



NEWSLETTER

AN OVERVIEW OF THE NEW SEC CROWDFUNDING RULES



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INTRODUCTION

Pursuant to the powers conferred on it by Section 313 of the Investment and Securities Act 2007 (ISA), the Securities and Exchange Commission (SEC) released Rules for the Regulation of Crowdfunding in Nigeria on January 21, 2021. The Rules amongst other things seeks to provide a definite regulatory framework for equity crowdfunding activities in Nigeria and to make the crowdfunding market safe, conducive, and reliable for all stakeholders. This newsletter evaluates the imports of the new Rules and their potential impact on Micro-, Small and Medium-sized Enterprises (MSMEs) and their access to capital for growth and expansion going forward.

BACKGROUND

Access to regular and affordable finance has been a major impediment to the growth of MSMEs in Nigeria – a fact that has been notoriously highlighted by both Nigerian stakeholders and the international development community.¹ According to the Pricewaterhouse Coopers (PwC) MSME Survey 2020, obtaining finance was reported as the most pressing problem facing MSMEs in Nigeria, especially considering the difficulty obtaining bank loans, double digits interest rates, and financial institutions' bias towards larger investors. This had over the years forced MSMEs to look outward for alternative means of financing, and crowdfunding – whether it be equity-based, debt-based, or donation-based –

has been a major and consistent source of solace for many.²

Regrettably, the SEC had in 2016 banned crowdfunding platforms from engaging in equity crowdfunding on the basis that it was an indirect way for participating companies/fundraisers to engage in capital market activities by raising equity from the public without regulatory authorization, an act which is prohibited by Nigerian business laws.³

But as the lack of finance persists and equity crowdfunding platforms (ECFs) continue to grow rapidly across the world,⁴ the SEC took the initiative to introduce the Crowdfunding Rules by exercising its power under Section 313 of the ISA which empowers the Commission to, through regulations issued to that effect, limit the scope of application of the Act to persons or class of persons or any securities or class of securities or any transaction. Although the legality of doing so is still the subject matter of debate,⁵ by promulgating the new Crowdfunding Rules, the SEC has expanded the eligibility requirement for the issuance of securities to the public to include private companies raising funds through crowdfunding portals, and in essence, amended the relevant erstwhile limiting provisions of the ISA and CAMA.

Meaning of Crowdfunding under the Rules

The Rules apply only to Investment-Based Crowdfunding, which it defines as the use of small amounts of money obtained from a large number of individuals or organizations to fund a project or a business through an online web-based platform. Also, any prospective crowdfunding must be done through a Crowdfunding Portal⁶ operated by a registered Crowdfunding Intermediary.⁷

FUNDRAISING/ISSUING REQUIREMENTS

Who can raise funds through crowdfunding?

To be eligible to raise funds through a crowdfunding portal, the relevant MSME must be incorporated as a company in Nigeria with a minimum of 2 years' operating track record OR, if it has less than 2 years' operating track record, it must have a strong technical partner that possesses a minimum of 2 years' operating track record or has a core investor. For perspective, going by the definition of MSMEs by the Small and Medium Scale Enterprises Development Agency of Nigeria (SMEDAN), it is only companies with assets and turnover below N500 million and less than 199 employees respectively that can raise funds via a Crowdfunding Portal.

Is there a limit to the amount that can be raised?

Yes, the limit to the aggregate amount that can be raised by an MSME within 12 months is NGN100m for medium-sized enterprises, NGN70m for small enterprises and NGN50m for micro-enterprises respectively. However, these limits do not apply to MSMEs operating as digital commodities or Digital Commodities Investment Platforms (DCIPs) e.g. Farmcrowdy, Thrive Agric, etc. Essentially, DCIPs set up, for example, to connect investors with agricultural or commodities project in exchange for returns are exempted.

Is there a limit to the amount that can be invested?

The Rules also limit the aggregate amount of investments instruments sold to any investor across all Fundraisers in investment-based crowdfunding during the 12 month period. Retail investors can not invest more than 10% of their net annual income in a crowdfunding platform in a calendar year. However,

Sophisticated, High Net Worth Individuals (HNIs) and Qualified Institutional Investors have no investment limits.

How can funds be raised?

Qualified MSMEs ("fundraiser/issuer") may only raise funds through Crowdfunding Portals operated by platforms registered by the SEC and that have a minimum paid-up share capital of N100 Million. Fundraisers are required to file a standardized offering document with the Crowdfunding portal, providing details on the issuer, the business, the business plan, the minimum amount required, etc.

A fundraising offer can only be listed on a crowdfunding portal for sixty (60) days extendable by thirty (30) days after which the offer is to be withdrawn, even if the issuer has not raised the minimum amount it requires.

Where an offer is withdrawn, the fundraiser cannot make a new offering until after thirty (30) days and after having updated relevant financial information to the satisfaction of the crowdfunding intermediary. The investors also have the option to withdraw their investment within 48 hours after the withdrawal or close of an offer.



CROWDFUNDING PORTAL REQUIREMENTS

Eligibility

Equity crowdfunding portals can be operated only by an entity registered with the SEC to facilitate transactions involving the offer or sale of securities or investment through an online electronic platform (Crowdfunding Intermediary). An entity is considered to be facilitating, operating, providing or maintaining a Crowdfunding Portal in Nigeria if:

- 1) the Crowdfunding Portal is operated, provided or maintained in Nigeria; or
- 2) the Crowdfunding Portal is located outside Nigeria but targets Investors in Nigeria; or
- 3) the component parts of the portal when taken together are physically located in Nigeria even if any of its component parts, in isolation, is located outside Nigeria;

Furthermore, a Crowdfunding Portal located outside Nigeria will be considered as actively targeting investors in Nigeria if the operator, or the operator's representative, promotes the Portal in Nigeria directly or indirectly.



Registration Requirement

To register as a Crowdfunding Intermediary, an application must be made to the SEC in the prescribed form and the manner specified by the Commission and accompanied with Certified True Copies (CTC) of the requisite documents e.g. certificate of incorporation, memorandum and articles of association, etc. An applicant is required to have a minimum paid-up capital of ₦100 million (\$256,000).

Obligations of a Crowdfunding Portal/Intermediary

In the running of a crowdfunding portal, the Crowdfunding Intermediary owes the duty to:

- a) comply with all rules, regulations, code of conduct, and laws governing capital market operators in Nigeria;
- b) make relevant disclosures to the Commission;
- c) conduct due diligence on prospective Fundraisers and their business plans;
- d) notify the Commission of reasonable suspicions of fraudulent activity;
- e) observe the relevant data protection and privacy requirements in the Rules.
- f) set up and operate a trust account for holding funds raised in an issue, before transfer;
- g) take measures to reduce the risk of fraud; etc.

Revocation of Registration

The SEC may revoke the registration of a Crowdfunding Intermediary where (1) the Crowdfunding Intermediary fails to meet the requirements under the Rules; (2) the Crowdfunding Intermediary fails or ceases to operate or maintain the Crowdfunding Portal for a consecutive period of 6 months; or (3) the Crowdfunding Intermediary fails to pay the prescribed fees.

CONCLUSION

MSMEs are considered a vital part and the growth engine of most modern economies, not the least developing economies like Nigeria. As of 2020, it was estimated that MSMEs make up 90% of all registered businesses, contribute over 50% of the country's nominal GDP, and account for over 80% of employment. This is why it is important to create a sustainable business environment for them to thrive if the country is to achieve any meaningful inclusive growth and development. It is, therefore, a welcome development that equity crowdfunding has now been formally added to the means by which MSMEs can source capital to fund their growth and expansion plans. This will provide credible channels for MSMEs to raise funds from the investing public and have a resultant catalytic effect on the Nigerian economy going forward.

REFERENCES

1. According to the World Bank, "approximately 70% of Micro-, Small and Medium-sized Enterprises (SMEs) in emerging markets lack access to credit. While the gap varies from region to region, its particularly wide in Africa and Asia." (World Bank 2019)
2. Most existing crowdfunding platforms in the country seem to focus more on financing businesses in the agricultural sector, e.g. startups such as Farmcrowdy, Pork Money and Thrive Agric, which have, to a reasonable extent, made it relatively easier for the public to invest in agricultural businesses and make some returns.
3. The prohibitions referred to are the applicable provisions of the Investment and Securities Act 2007 (ISA) and the repealed Companies and Allied Matters Act 2004 (CAMA). *Section 67 (1)* of the ISA provides that "no person shall make

any invitation to the public to acquire or dispose of any securities of a body corporate..." unless it is a public company or a statutory body empowered to do. A combined reading of *Section 22(3) & (5)* of the repealed CAMA provides that unless authorized by law, a private company shall not invite the public to subscribe to its shares or debentures and that the number of members shall not exceed fifty (50). *Section 67(2)* of ISA further imposes fines on companies and their officers and directors found to be contravening the ISA.

4. In 2019, the global crowdfunding market was valued at 13.9 billion U.S. dollars and was forecast to triple by 2026. <https://www.statista.com/statistics/1078273/global-crowdfunding-market-size/>
5. See Adetayo Adetuyi and Nnanke Williams, *The Legality of the SEC Proposed Rules on Crowdfunding in Nigeria* Available at <https://www.lexology.com/library/detail.aspx?g=1a03ac22-7362-47c5-a768-3bf45c00358f>. The learned authors posit that the SEC and participants within the sector may need to "consider the more appropriate option of sponsoring a Crowdfunding Bill at the National Assembly to amend the relevant provisions of the ISA and CAMA."
6. A website, platform, portal, intermediary portal, application, or other similar module that facilitates interaction between Fundraisers and the investing public.
7. An entity organized and registered as a corporation to facilitate transactions involving the offer or sale of securities

or investment instruments through a Crowdfunding Portal.



Kevin Martin Ogwemoh Legal "KMO Legal" is a commercial law firm operating primarily in Lagos, Nigeria, the commercial hub of West Africa, with branches in Abuja and the United States of America.

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