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THE DIGITIZATION OF INVESTMENTS: ADVOCATING STAKEHOLDER PROTECTION

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Digital investment solutions and self-directed investing are on the rise and this has led to a shift in the financial literacy and awareness of individuals across the globe. While this shift has been mostly positive, it has also left investors vulnerable to certain risks such as scams, capital loss, and asset invalidity. These risks have the tendency to discourage investment and stunt the growth of the financial system. They have also caused increased scrutiny of the activities of Financial Technology (“**FinTech**”) companies by relevant regulatory bodies: the Central Bank of Nigeria (the “**CBN**”), the Securities and Exchange Commission (the “**SEC**”) and the Nigerian Stock Exchange (the “**NSE**”).

While exploring the ease of investing in an advanced digital age amidst regulatory hurdles, this article also discusses the risk-mitigating factors available to maintain investors' security on these digitized investment platforms.

THE DIGITIZATION OF INVESTMENTS

The consumer side of Nigerian FinTech has recently seen substantial new activity, from seamless digital loans to on-the-go investment management and cryptocurrency transactions. The investment-tech sub-sector, is bustling, as investment platforms bridging the investment knowledge gap are met by young people ready to structure and insure their future wealth against the naira's volatility.

FinTech refers to software and other modern technologies used by businesses that provide automated and improved financial services. According to Nairametrics, financial technology is one of the new waves of disruption in the financial sector, that is fueled by the internet of things and the increasing digitalization of the world. The industry has grown in leaps and bounds, going from US$1.8billion in 2010 to US$19billion in 2015 (over 90% growth). A 2020 report stated that the global FinTech industry, currently valued at US$127.66billion, is expected to grow at an annual average of 22.17% to amount to $305 billion by 2025. With the advent and continued growth of FinTech in Nigeria, there is a continuous increase in the number of FinTech startups looking to offer better services than pre-existing ones. Nine out of ten times, this offer of 'better services' comes in the form of a digitized platform.

Investing in the digital age

What is meant by 'digitization'?

Simply put, it means transforming analogue and manual processes, functions, and tasks into a digital and more accessible model of things throughout a company. Digitization encompasses digitizing product and service offerings as well as expanding the business model and customer access by offering disruptive digital solutions.

In the wake of the global pandemic which left physical stock trading floors empty in 2020, the need for the adoption of digital tools, particularly in the world of investments, is more evident. It is more relevant than ever, to have digitized investor communications, real-time, high-quality data – and tools to help users make sense of them.

In addition to the nearly round-the-clock access to investment opportunities, online trading has been advantageous to its over 100 million participants. It has greatly reduced transaction costs. For example, in the 1980s, making a trade on the New York Stock Exchange cost hundreds or even thousands of US Dollars. Today, it can cost less than US$10.

It also allows the user to access a wide variety of asset classes – equities, bonds, commodities, exchange-traded funds, mutual funds, futures, options, contracts for difference and other products – from a single place. As such, users may diversify their portfolio across geographies and asset classes – an ability which is key in getting not just the highest, but most consistent Return on Investment (ROI).

The common forms of investments in Nigeria, which include stocks/shares from the NSE, short-term debt instruments such as Treasury Bills and Savings Bonds issued by the Federal Government of Nigeria (FGN) through the CBN, Fixed Deposits, Eurobonds and Money Market Funds (MMFs), have historically been hard to come by for the common individual. However, with this democratized age of information and resources, one can sit in the comfort of their home, download a mobile application on their mobile phone, and get their investment portfolio going.

Mobile applications by FinTech companies such as Bamboo, Chaka, PiggyVest, etc. are further driving the transition from the traditional bank-backed investment channels to online and mobile digital platforms. Such apps allow investors to trade on both the national and international stock markets, investing in large multinationals like Apple, Microsoft, Tesla, etc. These apps also enable users to track their investments on-the-go

Risks

While digital investment has many potential advantages, investors must take care to mitigate certain risks which are unique to the digital system.

All investment involves both returns and risks. Before digitization, investment risks commonly involved volatility, inflation, liquidity, portfolio concentration, and the financial standing of the company being invested in. Mitigating these risks usually involved portfolio diversification, and a few other measures. However, the explosion in global investors and investment opportunities driven by digitization has made users vastly more vulnerable to these risks, as well as created a set of unique risks. For instance, scams are a real risk, as even savvy institutional investors have fallen prey. The advent of digital investment platforms makes users more vulnerable to this risk, as it becomes difficult to identify unregulated providers.

Investing in digital assets such as cryptocurrency is fraught with risk, as evidenced in the limitation of liability clause of Altoira, a cryptocurrency investment platform. Risks listed include loss of all value, volatility as a result of regulatory changes, fraud or cyber-attack, as well as the lack of approval from the Internal Revenue Service.
Considering the above, how can an investor protect himself? Are there regulatory or legal measures in place to protect investors from risks brought on by investing using digital platforms?

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[1]Accessed at: https://www.marketdataforecast.com/market-reports/fintech-market on 12/03/21

[2]Accessed at: https://www.cnbc.com/2020/03/18/nyse-to-temporarily-close-trading-floor-move-to-electronic-trading-because-of-coronavirus.html on 12/03/21

[3]Accessed at: https://www.ftadviser.com/investments/2019/11/06/the-digitization-of-investing/ on 21/02/21

[4]financial assets owned by an investor such as transactions in equity, securities, such as common stock, and debt securities, such as banknotes, bonds, and debentures.

Investor Protection

As opposed to the age where most assets were tangible and could easily be protected; the digitization of investments has shifted value to intangible assets. This then raises the question of how best investors can secure their digital assets.

For investors, it is advisable to ensure adequate due diligence is carried out before investing monies into assets: understanding privacy policies, terms of use, end user agreement and general liability exclusion clauses. These are typically lengthy documents, but users of investment apps can specifically look out for clauses / text on whether their data can be shared with third parties, whether and when they can opt out of the services and the disclaimers in such instances, dispute resolution clauses, what uses the app can make of their data and what limitation is placed on the app.

Nigerian Regulators – Friend or Foe?

Apart from taking due care, the investor enjoys the protection of Nigerian regulatory bodies. Financial services companies operate in a highly regulated environment, which requires them to manage digital transformation while simultaneously meeting demands from stakeholders for greater transparency and trust.

In its role as the regulator of the banking system, the CBN generally oversees FinTech in Nigeria and in line with its mandate to direct monetary policy and ensure financial stability for the country, the CBN has the discretion to issue regulations and guidelines on what is acceptable in the financial system. As a measure of risk management, the CBN places a financial barrier of a minimum of NGN5,000,000,000 on entry into the FinTech market to ensure credibility and financial security of operators[6].

The mission of the NSE is to protect the integrity of the capital market from fraud, manipulation and abusive practices in ensuring fair and orderly market and investor protection. One of the mechanisms it uses in this regard is the Market Surveillance & Investigations team, which closely monitors all market activity on the NSE to cultivate an open, competitive, transparent, and financially sound market. This robust surveillance system identifies and investigates potential market abuse and infractions on NSE rules and securities laws. Its areas of focus include market manipulation, churning, and deceptive media campaigns, among others.

The SEC fulfils its mandate of protecting investors by regulating the stock market: providing trading access only to credible investment products and providing detailed and up-to-date information on investment products.

In a recent series of actions, the CBN, the SEC, and even the NSE have all appeared to particularly clamp down on digital investments.

For example, a previously mentioned FinTech app, Chaka, provides a platform which allows anyone with an internet-enabled smartphone to sign up with US$2 (approx.   1,000) to browse through shares of over 4,000 companies publicly listed on the NSE and stock exchanges in the US. On 19 December 2020, the SEC published astatement effectively barring Chaka from offering its core services in Nigeria. The SEC argued that the activities carried out by Chaka on its app were outside the regulatory purview of the SEC and without requisite registration. This has left users of the app wondering what will happen to the assets they have secured through the app.

This followed the SEC Statement on Digital Assets released on 14 December 2020 and the July 2020 Exposure Draft of the Proposed Rules for Broker to Fintech Collaborations (the "Draft Rules") released by the NSE, which seeks to regulate any business collaboration between Dealing Members of the NSE and a FinTech Entity which is aimed at providing a product or service via a Platform to end users, including clients of the Dealing Member. Most FinTech companies operate under this structure, so, although the Draft Rules do not make mention of any mandate for FinTechs involved in such collaborations to be registered, but instead cast responsibility on brokers to ensure the collaboration is in the best interest of users, the Draft Rules can be said to be a welcome development.

[5]Accessed at: https://grow.altoira.com/legal/cryptocurrency risks#:~:text=In%20addition%20to%20normal%20market,cyber%20attack%20and%20data%20corruption

[6]Accessed at: https://www.cbn.gov.ng/Out/2020/CCD/ on 12/03/21

[7]Accessed at: http://www.nse.com.ng/regulation/market-surveillance

The SEC has stated that its recent actions have come with the "*intention to encourage innovation within the market space, whilst also ensuring that all market activities are brought within regulatory purview and conducted within the ambit of the law and extant regulations. The [SEC] is concerned that without proper regulation, the genuine aspirations of market innovators and investors could be subverted through the activities of unscrupulous actors who would try to exploit the growing popularity of FinTech investment options, to the detriment of the investing public*".

The CBN Letter on Cryptocurrency was subsequently released, on 5 February 2021. The letter stated that cryptocurrencies were a threat to Nigeria's financial system and reiterated the CBN's ban on cryptocurrency

With 32% of Nigerians in a 2020 online survey by data platform, Statista, confirming that they used cryptocurrencies (the highest proportion of 74 countries surveyed), the country has gained a reputation as the African Cryptocurrency destination. As such, the recent actions of the CBN and the SEC can be interpreted as stifling the financial growth and independence of Nigerian citizens, and effectively that of the Nigerian economy as a whole.

These series of events culminated in widespread dissatisfaction after the recent CBN ban on cryptocurrency, as virtual account numbers used on cryptocurrency trading platforms such as Monnify and PiggyVest were deactivated without regard for investors. FinTech companies operating cryptocurrency trading platforms also lost partnerships with the banks providing them with the virtual accounts.

Investment Platform Protection

For FinTech companies, it is imperative that maximum compliance with the law is always maintained. As stated earlier, the financial sector in Nigeria is one which is highly regulated and therefore, operators in this sector will be doing a disservice to both themselves and their users if they find themselves on the wrong side of the law. Actions such as partnering with (registered and recognised) brokers, adequate communication with relevant regulators, particularly the CBN, adequate and air-tight legal documentation, adequate intellectual property protection and offering of adequate data protection to users, are all recommended in ensuring compliance with the law.

Conclusion

Digitization, with its almost indiscriminate access to investment, is undoubtedly a big step towards economic growth and financial inclusion. Although admittedly rife with risks, the benefits far outweigh the risks. As more Nigerians, empowered by technology and knowledge, take control of their financial goals, the financial services industry in Nigeria, along with its regulators, will need to respond by expanding its purview for adaptation to the current climate, in order to accommodate the evolution of the financial system. This will require a balance of protecting investors and broadening horizons to maintain financial growth. In this light, innovative regulation might prove more effective than bans in addressing certain issues in this nascent space.

[8]Accessed at https://sec.gov.ng/the-investments-and-securities-tribunal-ist-restrains-unregistered-fintech-company-from-stock-trading/on 22/02/2

[9]Discussed in depth here: https://www.templars-law.com/wp-content/uploads/2020/10/Thought-Leadership-Clarity-at-Last-An-Analysis-of-the-SEC-Statement-on-Digital-Assets-1.pdf 1

[10]Defined in the Draft Rules as a generic term used to refer to Dealing Members of the NSE. The Rule Book of the NSE defines 'Dealing Member' as a member company that has been granted a licence by the NSE to deal in stocks, shares, and other securities listed on the NSE.

[11]Defined in the Draft Rules as any corporate entity that provides financial services through Digital Applications or uses technology to automate and enhance financial services

[12]Defined in the Draft Rules as any hardware or software used to host a Digital Application or service offered to end users.

[13]Templars' FAQs on the subject here: https://www.templars-law.com/wp-content/uploads/2021/02/Templars-Fintech-Update-CBN-Letter-on-Crypto-FAQs-Answered.pdf

[14]Accessed at: https://www.statista.com/chart/18345/crypto-currency-adoption/ on 12/03/21

[15]Accessed at https://nairametrics.com/2021/02/07/providus-bank-deactivates-virtual-account-numbers/ on 20/02/21


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