Insights and Commentary from Dentons

The combination of Dentons and Adepetun Caxton-Martins Agbor & Segun offers our clients access to 12000+ lawyers in 203 locations and 80 countries around the world.

This document was authored by representatives of Adepetun Caxton-Martins Agbor & Segun prior to our combination's launch and continues to be offered to provide clients with the information they need to do business in an increasingly complex, interconnected and competitive marketplace.

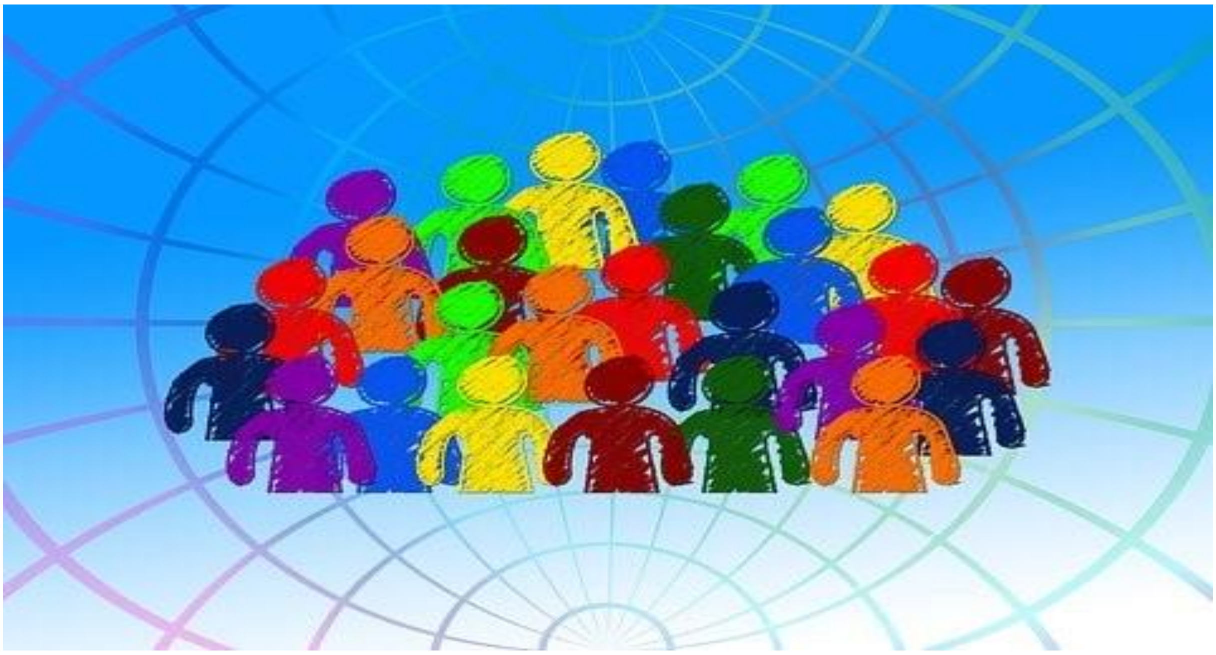
ACAS-LAW

ADEPETUN, CAXTON-MARTINS, AGBOR & SEGUN

BARRISTERS & SOLICITORS

NEWS ALERT APRIL, 2020

POST-COVID-19: CROWDFUNDING AS A VIABLE FUND-RAISING OPTION – A LOOK AT THE RULES PROPOSED BY THE SECURITIES AND EXCHANGE COMMISSION



Understandably, most current discourse center around the impact of COVID-19 on businesses and mitigation strategies that may be implemented to stay afloat. In considering mitigation strategies, it is also critical for businesses to start brainstorming about their post-COVID-19 operations as a key part of their business continuity strategy. Perhaps, a post-COVID-19 crisis team may be constituted to start exploring strategies to recast the business operations to ensure continuity.

An important post-COVID-19 issue for businesses to consider is fund-raising. While the Central Bank of Nigeria has introduced laudable financing schemes such as the N50 billion targeted credit facility to support households and micro, small and medium enterprises affected by the COVID-19 pandemic, and the N100 billion credit support for the healthcare sector to aid capacity building and expansion, another viable capital raising option that may be explored by businesses seeking to build/expand their capacity post-COVID-19 is crowdfunding.

In this post, which is the first in our crowdfunding series, we look at businesses that would be eligible to raise capital through crowdfunding based on the proposed rules and regulations guiding crowdfunding activities in Nigeria (the "**Proposed Regulations**") that were recently released by the Securities and Exchange Commission of Nigeria ("**SEC**").

Eligible Businesses - The Proposed Regulations define crowdfunding as *"the process of raising funds to finance a project or a business from the public through an online platform."* The online platform, known as a "*Crowdfunding Portal*" under the Proposed Regulations, must be registered with the SEC.

Under the Proposed Regulations, only Nigerian incorporated Micro, Small and Medium Enterprises ("**MSMEs**") (as prescribed by the Small and Medium Enterprises Development Agency of Nigeria in relation to total asset and annual turnover) with a minimum operating track record of two years are eligible to embark on fund-raising through a crowdfunding portal registered by the SEC. The MSMEs must be accredited and/or accepted by a crowdfunding portal; however, an issuer will be prevented from accessing a portal if the portal or any of its officers, directors, significant shareholders or associated persons, beneficially own or control more than 5% of the MSMEs' securities.

The Proposed Regulations however exclude the following entities from raising finance through crowdfunding:

(i) Complex structures (i.e. an entity without immediate transparency of ownership and/or control thereby making it difficult to immediately ascertain the beneficial owners of the entity);
(ii) Public listed companies and their subsidiaries;
(iii) Companies with no specific business plan or a blind pool (i.e. with a business plan which is solely for the purpose of merging with or acquiring an unidentified entity); and
(iv) Companies that propose to use the funds raised to provide loans or invest in other entities.

The SEC may also specify other entities that will be prohibited from crowdfunding. From the list of entities to be prohibited from raising finance through crowdfunding, it is clear that the SEC aims to protect investors' funds and also ensure that MSMEs are provided with a fair opportunity to approach the public for capital without going through the rigors of listing on a stock exchange.

Fund-Raising Limit – By the Proposed Regulations, MSMEs can raise funds in exchange for the issuance of shares, debentures or any other investment instruments to the investors, subject to limits on the aggregate amount of securities or investments that different categories of MSMEs are permitted to offer and sell within a 12- month period as follows:

- Medium enterprises are permitted to raise a maximum of N100 million;
- Small enterprises are permitted to raise a maximum of N70 million; and
- Micro enterprises are permitted to raise a maximum of N50 million.

Interestingly, MSMEs operating as digital commodities investment platforms (i.e. platforms that connect investors to specific agricultural or commodities projects for the purpose of sponsoring such projects in exchange for a return) are not subject to the capital limitations. The exclusion of digital commodities investment platforms from the capital limitations is logical given the need to attract investments to the agricultural and natural resources sectors of the Nigerian economy.

In addition to the capital limitations, the Proposed Regulations restrict retail investors from investing more than 10% of their annual income in a calendar year. There are no similar restrictions on sophisticated, high net worth and qualified institutional investors - they have no investment limit. The annual investment limit placed on retail investors is a strategy aimed at insulating retail investors from investment uncertainties, given the risk involved in online investments and the fact that retail investors would most likely not conduct any due diligence on the issuer and/or its proposed project. Additional protection provided is from the requirement that the issuer's constitutional documents shall provide for tag-along rights in favour of retail investors.

Minimum Funding Target – Under the Proposed Regulations, a crowdfunding offering shall only be active for a duration of 60 days, during which period the issuer is required to raise a specified minimum threshold, which must be at least 50% of the original funding target. The specified minimum threshold must be sufficient to accomplish the business objectives of the issuer.

Where the minimum threshold is not met within the 60 days period, the issuer is required to withdraw the offer; however, the issuer may commence a new crowdfunding offering not earlier than 90 days after the withdrawal. Where an offer is withdrawn, investors are to be refunded within 48 hours by the crowdfunding portal.

Applicable Securities/Investment Instruments – Under the Proposed Regulations, the securities/investments instruments that may be offered to investors are plain vanilla bonds/debentures, ordinary shares and simple investment contracts. Although the SEC may specify other instruments, any other investment instrument is non-permissible and cannot therefore be offered to investors.

Release of Funds - Funds raised through a crowdfunding portal would only be released to the issuer from the trust account used for the funding round after specified conditions are met and if the target amount or the minimum threshold is met. The trust account for each funding round is to be established and maintained by a registered custodian to be appointed by the crowdfunding portal.

Conclusion

Despite the current uncertainties caused by the COVID-19 pandemic, a certainty that is steeped in history is that at some point in the future, the COVID-19 pandemic will subside, just like previous pandemics. Considering the inevitable economic and business activities that will take place post-COVID-19, it is critical for c-suite executives to not be bogged-down by the short-term challenges posed by the COVID-19 pandemic, but to start considering long-term strategies that will place their businesses in a vantage position to latch on to post-COVID-19 business opportunities. One way of doing that is to map-out a clear and workable business continuity strategy for fund-raising - crowdfunding presents a viable option in this regard.

Adepetun Caxton-Martins Agbor & Segun by telephone (+234 1 462 2094), fax (+234 01 461 3140)