating digital assets across the globe, added to the facts due to the constant development of digital assets, existing legislation becomes incapable of regulating the sector. While some countries and regions have made effort towards advancing in digital assets regulations, others have not.

No wonder according to Professor Fairfield, users' legal protection is weakened by the private law's historical inability to safeguard property rights in specific digital goods.¹² This work looks at the legislations regulating digital assets with a view to finding the extent which the laws resolved issued arising from the assets.

⁴ The term “refers to an asset that is issued and transferred using distributed ledger or blockchain technology, including, but not limited to, so-called ‘virtual currencies,’ ‘coins,’ and ‘tokens.’” SEC, FRAMEWORK FOR “INVESTMENT CONTRACT” ANALYSIS OF DIGITAL ASSETS (last modified Apr. 3, 2019), <<https://www.sec.gov/files/dlt-framework.pdf>> [hereinafter THE SEC FRAMEWORK]. Cryptoassets are “an entry in a ledger that specifies that a particular user [can] . . . exercise a discrete set of powers.” ShaananCohney, David Hoffman, Jeremy Sklaroff & David Wishnick, Coin-Operated Capitalism, 119 COLUM. L. REV. 591, 602 (2019); According to the Law Reform Commission, Digital assets includes electronic signatures, cryptography, smart contracts, distributed ledgers and associated technology, see Digital Assets: Consultation Paper, Law Reform Commission, Law Com No 252.

⁵ Yuliya Guseva ‘A Conceptual Framework for Digital-Asset Securities: Tokens and Coins as Debt and Equity’ *Maryland Law Review* (2021) 80(1), 165, 167. Digital assets distributed by commercial companies and even the World Bank, such as digital securities, tokens, and coins, have been sold on capital markets.

⁶ Kate Goldman and Arnav Kumar, ‘A Taxonomy of Digital Assets’ [2021] The Milken Institute, 8, <<https://digitalcommons.law.umaryland.edu/mlr/vol80/iss1/7/>>

⁷ Financial Regulatory Authority, (n 7) 8

⁸ Congressional Research Services, (n 7) 8

⁹ American Bar Association, (n 7) 9.

¹⁰ Gianluca Elia, Alessandro Margherita, and Giuseppina Passiante, ‘Digital Entrepreneurship Ecosystem: How Digital Technologies and Collective Intelligence are Reshaping the Entrepreneurial Process’ (2020) 150, *Technological Forecasting and Social Change*, 119791.

¹¹ Adekoya (n 1)

¹² J Fairfield, ‘Virtual property’ (2005) 85 *Boston University Law Review* 1047, 1052.

2.1 The Markets in Crypto-assets Regulation (MiCAR) (Regulation (EU) No 2023/1114)

The MiCAR¹³ regulates crypto-asset issuance and service provision in the European Union (EU). MiCAR encompasses activities such as offering asset-referenced tokens (ARTs) and electronic money tokens (EMTs) to the public or seeking admission for trading, as well as issuing such tokens.¹⁴

Under MiCAR, the EBA (European Banking Authority) is entrusted with the task of supervising significant ARTs and EMTs, as determined by the EBA based on the criteria specified in MiCAR. Furthermore, given the possible lack of addressees for the regulatory measures and the absence of an issuer, MiCAR expressly excludes from its purview completely decentralized finance and local cryptocurrencies like bitcoin for reasons I would characterize as "structural."¹⁵ The "deterritorialization" of financial services is another factor that makes enforcing financial regulations more difficult. The ability of technology advancements to deliver services remotely has made it more challenging to pinpoint the jurisdiction of the supplier.¹⁶

2.2 Financial Services Regulatory Authority (FSMA) 2000

The principal characteristic of FSMA is the restructuring and unification of the supervision of banking, insurance, and other investment services through the creation of the Financial Services Authority, a strong unified and almost all-encompassing regulator of the financial services sector in the United Kingdom.¹⁷

Deposit taking, asset administration and safekeeping, investment dealing, investment arrangement, investment management, and investment advisory are only a few of the many activities

¹³ Regulation (EU) 2023/1114 of the European Parliament and of the Council of 31 May 2023 on Markets in Crypto-Assets, and Amending Regulations (EU) No 1093/2010 and (EU) No 1095/2010 and Directives 2013/36/EU and (EU) 2019/1937 (OJ L 150, 9.6.2023, p. 40). Other EU regulations includes: Markets in Crypto-assets Regulation; Regulatory Technical Standards on complaints handling procedures for issuers of ARTs; Technical Standards on information for authorisation as issuers of ARTs under MiCAR; Regulatory Technical Standards on information for assessment of a proposed acquisition of qualifying holdings in issuers of ARTs under MiCAR; Joint EBA and ESMA Guidelines on the suitability assessment of shareholders and members with qualifying holdings in issuers of ARTs and in CASPs; Joint EBA and ESMA Guidelines on the suitability assessment of the members of the management body of issuers of ARTs and of CASPs; Regulatory Technical Standards on the procedure for the approval of white papers of ARTs issued by credit institutions; Regulatory Technical Standards on the minimum content of the governance arrangements on the remuneration policy under MiCAR; and Guidelines on internal governance arrangements for issuers of ARTs under MiCAR etc.

¹⁴ The Markets in Crypto-Assets Regulation (MiCAR) which was entered into force at the end of June 2023 and will be applicable in its entirety by the end of 2024. See Article 149 of MiCAR where the applicability of the Regulation is postponed by 12 or 18 months after its entry into force.

¹⁵ 'I say "fully decentralised" here because research indicates that many DeFi arrangements have at least some degree of governance concentration and could therefore potentially be in scope of MiCAR. Moreover, while MiCAR does not impose white paper requirements for crypto-assets automatically created as a reward for the maintenance of the distributed ledger or the validation of transactions (like, for instance, in the case of bitcoin), providers of exchange services allowing the negotiation of such crypto-assets are required to publish a white paper. Furthermore, although DeFi is not regulated under MiCAR directly, related services or activities might be. For example, if a smart contract provides for the automated exchange of one crypto-asset for another, the smart contract is not regulated under MiCAR. However, offering crypto-assets to the public would, in principle, be subject to the obligation to publish a white paper, as set out in Article 4 of MiCAR'; See Andrea Enria, 'Regulating crypto finance: taking stock and looking ahead' (2023), Speech by Andrea Enria, Chair of the Supervisory Board of the ECB, at the Conference on MiCAR and its coordination with EU financial markets legislation, jointly organised by Ca'Foscari University of Venice and Banca d'Italia.

¹⁶ P T Jaeger, and others, 'Where is the cloud? Geography, economics, environment, and jurisdiction in cloud computin' First Monday, 2009 Apr 8; Joel R Reidenberg, 'Technology and Internet Jurisdiction' *University of Pennsylvania Law Review*, (2005) 153 (6) 1951-1974.

¹⁷ The solvency of occupational pension schemes remains separately regulated by the Occupational Pensions Regulatory Authority established by the Pensions Act 1993.

covered by FSMA regulations.¹⁸ It creates a uniform authorization process for all operations that are subject to regulation and plans to create a uniform set of rules for all financial service enterprises in the future.¹⁹ To limit the misuse of financial markets, the FSMA also imposes harsh new penalties. Although the act is lengthy (433 parts and 21 schedules), it is better viewed as a framework, with many specifics to be provided by secondary (delegated) legislation.²⁰ Part of the FSMA innovation set out in the functions of the FSA is for consumer protections, financial crimes prevention²¹ and stability of financial system.

Notwithstanding the laudable provisions of FSMA, it has not settled all the issues around digital assets as many specifics of the Act were left to be provided by future delegated legislations. Moreso, while unified agencies may be susceptible to problems of reputational contagion, the Unified financial regulatory agencies may prove less effective than anticipated if their very broad scope overloads senior management.²²

2.3 Central Bank of Nigeria (CBN) Guideline on Operation of Bank Accounts for Virtual Assets Service Providers (VASPs)

In February 2021, CBN issued a circular restricting banks and other financial institutions from operating accounts for crypto-currency services in view of the money laundering and terrorism financing risks.²³ However the CBN later found the need to regulate the activities of VASPs including crypto-currencies and crypto-assets.²⁴ It is in the light of the above that the CBN issued a guideline to provide guidance to financial institutions and VASPs in Nigeria.²⁵ Unfortunately, issues around digital assets regulation is also not settled in Nigeria as banks and other financial institutions are still prohibited from holding, trading and/or in virtual currencies on their own accounts thereby digital assets operations in Nigeria.

2.4 Securities and Exchange Commission (SEC) Rules

The top regulator of Nigeria's capital market, the Securities and Exchange Commission (SEC), released Rules on the Issuance, Offering Platforms, and Custody of Digital Assets in May 2022. The following are governed by the Rules: i) Digital asset issuance ii) Digital Assets Offering Platforms (DAOPs) registration requirements; iii) Digital Asset Custodians (DACs) registration requirements; iv) Virtual Assets Service Providers (VASPs) guidelines; and v) Digital Assets Exchange (DAX) guidelines.²⁶

¹⁸ Financial Services and Markets Act, 2000, c. 8, sched. 2, pt. 1 (Eng.), available at <<http://www.hmso.gov.uk/acts/acts2000/20000008.htm>> (accessed 20, March 2003).

¹⁹ See generally George Walker, 'Penalties for Market Abuse' in *Blackstone's Guide to the Financial Services & Markets Act 2000* (Michael Blair ed., 2001).

²⁰ Heidi Mandanis Schooner & Michael Taylor, 'United Kingdom and United States Responses to the Regulatory Challenges of Modern Financial Markets' *Texas International Law Journal*, (2003) 38 (2) 317, 330.

²¹ FSMA, 2000, c. 8, pt. 1, § 6 (3)(b). FSMA expanded the meaning of financial crime to include "misconduct in, or misuse of information relating to, a financial market.

²² Schooner (n 21) 317, 344; See the case of the UK HIH and Equitable Life Insurance company. See also Graeme Thompson, 'Perils of the Prudential Regulator, Speech delivered at the Investment and Financial Services Association Annual Conference' (Aug. 2, 2001), <<http://www.apra.gov.au/speeches/Perils-of-the-prudential-regulator.cfm>> (acknowledging the need to improve community understanding and public relations) (accessed 20 March 2003).

²³ Adekoya (n 1)

²⁴ The CBN is empowered by s. 30 of the Money Laundry (Prevention and Prohibition) Act 2022 which recognizes VASPs as part of the definition of a financial institution. Additionally, the SEC in May 2022 issued Rules on Issuance, Offering and custody of Digital Assets and VASPs to provide a regulatory framework for the operations in Nigeria.

²⁵ Guideline on Operations of Bank Accounts for Virtual Assets Service Providers (VASPs), <<chrome-extension://efaidnbmnnnibpcajpcglclefindmkaj/https://www.cbn.gov.ng/Out/2024/FPRD/GUIDELINES%20ON%20OPERATIONS%20OF%20BANK%20ACCOUNTS%20FOR%20VIRTUAL%20Asset%20Providers.pdf>>, assessed 8 February 2024.

²⁶ *ibid*, Adekoya (n 1)

3.0 Conclusion

While there exist few municipal and regional legislations regulating digital assets, these legislations remain unsettled and have not fully addressed the challenges of digital assets with particular challenge of inter-jurisdictional enforcement. Currently, digital assets are not categorized using a uniform approach as there is no common international acceptable legislation on digital assets.²⁷ This poses a challenge to the administration and regulation of digital assets, which are frequently found in global, multi-jurisdictional settings.²⁸

4.0 Recommendation

Therefore, a uniform and stricter regulatory framework is strongly recommended in light of the volatility seen in the cryptocurrency and digital asset markets, which includes current instances of flagrant fraud and unsustainable business models.²⁹

²⁷ For example, there is no legislative structure that governs the establishment, distribution, or requirement of purchasing VCCs (Voluntary Carbon Credits). For this see: A Brohé, N Eyre, N Howarth, *Carbon Markets: An International Business Guide* (2009) p 274. The fundamental goal of VCCs is to provide funds for emissions reduction programs so that individuals or organizations may jointly encourage the decrease of global emissions. In order to "offset" their own emissions, participants in the voluntary carbon markets can purchase VCCs, which provide as proof that money has been invested in or initiatives aiming at lowering atmospheric greenhouse gas emissions have been carried out. See *Digital Assets: Consultation Paper*, Law Reform Commission, Law Com No 252., p 150.

²⁸ J G Allen, et al 'Legal And Regulatory Considerations for Digital Assets' (2020) Cambridge Centre for Alternative Finance, 7. According to Allen, the discipline of categorization known as taxonomy involves naming various things or items, recognizing them, and developing standards for grouping them into discrete categories and subcategories. Common definitions, terminologies, and semantics that are applicable to various systems are introduced by this method.

²⁹ Lianos, Ioannis, Philipp Hacker, Stefan Eich, and Georgios Dimitropoulos, eds. *Regulating blockchain: techno-social and legal challenges*. (Oxford University Press, 2019).