Introduction

The Securities and Exchange Commission (SEC) on 15th August 2016 released a statement through its Director General essentially stating that any crowdfunding activities in Nigeria should be suspended due to legal challenges. The reason given was that the capital market regulations and laws in Nigeria such as the Investment and Securities Act (ISA, 2007)\(^2\) and the Companies and Allied Matters Act (CAMA, 1990)\(^3\) did not anticipate Crowdfunding activities and therefore did not make provisions for it.\(^4\) The suspension of Crowdfunding activities has started a debate in Nigeria about how to incorporate Crowdfunding into our corporate financing structures, regulations and culture in view of its recognition as a viable mechanism for raising funds by companies and individuals all over the world. This paper seeks to analyse this trend and apply it in the Nigerian context.

What is Crowdfunding?

Crowdfunding can be defined in several ways, but for our purpose it can be referred to as a method by which individuals or companies raise funds online from the general public to finance a company or a particular project.\(^5\) Crowdfunding can also be said to be a process of

---

1 Ibidolapo Bolu, Associate, Corporate Finance and Capital Markets, SPA Ajibade & Co., Lagos, Nigeria.
2 Act No.29 of 2007
5 Some popular examples include: Kickstarter, Indiegogo, RocketHub, GoFundMe, Crowdrise, PledgeMusic and CrowdFunder to name just a few; and there now appears to be a crowdfunding initiative for diverse areas of business.
raising funds in the hopes of turning “promising ideals” into “business realities” by connecting investees with potential supporters.⁶

There are many earlier incidences of Crowdfunding; but the global economic crisis that took place in 2008 reduced the incidence of lending by the banks and lowered the trust people had in the banking system. These occurrences in the banking industry during this time encouraged people to get creative with alternate financing options. Also, the exponential rise of digital technology and the needs of Small and medium-sized enterprises (SMEs), new start-ups and individuals with innovative ideas could all be credited for bringing to life this alternative form of financing, which uses internet platforms to connect ‘project ideas’ and the crowd of funders willing to invest the funds.⁷

**Forms of Crowdfunding**

Crowdfunding is usually categorized based on the purpose of the fund. These categories include:

**Reward based Crowdfunding:** This is where funds are contributed in return for a product or services.

**Donation Crowdfunding:** Is where funds raised are regarded as mere donations with no expectation of returns/rewards to the contributors (crowd funders). This is usually seen in situations whereby funds are raised for charitable causes e.g. the gofundme.com online platform.

**Equity- based Crowdfunding:** Here the funds are provided in return for an equity stake (shares) in the project/ company.

**Lending-based/debt based Crowdfunding** which constitutes direct lending with the contributors as lender and the project owner as the borrower.⁸

For the purpose of this paper, we will rely on the equity and lending/reward based Crowdfunding.

1. **Equity Based Crowdfunding**

This type of crowd funding involves the issuance of shares through the internet, investors acquire shares in companies for a small amount of money, with an equity stake in the

---


company’s future cash-flow. It allows companies that are not otherwise listed on the Stock Exchange to invite the public to invest in their shares. The investors i.e. crowd funders in this case now have a stake in the company's profits if any. If the company does not make any profit, then the investors lose some or all of their investment. Equity Crowdfunding is an attractive method of corporate finance, as it allows companies to gain access to funding when they have failed to get investment from friends or family, angel investors, government programmes or the banks.⁹

2. **Lending/Debt Based Crowdfunding**

This type of Crowdfunding involves the funders receiving either real products or services in exchange for their contributions. This type of Crowdfunding is similar to bank loans or other types of loans; however they usually have lower and more competitive interest rates. This type of crowdfunding evolved from the peer-to-peer model of lending. The procedure of reward/debt-based Crowdfunding starts when the project initiators post all relevant information, and is continued by offering sales incentives. The exact goal of the project, the needs of the investment and the deadlines are posted on the project website.¹⁰ If the project does not receive the amount that has been solicited for, then the funders’ may be refunded under this model. This rewards based model usually works better with “business to consumer ideas” rather than with “business to business” projects.¹¹

**REGULATION OF CROWDFUNDING:**

**Crowdfunding Regulation in the United States**

On 30th October 2015, the Securities and Exchange Commission in the United States adopted the final rules to allow companies offer and sell securities through Crowdfunding. The Commission also voted to propose amendments to the existing Securities Act rules in order to facilitate intrastate and regional securities offerings.¹² Title III of the JOBS Act¹³ created a Federal exemption under the securities law, so that this type of funding may be used to offer and sell securities.

The final rules on Regulation Crowdfunding allow individuals to invest in securities-based crowdfunding transactions but are subject to certain investment limits. The final rules also limits the amount of money an issuer/fundee can raise using crowdfunding, and imposes

---

⁹ Kuti, supra p. 2.
¹⁰ Ibid, p.2.
disclosure requirements on issuers for certain information about their business and securities offering, and it creates a regulatory framework for the broker-dealers and funding portals that facilitate the crowdfunding transactions.14

A summary of some of the provisions in the final rules include:

- Permission for a company to raise a maximum aggregate of $1,000,000 (One Million dollars) through crowdfunding offerings in a 12 month period.

- Investment: Individuals investors are permitted to invest an aggregate of $100,000 (One Hundred Thousand dollars) in a 12 month period.

- Eligibility: Certain companies are ineligible for the exemption under Title III of the JOBS Act, such as non-U.S. companies, companies that have failed to comply with the annual reporting requirements under Regulation Crowdfunding.

- Disclosure: The companies that rely on these recommended rules to conduct crowdfunding offerings must file certain information with the Commission such as the price of the securities to the public and the method for determining the price, the target offering amount, the company’s financial condition, financial statements for the past 12 months, the company’s tax returns, information about directors and officers in addition to other disclosures.15

- Registration: The final rules also require a Crowdfunding portal to be registered with the Commission and become a member of a national securities association (currently FINRA)16. A company relying on the rules would be required to conduct its offering exclusively through one intermediary platform at a time. The intermediary platforms also have to adhere to some requirements such as reducing the risk of fraud, and comply with the maintenance and transmission of funds requirements under the rules.17

**Crowdfunding Regulation in Nigeria**

As mentioned earlier, the Securities and Exchange Commission has suspended Crowdfunding activities in Nigeria for the foreseeable future. The reasons the Commission gave are valid in our view, as the Investment and Securities Act 2007 and the Companies and Allied Matters Act 1990 did not envision the phenomena of Crowdfunding. As SEC regulates all securities offered for sale to the general public in Nigeria, they have a duty and

---

15 Ibid p. 2.
16 Financial Industry Regulatory Authority (FINRA): *is the largest independent regulator for all securities firm doing business in the United States.*
17 Ibid p. 2.
also jurisdiction over the regulation of Crowdfunding and its implementation. The Commission has however promised that they are finding ways to accommodate Crowdfunding activities in Nigeria. According to Mounir Gwarzo, the Director General of SEC, the Commission is looking at Crowdfunding laws in the United States and Canada in order to institute enabling legal and regulatory framework that will support the innovation.\footnote{Thisdaylive, SEC Rules out Crowdfunding in Nigeria for Now, available at http://www.thisdaylive.com/index.php/2016/08/15/sec-rules-out-crowdfunding-in-nigeria-for-now/ accessed on 4\textsuperscript{th} October 2016.}

**Recommendations for Regulating Crowdfunding in Nigeria**

In the Canadian provinces that have implemented Crowdfunding rules, the limit that can be raised in a 12 month aggregate is $1,500,000 (One Million, Five Hundred Thousand dollars). There is a limit on non-accredited investors as they may not invest more than $2,500 per distribution and accredited investors not more than $25,000. In Ontario, non-accredited investors are also subject to a $10,000 annual limit in reliance on the crowdfunding prospectus exemption of accredited investors subject to a $50,000 annual limit. Ontario, however, has exempted investors from both the distribution and annual limits if they qualify as “permitted clients” by having net “financial assets” of greater than $5 million.\footnote{Claire Gowdy, O. Soliman and A. Parker, Final Crowdfunding Rules to come into Force in Five Provinces including Ontario in January 2016, Securities Regulation Canada, December 1\textsuperscript{st} 2015, available at http://www.securitiesregulationcanada.com/2015/12/final-crowdfunding-rules-to-come-into-force-in-five-provinces-including-ontario-in-january-2016/, accessed on 10\textsuperscript{th} November 2016.} Similar to the U.S. Jobs Act, the Canadian rules also require disclosure and funding portal requirements.\footnote{Ibid p. 1.} The Nigerian Securities and Exchange Commission can follow in the footsteps of the Canadian Provinces. The Commission can adopt these rules and adapt them to fit into the Nigerian context. Important provisions under the SEC rules to regulate Crowdfunding in Nigeria should most importantly aim to protect public interest, and this can be achieved through some of the following recommendations:

- Placing limits on the amounts that can be raised through the platforms, e.g. ₦100,000,000 (One Hundred Million Naira) in a 12 month aggregate;
- Placing limits on the amount the investors can invest, to avoid taking advantage of investors, e.g. ₦10,000,000 (Ten Million Naira) in a 12 month aggregate;
- In terms of eligibility, the Commission should seek to restrict Crowdfunding platforms to Nigerian companies or place more stringent regulations on foreign companies;
- The platforms must have measures in place that will significantly reduce the risk of fraud;
• Disclosure of the company’s financial status;
• Disclosure of the directors and officers of the company;
• Disclosure on the use and objectives of the funds raised;
• Disclosure on potential risks associated with the investment;
• Registration of the platforms with the Commission.

This list is not exhaustive and the Commission certainly has its work cut-out for it. The Commission in its quest to protect the public must also be careful not to over regulate this sector, as a large part of its appeal is the easy access to the general public. Crowdfunding activities have taken over the corporate finance world and it is an easy, convenient and effective way for Small and Medium sized Enterprises to raise funds and Nigeria should not be left out of this movement.

For further information on this article and area of law please contact Ibidolapo Bolu at S. P. A. Ajibade & Co., by telephone (+234 1 472 9890), fax (+234 1 4605092) mobile (+234 8150865646) or email (dbolu@spaajibade.com)

www.spaajibade.com