



OVERVIEW OF THE SECURITIES & EXCHANGE COMMISSION RULES ON CROWDFUNDING.

Following the issuance of draft guidelines in May 2020, the Securities and Exchange Commission (the “**Commission**”) has, through its Rules on Crowdfunding (the “**Guidelines**”), on 21 January 2021 published updated rules regulating the use of crowd funding activities in Nigeria.

The Guidelines seek to protect the public when investing in crowd funding platforms and highlight the requirements that online platforms must adhere to, particularly for the funding of Micro, Small and Medium Enterprises (“**MSMEs**”). In this newsletter, we set out the key aspects of the Guidelines.

WHAT IS CROWD FUNDING?

Under the Guidelines, crowd funding is defined as “*the process of raising funds to finance a project or business from the public through an online platform*”.

Despite the increase in private equity and venture capital investment in Nigeria, one of the biggest hurdles startups face is raising financing. Crowdfunding has become a popular alternative method for companies to raise funds and campaign for their projects. In particular, the growth of AgriTech platforms such as FarmDrive, Farmcrowdy and Twiga foods can be attributed in part, to the popularity of crowdfunding.

Crowd funding can be done in 3 ways; (i) donation based – raising funds to support a cause with no promise/assurance of repayment, equity or other ownership rights, (ii) reward based – providing small amounts of financing to a company in exchange for an agreed reward (usually in the form of returns) or (iii) equity based – providing early stage investments in the company in exchange for shares.

Ordinarily, private companies are unable to raise equity financing from the general public without regulatory approval, as a result, platforms operating equity crowd funding models were banned by the Commission in

2016. As reward based and donation based crowdfunding was not included in the 2016 ban, there were minimal limitations on who could raise funds through crowdfunding.

Under the Guidelines, eligible entities can raise funds through registered crowd funding portals operated by intermediaries who have also registered with the Commission. Eligible entities include all MSMEs incorporated as a company in Nigeria with a minimum operating track record of 2 years.

Permitted investment instruments that can be issued under the Guidelines include shares, plain vanilla bonds or debentures and simple investment contracts.

KEY PLAYERS IN THE CROWD FUNDING PROCESS

The Guidelines outline 4 key participants in the crowdfunding process which are now regulated by the Commission. These are:

Crowdfunding Intermediaries

Intermediaries are defined by the Commission as “intermediaries organized and registered as a corporation to facilitate transactions involving the offer or sale of securities or investments through an online electronic platform”. Only entities registered with the Commission as an Exchange, Dealer¹, Broker, Broker/Dealer or Alternative Trading Facility may be registered as a Crowdfunding Intermediary.

Crowdfunding Intermediaries are prohibited from:

- (i) allowing an Issuer to access the Crowdfunding Portal if the portal or any of its officers, directors, significant shareholders or associated persons own or control more than 5% of the securities of that Issuer;
- (ii) providing financial assistance to investors for the purpose of investing in

¹ Dealers who intend to register as Intermediaries can only register as Restricted Dealers and are subject to additional restrictions and can no longer carry out other capital market activities.

- an offer hosted on its platform or for which it has provided a service;
- (iii) compensating a finder for providing them with information on potential investors.

Crowdfunding Portals

Crowdfunding Portals are platforms which facilitate the interaction between fundraisers and the investing public. The definition of this has been widened to include:

- (i) platforms operating in Nigeria;
- (ii) platforms that operate outside of Nigeria but target Nigerian investors; and/or
- (iii) a platform with component parts which, when taken together, are physically located in Nigeria².

In order to be registered with the Commission, Crowdfunding Portals are required to have, amongst other things, a minimum paid up capital of N100 million (approximately \$250,000). These Crowdfunding Portals can only be operated by registered Intermediaries.

Additional duties of Crowdfunding Portals include:

- (i) conducting due diligence on prospective issuers;
- (ii) complying with data protection and privacy requirements;
- (iii) maintaining adequate record keeping for a minimum of 7 years; and
- (iv) fulfilling all monitoring and reporting obligations requested by the Commission.

Issuers

Issuers are the originators or creators of the security or investment being registered with the Crowdfunding Intermediary. Pursuant to the Guidelines, MSMEs are eligible to be issuers provided they have a minimum operating track record of 2 years however, it

² This definition also includes platforms which have component parts which, in isolation, are located outside of Nigeria.

is important to note the maximum limits imposed within a 12 month period³.

The following entities are unable to act as Issuers on a Crowdfunding Portal:

- Complex structures;
- listed companies and their subsidiaries;
- companies with no specific business plan or blind pool;
- companies that propose to use the funds raised to provide loans or invest in other entities; and
- such other entities as specified by the Commission.

Crowdfunding offerings by Issuers can only be for a maximum period of 60 days. Where an Issuer's target has not been reached within the 60 day period, the offer must be withdrawn and a new offering can commence not earlier than 90 days from said withdrawal. Furthermore, Issuers cannot host concurrent offerings on multiple platforms.

Eligible Issuers are required to submit the following information to the Crowdfunding Intermediary:

- key information on the Issuer;
- the use of proceeds from the offering;
- the nature of its existing or proposed business, a business plan, the offering amount to be raised and duration of offer;
- two years audited financial statements; and
- a certification signed by the Issuer stating that:
 - (i) the offering document does not contain any misrepresentations; and
 - (ii) investors have rights of actions and withdrawal in the case of a misrepresentation.

Investors

An Investor is any person or entity that seeks to make, is making or has made an investment in an investment vehicle with the expectation of achieving returns. The Guidelines provide additional safeguards for Investors such as:

- rights of action and withdrawal in the case of a misrepresentation;
- the right to withdraw an offer or agreement to purchase securities or investment instruments within 48 hours (include the release or refund of amounts debited or held in the account of the Investor);
- the ability to rescind their investment within 7 days of a material adverse change affecting the project or Issuer; and
- offerings are subject to the existence and confirmation of tag along rights for retail investors.

Investors are prohibited from transferring their securities or investment instrument for a period of 1 year unless the transfer is:

- (i) to the issuer of the securities or investment instrument;
- (ii) to an institutional investor; or
- (iii) part of an offer for sale registered with the Commission.

OTHER KEY PROVISIONS

Digital Commodities Investment Platforms

The Guidelines provide for additional obligations for digital commodities investment platforms. These are defined as “a digital platform that connects investors to specific agricultural or commodities projects for the purpose of sponsoring such projects in exchange for a return” and address the requirement for digital commodities platforms to register with the Commission. Digital Commodity Investment Platforms that are in existence should apply to the

³ Total amount being raised cannot exceed N100 million, N70 million and N50 million for medium, small and micro enterprises respectively.

Commission for a letter of “no objection” to continue operations.

Trust Accounts

Crowdfunding Portals are required to open separate trust accounts for each funding round on its platform with institutions registered as Custodians by the Commission.

Warning Statements

All Crowdfunding Portals are required to display a warning statement on the home page of the portal, subscription landing page, and all application forms for investing, warning investors of the risk of investment. Further, the Crowdfunding Portals are required to ensure that every Investor completes an acknowledgment form

confirming their awareness of the risks and the benefits and protections available to them.

Infringements and Sanctions

Failure to comply with the Guidelines by any crowdfunding portal or crowdfunding intermediaries may lead to a fine of not less than N1,000,000 and a daily fine of N10,000 for every day the violation continues (approximately \$2500 and \$25 respectively).

Further, the Commission may revoke the registration of any Crowdfunding Portals or Intermediaries that fail to meet the requirements under the Guidelines, fails to operate or maintain a portal for a consecutive period of 6 months or fails to pay the fees prescribed by the Commission.

Conclusion

The Guidelines are a welcome step in the right direction providing clear guidance for key stakeholders in the crowdfunding process and added protection for investors. However, the Guidelines alienate crucial players in the crowdfunding sector (such as creators of crowdfunding mobile applications) requiring them to register with the Commission. Additionally, the Guidelines impose limits on retail investors intending to invest in crowdfunding offerings however, these limits are not applicable to high-net-worth individuals, qualified institutional investors and sophisticated investors.

This may have been a deliberate step by the Commission to protect members of the general public who may not have access to sophisticated investment advice nevertheless, it is appropriate for the Commission to provide additional guidance on how these limits will be enforced.

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