

G. ELIAS



**Crowdfunding in
Nigeria**

Introduction

Crowdfunding is the practice of raising money from a large number of people who may contribute a relatively small amount of money in order to finance a project or business. In crowdfunding, capital is usually raised to finance a project or business *via* the internet. It is the use of small amounts of money, obtained from a large number of individuals or organizations to fund a project or business through an online website platform.¹ Depending on the type of crowdfunding, individuals may donate altruistically² or may acquire a stake in the form of equity or bond, or debenture in the project, business, or venture being funded by them.



The agency responsible for regulating crowdfunding in Nigeria is the Securities and Exchange Commission (the “SEC”). Crowdfunding is regulated by the Securities and Exchange Commission Rules 2021 which came into force on January 21, 2021 (the “**Crowdfunding Rules**”). It must, however, be stated that prior to the making of the Crowdfunding Rules, crowdfunding in Nigeria was unregulated. Companies, private entities as well as individuals raised money from online platforms with no form of regulation and supervision. Members of the public in the past used to donate to the projects of MSMEs³ and also startup companies altruistically with no intention to receive anything in return.

Upon the making of the Crowdfunding Rules, MSMEs and startup companies that intend to raise funds from members of the public are now required to register with a Crowdfunding

¹ Rule 1 of the Crowdfunding Rules.

² However, the Crowdfunding Rules do not provide for donations made through crowdfunding for altruistic purposes.

³ MSME means micro, small and medium enterprises as prescribed by the Small and Medium Enterprises Development Agency of Nigeria (SMEDAN) in relation to total asset, annual turnover or number of employees. Rule 1 of the Crowdfunding Rules.

Intermediary⁴ before they can utilize its crowdfunding portal⁵ to raise capital. Rule 2 of the Crowdfunding Rules provides that the Crowdfunding Rules apply to Investment-Based Crowdfunding.⁶ Companies may now raise capital from the investing public by the issuance of investment instruments.⁷ By the Crowdfunding Rules, the SEC seeks to make provisions for not just equity-based crowdfunding but also loan-based crowdfunding. It, therefore, means that the Crowdfunding Rules do not apply to crowdfunding for the purpose of non-investment in a company such as donations for altruistic purposes.

Crowdfunding Requirements for Companies under the SEC Rule

Companies seeking to raise funds from members of the public must do so through a crowdfunding portal, operated by a registered Crowdfunding Intermediary. Such companies must be MSMEs incorporated as a company in Nigeria with a minimum of two (2) years' operating track record or where such MSMEs have less than two (2) years' operating track record, they must have a strong technical partner that possesses a minimum of two (2) years' operating track record or have a core investor.⁸ It is also expected of such companies to issue investment instruments⁹ to members of the public from whom funds are raised. Prior to the making of the Crowdfunding Rules, companies raised money from members of the public without obligation to give anything in return in the form of an investment instrument.

Following the enactment of the Nigeria Startup Act which was signed into law on October 19, 2022, provisions are made also for startups to raise funds through Crowdfunding Intermediaries and Commodities Investment Platforms duly licensed by the SEC. The Nigeria Startup Act establishes a National Council for Digital Innovation and Entrepreneurship charged with the responsibility to provide recommendations and proposals to the SEC and collaborate towards ensuring that the SEC consider rules that fast-track crowdfunding processes for labelled startups.¹⁰

Again, the Crowdfunding Rules placed a limit on the amount of investment instruments that can be sold by companies to any investor within 12 months period. Retail investors¹¹ are expected not to invest more than 10% of their net annual income in a calendar year, whereas

⁴ A crowdfunding intermediary is 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. Rule 1 of the Crowdfunding Rules.

⁵ A crowdfunding portal is a website, platform, portal, intermediary portal, application or other similar module that facilitates interaction between fundraisers and the investing public. Rule 1 of the Crowdfunding Rules.

⁶ With the making of the Crowdfunding Rules, it now seeks to regulate the *modus operandi* of raising capital from members of the public with the need to either make returns to them or provide them with an equity stake in the company.

⁷ Investment instruments includes ordinary shares, plain vanilla bonds or debentures, and simple investment contracts approved by the SEC for issuance through a crowdfunding portal. Rule 1 of the Crowdfunding Rules.

⁸ Rule 3 of the Crowdfunding Rules.

⁹ Investment instruments includes ordinary shares, plain vanilla bonds or debentures, and simple investment contracts approved by the SEC for issuance through a crowdfunding portal. Rule 1 Crowdfunding Rules.

¹⁰ Section 32 of the Nigeria Startup Act. A labelled startup means a startup labelled under the Nigeria Startup Act and issued a digital certificate by the Coordinator of the Startup Portal.

¹¹ Retail Investors are individual investors other than a corporate, High Net worth, Sophisticated Investors or Qualified Institutional Investors. Rule 1 of the Crowdfunding Rules.

Sophisticated,¹² High Net Worth,¹³ and Qualified Institutional Investors¹⁴ are not subject to the limitation placed on retail investors.¹⁵

Furthermore, as an exception, companies may offer or sell investment instruments to members of the public without the need for prior registration of the investment instruments with the SEC if it is an entity incorporated in Nigeria and accredited and/or accepted by a Crowdfunding Intermediary to utilize its portal.¹⁶ However, the amount of investment instruments that can be offered and sold by such companies within a period of twelve (12) months must comply with the following rules: (a) the maximum amount that may be raised by a medium enterprise must not exceed ₦100,000,000 (One Hundred Million Naira), (b) the maximum amount that may be raised by a small enterprise must not exceed ₦70,000,000 (Seventy Million Naira), and (c) the maximum amount that may be raised by a micro enterprise must not exceed ₦50,000,000 (Fifty Million Naira).¹⁷ The limitation as set forth above does not apply to Commodities Investment Platforms¹⁸ and such other MSMEs as may be designated by the SEC from time to time.¹⁹ A shortcoming of the Crowdfunding Rules is that it fails to define what qualifies a company to be categorized as a medium enterprise, a small enterprise, or a micro enterprise. The Crowdfunding Rules only contemplates the amount of money that can be raised by MSMEs without setting parameters (such as net assets or annual turnover) that may qualify a company to be categorized as a medium, small, or micro enterprise. Where the fundraiser is a public company, the exception provided to companies who may have been accepted by a Crowdfunding Intermediary to utilize its portal without prior registration of its investment instrument will run contrary to section 54 of the Investments and Securities Act, 2007 requiring every public company to register its securities²⁰ with the SEC. It is trite that subsidiary legislation must be in conformity with the principal legislation. In the event of any inconsistency in the provisions of a principal legislation and subsidiary legislation, the provision of the principal legislation shall prevail. *NNPC et al. v Famfa Oil Limited* (2012) LPELR-1812SC. Thus, investment securities issued by a fundraiser that is a public company without registration with the SEC may be voided if challenged in court.

Registration Requirements for Crowdfunding Intermediary

¹² A Sophisticated Investor means any person with 3 years' experience of actively investing in the capital market and understands the relationship between risk and return. Rule 1 of the Crowdfunding Rules.

¹³ A High-Net-Worth Investor is an individual with a net worth of at least Three Hundred Million Naira (₦300,000,000), excluding automobiles, homes and furniture. Rule 321 of the SEC Rules and Regulation 2013; Rule 1 of the Crowdfunding Rules.

¹⁴ A Qualified Institutional Investor means a purchaser of securities that is financially sophisticated. Rule 1 of the SEC Rules and Regulation 2013; Rule 1 of the Crowdfunding Rules.

¹⁵ Rule 4(3) of the Crowdfunding Rules.

¹⁶ Rule 4(1) of the Crowdfunding Rules.

¹⁷ Rule 4(1) of the Crowdfunding Rules.

¹⁸ Commodities investment Platform is an electronic platform that connects investors to specific agricultural or commodities projects for the purpose of sponsoring such projects in exchange for a return. Rule 1 of the Crowdfunding Rules.

¹⁹ Rule 4(2) of the Crowdfunding Rules.

²⁰ Securities mean debentures, stocks, shares, bonds or notes issued or proposed to be issued by a corporate body. Section 315 of the Investment and Securities Act 2007.

Every Crowdfunding Portal used by companies in raising funds from members of the public through crowdfunding must be operated by an entity registered as a Crowdfunding Intermediary. A Crowdfunding Intermediary would be said to be facilitating, operating, providing, or maintaining a Crowdfunding Portal in Nigeria if the Crowdfunding Portal is: (a) operated, provided, or maintained in Nigeria; or (b) located outside Nigeria but targets investors in Nigeria; or (iii) the components parts of the portal when taken together are physically located in Nigeria even if any of its components parts, in isolation, is located outside Nigeria.²¹

An application for registration of a Crowdfunding Intermediary must be submitted to the SEC accompanied, amongst others, with certified true copies of its certificate of incorporation and memorandum and articles of association.²²

Power of SEC to Supervise Crowdfunding in Nigeria

The SEC is saddled with the responsibilities, amongst others, to: (i) regulate investments and securities business in Nigeria; (ii) regulate all offers of securities by public companies and entities; and (iii) register securities of public companies. Therefore, the SEC plays a supervisory role in crowdfunding. The SEC has the discretionary power to register or refuse to register a Crowdfunding Intermediary whose Crowdfunding Portal may be used by companies to raise funds, where the Crowdfunding Intermediary fails to satisfy the requirements of the Crowdfunding Rules.

The SEC may register a Crowdfunding Intermediary if it is satisfied that the Crowdfunding Intermediary will be able to: (a) operate an orderly, fair and transparent system in relation to the investment instruments that are offered through its electronic platform; (b) the board, chief executive, and any officer of the Crowdfunding Intermediary who is primarily responsible for the operations or financial management of the Crowdfunding Portal, are fit and proper persons; (c) manage any risk associated with its business and operation; (d) take appropriate action against a person in breach of any rules, policies, terms and other standards of the portal including directing the person in breach to take any necessary remedial measure; (e) the Crowdfunding Intermediary has sufficient financial, human and other resources for the operation of the Crowdfunding Portal; and (f) the rules of the Crowdfunding Intermediary make satisfactory provisions for the protection of investors and public interest (i) to ensure proper functioning of the market, (ii) to promote fairness and transparency, (iii) to manage any conflict of interest that may arise, (iv) to promote fair treatment of all users, (v) to ensure proper regulation and supervision of its users, or any person utilizing or accessing its portal, including suspension and expulsion of such persons after consultation with the SEC, and (vi) to provide an avenue of appeal against the decision of the operator.²³

Similarly, the SEC may revoke the registration of a Crowdfunding Intermediary if such Crowdfunding Intermediary (a) fails to meet the above-stated requirements, (b) ceases to be

²¹ Rule 5 of the Crowdfunding Rules. Examples of some Crowdfunding Portals in Nigeria includes Kickstarter, Crowdfunder, NaijaFund, GoFundMe, MicroVentures, Indiegogo, Fundanenterprise, CircluUp, QuickRaiz. <https://utibeetim.com/10-crowdfunding-sites-for-nigerian-businesses/>

²² Rule 6 of the SEC Rule on Crowdfunding.

²³ Rule 7 of the Crowdfunding Rules.

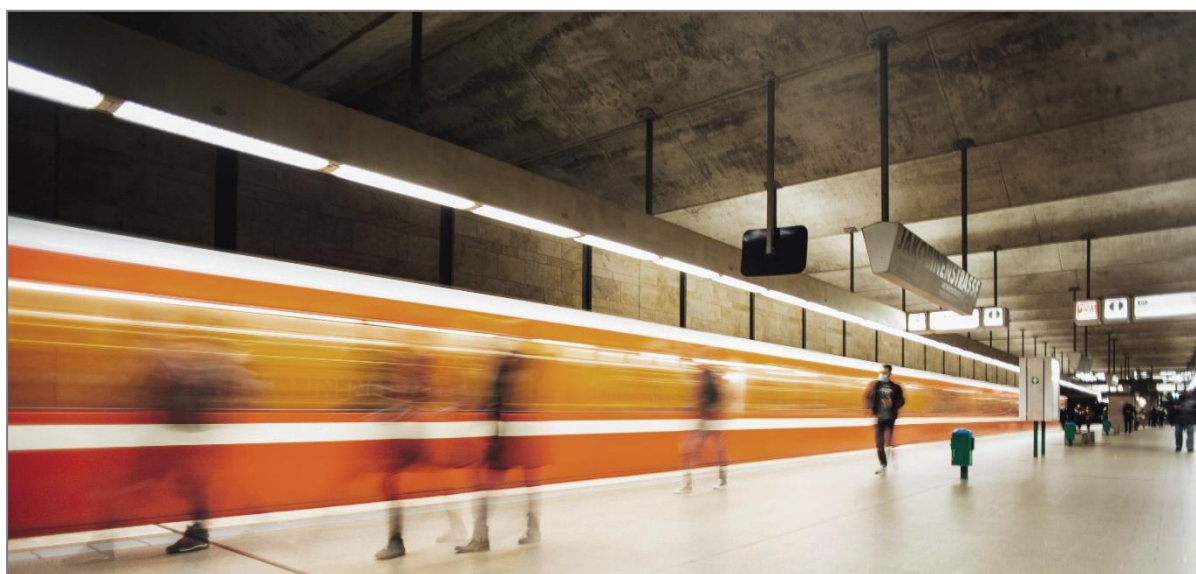
in operation or maintain its Crowdfunding Portal for a consecutive period of six (6) months, or (c) fails to pay fees as prescribed by the SEC.²⁴ Notwithstanding, where a Crowdfunding Intermediary intends to discontinue operations or wishes to change its ownership structure, prior notification of such change and discontinuation must be given to the SEC accompanied with a plan for the reasonable conclusion of any of its ongoing operations or process for the consideration of the SEC.²⁵

Penalties

A Crowdfunding Intermediary that fails to comply with Crowdfunding Rules is liable to a fine of not less than ₦100,000.00 (One Hundred Thousand Naira) and ₦5,000.00 (Five Thousand Naira) for every day the violation continues. Such Crowdfunding Intermediary is also liable for any loss of investor funds arising due to its failure to comply with the Crowdfunding Rules.²⁶

Shortcomings or Lapses under the SEC Rule on Crowdfunding

The Crowdfunding Rules prohibit the following entities from raising funds through a Crowdfunding Portal, namely: (a) complex structures; (b) public listed companies and their subsidiaries; (c) companies with no specific business plan or a blind pool; (d) companies that propose to use the funds raised to provide loans or invest in other entities; and (e) such other entity as may be specified by the SEC.²⁷ Hence, only unlisted public companies can raise capital by means of crowdfunding, as private companies are prohibited from inviting members of the public to subscribe to any of its share or debenture; or deposit money for fixed periods or payable at call, whether or not bearing interest.²⁸ It also restricts companies engaged in Collective Investment Schemes from pooling funds from members of the public which could be subsequently invested in other companies.



²⁴ Rule 8 of the Crowdfunding Rules.

²⁵ Rule 9 of the Crowdfunding Rules.

²⁶ Rule 42 of the Crowdfunding Rules.

²⁷ Rule 39 of the Crowdfunding Rules.

²⁸ Section 22(5) Companies and Allied Matters Act 2020; Section 67(1) Investment and Securities Act, 2007

Although the Crowdfunding Rules make it a mandatory requirement for Crowdfunding Intermediaries whose Crowdfunding Portals are utilized by companies to raise funds from members of the public, to carry out due diligence exercise on such companies by ensuring that the board of directors, officers and controlling shareholders of such companies are fit and proper persons and ascertain the accuracy and viability of the business proposition of such companies and its solvency, the Crowdfunding Rules do not make provision for circumstances where such companies become insolvent and how members of the public who had invested in such companies may recover their investments.

Conclusion

The Crowdfunding Rules are a welcome development as they aim to regulate crowdfunding in Nigeria. An unlisted public company seeking to raise capital for its business need not rely only on traditional financial institutions or venture capital firms but can also seek funds to finance its business through crowdfunding. Since most MSMEs are private companies and stand to benefit more from crowdfunding, the Companies and Allied Matters, 2020 should be amended to allow private companies to raise capital from the public *via* subscription for shares or debenture.

Author(s)



Faith Emmanuel
Associate
faith.emmanuel@gelias.com

LOCATIONS

LAGOS OFFICE

6 Broad Street
Lagos, Nigeria

T: +234 (1) 460 7890

E: gelias@gelias.com

ABUJA OFFICE

2nd Floor, Abia House,
Plot 979, First Avenue,
Central Business District
F.C.T, Abuja.

T: +234 (1) 888 8881

● Corporate ● Mergers and Acquisitions ● Securities Offerings ● Project and Structured Finance ● Tax ● Litigation and Arbitration ● Privatization ● Intellectual Property ● Employment ● Compliance ● Insurance ● Pensions ● Private Equity ● Oil and Gas ● Electricity ● Food and Healthcare ● Trade and Industry ● Media and Entertainment ● Telecommunications and Technology ● Real Estate and Construction ● Infrastructure ● Transport and Logistics ●

www.gelias.com