

THE LEGALITY OF THE SEC PROPOSED RULES ON CROWDFUNDING IN NIGERIA

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1. Overview

In a move to regulate crowdfunding in Nigeria, the Nigerian Securities and Exchange Commission (SEC) in March 2020, exposed draft rules to regulate crowdfunding activities in the country (the **Draft Rules**) and invited comments from the general public. The Draft Rules seek to provide a framework for the regulation of debt and equity crowdfunding activities in Nigeria. This commentary provides an overview of the Draft Rules and examines the power of the SEC to regulate crowdfunding in light of the provisions of the Investment and Securities Act, 2007 (ISA).

2. The Draft Rules

The Draft Rules define crowdfunding as the process of raising funds to finance a project or business from the public through an online platform. It provides the key participants in crowdfunding as the issuers (which are medium, small and medium enterprises (MSMEs)), crowdfunding portals,

crowdfunding intermediaries and investors investing in crowdfunding investment instruments.

The Draft Rules appear to apply only to debt and equity crowdfunding, therefore leaving other forms of crowdfunding outside its ambit.² We have discussed the distinctive types of crowdfunding [here](#).

Issuers and Investors³

The Draft Rules specifically provides that all MSMEs duly incorporated as companies in Nigeria and with a minimum of 2-years operating track record, are eligible to raise funds through a crowdfunding portal registered by the SEC, in exchange for the issuance of shares, debentures, or other investment instruments determined by SEC.

The Draft Rules exempt eligible issuers⁴ from certain requirements under the ISA. Under the Draft Rules, issuers are authorised to offer or sell securities or other investment instruments without the need for prior registration of the

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² Other forms of crowdfunding include donations-based and rewards-based crowdfunding.

³ Rules 2 and 3 of the Draft Rules.

⁴ An issuer is defined as the originator, maker, obligor, or creator of the security or investment instrument which shall be registered with a crowdfunding intermediary. Only MSMEs are eligible issuers under the Rules. Please see Rules 1, 2, 3 of the Draft Rules

securities or investments pursuant to the ISA. The Rules may be referring to the requirements of section 67 of the ISA that only a public company, and a statutory body or bank established by an Act of the National Assembly and empowered to accept deposits and savings from the public or issue its own securities, are authorised to offer or sell securities to the public.⁵ The SEC is however empowered under section 313(1)(f) of the ISA to prescribe that the provisions of the ISA 'shall not apply or shall apply with such modifications (if any) as may be specified in the regulations to any person or class of persons or any securities or class of securities or to any transaction.' In light of section 313(1)(f), the SEC has issued the Draft Rules functionally exempting MSMEs from the requirements of incorporating as public companies before they are eligible to offer securities to the public.

The Draft Rules however prescribe certain limitations on MSMEs in issuing securities to the public:

- a. such MSMEs must be incorporated in Nigeria and accredited and/ or accepted by a crowdfunding portal to use its platform; and
- b. a maximum amount of securities or investment instruments that can be offered/ sold by an issuer within a 12 – month period. Micro enterprises are not permitted raise above NGN50 million; small enterprises above

NGN70 million and medium enterprises above NGN100 million.

These limits do not apply to MSMEs operating as digital commodities investment platforms or any other MSME exempted from those limitations by the SEC. Retail investors are also limited to investing no more than 10% of their annual income on all crowdfunding platforms in a year. High net worth and qualified institutional investors have no investment limits. The issuance of securities or investment instruments under the Draft Rules is only compliant when conducted through a registered crowdfunding portal.

*Crowdfunding Portals and Crowdfunding Intermediaries.*⁶

The Draft Rules define a crowdfunding portal as a website, portal, intermediary portal, application or other similar module that facilitates the interaction between fundraisers and the investing public.⁷ All crowdfunding portals facilitating investment-based crowdfunding⁸ in Nigeria are required to be registered with the SEC. This requirement applies to platforms that are operated, provided or maintained in Nigeria, platforms that though located outside Nigeria, actively target Nigerian investors through promotion of their services in Nigeria, and platforms whose component parts when taken together, are physically located in Nigeria.

The Rules define a crowdfunding intermediary as an intermediary organized and registered

large number of people through an online platform in exchange for shares, debt securities, or other investment instruments approved by SEC.

⁵ Section 67(1)(a) and (b) of the ISA, 2007

⁶ Rule 4 of the Draft Rules.

⁷ Rule 1 of the Draft Rules.

⁸ The Draft Rules define investment-based crowdfunding as the process of raising funds from a

as a corporation to facilitate transactions involving the offer or sale of securities or investments through an online electronic platform. Only entities registered with SEC as an exchange, dealer, broker, broker/ dealer or alternative trading facility as prescribed under ISA and SEC Rules may be registered as a crowdfunding intermediary.

The rules applicable to a crowdfunding portal or intermediary do not apply to a technology service provider who merely provides the infrastructure, software or the system to an operator, an operator of a communication infrastructure that merely enables orders to be routed to an approved stock market, and an operator of a financial portal that aggregates content and provides links to financial sites of service and information providers.

Crowdfunding portals are required to register with the SEC, and successful registration is subject to the intermediary meeting the registration requirements contained in the Draft Rules.⁹ Crowdfunding portals are subject to disclosure, due diligence, monitoring and reporting obligations concerning issuers on their platform. They are mandated to comply with data protection and privacy rules.

Penalty for Non-Compliance

Crowdfunding portal or intermediary will be liable to fines for non-compliance with the Rules, of not less than NGN1million and an additional sum of NGN10,000 for every day any such violation continues.

⁹ Rule 6 of the Draft Rules.

Exceptions

Certain entities and business ventures are exempted from the provisions of the Rules. Businesses not utilising the internet to raise funds to finance a project or a business will not qualify as being engaged in the business of crowdfunding. MSMEs which are only registered as business names also do not fall within the eligibility provision of the Draft Rules. Therefore, individuals (or sole proprietors) registered as business names will not have access to raise funds from the public through these platforms. Complex structures, public listed companies and their subsidiaries, companies with no specific business plan or a blind pool cannot raise money through a crowdfunding portal. The Draft Rules also appear to exclude private companies who are bigger than MSMEs from the opportunity to access funding through regulated crowdfunding.

3. Analysis of The Power of the SEC to Regulate Crowdfunding

By virtue of the provisions of the ISA, the SEC has amongst its other functions, the duty to regulate investments and securities business in Nigeria, register and regulate securities exchanges, capital trade points, futures, options and derivative exchanges, commodity exchanges, and any other recognised investment exchange and to regulate all offers of securities of public companies and register securities of public companies.¹⁰ The SEC is also expressly permitted to make rules and

¹⁰ Section 13 of the Investment and Securities Act (ISA), 2007

regulations generally for carrying out the principles and objectives of the ISA.¹¹

However, it is relevant to consider whether the SEC can regulate the issuance of securities to the public by private companies, especially in the manner it intends to do through the Draft Rules. Crowdfunding, as defined by the Draft Rules, is the issuing of securities by a private limited liability company to the public. By the provisions of the Companies and Allied Matters Act (CAMA), Cap C20, Laws of the Federation, 2004, a private company is prohibited from issuing shares or debentures to the public or inviting the public to deposit money for fixed periods or payable at call, whether or not bearing interest unless authorised by law.¹² The provisions of the ISA reflects the provisions of the CAMA by prohibiting in absolute terms, the issuance of securities by a private company to the public. The ISA further provides that no person except the following two categories of entities are permitted to offer securities to the public: (a). a public company, whether quoted or unquoted; and (b). a statutory body or bank established by or pursuant to an Act of the National Assembly which is empowered to accept deposits and savings from the public or issue its own securities.¹³ The ISA prescribes fines as penalty for any entity that acts in breach of the provisions of the ISA.

As noted above, section 313 of the ISA permits the SEC to prescribe that the provisions of the ISA *shall not apply or shall apply with such modifications (if any) as may be specified in the*

regulations to any person or class of persons or any securities or class of securities or to any transaction, thus allowing the SEC to vary the provisions of section 67 of the ISA, expand the eligibility requirement for the issuance of securities to include private companies and in essence, amend the provisions of the ISA and by extension, the CAMA, as the SEC intends to do through the Draft Rules. Since section 22 of the CAMA qualifies its provisions by noting that private companies may offer securities to the public when authorised by law, when the Draft Rules are formally issued, they may amount to a valid exemption to the provision. This position is however subject to notion that subsidiary legislation can vary the provisions of the originating statute and it is unclear whether any subsidiary legislation is able to so do under Nigerian law as subsidiary legislation has the force of law.

However, in the case of *Olanrewaju v. Oyeyemi & Ors*,¹⁴ the Court of Appeal stated that a subsidiary legislation cannot expand or curtail the provisions of the substantive statute. The subsidiary legislation must conform with the principal laws which provided the source of its existence.¹⁵ To further this point, in the recent decision of *The Registered Trustees of Hotel Owners and Managers Association of Lagos (suing for itself and on behalf of all its members) v. Attorney General of the Federation and the Minister of Finance*,¹⁶ the Federal High Court considered the question whether the Minister of Finance pursuant to powers granted to him by an Act

¹¹ Section 313 (1) (h)

¹² Section 22(5) of the Companies and Allied Matters Act (CAMA), Cap C20, Laws of the Federation, 2004

¹³ Section 67(1)(a) and (b) of the ISA, 2007

¹⁴ (2000) LPELR-6045

¹⁵ NNPC v Famfa Oil (2012) 17 NWLR Pt 148

¹⁶ FHC/L/CS/1082/19

of the National Assembly¹⁷ can amend the Schedule to said Act. It held that any exercise of power that affects the terms and wordings of an enactment cannot be delegated legislation but an amendment to the legislation. This power to legislate or amend legislation is for the Parliament to exercise and cannot be shared with another body as this will violate the principle of separation of powers set out in Sections 4, 5 and 6 of the Constitution of the Federal Republic of Nigeria, 1999 (as amended). In light of the court's decision in that case, to the extent that the Draft Rules intend to extend public offer of securities to private companies, it does not conform with section 67 ISA and section 22 of CAMA, and cannot be said to be delegated legislation but an amendment of the principal legislation and therefore unconstitutional. Until this decision is set aside by a superior court, the SEC cannot be considered as acting appropriately within its powers as delegated under the ISA to issue the Draft Rules. However, the SEC and participants within the sector may consider the more appropriate option of sponsoring a Crowdfunding Bill at the National Assembly to amend the relevant

provisions of the ISA and CAMA as well as to address the activities considered in the Draft Rules.

4. Conclusion

It is commendable that the SEC is looking to regulate the crowdfunding space and bring some structure and legality to the activities within the space. It is also important for the SEC regulate the space so as to encourage foreign investment within the space and the further development of the sector. However, concerns about whether the SEC is able to regulate crowdfunding by private companies exist. On the face of it, these considerations are easily dismissed given the blanket powers granted to the SEC in section 313 of the ISA. The question about whether the ISA is able to delegate powers to a regulator to vary its provisions will be subject to judicial interpretation. However, given that the Draft Rules intend to functionally amend the provisions of two separate pieces of legislation, the SEC may find itself unable to administer the Rules.

¹⁷ Section 1(2) of the Taxes and Levies (Approved List of Collection) Act.