

ALIGNING THE RULES ON CROWDFUNDING 2021 WITH THE EXISTING LEGAL FRAMEWORK REGULATING NIGERIA'S SECURITIES MARKET**

ABSTRACT

To a large extent, the relatively recent introduction of web-based crowdfunding into Nigeria's capital market space and its wide patronage by micro, small and medium enterprises (MSMEs), has lessened the conundrum associated with accessing investment funds by Startups and MSMEs in Nigeria. Sadly, despite the prominence, this laudable development is without statutory backing. The absence of a legal framework poses some measure of risk for investors as well as regulatory challenges. One nagging truism is that legislation in Nigeria usually lags heavily behind developments. Thus, to cure the regulatory gap, the Securities and Exchange Commission (SEC) in protection of the investing public and to provide regulators with legal tools to regulate the use of investment-based crowdfunding in Nigeria made the Rules on Crowdfunding 2021. This article interrogates the extent to which the existing principal statutes regulating the Nigerian capital market sanction the use of financial instruments of the nature of investment-based crowdfunding to raise capital by MSMEs and the validity of the SEC Rules on Crowdfunding 2021 vis-à-vis the statutes.

Keywords: Securities, MSMEs, Crowdfunding, Equity-Crowdfunding, FinTech, Fund

INTRODUCTION

Ordinarily, dealing in company securities or capital (employed interchangeably), like most other private arrangements creates contractual relationships. Under Nigeria's *corpus juris* contractual relationships are generally regulated by Common Law principles of the law of contract except where such relationship is expressly regulated by statute. Contractual relationships arising from dealings in corporate entities' securities qua capital market is one of the areas that are statutorily regulated in Nigeria. The necessity for legislative intervention in the securities sector finds justification based on the need to ensure market predictability, certainty and transparency. This is predicated on the need to protect investors' funds, by ensuring that transactions are conducted fairly and transparently,¹ coupled with the need to prevent systemic failure. At the international level, the International Organisation of Securities Commission (IOSCO),² the global watchdog of the securities sector,³ has over the years been vigorously encouraging nations to put laws in place to regulate all facets of the

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¹ IJ Essian, 'Re-Affirming the Principles of Corporate Governance in the Nigerian Capital Market: The Role of Securities and Exchange Commission' in S.I. Oji (ed.), *Philosophical Legacy on Issues in Nigerian Public Law* (Faith Printers International, Zaria, 2008)

² IOSCO, 'A Resolution of the President Committee, Adoption of the Objectives and Principles of Securities Regulation passed by the President Committee' (1998) <www.iosco.org> accessed on 4 June 2020

³ <www.iosco.org/about/?subsection=about_iosco> accessed 24 February 2022

securities market. Explaining the significance of the tripod provided by the law in this regard, the body claims that it offers protection to investors by ensuring that the markets are fair, efficient and transparent, thereby reducing the incidents of systemic risk.⁴

Against the backdrop of the dwindling oil revenue receipts, more than ever before, the need to diversify the Nigerian economy has become imperative. To be sustainable, it is essential the process of diversification is made inclusive and driven by all sectors of the economy, particularly the micro, small and medium enterprises (MSMEs); who are the major employers of labour and producers of goods and services in the country. One major setback in achieving an inclusive sustainable development is the difficulties faced by start-ups and MSMEs in accessing capital funds. On the bright side, recent developments in Nigeria show that some start-ups and MSMEs in addressing the issue of paucity of capital funds are resorting to Financial Technology (FinTech) hoisted on Nigeria's cyberspace to access funds via the instrumentality of crowdfunding. Laudable as this development, the question is does Nigeria's legal framework accord every entity in Nigeria the right to source for investment or capital funds from the public? In providing answer, this piece evaluates the extent to which Nigeria's securities legal framework directly or indirectly accommodates or permits the use of the emerging FinTech phenomenon of crowdfunding by MSMEs, start-ups and social entrepreneurs to access unsecured finances from the public. In doing this, this piece shall consider the nature of crowdfunding within the scope of the new rules made by the Securities and Exchange Commission (SEC), including some salient provisions of the Investments and Securities Act 2007, cum Companies and Allied Matters Act 2020.

LEGAL FRAMEWORK REGULATING THE SECURITIES MARKET

Over the years a plethora of federal statutes designed to regulate the securities/capital market has been signed into law. Incidentally, the legal basis for the enactment of these federal statutes is traceable to the Constitution of the Federal Republic of Nigeria 1999 as amended (CFRN 1999). The CFRN allocates legislative powers over items contained in the Exclusive Legislative List to the Federal Government of Nigeria; the items include capital, corporate bodies and the likes.⁵ In line with these powers so conferred, both general and specialized federal statutes with direct and indirect implications for the capital market have been made,

⁴ IOSCO, *Objectives and Principles of Securities Regulations* (2003) 5, <www.iosco.org/library/pubdocs/pdf/IOSCOPD154.pdf> accessed 18 July 2020

⁵ For instance, see the CFRN 1999, Second schedule, items 6, 7, 12, 19 and 32.

some of which are the Companies and Allied Matters Act,⁶ Central Bank of Nigeria (Establishment) Act,⁷ Nigerian Investment Promotion Commission Act of 1995,⁸ the Investments and Securities Act 2007 (ISA) and others. Among these statutes, the legislation with the greatest impact on the Nigerian securities market is the ISA.

Without gainsaying, the statute in many respects meets with the proclivity of contemporary best practices. A perusal of the ISA reveals that its provisions are to a large extent very robust. The ISA established the Securities and Exchange Commission as the apex regulator of the capital market.⁹ From the long title, the objectives of the Act include the promotion of sound corporate governance principles, building confidence in the Nigerian securities system, upholding the integrity of the market and guaranteeing a free, fair and transparent market.¹⁰ Section 13 of the ISA enumerated the basic functions of SEC. The common thread that binds the enumerated functions is the objective of protecting the interest of investors along with enhancing ‘their confidence in the capital market and ensuring orderly and equitable dealings in the securities business.’¹¹

Nevertheless, as laudable as the provisions appear to be, recent developments in the capital market expose some legislative gaps not envisaged by the lawmakers. These gaps, if not expeditiously addressed may impinge upon the confidence and integrity of the Nigerian capital market, as well as deter investors and hamper the ease of accessing capital finance in Nigeria. Among these gaps is the regulatory challenge posed by emerging FinTech products particularly the information and communications technology (ICT) based modes of corporate financing known as Crowdfunding.

STATUTORY REGULATION OF PUBLIC SALE OF SECURITIES

Taking into consideration the mode of sourcing for investors qua funds, one query that logically arises is whether investment-based crowdfunding is a kind of public offer (public sale of securities)? Over the years, public offer of securities has proven to be an efficient method of accessing long term unsecured capital finance by public companies. Generally, the capital market is bifurcated into the primary and secondary markets. The primary market deals with new issues; this includes Initial Public Offering or raising additional capital. Under

⁶ 2020

⁷ 2007 No. 63.

⁸ Cap N 117, LFN 2004

⁹ ISA, s 13

¹⁰ *ibid*

¹¹ Perekedou James Fawei, ‘An Analysis of the Roles of Regulatory Agencies in the Nigerian Capital and Stock Market’ (2016) 1 (1), *Ajayi Crowther University Law Journal*, 1, 8

Nigerian law, in line with the provisions of the ISA, the term securities mean debentures, stock, shares, bond or notes issued or proposed to be issued by a government or a body corporate as well as any right or option in respect of any such instrument and include commodities, futures, contracts, options and other derivatives, which may be transferred utilizing any electronic mode approved by the ISA and which may be deposited, kept or stored with any licensed depository or custodian company.¹² Similarly, as mentioned above, investment-based crowdfunding in the Nigerian context is “the process of raising funds from the public through an online portal in exchange for shares, debt securities or other investment instruments ...”¹³

As part of the strategies to protect investors from the danger of losing their money to fraudulent offers, the ISA places several restrictions on invitations by corporate entities to the public to buy securities.¹⁴ A cursory reading of the provisions shows that the stringent conditions and procedures laid down by the Act are mandatory and every company is obliged (along with other conditions prescribed by other statutes) to comply with them before its securities can be legally offered to the public. The ISA contains copious provisions designed to protect investors from becoming victims of fraudulent offers and to prevent companies at the brink of collapse from accessing the securities market.¹⁵ Thus, the ISA requires that before the securities of any company or collective investment schemes are introduced to the securities market, they must have been compulsorily scrutinized and registered by SEC.¹⁶ Upon scrutiny by the SEC, if it finds it necessary for the protection of the investors and other market operators, it may refuse, suspend or prohibit further trading in the securities as the case may be.¹⁷

In addition to these prudential requirements, the ISA expressly limited the right to make public offers to certain categories of corporate entities. One inescapable deduction arising from the combined reading of sections 67(1) ISA and 22(5)(b) Companies and Allied Matters Act 2020 (CAMA 2020), is that the use of public sale of securities by corporate entities is only available to public companies, statutory bodies, banks or an entity empowered by a federal statute. For emphasis, section 67, ISA states that

¹² ISA, s 315

¹³ Rule on Crowdfunding 2021, r 1

¹⁴ ISA, ss 55-59 and 67-116

¹⁵ ISA, 105-116

¹⁶ ISA, s 54

¹⁷ ISA, s 36

(1) No person shall make any invitation to the public to acquire or dispose of any securities of a body corporate or to deposit money with any body corporate for a fixed period or payable at call, whether bearing or not bearing interest unless the body corporate concerned is-

(a) a public company, whether quoted or unquoted, and the provisions of sections 73 to 87 of this Act are duly complied with; or

(b) a statutory body or bank established by or pursuant to an Act of the National Assembly and is empowered to accept deposits and savings from the public or issue its own securities (as defined under this Act), promissory notes, bills of exchange and other instruments:

Provided that nothing in this subsection shall render unlawful the sale of any shares by or under the supervision of any court or tribunal as may be authorised by law.

On its part, CAMA expressly (but subject to other statutory provisions) prohibits a private corporate entity from sourcing for finances through Public Offers. It states that ‘a private company shall not, unless authorised by law, invite the public to (a) subscribe for any shares or debentures of the company; or (b) deposit money for fixed periods or payable at call, whether or not bearing interest.’¹⁸ A violation of this provision may give rise to both criminal (a fine) and civil (right to rescind the contract or claim compensation) actions.

For the avoidance of doubt, an invitation will qualify as an invitation to the public if it is an offer or invitation to make an offer published, advertised or disseminated by a newspaper, broadcasting, cinematography or any other means like the internet or circulated among any person whether selected as members or as debenture holders of the company concerned or as clients of the persons making or circulating the invitation or in any other manner. It also includes an invitation to acquire securities dealt in on a Securities Exchange or Capital Trade Point. It, however, excludes invitation directed to a particular person or a domestic concern of the persons making and receiving it.¹⁹

NATURE OF CROWDFUNDING

Raising capital for companies is usually somewhat of a conundrum, particularly for start-ups and MSMEs. Incidentally, as mentioned earlier, one of the modes statutorily designed for

¹⁸ CAMA 2020, s 22(5)

¹⁹ ISA. s 69

accessing unsecured finance by corporate entities from the capital market is usually through public offer (public sale of securities). This mechanism in Nigeria as shown above is statutorily reserved for the benefit of public companies and other statutorily empowered entities to the exclusion of private companies; the bulk of which are usually MSMEs. Sequel to the digitalization of the global and local economy, which incidentally has created a robust world of financing, there appears to be a paradigm shift in the mode of sourcing for funds by some MSMEs.²⁰ The shift involves a recalibration from traditional private sourcing to sourcing for unsecured funds directly from the general public by way of public invitations; a phenomenon known as crowdfunding. Though the concept of crowdfunding is believed to have originated in the USA in the 1800s, modern crowdfunding became more popular in the wake of the 2008 global financial crisis when banks cut-back on small business lending thereby making access to finances more difficult.²¹

As in most climes, the basic impetus for the expanding crowdfunding ecosystem in Nigeria is the untrammelled spread and access to the internet as well as FinTech tools by a large chunk of the Nigerian population, coupled with the ease of inviting investors through the medium by fundraisers.²² Initially, crowdfunding was considered as an infinitesimal method of finance not warranting any regulatory concern beyond issuing a caution. For instance, in 2014 the Central Bank of Ireland merely issued a notice warning consumers to exercise caution in investing through crowdfunding.²³ The SEC in Nigeria merely warned against patronising the different platforms.²⁴ However, with the rapid growth and projected value of funds invested through the medium, it became expedient for regulators to intervene. However, regulating the novel practice posed some challenges to existing laws. This is because most pre-FinTech laws did not envisage the development. At the moment, there are not so many countries in the world that regulate crowdfunding. However, countries like the United States of America, Canada, New Zealand some European countries²⁵ and recently Nigeria, are among the countries that do.

²⁰ The assumption is that most MSMEs are private entities or owned by individuals.

²¹ Ying Zhao, Phil Harris and Wing Lam, 'Crowdfunding Industry—History, development, policies, and potential issues' (2019) 19(1) *Journal of Public Affairs* DOI: [10.1002/pa.1921](https://doi.org/10.1002/pa.1921)

²² TY Baulieu and S Sarker, S. 'A conceptual framework for understanding crowdfunding' (2015) 37 *Communications of the Association for Information Systems*, 1

²³ Consumer Notice on Crowdfunding, including Peer-to-Peer Lending 17 June 2014

²⁴ FinTech Nucleus 'FinTech in Nigeria' <<https://ilca.africa/fintech-in-nigeria/>> accessed 21 February 2022

²⁵ Council Regulation (EU) 2020/1503 on European crowdfunding service providers for business (the EU Regulation") Adopted 7 October 2020. < <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32020R1503&from=EN>> accessed 20 February 2022. In the UK Equity crowdfunding, has been regulated by Financial Services and Markets Act 2000 even before the "crowdfunding term was coined.

Responding to the growing interest in the use of crowdfunding as a means of raising capital by some MSMEs in Nigeria, the SEC in the protection of the investing public (the crowd) released Rules on Crowdfunding 2021²⁶ (the "Rules on Crowdfunding") effective from 21 January 2021.²⁷ The new Rules on Crowdfunding described the concept 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.’²⁸ This definition is largely similar to the definition given by the United States of America Securities and Exchange Commission (US SEC), which defines it as ‘... a financing method in which money is raised through soliciting relatively small individual investments or contributions from a large number of people.’²⁹

Similarly, crowdfunding service within the European Union means “... the matching of business funding interests of investors and project owners through the use of a crowdfunding platform and which consists of any of the following activities: (i) the facilitation of granting of loans; (ii) the placing without a firm commitment basis, ... of transferable securities and admitted instruments for crowdfunding purposes issued by project owners or a special purpose vehicle, and the reception and transmission of client order, ... in relation to those transferable securities and admitted instruments for crowdfunding purposes.”³⁰ While “crowdfunding platform means a publicly accessible internet-based information system operated or managed by a crowdfunding service provider.”³¹ The common thread from the foregoing is that crowdfunding is a mode of finance/funding by which many individuals (the crowd) pooling their money together for a common goal, usually conducted in contemporary times through different online platforms (internet) addressed to the general public.³² The individuals or crowd are generally invited from among the members of the general public using the medium of the internet.

²⁶ <<https://sec.gov.ng/wp-content/uploads/2021/01/Jan-2021-Executed-Rules.pdf>> accessed 24 February 2022. The Rules came into effect on 21 January 2021.

²⁷ SEC, ‘Effective Date of the Crowdfunding Rules’ <<https://sec.gov.ng/effective-date-of-the-crowdfunding-rules/accessed>> accessed 5 January 2022

²⁸ Rule on Crowdfunding, New Rules and Amendments to the Rules and Regulations of the Commission (Rule on Crowdfunding), < <https://sec.gov.ng/wp-content/uploads/2021/01/Jan-2021-Executed-Rules.pdf>> accessed 5 June 2021.

²⁹<www.investor.gov/introduction-investing/investing-basics/glossary/regulation-crowdfunding> accessed 29 July 2020

³⁰ EU Regulation, art 2, r 1(a).

³¹EU Regulation, art 2 r 1(d).

³² For further reading see Dave Milliken, ‘Investment Crowdfunding Analysis: Crowdfunding Soars While a Pioneer Shatters’ [2012] <www.crowdsourcing.org/document/investment-crowdfunding-analysis-crowdfunding-soars-while-a-pioneer-shatters/11525>; accessed 7 July 2021; Brigitte Bradford, ‘Week in Review: The True Power of Crowdfunding,’ (2013) 46 *Cornell Int’l L.J.*, 427; Joseph Green, John F. Coyle ‘Crowdfunding and the Not-So-Safe SAFE’ (2016) 102 *Virginia Law Review*, 168

As crowdfunding activities continue to ramp-up, over the years, different models of the phenomenon emerged. Presently the different models can be categorised into four broad spectrums. These are, (i) ‘Donation’ crowdfunding (sometimes referred to as charitable crowdfunding; non-profit corporate entities use this type of crowdfunding to raise funds for charitable purposes), (ii) ‘Reward’ (also known as ‘Royalty; under this model, fund are sourced in exchange for a reward in the future), (iii) ‘Loan based’ crowdfunding (sometimes referred to as ‘debt’, ‘lending-based’ ‘peer-to-peer (P2P) lending’; here, the investors are considered as lenders while the receiving entity is the borrower. The loan is expected to be paid back within a specified period along with accrued interest, at a rate agreed or fixed via the crowdfunding platform), and (iv) Investment crowdfunding otherwise known as ‘Equity’ or equity-based Crowdfunding (under this model, the investor directly or indirectly purchases an interest in the receiving corporate entity or project in the form of shares, debenture, *Sukuk*, etc.).³³

Under the extant rules regulating crowdfunding in Nigeria, there is no clear-cut distinction between lending-based and equity crowdfunding; they are jointly referred to as investment-based crowdfunding.³⁴ The Rule on Crowdfunding describes investment-based crowdfunding as a “...process of raising funds from the public through an online portal in exchange for shares, debt securities or other investment instruments approved by”³⁵ SEC. Subject to the terms of the offer, the investment instruments that may be issued to an investor may take the form of ordinary shares, plain vanilla bonds or debentures, and simple investment contracts. Thus, the definition of investment-based crowdfunding, includes both lending-based and equity crowdfunding.

A perusal of the practice in most jurisdictions where crowdfunding is regulated reveals a global pattern of regulating only lending-based and equity based crowdfunding, as is the case in Nigeria. Understandably, this position is justifiable since the other types of crowdfunding do not primarily involve what in economic parlance may be termed as financial services. In most of the jurisdictions, while lending-based and investment-based crowdfunding are regulated, others like donation and reward-based crowdfunding are not, primarily because they do not involve

³³ Ying Zhao (n 21)

³⁴ Rule on Crowdfunding, r 1, New Rules and Amendments to the Rules and Regulations of the Commission (Rules on Crowdfunding), < <https://sec.gov.ng/wp-content/uploads/2021/01/Jan-2021-Executed-Rules.pdf>> accessed 24 June 2021.

³⁵ Rules on Crowdfunding, r 1.

the issuance of investment instruments;³⁶ though in some of the jurisdictions there are minimal regulations designed to exclude fraudulent practices in these areas.

WHY REGULATE CROWDFUNDING

From the definition of crowdfunding above, vis-à-vis the meaning of public offer, it is safe to conclude that crowdfunding qualifies as an invitation to the public to buy the securities of the fundraiser. The EU Regulations aptly captured the essence or the targeted investors of crowdfunding, when it defined a crowdfunding platform as “... a publicly accessible internet-based information system operated or managed by a crowdfunding service provider.”³⁷ However, despite its numerous advantages for start-ups and MSMEs, being in the nature of a public offer, crowdfunding carries with it several inherent risks.³⁸ For instance, the potential of loss of investment due to unprofessional conduct perpetrated by intermediaries or fundraisers’ or related parties such as fraud, misappropriation or outright inadvertent breach of obligations assumed under the crowdfunding arrangement, etc.³⁹ There is also the potential of being used as a money laundering destination; a risk that possesses a prospect of great loss for innocent investors and fundraisers (for instance where the assets of the fundraiser are confiscated as a result). Additionally, because start-ups and MSMEs companies are inherently volatile and make extremely risky investments; projections on returns on securities are hardly accurate.⁴⁰ There is also the likelihood of the absence of transparency or the use of inaccurate information touching on the level of hazard connected to the investment or projected returns, to attract and mislead potential investors.⁴¹ The likelihood of these and other anomalies including aligning the practice with the existing laws reinforces the need for statutory backing.

REGULATING CROWDFUNDING IN NIGERIA

³⁶ Kirstene Baillie ‘Regulation of Crowdfunding in the UK: Past, Present and Future’(2019) 20 *Bus. L. Intl*, 147

³⁷ EU Regulation, art 2 r 1(d).

³⁸ RB Carter and H Van Auken, ‘Bootstrap financing and owners' perceptions of their business constraints and opportunities’ (2005) 17(2) *Entrepreneurship & Regional Development*, 129

³⁹ World Bank Group, [2021] POLICY RESEARCH PAPER Consumer Risks in Fintech New Manifestations of Consumer Risks and Emerging Regulatory Approaches. <<https://documents1.worldbank.org/curated/en/515771621921739154/pdf/Consumer-Risks-in-Fintech-New-Manifestations-of-Consumer-Risks-and-Emerging-Regulatory-Approaches-Policy-Research-Paper.pdf>> accessed 11 July 2021.

⁴⁰ D North, R Baldock and I Ekanem, ‘Is there a debt finance gap relating to Scottish SMEs? A demand-side perspective’ (2010) 12(3) *Venture Capital*, 173 <<https://doi.org/10.1080/13691061003658670>> accessed 10 July 2021. Timothy Bates and Alfred Nucci, ‘An Analysis of Small Business Size and Rate of Discontinuance,’ *Journal of Small Business Management* (1989)1, 4

⁴¹ S Jonsson and J Lindbergh, ‘The development of social capital and financing of entrepreneurial firms: From financial bootstrapping to bank funding.’ (2013) 37(4) *Entrepreneurship: Theory and Practice*, 661 <https://doi.org/10.1111/j.1540-6520.2011.00485.x>.

Until 2021, the practice of crowdfunding was unregulated in Nigeria. However, as a result of the sustained interest in crowdfunding and the continuous expansion of its ecosystem, SEC in 2021 released the Rules on Crowdfunding 2021⁴² (the "Rules"). The Rules purportedly made on the authority of the ISA, rather than allow fundraisers to approach the market directly, introduced crowdfunding intermediaries. Towards this end, only registered crowdfunding intermediaries are allowed to register and manage crowdfunding portals in Nigeria. The Rules define the intermediary as '[A]n entity organized and registered as a corporation to facilitate transactions involving the offer or sale of securities or investment instruments through a Crowdfunding Portal.'⁴³ In other words, crowdfunding intermediaries are crowdfunding service providers and operators of crowdfunding platforms. Accordingly, any person wanting to raise funds through crowdfunding in Nigeria (referred to as a 'fundraiser' in the Rules) must go through an intermediary.⁴⁴

The Rules impose a plethora of prudential requirements on the intermediaries and other parties. First, an intending intermediary must be registered and licenced to operate in Nigeria by the SEC. Whether the intermediary operates or is located within or outside Nigeria, so long as it provides a platform for interface between fundraisers and investors (crowd) in Nigeria, the intermediary is considered as targeting the investing public in Nigeria and as result must be registered and licenced to so operate. This requirement is designed to enable the SEC to regulate and supervise crowdfunding service providers. Failure of any intermediary to comply may result in regulatory sanctions which may include the imposition of fines, stoppage of operations and labelling the operation as illegal. An intending intermediary must be a corporate entity with a minimum paid-up capital of N100, 000,000.00 (One Hundred Million Naira). In addition, such intermediary must have a fidelity insurance bond whose value must not be less than 20% of the required minimum paid-up capital, must show evidence of having in its employment sufficient and qualified personnel, coupled with the provision of adequate 'security measures, systems capacity, business continuity plan and procedures, risk management, data integrity and confidentiality'⁴⁵

To mitigate investors' risk exposures, intermediaries are required to conduct due diligence on fundraisers, comply with all know Your Customer and Anti-Money Laundering /Combating

⁴² <https://sec.gov.ng/wp-content/uploads/2021/01/Jan-2021-Executed-Rules.pdf> . The Rules came into effect on 21 January 2022.

⁴³ The Rules on Crowdfunding, r 1

⁴⁴ The Rules on Crowdfunding, r 4(4).

⁴⁵ The Rules on Crowdfunding, r 6(xxiii)

the Financing of Terrorism regulations and ensure that fundraisers comply with the Rules and the requirements of all existing laws.⁴⁶ Where the intermediary, reasonably believing that the fundraiser or the offering presents the potential for fraud or otherwise raises concerns about investor protection, such intermediary is required to deny to such fundraiser the use of its platform. In addition, during the course of the offer, the intermediary is obliged to detect and prevent violations of the securities laws and the regulations and make periodic reports to the SEC.⁴⁷ Towards this end, every intermediary is obliged to be ‘knowledgeable about the general structure, features and risks of investment instruments presented on its portal.’⁴⁸

To qualify as a fundraiser under the Rules, the corporate entity must be an MSME with less than Five Hundred Million Naira assets, incorporated in Nigeria, and has been operating for not less than two years.⁴⁹ Companies with complex structures including listed companies and their subsidiaries, companies lacking a specific business plan or set up solely to merge with or acquire unidentified business concerns, and companies that propose to use the funds raised to provide loans or invest in other business entities are disqualified from raising funds through crowdfunding portals.⁵⁰ Nevertheless, where an entity has less than two years operating track record, and yet seeks to raise funds through a crowdfunding platform, the MSME may be permitted to if it has a strong technical partner that possesses a minimum of a 2-year operating track record or a core investor.⁵¹ The crowdfunding offer remains open for acceptance for a period of 60 days. However, if the total subscription realised is less than the targeted amount, the period may be extended for another 30 days, subject to conditions that may be specified by the intermediary.⁵² Thereafter, if the targeted amount is not realised, the offering must be withdrawn. Where an offer has been withdrawn, a new offer cannot be made by the same fundraiser until 30 days and the fundraiser has updated all financial information to the satisfaction of the crowdfunding intermediary.⁵³

Presumably, still acting from the standpoint that MSMEs and start-up investees pose a high-risk investment and in the protection of investors, the Rules places a ceiling on how much money the different sizes of companies can raise on a crowdfunding platform within twelve calendar months (for medium enterprises the amount is N100Million; a small enterprise is

⁴⁶ The Rules on Crowdfunding, r 12.

⁴⁷ The Rules on Crowdfunding, r 13.

⁴⁸ The Rules on Crowdfunding, r 23.

⁴⁹ The Rules on Crowdfunding, r 3

⁵⁰ The Rules on Crowdfunding, r 39.

⁵¹ The Rules on Crowdfunding, r 3.

⁵² The Rules on Crowdfunding, r 26.

⁵³ The Rules on Crowdfunding, r 26(C)(i)&(ii).

N70Million; and micro enterprise N50Million).⁵⁴ By the same token, the Rules divided investors into Retail Investors, Sophisticated Investors, High Net Worth investors and Qualified Institutional Investors. As earlier mentioned, while crowdfunding promises the potential of increasing access to funding, it also constitutes a riskier investment destination, particularly for retail investors.⁵⁵ This is because the majority of such investors may not possess sufficient knowledge or experience, or have access to financial advice, to assess offers. To limit the potential harm to which this group of investors may be exposed, the Rules limit the investment any retail investor may make within a calendar year to not more than 10% of his net annual income; understandably the other classes of investors are not subject to any limit.⁵⁶

To avoid the risk of insolvency, prevent intermediaries from absconding or tampering with investors' funds, the Rules require every intermediary to appoint a custodian who must also be registered with the SEC. The role of the custodian includes the establishment and maintenance of a distinct trust account for each fundraising. The funds must be kept in an interest yielding trust account.⁵⁷ The total funds raised and the accruing interest are released to the fundraiser within 24 hours of closing the offer⁵⁸ on the authorisation of the intermediary subject to (a) the targeted amount or the minimum threshold been met; (b) an absence of material adverse change relating to the offer; and (c) all other requirements under the Rules including the registration of securities have been met.⁵⁹ It is important to note that where the targeted amount sought to be raised is not met, but the minimum threshold has been met, the custodian is not obliged to release the funds until the fundraiser has provided a revised plan for the proposed use of the funds to the investors and the intermediary within one week of the end of the offer, and the intermediary is satisfied that the proposed venture can be downscaled and effectively executed with the funds raised. However, where the minimum threshold is not reached at the end of an offer, the Intermediary is obliged to make a refund to all investors

⁵⁴ The Rules on Crowdfunding, r 4(1)(b). The Small and Medium Enterprises Development Agency of Nigeria (SMEDAN) designates an enterprise as Micro, Small or Medium if has less than 10, 50 or 200 employees or assets (excluding land and building) less than N5million, N50million or 500million respectively. See National Policy on Micro, Small or Medium Enterprises < <https://smedan.gov.ng/images/PDF/MSME-National-Policy.pdf>> accessed 11 July 2021

⁵⁵ World Bank Group, [2021] POLICY RESEARCH PAPER Consumer Risks in Fintech New Manifestations of Consumer Risks and Emerging Regulatory Approaches. < <https://documents1.worldbank.org/curated/en/515771621921739154/pdf/Consumer-Risks-in-Fintech-New-Manifestations-of-Consumer-Risks-and-Emerging-Regulatory-Approaches-Policy-Research-Paper.pdf>> accessed 11 July 2021.

⁵⁶ The Rules on Crowdfunding, r 4(3)

⁵⁷ The Rules on Crowdfunding, r 15(c)

⁵⁸ The Rules on Crowdfunding, r 15(d)

⁵⁹ The Rules on Crowdfunding, r 15(b)

within 48 hours,⁶⁰ unless the time is extended as mentioned above. Where, at the end of the offer the fund realised is released to the fundraiser, in exchange the fundraiser is required to issue investment instruments which may take the form of shares, plain vanilla bonds or debentures or any other investment instruments that may be approved by SEC subject to the terms of the offer.

Undoubtedly, these are salutary and laudable provisions, and to a large extent, they meet with international best practices. As mentioned earlier, prior to the release of the Rules and against the backdrop of the absence of legislative backing, SEC sternly warned investors against investing through Equity Crowdfunding because of the absence of statutory backing. The question is why revisit the concept of crowdfunding in the absence of a new law on crowdfunding or amendment to the ISA?

LEGALITY OR OTHERWISE OF THE RULES

Apparent from the foregoing, the entrance of equity crowdfunding into Nigeria's capital market and the need to regulate it posed significant challenges to the pre-existing legal framework regulating the capital market, ipso facto public offer or sale of companies' securities.⁶¹ Presumably to bridge the gap and protect the investing public, the SEC made the Rules on Crowdfunding. Accepted that the ISA grants the SEC wide discretionary powers to make rules and supervise the securities and exchange market including novelties that might arise in the future as a result of advancements in the economy and the capital market,⁶² the question is if the Rules on Crowdfunding is juxtaposed with the relevant provisions of ISA and CAMA 2020 discussed above, can the Rules be said to be valid?

There is no gainsaying that the oversight cum regulatory functions of the SEC (also a creation of statute) is expressly derived from statute; ISA along with other statutes. It follows that being a creature of statute, the extent and limit of the powers of SEC are statutorily defined and spelt out.⁶³ Thus without an enabling statute, the SEC lacks the authority to regulate trading on some of the emerging securities not envisaged by enabling statutes. The implication is that in the absence of enabling provisions, the regulation of such securities is ultra vires the

⁶⁰ The Rules on Crowdfunding, r 26(i)

⁶¹ See ISA, Pt IX

⁶² Fawei (n 11) 9; see also JO Orojo, *Company Law and Practice in Nigeria*, (5th edn., LexisNexis Publishers 2008) 367.

⁶³ *Eperokun & Ors v University of Lagos* [1986] 4 NWLR (PT.34) 162; *Owena Bank (Nigeria) Plc v Nigerian Stock Exchange Limited* [1997] 8 NWLR (Pt. 515) 1 S.C.

powers of the SEC and void.⁶⁴ In other words, the SEC cannot legally exercise any powers, carry out any duty or execute any functions outside the parameters of its enabling statute or statutes,⁶⁵ and lacks law-making powers to amend any of the provisions of CAMA 2020 and ISA.

As mentioned earlier, the provisions of CAMA 2020 and ISA expressly prohibit private companies in Nigeria from offering their securities to the public at large. Section 22(5) CAMA 2020 provides that private companies cannot invite the public to subscribe for shares, deposit money for a fixed period, or deposit money payable at call unless authorized by law. Similarly, section 67 of ISA provides that no person can make an invitation to the public to acquire or dispose of any securities of a body corporate unless the body corporate is a public company. One incontestable fact is that “[T]he provision of crowdfunding services aims to facilitate the funding of a project by raising capital from a large number of people who each contribute relatively small investment amounts through a publicly accessible internet based information system.” Indeed, Merriam-Webster dictionary defines crowdfunding as “the practice of obtaining needed funding (as for a new business) by soliciting contributions from a large number of people especially from the online community”⁶⁶

Under the ISA, a Prospectus - a financial security instrument expressly reserved for the use of public companies, is defined as “... any written or electronic information, notice, advertisement or other forms of invitation offering to the public for subscription or purchase, any shares, debentures or other approved and recognised securities of a company and other issues or scheme.”⁶⁷ In the strict legal sense, private companies utilization of investment-based crowdfunding as it is currently understood as well as under the Rules on Crowdfunding, is tantamount to making offers to the public as defined under CAMA 2020 and ISA. Without express statutory backing, such an offer violates the provisions of the two principal statutes⁶⁸ regulating the Nigerian capital market.

It is trite that subsidiary legislation, (in this case the Rules on Crowdfunding) derives its authority and validity from the substantive law (ISA and CAMA). It follows that any Rule purportedly made on the authorization of a principal legislation cannot extend the scope of the

⁶⁴ *University of Nigeria Teaching Hospital Management Board v Hope Chinyelu Nnoli* [1994] 8 NWLR [Pt. 363] 376

⁶⁵ *Owena Bank (Nigeria) Plc* (n 63)

⁶⁶ <<https://www.merriam-webster.com/dictionary/crowdfunding>> accessed 24 June 2021.

⁶⁷ ISA, s 315.

⁶⁸ CAMA 2020 and ISA.

law.⁶⁹ In this instance, the Rule on Crowdfunding made by the SEC does not have the authority to extend the scope of the ISA by allowing private companies to make public offers against the express prohibition of the ISA and CAMA 2020 - the substantive laws which exclude private companies from making a public offer. The power vested in the SEC to make rules and regulations for the capital market does not include the power to amend the principal statute.⁷⁰ Subsidiary legislation is designed to support, aid, assist, supplement and be subordinate to existing legislation and not to supplant or repeal it.⁷¹ The Rules on Crowdfunding is ultra vires the statutory powers of the SEC. A subordinate legislation 'is prima facie ultra vires if it is inconsistent with the substantive provisions of the statute by which the enabling power is conferred.'⁷² That being so, the Rules on Crowdfunding cannot stand.

Again, the SEC cannot hide under the canopy of collective investment schemes to regulate crowdfunding or to issue Crowdfunding Rules. On the contrary, a careful perusal of the SEC's obligations under the ISA reveals that the SEC is obliged to prohibit the practice and prosecute violators. Though collective investment schemes, which may be operated by non-public companies, are statutorily permitted⁷³ to invite the public to invest or contribute money or other assets to and to hold a participatory interest in the scheme, it would, however, be wrong to equate equity crowdfunding with collective investment scheme as envisaged by the ISA. The Act expressly defines persons that can engage in the business of collective investment scheme and states that 'No person shall perform any act or enter into any agreement or transaction for the purpose of administering a scheme, unless such person is (a) incorporated under the Companies and Allied Matters Act; (b) registered as a fund or portfolio manager by the Commission.'⁷⁴ It follows that only entities registered as portfolio managers or trustees or custodians of a collective investment scheme under ISA that may administer a collective investment scheme;⁷⁵ and not an investee. In other words, an entity not registered as a manager or a trustee or a custodian, carrying on the business of collective investment ipso facto a fundraiser under a crowdfunding platform, cannot be validly referred to as a collective

⁶⁹ *Gov Oyo State v Folayan* (1995) 8 NWLR (Pt. 413) 292; see also *SEC v Kasunmu* [2009] 10 NWLR (Pt. 1150) 509

⁷⁰ *Kennedy v INEC* [2009] 1 NWLR (Pt 1123) 614, 642

⁷¹ *Conac Optical (Nig.) Ltd, v Akinyede* [1995] 6 NWLR (Pt. 400) 212, 222; *Phoenix Motors Ltd v NPFMB* [1993] NWLR (Pt. 272) 718, 728-729.

⁷² *I.G.P. v Mobil Producing (Nig.) Unltd* [2018] NWLR (Pt. 1639) 379, 393, See also Volume 36 Halsbury, Laws of England, 3rd Edition, Pages 491-492, Paragraph 743

⁷³ ISA, ss 152-196

⁷⁴ ISA, s 158

⁷⁵ ISA, s 159(1)

investment scheme unless it is so registered by the SEC and the funds utilized as statutorily directed.

LESSONS FROM OTHER JURISDICTIONS

In the United States of America where the concept of organised crowdfunding emanated, in regulating crowdfunding, the US SEC relied on the provisions of the Jumpstart Our Business Startups Act 2012 (the “JOBS Act”). The JOBS Act legalised equity crowdfunding in that country by relaxing various laws and regulations which placed restrictions on the sale of securities to the public.⁷⁶ The JOBS Act by implication imposed on the US SEC the obligation to make rules amending the existing exemptions from registration under the Securities Act of 1933 and creating new exemptions that permit issuers of securities to raise capital without registration.⁷⁷ In compliance, the US SEC has since 2013 amended its rules to implement the requirements. And in 2016 it adopted Regulation Crowdfunding.⁷⁸ The regulation among others provides the framework for regulating crowdfunding.

In Canada, the Securities Act of Ontario and that of the other provinces empowers the various Securities Commissions upon application to make orders for exemptions regarding registration and the filing of prospectuses by dealers and issuers respectively, as it may deem appropriate.⁷⁹ Canadian Securities Administrators (CSA)⁸⁰ have recently developed an instrument – NI 45-110, targeted primarily at start-ups’ and early stage issuers, released in June 2021 and to come into force in September 2021.⁸¹ The Instrument already adopted by the Securities Commissions of the different Canadian provinces allows an issuer to distribute eligible securities through an online funding portal while being exempted from the requirement of publishing a prospectus. The NI 45-110 also provides an exemption from the dealer registration requirement for funding portals that facilitate online distributions by issuers that rely on the Start-ups crowdfunding prospectus exemption.⁸² The primary objective of these Rules is to foster the use and efficiency of securities crowdfunding as a

⁷⁶ Mollick, E. ‘The dynamics of crowdfunding: An exploratory study’ (2014) 29(1) *Journal of Business Venturing*, 1 < <https://doi.org/10.1016/j.jbusvent.2013.06.005>> accessed 11 July 2021.

⁷⁷ JOBS Act, Title III, s. 201(a).

⁷⁸ < <https://www.sec.gov/rules/final/2015/33-9974.pdf>> accessed 11 July 2021.

⁷⁹ Ontario Securities Act R.S.O 1990, s 74(1)

⁸⁰ The umbrella organization of Canada’s provincial and territorial securities regulators <www.securities-administrators.ca/aboutcsa.aspx?id=45> accessed on 28 July 2021

⁸¹ CSA Notice of Publication – National Instrument 45-110 Start-up Crowdfunding Registration and Prospectus Exemptions <www.osc.ca/sites/default/files/2021-06/csa_20210623_45-110_crowdfunding-registration-prospectus-exemptions_0.pdf> accessed 28 July 2021

⁸² CSA Notice of Publication. Annex C

means for start-ups and early stage issuers to raise capital for their businesses while maintaining adequate investors' protection.

In the UK, the Financial Services and Markets Act 2000 regulates both loan-based and investment-based crowdfunding,⁸³ while crowdfunding in countries under the European Union will starting from 1 November 2021 be regulated by the EU Regulation 2020/1503 on European Crowdfunding Service Providers for Business; an international binding legal instrument, binding on member states.

RECOMMENDATIONS

Understandably, the quest to strike the right balance between encouraging financial innovations on the one hand and ensuring an appropriate level of investor protection on the other, explains the SEC's regulation of crowdfunding as a means of raising capital from the public. Flowing from the foregoing analysis, the following are suggested to further promote the ease of doing business in Nigeria and the pursuit of achieving the goal of sustainable inclusive development.

First, equity and debt-based crowdfunding have been shown to be a viable alternative to the traditional ways of raising funds. However, the SEC as shown above lacks the statutory backing to introduce regulations or rules on the use of crowdfunding by private companies to raise finance in Nigeria. If nothing else, one lesson from the jurisdictions reviewed above is the absolute reliance on statutes or its equivalence for legal backing to regulated crowdfunding ecosystems within their domains. The current SEC Rules on Crowdfunding can only be valid if the relevant statutes (ISA and CAMA 2020) are amended to provide the needed statutory backing, or an entirely specialised statute is enacted to close the existing statutory gap. Consequently, it is recommended that section 22 of CAMA 2020 and section 67 of the ISA be amended to such an extent that private companies are allowed to utilize equity and debt-based crowdfunding to finance their activities or a new statute of the nature

⁸³ Financial Conduct Authority 'Crowdfunding and Authorisation' <www.fca.org.uk/firms/authorisation/how-to-apply/crowdfunding> accessed 11 July 2021.

of the US JOBS Act be enacted to regulate crowdfunding in Nigeria. This would be a more cheering news for the MSMEs and start-ups that are looking for viable non-traditional financing methods to raise capital for their business activities.

CONCLUSION

In addition to providing an alternative source of financing, crowdfunding offers other benefits to businesses such as validating a business idea, giving entrepreneurs access to a large number of people who may provide greater insight and information, and simultaneously serving as a marketing tool.⁸⁴ The regulation of such sensitive aspects of the financial market cannot be effectively regulated by soft law or statutory unsupported subsidiary legislation, in this case, the Rules on Crowdfunding. Towards maximising the benefits of crowdfunding there is a dire need to review and amend the extant statute to align it with the proclivity of modern commercial best practices or enact a law on crowdfunding in Nigeria.

⁸⁴ The EU Regulation.