



## **CROWDFUNDING IN NIGERIA – A REVIEW OF THE SECURITIES AND EXCHANGE COMMISSION PROPOSED RULES**

## INTRODUCTION

Crowdfunding, also known as “online financing,” is defined as raising funds to finance a project or business from the public using an online platform.<sup>[1]</sup> A crowdfunding platform could be a website portal, intermediary portal, mobile application, or other similar medium of exchange employed to facilitate interaction between fundraisers and the investing public.<sup>[2]</sup> The concept of crowdfunding has deep international roots, used frequently to finance book prints in Europe in the 17th century and to raise money to hold music concerts.<sup>[3]</sup> Crowdfunding activities are not novel in Nigeria with practices such as Esusu (Igbo); Ajoo (Yoruba), Adashi (Hausa) where a group of people contribute money to be distributed on a need or in a chronological manner.<sup>[4]</sup> Modern day crowdfunding has, however, become an incredible force for businesses throughout the world.<sup>[5]</sup> Globally, crowdfunding has earned massive popularity through platforms such as Kickstarter and IndieGoGo amongst others. It typically serves as an alternative for small businesses categorized as Micro, Small and Medium Enterprises (“MSMEs”) to raise funds/capital for their business without being limited to conventional financing options, such as bootstrapping, family and friends’ contributions, angel investments, venture capital, government programs or bank loans. Crowdfunding provides entrepreneurs with a platform to access investors across borders and create awareness about their businesses or products.<sup>[6]</sup>

As more countries take steps to regulate and legalize different models of crowdfunding, more investments are being made in early stage businesses across the world.<sup>[7]</sup> Different regulators in different countries have taken different approaches to equity crowdfunding, with varying effects on the development of each of their respective financial ecosystems.<sup>[8]</sup> Some countries have taken very liberal approaches to equity crowdsourcing, while others are very protectionist.<sup>[9]</sup> Although crowdfunding activities have always thrived in Nigeria, through platforms such as FundAnEnterprise.org, NaijaFund.com, PiggyVest<sup>[10]</sup> and Farmcrowdy<sup>[11]</sup>, the Nigerian Securities and Exchange Commission (SEC), has only just recently come up with a proposed regulatory framework for crowdfunding.

This article seeks to review SEC’s proposed regulatory framework for crowdfunding in Nigeria with emphasis

on the equity-based crowdfunding model because its activities have a direct impact on the capital market and therefore, requires some form of regulation.

### Crowdfunding Models.

Just like there are many types of capital round raises for businesses in all stages of growth, there are a variety of crowdfunding models.<sup>[12]</sup> Crowdfunding exists in four forms: donation-based crowdfunding, reward-based crowdfunding, equity-based crowdfunding and debt-based crowdfunding.<sup>[13]</sup>

Donation-based crowdfunding connotes that there is no financial return to the investors or contributors. Common donation-based crowdfunding initiatives include fundraising for disaster relief, charities, non-profits, and medical bills.<sup>[14]</sup> Reward-based crowdfunding is a type of financing where entrepreneurs solicit financial donations from individuals in return for a product or service.<sup>[15]</sup> Platforms such as Indiegogo and Kickstarter have allowed start-ups to directly raise capital in exchange for returns such as the promise of product that would hopefully be produced. Equity-based crowdfunding allows a start-up to raise capital from the crowd through the sale of securities (equity, convertible note, debt, revenue share, and more) in a private company. Investors in equity crowdfunding don’t participate just to buy a product at a discount a year before its release; they stand to make a profit if they make a good investment and the company they invested in, grows.<sup>[16]</sup> Debt-based crowdfunding is also known as peer-to-peer lending or P2P.<sup>[17]</sup> For this type of crowdfunding, individuals lend money to businesses or other individuals with the expectation that it would be repaid together with interest added.<sup>[18]</sup>

It is important to note that equity-based crowdfunding model is expressly prohibited by the Investment and Securities Act, 2007 and the Companies and Allied Matters Act, Cap C20, LFN 2004 in Nigeria.<sup>[19]</sup> The recognition of the aforesaid regulatory restrictions has continually posed questions about the legality or otherwise of crowdfunding platforms in Nigeria.



On several occasions, the SEC has warned the public against patronising unregistered crowdfunding platforms in a bid to protect gullible investors from being victims of hoax schemes, due to the absence of regulation.

With technological advancement in the financial ecosystem, there have been calls on the SEC to enact regulations to regulate crowdfunding in Nigeria. The Securities and Exchange Commission, on March 28, 2020, released a proposed regulatory framework that would allow private companies with the required structure and mechanism in place to raise capital from the public through crowdfunding. The proposed rules seek to regulate crowdfunding in Nigeria and to encourage financial inclusion amongst MSMEs and also provide a level playing field amongst entrepreneurs in the capital market. Likewise, the rules are also supposed to reduce the risks associated with investment for investors and financiers.

### **Review of SEC's Proposed Rules on Crowdfunding in Nigeria**

The proposed regulation, incorporates a number of investor protection provisions, including investment limitations, issuer disclosure requirements, and a

requirement to use regulated intermediaries. The rules seek to establish the requirements for issuers and intermediaries seeking to participate in an Internet-based crowdfunding contribution.

Rule 2 of the proposed regulation states the eligibility criteria of a company to raise funds through crowdfunding portals, in exchange for the issuance of shares, debentures, or any other investment or instruments. The rule requires a company to be incorporated in Nigeria with a minimum of two years' operating track record.

Under the Rules, persons would be considered to be operating, providing, or maintaining a Crowdfunding Portal in Nigeria if: (a) The platform is operated, provided or maintained in Nigeria; (b) The platform is located outside Nigeria but actively targets Nigerian investors; or (c) The parts of the platform, when taken together, are physically located in Nigeria, even if any of its parts, in isolation, is located outside Nigeria.<sup>[20]</sup>

The Rules stipulates the limit an aggregate amount of securities or investment instruments can be offered and sold by an issuer within a 12-month period. The rule provides that the maximum amount that can be raised by a Medium enterprise shall not exceed N100Million; the maximum amount for a Small enterprise shall not exceed N70Million; and the maximum amount by a Micro enterprise shall not exceed N50Million.<sup>[21]</sup> These limits were set based on the definitions of MSMEs by the Small and Medium Enterprises Development Agency of Nigeria (SMEDAN).<sup>[22]</sup> These limits do not, however, apply to MSMEs operating as a digital commodities investment Platform.

The rules require the crowdfunding portal to be registered with SEC and operated only by an operator registered with the Commission as a Crowdfunding Intermediary. Only entities registered with the Commission as an Exchange, Dealer, Broker, Broker/ Dealer or Alternative Trading Facility as prescribed under the Act and the SEC Rules and Regulations can be registered as a Crowdfunding Intermediary. These Intermediaries will be thoroughly screened by the SEC before commencing operations to ensure the safety of the investing public in dealing with such institutions. In addition, crowdfunding portals will now require a paid-up capital of 100 million, amongst other registration requirements. By virtue of this requirement, most crowdfunding platforms can only raise funds through an intermediary that has all the capital requirements which may be a condition that could prove tough for regular start-ups to meet.

The rules impose limits on the amount that an investor can invest in a crowdfunding offering over a 12-month period. Retail investors cannot invest more than 10% of their annual income in a calendar year. Sophisticated, High Net worth and Qualified Institutional Investors are, however, not subject to this limitation.

To ensure that investments are safeguarded, crowdfunding portals are mandated, among other obligations, to conduct due diligence exercise on all prospective issuers intending to use its platform in a bid to minimize the risk of fraud. They are expected to monitor the conduct of issuers and investors by ensuring compliance with prescribed fundraising limits and investment limits, respectively. Investors are expected to affirm to a risk acknowledgment form before they can go ahead to invest in the securities. Crowdfunding portals are required to keep records of investors and

issuers that attempt to or do invest and raise funds using its platform.

The proposed rules stipulate the obligations of each participant to crowdfunding offer. As an issuer and a participant to a crowdfunding offer, the issuer must offer its securities or investments through a registered crowdfunding portal. The Rules prescribe 60 days for the maximum period for a crowdfunding offer. Where the issuer is unable to meet the minimum threshold for the target amount within 60 days, the issuer must withdraw the offer and may only commence a new crowdfunding offer after 90 days from the expiration of the initial offer. The implication is that, where an offer is withdrawn due to the inability of the issuer to meet its prescribed minimum threshold before the end of the 60 days, the issuer would not be allowed to cash out on any of the responses it may have already received on its crowdfunding offer. In such instances, the Rules prescribe that such investors are to be refunded within 48 hours of the offer's expiration.<sup>[23]</sup> Following the close of a crowdfunding offer, investors have a contractual right to withdraw an offer or agreement to invest in the securities or investment instrument by delivering a notice to the crowdfunding portal within 48 hours of the close of the offer. Where the issuer's target amount has been met, the crowdfunding portal must refund the excess of the funds raised to the issuer within 24 hours of the end of the 48 hours cooling-off period. Where the issuer's target amount was not achieved, but the prescribed minimum threshold was met, the issuer can provide a revised plan to the crowdfunding portal and investors for the use of the funds, and the portal shall pay over the funds provided the underlying project can be downscaled without negatively impacting the issuer's operations.

Investors can invest in companies hosted on a crowdfunding portal subject, however, to the investment limit specified by the Commission from time to time. Investors would be given a cooling off period of 48 hours from the date of close of the offer within which they may withdraw their investment. If there is a material adverse change, affecting the project or the issuer, investors have the right to rescind the investment within 7 days from the date the material adverse change became public.



Where an investor cancels the offer or agreement to purchase securities or investment instrument, all funds which may have been debited from, or blocked in the account of the investor shall be refunded or released within 48 hours of the request to cancel.[\[24\]](#)

The Rules prohibit the following entities from raising funds on a crowdfunding portal:

- i. Complex structures;[\[25\]](#)
- ii. Public listed companies and their subsidiaries. The Rules, however, provide for a situation where the Issuer is a private company whose members exceed 50 at the end of a funding round. It states that the securities offered must be registered with the SEC before the crowdfunding portal can pay over/remmit the funds to the Issuer. The implication of this is that, the private company will be compelled to convert to a public company in line with the provisions of CAMA;[\[26\]](#)
- iii. Companies with no specific business plan or a blind pool;[\[27\]](#)
- iv. Companies that propose to use the funds raised to provide loans or invest in other entities. Any crowdfunding portal or crowdfunding intermediary that fails to comply with these rules are liable to a fine of not less than one million naira and the sum of ten thousand naira for every day the violation continues.[\[28\]](#) SEC, also reserves the right to revoke the registration of any crowdfunding portal for failure to comply with any provision of the rules; and to suspend or revoke the registration of a crowdfunding intermediary who contravenes any provisions of the ISA, the SEC Rules and Regulations, the Code of Conduct for Capital Market Operators, and the Rules.

## Conclusion

Considering the increasing number of MSMEs in Nigeria and their contribution to the GDP, the proposed regulation seeks to eliminate the challenge of legal uncertainty with equity-based crowdfunding in Nigeria. The proposed regulation performs a gatekeeping function (Gatekeeping implies setting parameters for companies to be included and/or excluded) for crowdfunding platforms as a vital tool for an efficient system.[\[29\]](#) It goes without saying that the case for equity crowdfunding is compelling, as it allows start-ups and growing companies to fill the “funding gap”.[\[30\]](#) But for it to become a substantial force, it is important for SEC to create a balance between hard and soft regulation so as not to stifle innovation.

The argument that the limit on the amounts that can be raised by MSMEs are not realistic, especially for platforms that have fewer assets but generate high turnovers could be addressed through the introduction and recognition of intellectual property (IP) as a collateralized asset class. Most start-ups, by their digital nature, are asset-light, their asset base is usually intangible embracing both hard and soft IPs, and as such, IP financing should form an integral part of the economics of scale.

This article is only for general information purposes, it does not constitute legal advice, and does not purport to be comprehensive. We advise MSMEs looking to raise funds via crowdfunding to ensure that they seek proper legal and financial advice on the model most appropriate for their business structure.

If you have any questions or require any clarification on how this article can be applied to your business, or require the services of Corporate and commercial and business advisory team, please contact **info@topeadebayollp.org**

[1] SEC Proposed Rules on Crowdfunding.

[2] Id.

[3] Will Schroter, Crowdfunding Around the World, FORBES, (Jul. 9, 2014, 9.11am EDT) <https://www.forbes.com/sites/wilschroter/2014/07/09/crowdfunding-around-the-world/#363da42a2448>.

[4] Onyinyechilgodo, Equity Crowdfunding in Nigeria- A Legal and Regulatory Guide, Medium, (Aug. 20, 2019) <https://medium.com/@karcynn/equity-crowdfunding-in-nigeria-a-legal-and-regulatory-guide-4e0cb5e9047f>.

[5] Id.

[6] Crowdfunding platforms usually charge a pre-agreed percentage of the funds raised as their fee for promoting business on their platform.

[7] Id.

[8] Nathan Rose, How the World Regulates Equity Crowdfunding, The Regulatory Review, (Jun. 26, 2019) <https://www.theregview.org/2019/06/26/rose-how-world-regulates-equity-crowdfunding/>.

[9] Id.

[10] Piggy Vest is CBN licenced financial Institution that provides crowd funding opportunities for different businesses through an investment application.

[11] Farmcrowdy is an investment application that provides crowdfunding and investments opportunities specifically in Agritech companies:

[12] Emma McGowan, Types of Crowdfunding: Donation, Rewards, and Equity-Based, Startups.com, (Apr. 25, 2018) <https://www.startups.com/library/expert-advice/types-of-crowdfunding>.

[13] Abubakar Idris, Nigerian crowdfunding startups are finally coming under heavy regulation, TechCabal, (Apr. 1, 2020) <https://techcabal.com/2020/04/01/nigerian-crowdfunding-startups-regulation/>

[14] Emma McGowan, supra note 49.

[15] Jackie Zimmerman, Rewards-Based Crowdfunding: What It Is, When It Works, NerdWallet, (Dec. 6, 2017) <https://www.nerdwallet.com/blog/small-business/>

[reward-crowdfunding/](#)

[16] Howard Marks, What is Equity Crowdfunding?, FORBES, (Dec. 19, 2018, 8.00am) <https://www.forbes.com/sites/howardmarks/2018/12/19/what-is-equity-crowdfunding/#312d9a103b5d>

[17] The definition of 'Debt-based crowdfunding, Syndicate Room, <https://www.syndicateroom.com/learn/glossary/debt-based-crowdfunding>.

[18] Id.

[19] See Section 67(1) of the Investment and Securities Act (ISA); and Sections 22 (3) & (5) of the Companies and Allied Matters Act (CAMA).

[20] See, Rule 4.

[21] See, Rule 3 (b).

[22] Emmanuel Paul, How Nigerian Crowdfunding Startups can Survive New SEC Regulations, Techpoint.Africa, (Apr. 9, 2020) <https://techpoint.africa/2020/04/09/crowdfunding-survive-sec-regulations/>.

[23] See, Rule 19(h).

[24] See, Rule 27

[25] A complex structure is a company without immediate transparency of ownership and/or control, making it hard to determine the beneficial owners of the entity.

[26] Section 22 (3) CAMA, C20 LFN 2004

[27] A business plan which is solely for the purpose of merging with or acquiring an unidentified entity

[28] Part 10 of the Rules.

[29] Onyinyechilgodo, supra note 4.

[30] Nathan Rose, supra note 7.

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