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CRYPTOCURRENCY AS A SECURITY ASSET: ANALYZING THE ROLES OF VARIOUS STAKEHOLDERS IN THE ADOPTION OF VIRTUAL ASSETS UNDER THE CAPITAL MARKETS AUTHORITY (AMENDMENT) BILL, 2023

Aggrey Bazirake*

ABSTRACT

The Fourth Industrial Revolution has ushered in blockchain and virtual assets develop and significantly impact social, economic, and political spheres, including Uganda's financial ecosystem. However, Uganda Securities Exchange has yet to adopt these technologies. Hon. Nathan Igeme's Capital Markets Authority (Amendment) Bill 2022 seeks to amend the Capital Markets Authority Act to regulate virtual assets like cryptocurrencies and licensed operators, rather than just products and activities. This article explores the potential consequences of this regulatory development and the measures that need to be taken to seamlessly integrate it into Uganda's securities framework and stock exchange. It examines the roles of various stakeholders and identifies vulnerabilities that could compromise the system's efficacy.

1.0. INTRODUCTION

The concept of the 'Fourth Industrial Revolution' originated from to a team of scientists who developed a high-tech strategy for the German government, in an article published by the Foreign Affairs.[1]The term 'Fourth Industrial Revolution' was coined by Klaus Schwab,[2]to describe a world in which individuals seamlessly transition between digital domains and offline reality,

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1 Schwab, Klaus (12 December 2015). The Fourth Industrial Revolution, Foreign Affairs. Accessed on June 29, 2023

2 Founder and Executive chairman of the World Economic Forum

leveraging connected technology to enhance and manage their lives.[3]This concept emerged in Germany between 2011 and 2015 with a primary focus on the practical application, and implementation of digital technologies.[4]
This revolution has been characterized by the advent of artificial intelligence, the Internet of Things,[5] the potential of quantum computing, and the utilization of distributed ledger systems.[6] It represents a phase in the digital transformation of the manufacturing sector, driven by disruptive trends through enhanced connectivity, human-machine interaction and improvement in robotics. Consequently, this has presented unprecedented opportunities for individuals, industries, and nations worldwide through application of blockchain technology, artificial intelligence, virtual reality, and robotics.

Blockchain is the cornerstone of the fourth industrial revolution, operating a decentralized system in the form of a digital ledger that stores and chains together encrypted blocks of digital assets.[7] Virtual assets, such as cryptocurrencies, leverage blockchain technology and, due to their decentralized nature, are not reliant on any centralized point of authority, including central banks or commercial bank, for their operation and validation.

Apparently, Uganda lacks a legal framework governing the use of cryptocurrencies, as there is no legislation permitting or prohibiting their use or trade.[8] On 29th April, 2022, the Bank of Uganda issued a circular

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3 Hassoun, A, Ait-Kaddour, Abu-Mahfouz, A.M Rathod, N.B Bader, F Barbra, F.J & Regenstein. J (2023) The Fourth industrial revolution in the food industry- Part 1: Industry 4.0 technologies. Critical Reviews in Food Science and Nutrition 63, no. 23 (2023) 6547-6563

4 Journal of International Affairs, Vol 72, No. 1

5 This describes a network of connected devices and technology embedded with sensors, software for purposes of connecting, and exchanging data with other devices over the internet. These include LAN, LPWAN, and Mesh Protocols.

6 Chou, S. Y. (2018). The fourth industrial revolution. Journal of International Affairs, 72(1), 107-120.

7 A blockchain works in form of a distributed ledger system where data used in transactions are stored in a publicly available blocks containing a digital signature and timestamp for them to be individually immutable chain of blocks hence blockchain

8 Silver Kayondo v Bank of Uganda (Miscellaneous Cause No. 109 of 2022) UGHCCD 113 (24 April 2023)

cautioning licensed financial institutions and payment merchants, including mobile money operators, against trading and engaging in cryptocurrency transactions, citing the risks associated with this technology.

In a correspondence between the Capital Markets Authority and Binance Limited, the latter had submitted a request to operate a crypto asset exchange. However, in a letter dated 15th August, 2018, the Capital Markets Authority declined this request, citing that it fell outside its regulatory purview. The Capital Markets Authority relied on the fact that Binance Limited was engaged in the in exchange of securities or securities related assets. However, although there's currently no regulatory framework governing virtual assets, they nonetheless continue to exist and operate within Uganda's jurisdiction.[9]

This article examines the move by Hon. Igeme Nabeta to table a Private Member's Bill, the Capital Markets Authority (Amendment) Bill. The proposed legislation seeks to regulate the transfer of virtual assets by specifying the due diligence requirements for service providers to facilitate asset tokenization on the blockchain.[10] It establishes a nexus between blockchain technology and virtual assets, such as crypto currencies, while considering the roles and responsibilities of various stakeholders in achieving its objectives.

2.0. BLOCKCHAIN AND CRYPTO ASSETS

2.1. BLOCKCHAIN

A blockchain is a decentralized, distributed database that is replicated across a network of computers or nodes, each containing identical information. Each node is linked to all preceding blocks, tracing back to the inaugural block, known as *the genesis block*. A node may be designated as a miner when it proposes, validates, and confirms transactions, and performing mining

[9] Regulatory Options for Crypto Assets in Uganda Final.pdf available at <https://cmauganda.co.ug/wp-content/> [Accessed on 18 September 2023]

[10] This refers to the process of representing ownership of an asset as a digital token on the blockchain network. It allows for the asset to be stored, transferred, and traded in a secure, transparent, and decentralized manner. Tokenization is a process of creating a digital representation of an asset, called a token, which is stored on the blockchain.

operations to achieve consensus, thereby securing the blockchain. This blockchain technology can facilitate various functions, including simple payment verification, among others, depending on the specific blockchain implementation.

Blockchain technology is predicated on a decentralized network, functioning as a peer-to-peer network rather than a centralized authority, such as a bank. It maintains a distributed database of transaction records, validated and upheld by a global network of computers. The integrity of these records is ensured by a vast community of supervisors, precluding any single individual from exerting control, thereby rendering the information tamper-proof. Furthermore, the decentralized nature of the network makes it impossible to pinpoint the specific location of any particular data element.[11]

More to the above, a blockchain is a decentralized ledger of distributed database of records, or public ledger of all transactions that have been executed and shared among participating parties. This decentralized ledger shares and replicates database, synchronized across the network, maintaining a permanent and tamper-proof record of transactions among the participants. The decentralized nature of blockchain technology renders it resilient to interference from any individual, entity, or system. The inherent characteristic enables the network to mitigate common challenges in the financial markets such as counterfeiting, forgery and double transactions. The utilization of advanced cryptographic techniques ensure that these systems are completely immune against fraud and counterfeiting, providing a secure and tamper-proof environment for transactions.

Satoshi Nakamoto is widely regarded as the inventor of blockchain technology, which was first introduced in the 2008 Bitcoin whitepaper, titled '*Peer-to-Peer Electronic Cash System.*'[12]Nakamotos' primary objective was to facilitate direct online payments between two parties without relying on

[11] The bitcoin big bang; the economics of digital currencies 165-168 (2016)
[12] Bitcoin: A Peer-to-Peer Electronic Cash System; available at <https://bitcoin.org/en/bitcoin-paper> [Accessed on 16 September 2023]

intermediaries, such as central banks, governments, or financial institutions. The Bitcoin whitepaper, published in 2008, was made publicly available via a cryptography mailing list. The white paper described a novel electronic currency system, although subsequent use cases have emerged, including the utilization of smart contract technology. Notably, the data recorded on a blockchain is immutable and verifiable, ensuring the integrity and transparency of the network.[13]

Illegal Ponzi schemes have found fertile ground in Uganda to steal money from, and lure mostly the youth, and the wider unsuspecting ignorant population into schemes where they have ended up losing their money. Certain Ugandan individuals have fallen victim to fraudulent schemes and Ponzi scams perpetrated by entities purporting to operate in the cryptocurrency sector. This phenomenon can be attributed to the absence of clear regulatory frameworks governing the crypto market in Uganda. A notable example is the case of Capital Chicken that defrauded Ugandans over 8 billion shillings, BLQ, One coin, D9, Dutch World International, FX trade, Reilang investments, Cashmulla, Cowe, among others, which defrauded Ugandans of billions of monies between the years 2020-2023.[14]
Dunamis coins Resources Limited, which allegedly defrauded approximately $2.7 million from around5000 individuals in areas of Kampala, Masaka and Mbarara in 2019.[15] This scam served as a wake-up call, prompting the involvement of the law enforcement agencies and government intervention, which ultimately became a crucial catalyst for the development of cryptocurrency regulations in Uganda.

13 Nakamoto, S. Blockchain: A peer to peer electronic cash system, 2008 available at <https://bitcoin.org/bitcoin.pdf> [Accessed on 16 September 2023]

14 Police hunt for Capital Chicken directors who conned Shs 1.6B from Ugandans. available at <https://www.newvision.co.ug/category/news/capital-chicken-directors> [Accessed on 6 October 2023]

15 Clients lose Shs 10b in cryptocurrency scam available at <https://www.monitor.co.ug/uganda/news/national/clients-lose-shs10b> [Accessed on 16 September 2023]

2.2. CRYPTO ASSETS

A crypto asset is a digital representation of value that can be digitally traded, can serve as a medium of exchange, and a unit of account or a store of value.[16]While often referred to as tokens, crypto assets are categorized based on their economic functions, including payment tokens (cryptocurrencies), utility tokens, and security tokens. This article primarily focuses on payment tokens (cryptocurrencies) due to their distinctive characteristics.

Cryptocurrencies are intangible digital assets created through the utilization of distributed ledger technology or a similar technology, distributed and transmitted via digital networks.[17] They can be generated through a process known as mining, which employs computational power to produce coins, or acquired directly from brokers through peer-to-peer transactions. Furthermore, cryptocurrencies can be stored securely using cryptographic wallets. Cryptographic wallets, available in both software and hardware forms, enable users to securely store and utilize cryptocurrencies. The wallets employ cryptographic algorithms, utilizing a private key to facilitate the user's ability to send and access cryptocurrency coins, while a public key can be shared with third parties to receive cryptocurrency.

Consequently, the decentralized nature of crypto currencies enables the facilitation of electronic payments through peer-to-peer transactions, without necessarily of involving the Central Bank of Uganda, or any licensed financial institution. For instance, crypto assets like bitcoins can be utilized for payment purposes, issued within a scope of a blockchain project.[18] In essence, these cryptocurrencies can serve as a medium of exchange for goods and services, or as a means of value transfer.[19]

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16 Abu Dhabi Financial Services Regulatory Authority. (June 2018). Guidance- Regulation of crypto asset activities in Abu Dhabi Global Market.

17 European Union's Directive, Markets in crypto assets and Amending directive (EU) 2019/1937

18 Ibid

19 Swiss Financial Market Supervisory Authority. Guidelines for enquires regarding the regulatory framework for Initial Coin Offerings (ICOs)

The International Financing Reporting Standards Interpretations Committee (IFRSIC) defined cryptocurrencies based on three key characteristics, namely:[20]

i) a digital currency recorded on a public ledger, utilizing cryptography for security purposes;

ii) It does not give rise to a contractual relationship between the holder and another party;

iii) It is not issued by a jurisdictional authority or any other party.

These characteristics provide a clear definition of cryptocurrencies, distinguishing them from traditional fiat currencies and other financial instruments. Consequently, cryptocurrencies are regarded as an investment by some individuals, while others view them as a commodity or property. Notwithstanding their lack of physical substance, cryptocurrencies may be considered intangible assets, possessing value and transferable rights.[21]

As mentioned earlier, certain cryptocurrencies, such as Bitcoin, have been recognized as legal tender in various countries due to their transformative impact on traditional monetary systems. Notably, El Salvador has been hailed as the first country to adopt Bitcoin as legal tender, alongside the US dollar, and this pioneering move has inspired other countries, including those in Africa, such as Central African Republic and Botswana, to follow suit.[22] However, as this article will demonstrate, the utility of virtual assets extends beyond their use as legal tender, as they can also be traded as security assets on the stock market, as exemplified by cryptocurrencies like Ripple in the

20 This committee comprises of members representing the best available combination of technical expertise and diversity of international business of international business and market experience in the practical application of International Financing Reporting Standards.

21 Are Cryptocurrencies considered assets? available at <https://wisaccountancy.co.uk/are-cryptocurrencies-considered-assets/> [Accessed on 16 September 2023]

22 El Salvador becomes first country to adopt bitcoin as legal tender; available on <https://www.theguardian.com/world/2021/jun/09> [Accessed on 16 September 2023]

United States.[23]

Crypto currencies are a form of digital currency that utilizes cryptography and blockchain technology.[24] They are a quintessential application in the blockchain ecosystem, were digital payment systems exist solely as digital entries in an online database, recording specific transactions.[25] These cryptocurrencies are stored in a virtual wallet, comprising a combination of private and public keys, which facilitate use for purchases and transfers through peer-to-peer transactions.[26]

Unlike cryptocurrencies which are decentralized, fiat currency is government-controlled money and serves as legal tender. The governments control over fiat currency provides policymakers with a platform to regulate and manage the money supply in response to economic dynamics. In contrast, cryptocurrencies constitute a medium of exchange between parties and a store of value. Moreover, cryptocurrencies utilize a cryptographic computer networking technology known as blockchain, which fosters efficiency and minimizes corruption in monetary systems. This innovation represents a significant revolution in the financial sector, as digital currency can be sent and received by anyone, anywhere in the world, without government intervention.

Some individuals fail to draw a distinction between blockchain and cryptocurrency due to the complex technical terminology associated with this emerging technology. However, a clear distinction exists between the two: blockchain is a decentralized, digital ledger that records all transactions, updated and maintained by a network of cryptocurrency users in real-time.

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23 Virtual assets refer to any digital representation of value that can be digitally traded, transferred or used for payment. And do not include digital representation of fiat currencies.

24 Ntamugambwe Victor and Joshua Kingdom (2021), "The Legal Risks of cryptocurrency on state sovereignty; A case study of Uganda" volume 18 Issue 3, Makerere Law Journal pp 118-152

25 When crypto currencies are transferred, the transactions are recorded in a public ledger and stored in digital wallets

26 Joseph J. Paul R. Blockchain A practical guide to developing business law and technology solutions Mc Grow-Hill Education 2018 at p 18

In contrast, cryptocurrencies are digital assets whose value is determined solely by market forces, namely supply and demand, due to their decentralized nature, unlike government-backed fiat currency. This system circumvents centralized government systems and traditional intermediaries, such as central banks. Consequently, crypto currencies are digital coins that require owners to use private keys to digitally sign and authenticate transactions by appending a unique hash.[27] To use crypto currency, individuals must possess a blockchain wallet, which enables them to receive, store, and transmit their digital coins. The wallets can either be hot wallets or cold wallets.[28]

Crypto currencies may be considered as a type of property, asset, financial instrument, investment, a commodity depending on whether they meet the definition of such in that jurisdiction.[29] Notably, cryptocurrencies are incorporeal in nature, being intangible and unable to be stored on physical servers due to their distributed data structure. Furthermore, cryptocurrencies are highly volatile and susceptible to cyber-attacks. In the case of Uganda, they are not denominated in the local currency.

In the United States of America, crypto currencies like Bitcoin are classified as assets, akin to property, by the Internal Revenue Service (IRS) and are subject to taxation accordingly. Tax payers in the US are required to report transactions for tax purposes. Consequently, retail transactions involving Bitcoin such as purchases or sales of goods, are subject to capital gains tax. The Government of Uganda may consider benchmarking and conducting further research on the success of this approach, should it contemplate adopting and benefiting from such advancements.

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27 A hash is an encrypted record of transactions connected to each other to form a blockchain

28 Both are means of storing cryptocurrency and token private keys. Hot wallets are cryptocurrency wallets with a software that stores private keys on a device connected to the internet and they can be accessible from internet-based devices, such as mobile phones, tablets, and laptops. However, cold wallets do not have a connection to another device or the internet, and are in form of USB sticks. Cold wallets are entirely offline.

29 Central African Republic adopted Bitcoin as a legal tender on 23rd April 2022 as well as El Salvador on 9th June 2021

3.0. UGANDA'S LEGAL FRAMEWORK ON CRYPTOCURRENCIES

The existing legal framework in Uganda does not specifically address crypto currencies, despite the Electronic Transactions Act providing a general regulatory framework for electronic transactions.[30] The decentralized nature of virtual assets has hindered the government and majority of Ugandans from embracing and adopting this technological innovation, and advancement, primarily due to concerns regarding its volatility and potential uncertainties. The inherent characteristics of virtual assets pose significant law enforcement challenges, due to their ability to rapidly transcend national borders and their anonymity resulting from their encryption.

Notwithstanding the risks and lack of clear regulations, some crypto currency traders and companies continue to operate in the industry. However, the Ministry of Finance, Planning and Economic Development cautioned the public about the risks associated with trading in cryptocurrencies. Significantly, the Ministry of Finance, Planning and Economic Development did not declare cryptocurrencies illegal in Uganda. Meanwhile, the Bank of Uganda in exercising its regulatory mandate over currency and payment systems, has issued statements cautioning financial institutions, particularly mobile money operators regulated under the Financial Institutions Act, against facilitating cryptocurrencies transactions.[31]Nevertheless, it is evident that the world is moving towards digitalization, and some members of the public continue to trade in cryptocurrencies.[32]

The Financial Institutions Act, 2020, primarily enacted to regulate financial institutions, defines a financial institution as a company licensed conduct financial institution business in Uganda, as classified by the central bank.[33] Financial operators regulated under the National Payment System Act, 2022,

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[30] Act 8 of 2011

[31] Article 162 of the 1995 Constitution of the Republic of Uganda, sections 4, 19 and 20 of the National Payment Systems Act, 2020

[32] Bank of Uganda Circular reference number NPSD 306 dated 29th April, 2022, barring all entities licensed under the National Payment Systems Act, 2020 from facilitating cryptocurrency transactions.

[33] Section 1(n)

were cautioned against trading in cryptocurrency, citing the risks posed by the technology. In its statement, the Bank of Uganda noted:

> *"Bank of Uganda has noted press reports and adverts advising the public that they can convert cryptocurrencies into mobile money and vice-versa. We are also aware that such a conversion cannot happen without the participation of payment service providers and or payment system operators,"*[34]

The advent of 5G technology and the Meta verse presents an opportunity for Uganda to embrace these technological advancements and reap from their benefits. It would be better for the Ministry of ICT to encourage tech companies and blockchain traders to explore safe and legal ways to participate in this emerging field, particularly among the youth. While Uganda may not have the capacity to regulate decentralized systems, it can consider introducing a centrally issued and regulated digital coin as a starting point.

On 1st June, 2022, the Bank of Uganda opened up to the idea of considering the idea of the cryptocurrency businesses in its ***Regulatory sandbox***. The National Payment Systems Act, 2020 under section 6 and the National Payment Systems (Sandbox) Regulations gives powers to the Bank of Uganda to establish a Regulatory Sandbox Framework. This framework allows innovative financial solutions in the payments eco system to be tested in a live environment with regulatory oversight though subject to particular safeguards.[35] This move was welcomed by the blockchain Association of Uganda as a step in the right direction. This was an acknowledgment of the existence of cryptocurrencies in the market. Efforts have been made to engage policy-making for the crypto market, including public consultations.

Notably, the first policy makers' workshop in Uganda took place in July 2018, with the aim of soliciting public proposals on multi sectoral approaches to

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34 Bank of Uganda Website available at <https://www.bou.or.ug/bou/bouwebsite/Supervision/Circulars.html> [Accessed on 18 September 2023]

35 Bank of Uganda grants approval to Culipa limited and Absa Bank Uganda Limited to test innovations under the regulatory sandbox; BOU gives green light to more financial payment solutions available at <https://www.independent.co.ug/bou-more-financial-payment-solutions/> [Accessed on 19 September 2023]

policy making, and development. This marked another step towards advocating for the regulation of crypto currencies and the blockchain in Uganda. Consequently, all stakeholders in the cryptocurrency market should continue to push for either adoption or regulation of the cryptocurrencies, while also educating those interested on how to trade safely. Self-regulation could be the starting point, involving the reporting of fraudulent activities and scammers to law enforcement agencies.

In the application for judicial review in Silver Kayondo v Bank of Uganda, the applicant contended that the Bank of Uganda lacked the powers to regulate or ban crypto assets in Uganda.[36] This assertion was made in response to the circular by the Bank of Uganda, which prohibited all financial institutions regulated under the Financial Institutions Act from dealing and liquidating cryptocurrencies. However, in his judgement, Justice Ssekaana primarily relied on the characterization of crypto assets as a mode of payment, concluding that they could not be used as a legal means of payment. The judgement appeared to have overlooked the substantive issues raised in the petition and instead attempted to reframe the issue and resolve it.[37]

The decision in the Silver Kayondo case leaves market players operating in an uncertain and unsafe business environment, exposing them to scams without recourse, resulting in significant financial losses, and potentially facilitating money laundering. However, this outcome also underscores the need for regulatory clarity in Uganda's jurisdiction, highlighting the imperative for regulations to address these issues. Moreover, the case emphasized that while crypto assets are not considered payment instruments under the National Payment System (NPS) Act, the Act does not explicitly prohibit the use and trading of cryptocurrencies in Uganda.

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36 Miscellaneous Cause no. 109 of 2022

37 The applicant sought for a declaration that crypto assets and cryptocurrencies are legitimate digital assets tradable in the digital economy and can be liquidated/cashed out via mobile money and other payment systems in settlement for Uganda Shillings (UGX) which is the legally recognized legal tender of the Republic of Uganda at the prevailing free-floating exchange rates established by the global and national market forces of demand and supply.

4.0. CRYPTOCURRENCIES AS SECURITY ASSETS

The Capital Markets Authority Act of 1996 defines 'securities' to mean; bonds, stock, warrants, options, futures, and any other instrument commonly known as securities.[38] Securities are commonly associated with stocks, bonds, and similar instruments, which refer to fungible, negotiable financial instruments that represent a monetary value. These instruments are used to raise capital in both public and private markets.

In Uganda, the public sale of securities is regulated by the Capital Markets Authority (CMA),[39] the statutory body responsible for regulating and promoting the development of capital markets in Uganda. This Authority is responsible for licensing, investigating, and inspecting the operations of capital markets in Uganda. It is through the sale of securities, that companies generate money from the public for further investment purposes. Pursuant to the Capital Markets Authority Act, any entity seeking to offer investment contracts to the public must publish the offerings to the public.[40]

Securities in Uganda are listed on the Uganda Securities Exchange, where the public can access listings and trade. These securities are issued through an initial public offer (IPO), or private placement.[41]As public offerings are regulated by the Uganda Securities Exchange, stock trading is facilitated through licensed brokers regulated by the Capital Markets Authority. Consequently, the Capital Markets Authority has oversight over listings on the securities exchange. In this context, if the Capital Markets Authority is to recognize cryptocurrencies as an asset class, it would need to exercise its mandate accordingly.

Uganda is yet to follow the lead of countries like Botswana and Mauritius, which have already regulated virtual assets. In 2015, the then governor of

38 Section 1(hh)

39 The Capital Markets Authority was established in 1996 by the CMA Act Cap 84 to monitor approval of prospectus, ensure development of capital markets, protection of investors, management of the investor compensation fund, among others

40 Section 5.1(a) and Section 90(G) of the Capital Markets Authority Act.

41 Under Private placement, the entity that offers security's (issuer) may restrict them to a qualified group (investors).

the Bank of Kenya cautioned banks against trading in crypto currencies. However, the court in the case of *Wiseman Talent Ventures v Capital Markets Authority* emphasized the need to protect investors in the course of their dealings.[42] Kenya has a pending Bill seeking to amend the Capital Markets Act to include virtual assets, specifically blockchain, cryptocurrency, and other digital currencies.

On 16th November, 2023, Hon Nathan Nabeta Igeme[43] was granted leave by parliament to introduce a Private Members Bill titled the Capital Markets Authority (Amendment) Bill. Uganda's Capital Markets (Amendment) Bill seeks to amend the Capital Market Authority Act by regulating the transfer of virtual assets, specifically by stipulating the required due diligence measures. The due diligence measures that service providers should undertake to facilitate asset tokenization on the blockchain include segregating clients' assets from those held by the custodian on behalf of their clients.[44] This marks the first regulatory effort in Uganda to govern virtual assets, paving the way to unlock the potential of blockchain technology and virtual assets in the country.

Most importantly, Parliament and the Capital Markets Authority must be aware that virtual assets, given their decentralized nature, can lead to an influx of crypto assets that may fall outside the Authority's mandate and scope. It should also be noted that these emerging virtual assets bring both benefits and challenges in the long run, including potential security lapses and increased hacking attempts. However, this should not hinder technological advancement; rather, it should be embraced with modifications to ensure a seamless integration into Uganda's fintech ecosystem.

However, the future of this Bill remains uncertain due to the majority of the parliamentarians' lack of understanding regarding the operation of virtual

42 [2019] KLR

43 Member of Parliament, Jinja South East Division.

44 As per schedule five, for a token to be issued, it should be accompanied by a white paper similar to a prospectus of a company that's yet to issue shares on the stock market.

assets and blockchain technology in the broadest context. The complexity of crypto currencies, as evident from aforementioned context, stems from the specialized terminologies and operational procedures involved. Indeed, it is challenging to regulate what one does not comprehend. Uganda has yet to establish a technical team to address such developments; therefore, it is imperative for the parliament to collaborate with associations, and entities currently engaged in cryptocurrency transactions during the drafting process of this Bill.

In determining whether crypto assets are securities, the United States Securities and Exchanges Commission(SEC) has consistently relied on the landmark decision of the U.S. Supreme Court in *Securities and Exchange Commission v W. J. Howey Co.*[45]The SEC regulates the stock market in the United States under the Securities Act of 1933, which provides the framework for determining what constitutes a security..[46] In the Howey case, the court held that 'an investment of money in a common enterprise with profits to come solely from the efforts of others' constitutes a type of security called an investment contract'. In contrast to other assets, such as commodities, crypto assets should be strictly regulated and require detailed disclosures to inform investors of the potential risks involved.

Securities can be categorized into three main types:

1) Equity securities, which represent ownership rights to shareholders in an entity, realized through capital stock, and generate dividends after a specified period of time. Shareholders can as well sell their securities for profits in case there has been an increase in their value.
2) Debt securities, typically issued for a fixed term, such as government treasury bills and bonds. These instruments essentially represent loans, repaid through periodic payments.

45 328 U.S. 293 (1946)

46 It was founded in 1934 at the height of the Great Depression aiming at protecting investors, maintain fair, orderly, and efficient markets, and facilitating capital formation available at <https://www.sec.gov/about/mission> [Accessed on 17 September 2023]

3) Hybrids securities, which combine elements of both equity and debt securities.

In the landmark case of Howey v SEC,[47]the court laid down the following test to determine whether an investment can be regulated as a security:

- There is an investment of money;
- The investment is made into a common enterprise;
- The investors expect to make a profit from their investment; and
- Any expected profits or returns are due to the actions of a third party or promoter.

The Howey test intended to effectuate the statutory policy of providing comprehensive protection to investors in the United States, protection that is not to be undermined by unrealistic and irrelevant formulae.[48]The Howey test requires a holistic examination of the parties' understandings and expectations, analyzing and evaluating the transaction based on the content of the relevant instruments, the purposes to be achieved, and the overall factual context.[49]The Howey decision and its subsequent interpretations have established that a wide range of tangible and intangible assets can be subject of an investment contract.[50]Consequently, the presence of a speculative motive on the part of the purchaser or seller does not necessarily indicate the existence of an investment contract. However, trading in crypto currencies, which is driven by an expectation of profits and returns from service providers, satisfies the essential elements of an investment contract.

Furthermore, as evident in the case of *Ripples v SEC*[51], programmable sales are not considered securities because investors do not anticipate profits from the token issuers. In contrast, institutional sales constitute an investment contract or security asset due to an expectation of profits from investments made with the issuers. Consequently, crypto currencies that merely function

47 328 U.S. 293 (1946)
48 SECs V Ripple 1:20-cv-10832 District Court, S.D. New York
49 Marine Bank V Weaver 455 U.S 551(1982)
50 Securities Exchange Commission v Howey Co. 328 U.S. 293 (1946)
51 20 Civ. 10832 (AT)

as substitutes for traditional fiat currency are classified as commodities rather than securities within this context.[52]

The parliament of Uganda may consider benchmarking from countries that have classified crypto currencies as security assets and those that have implemented policies to regulated virtual assets. A notable example is the Capital Markets Authority (Amendment) Bill, 2023 of Kenya. This presents a significant step towards regulating cryptocurrencies or virtual assets before they are introduced to the public and the stock market. This will also inform the Authority on the procedures to be followed before a company is listed on stock exchange, including registration with the issuance of licenses by the Capital Markets Authority, thereby ensuring a robust regulatory framework.

5.0 INSTITUTIONAL AND INDUSTRY RESPONSIBILITIES: ROLEOF GOVERNMENT AND INDUSTRY PLAYERS

The government, through the collaborative efforts of the Ministry of Information and Communications Technology, Uganda Communications Commission, and National Information Technology Authority (NITA-U) of Uganda, jointly coordinated the drafting of the Data Protection and Privacy Act, 2019.[53] The government should take the lead in ensuring enhanced protection and privacy for Ugandans. Since most crypto currency operators acquire access to clients' private information during registration, it is essential for individuals to be informed about the purposes, timing, and manner in which their personal data is utilized.

Crypto currencies should be acquired by companies, vetted by the Uganda Securities Exchange, and listed or traded on the stock exchange, subject to regulation by the Capital markets Authority. This framework would enable the public to trade with confidence, investing in the crypto assets and generating returns. Moreover, when held as assets, cryptocurrencies can

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52 From a statement by the United States Securities and Exchange Commission Jay Clayton to the CNBC in 2018

53 This Act protects the privacy of an individual and of personal data by regulating the collection and processing and disclosure of Ugandans.

contribute to the income tax base of the country through taxation, similar to other stocks and securities, thereby increasing government revenue.

The Ministry of finance is forfeiting Billions in revenue due to an unregulated cryptocurrency transaction that remain untaxed. Many officials at the Finance Ministry have failed to invest into understanding the concept of asset tokenization, and how using blockchain technology could help the government deepen its bond market, and widening the revenue tax base to finance the development of Uganda.[54]Once regulations are put in place, Uganda Revenue Authority will be able to amend its tax laws to collect capital gains and withholding tax on transfers of cryptocurrencies. Through a comprehensive tax policy, cryptocurrencies can be taxed as security assets on the Uganda Securities Exchange, falling under existing laws on income tax, capital gains tax, or value added tax. It is the governments mandate to ensure that individuals comply with their tax obligations, grounded on a moral duty to contribute to the tax system.

The Capital markets Authority can regulate the activities of cryptocurrency and Electronic Fungible Token brokers. The Authority can establish a policy requiring cryptocurrency brokers to acquire these holdings and offer them to the public for trading under the supervision of the Capital Markets authority. This will enable stock market investors to diversify their portfolios by investing in an additional asset class, potentially increasing tax revenues for the treasury. Adoption of virtual assets by the Capital Markets Authority of Uganda will usher Uganda into the new dawn of the internet age of asset management in the capital markets, called Web 3.0. The Web 3.0 entails use of virtual assets and blockchain technology thus owning and managing the settlement of real-world tokenized assets.

Most importantly, the government should register market players who have gone through scrutiny and verification. These market players must be willing

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54 Ministry of Finance's incompetence frustrates Hon. Nathan Nabetas Capital Markets Authority Bill, 2023 available at <https://strikemachine.net/ministry-of-finances-incompetence/> [Accessed on March 11, 2024]

to comply with the Know your customer requirements, which will also help to combat money laundering, acts to finance terrorism, acts of treason, and other high crime offences. A robust legal and regulatory framework can also enable regulators to identify and eliminate criminal elements or illegal schemes through the Know Your Customer (KYC) requirements for virtual asset service providers and traders when trading in these assets.

The prevailing knowledge gap regarding blockchain technology among both the public and private sectors has led to misinformation about crypto currencies and their potential to be used as security assets. To address this, current market players in the blockchain industry should nationwide awareness strategies and programmes. Key areas of focus should include information security, bridging the skills gap in utilizing of cryptocurrencies as security assets, and developing a comprehensive cross-sectoral training policy to alleviate the market's skills shortage.

6.0 RECOMMENDATION

The government, through the central bank, has a duty and mandate to regulate the financial sector for an effective economic development. Due to lack of regulations, numerous Ugandans have lost billions of money, although some victims have not come forward to expose themselves as having been scammed. Therefore, there is a need to protect Ugandans who have adopted technological developments and advancements. To this end, the government, through the Capital Markets Authority, should undertake the regulation of the emerging virtual assets.

The government may enter into Memoranda of Understanding (MOU) with traders and companies dealing in cryptocurrencies to foster harmonized engagement and political will among stakeholders. Furthermore, the Capital Markets Authority may engage with global companies trading in cryptocurrencies to establish a memorandum outlining how to operate as separate entities in Uganda, district from their global markets, under regulations adopted by the Authority. This will facilitate monitoring and regulation of their activities in Uganda, thereby protecting Ugandans from scams. Additionally, these entities may be required to operate a protective depository to compensate cryptocurrency investments in event of any fraud.

The Government, through the bank of Uganda and Capital Markets Authority, may consider investing in crypto equity by acquiring shares from companies engaged in crypto mining and exchange. This investment can help build public trust and confidence in virtual assets, paving the way for their adoption by the Capital Markets Authority. Meanwhile, the Bank of Uganda can utilize its regulatory sandbox to test the operation of crypto currencies, assessing their viability and sustainability within the economy.[55] This should be accompanied by the creation of a conducive environment for local investors who have embraced blockchain and crypto currency to educate and train local individuals, thereby empowering them to invest in these technologies and ultimately boost the economy.

7.0 CONCLUSION

The increasing global shift towards digitalization suggests that the future of crypto currencies as security assets in Uganda will be significantly influenced by international trends. As cryptocurrencies gain wider acceptance worldwide, their adoption in Uganda is likely to follow suit. Inherent to their decentralized nature, cryptocurrencies are characterized by high volatility and operate independently of any central authority's control.

Therefore, the government, under the auspices of the Capital Market authority, should harness the potential of blockchain technology in cryptocurrencies to capitalize on the opportunities that come with it. By implementing reasonable measures to regulate the market players in the virtual assets, the Authority can position itself to generate revenue through tracing transactions on the blockchain, while also streamlining businesses if done judiciously.

[55] This is a framework set by a regulator allowing Fintech startups and other innovators to conduct live experiments in a controlled environment under the regulator's supervision.

Lastly, the authorities should establish a clear regulatory framework for the operation of virtual assets. While virtual assets, such as cryptocurrencies, may be integrated into Uganda's financial system, regulators must prioritise financial stability and consumer protection. This is crucial because virtual assets can potentially trigger inflation and be exploited for illicit activities, including money laundering, corruption, and terrorism financing.

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