



Position Paper

The Draft SEC Regulation on Crowdfunding

This position paper is developed as part of the mapping and analysis of national legislations, regulations and policies relevant for business enabling environment, trade and competitiveness, MSMEs and value chains development in Nigeria, commissioned by Nigeria Competitiveness Project (NICOP) and implemented in partnership with Centre for Trade and Business Environment Advocacy (CTBA) and Federal Ministry of Industry, Trade and Investment. NICOP is co-funded by the European Union (EU) and the German Government; and implemented by GIZ SEDIN Programme with the Federal Ministry of Industry, Trade and Investment (FMITI) as national partner.

Overview

Crowdfunding has emerged as an innovative funding mechanism for MSMEs, especially in the agricultural sector. Crowdfunding involves raising small amount of money from many people using an online platform. While crowdfunding is relatively well developed in more advanced economies, the phenomenon is gaining increasing popularity in Nigeria, especially in the agricultural sector where a number of start-up online platforms, such as Farmcrowdy, Pork Money and Thrive Agric have carved a niche in the market. These platforms help farmers raise funds for their projects and the farmers in turn repay the investing public based on the pre-agreed interest rate. According to the CrowdfundingHub in their report, Crowdfunding Potential for Nigeria (2017), Nigeria accounted for between \$7 to \$8m out of the \$83.3 million raised by the African crowdfunding market in 2015. 90% of this amount is attributed to peer-to-peer business lending and equity crowdfunding, while microfinance, donation and reward-based crowdfunding accounted for 10%. However, there is no specific regulatory framework in Nigeria for this emerging financial market, thereby exposing market participants to uncertainties and risk.

In March 2020, the Securities and Exchange Commission (SEC) published the “Exposure of New Rules to the Rules and Regulations of the Commission” which contained the proposed Rules on crowdfunding in Nigeria. The proposed Rules defined crowdfunding as “[T]he process of raising funds to finance a project or business from the public through an online platform”. According to the proposed Rules, all “MSMEs incorporated as a company in Nigeria with a minimum of two-years operating track record shall be eligible to raise funds through a Crowdfunding Portal registered by the Commission, in exchange for the issuance of shares, debentures, or such other investment instrument as the Commission may determine from time to time” (Section 2).

Furthermore, the Rules set limits on the maximum amount of money that can be raised by Medium Enterprises (NGN100m), Small Enterprises (NGN70m) and Micro Enterprises (NGN50m) (Section 3) within a 12-month period. However, subsection (2) of Section 3 makes an important distinction between regular investment instruments and the commodity sponsorship kind of investment. It provides that the “limits set forth above shall not apply to MSMEs operating as digital commodities



investment platforms...”. A “digital commodities platform” is defined under the Draft Rules as “digital platform that connects investors to specific agricultural or commodities projects for the purpose of sponsoring such projects in exchange for a return”. This definition captures agritech platforms that farmers use to raise fund for projects such as seasonal farming, commodity processing, export financing, etc.

The value of crowdfunding to MSMEs in Nigeria lies in the fact that while traditional sources, such as bank loan, come with cumbersome documentation/collateral requirements as well as high interest rates; extant laws make it illegal for the MSMEs to seek investments from the public in return for equity. By virtue of Section 67 (1) of the Investment and Securities Act (ISA) 2007, “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 so”. Similarly, Section 22(5)(a) of CAMA prohibits a private company, unless authorised by law, from inviting the public to subscribe for any shares or debentures of the company; while subsection (b) prohibits a private company from inviting the public to deposit money for fixed periods or payable at call, whether or not bearing interest. In keeping with these statutory impediments, the SEC had in 2016 placed a ban on the use of crowdfunding for equity type of investment. This proposed Rules seek to regulate the practice of crowdfunding, including for equity type investment instruments.

The proposed Rules contain other provisions to safeguard the interest of investors and the integrity of the market. It also defines and sets out regulations for the various operators/mechanisms such as the Crowdfunding Portal (the platform used to raise the funding); the Crowdfunding Intermediary (the company running the portal) and the issuer (the company seeking the funding). The proposed Rules also exempt from registration the digital commodity investment portals in operation before coming into force of the Rules and imposes on them only the duty to obtain a “no objection” from SEC (Section 43).

Key issues

The major concern around the proposed Rules is that it has not addressed the legal impediment contained in section 22(5)(a-b) of CAMA which prohibits a private company from inviting the public to subscribe for any shares or debentures of the company, and to deposit money for fixed periods or payable at call, whether or not bearing interest. It is also doubtful whether it has addressed the legal impediment in Section 67 of ISA. There is a wiggle room to address the impediment contained in Section 67 of the ISA: it can be argued that SEC could rely on Section 313(1)(h)¹ of the ISA to exempt crowdfunding from the application of certain provisions of the ISA, including Section 67. However, such regulation/exemption by SEC does not cure the impediments posed by CAMA. This proposed Rules by SEC cannot operate as a “law” authorising private companies to deviate from the provision of Section 22(5)(a-b). It is important to note that the present operations of the digital commodity platforms seem to be in violation of Section 22 of CAMA to the extent that they receive deposits in return for interest. These conflicting legal provisions would have been addressed in the

¹ Section 313(1)(h) of ISA provides that the Regulation making powers of the SEC extends to “prescribing that the provisions of this Act 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”.



recent re-enactment of CAMA had the stakeholders taken up the cause of advocating for the change.

Other concerns revolve around the minimum capital requirement of NGN100m for the registration of crowdfunding portals; the seeming misplacement of obligations between the crowdfunding platform and crowdfunding intermediary (such as placing due diligence obligations on the platform rather than on the intermediary, which is the operator of the platform); lack of provision for secondary market for the securities as obtainable in countries like the UK, etc².

Conclusion and Recommendations

It is acknowledged that the operations of commodity focused crowdfunding platforms would not be fettered by the Rules as proposed; however, the proposed Rules are still problematic from a general MSMEs funding perspective. In view of the importance of crowdfunding as an innovative financing mechanism for MSME and the need to eliminate all regulatory uncertainties, it is recommended that SEC and other stakeholders should approach the National Assembly for a bespoke legislation on Crowdfunding. The Draft Rules already present a good draft for a Bill in this regard. NICOP can engage in this process by supporting identified organisations to champion this process.

² <http://www.olaniwunajayi.net/wp-content/uploads/2020/04/Unveiling-the-Securities-and-Exchange-Commission-Regulations-for-Crowdfunding.pdf>