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SEC's NEW LICENCE REQUIREMENTS FOR DIGITAL STOCK TRADING IN NIGERIA

Introduction

On December 19, 2020, the Securities and Exchange Commission ("SEC") published a statement, informing the public that the Investments and Securities Tribunal, ("IST") had made interim Orders restraining a Fintech company, Chaka Technologies Limited, and its promoters from advertising or offering for sale shares, stock or other securities of companies or other entities. SEC's position was that companies that offer a digital platform for the purchase of shares in foreign companies acted outside its regulatory purview and in breach of extant laws and regulations, particularly the Investments and Securities Act and SEC Rules and Regulations.

Investment tech companies were faced with another dilemma when on April 8, 2021, SEC ordered that by the provisions of **Sections 67-70 of the Investments and Securities Act (ISA), 2007, and Rules 414 & 415 of the SEC Rules and Regulations,** only foreign securities listed on any Exchange registered in Nigeria may be issued, sold, or offered for sale or subscription to the Nigerian public. The SEC noted that it is aware that most investment tech companies, like Chaka, have partnerships with registered Capital Market Operators in Nigeria to offer foreign shares to Nigerians contrary to the provisions of ISA & SEC Rules and Regulations. Nigerians who used such platforms and saw the innovation they offered as the democratisation of the purchase of shares were frustrated by the actions of the SEC, especially those who had purchased many shares.

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However, on April 22, 2021, SEC amended its Consolidated Rules and Regulations to make provisions for the incorporation of the activities of the Sub-Brokers especially with regard to the definition of sub-brokers, license requirements for digital stock trading, the keeping of the records of transactions with clients, and the introduction of a risk management regime.

In this article, we examine the new license requirements for the Digital Stock Trading as well as highlighting the potential implications of these new license requirements on Fintech companies and end-users.

Who Is A Digital Sub-Broker?

To incorporate the trading activities of the digital platforms employed by these sub-brokers, the Amendments provide a new definition of a Sub-Broker. A sub-broker is defined as any person or entity not being a dealing member of an Exchange who acts on behalf of a sponsoring Broker/Dealer as an agent or otherwise for assisting the investors in buying, selling, or dealing in securities through such sponsoring Broker/Dealer.

The above definition encapsulate the activities of most investment tech companies as they leverage on their digital platforms and collaborate with registered brokers to offer shares on their platforms.

Registration Requirements as detailed in the regulations

To operate a digital sub-broker platform in Nigeria, prospective operators are required to submit an application to the SEC for registration as a Sub-Broker/Sub-Broker Serving Multiple Brokers through a Digital Platform accompanied by prescribed requirements such as evidence of payment of relevant registration fees and Sponsored Individual Fee, and applicable duly executed SEC Forms.

The minimum paid-up capital for a Sub-Broker/Sub-Brokers Serving Multiple Brokers through a Digital Platform is N10,000,000 (Ten Million Naira). Such Sub-Broker must also have a Current Fidelity Insurance Bond covering at least 20% of the minimum paid-up capital as stipulated by the SEC Rules and Regulations. Applicant sub-broker operators must have a minimum of three sponsored individuals including the Managing Director of the Company and must provide the specified necessary information on these sponsored individuals. Applicant operators must also submit to the SEC the company's profile, copy of the agreement with the sponsoring broker/dealer firm, business plan, etc. and the company's corporate documents including duly certified copies of the Certificate of Incorporation, Memorandum and Articles of Association, etc.

An application for registration will only be considered as having been filed when all document(s)/information stated above have been provided to the SEC. Applicants are also expected to exhibit

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a fair knowledge of the SEC Rules and Regulations, the Investments & Securities Act 2007 (ISA) and the Capital Market as a prerequisite for registration.

There are also some additional registration requirements particular to Sub-Brokers Serving Multiple Brokers. These include;

- Copy of multiple principal agreement with every sponsoring broker;
- Description of the technology on which infrastructure is built;
- Certification that the infrastructure is sufficient to perform the required function by an IT service provider registered by the National Information Technology Development Agency or other recognized agency, and endorsed by a representative of the Association of Securities Exchanges;
- Electronic Communication channel through which all communications with clients would be made;
- Method of establishing the suitability of potential clients to utilize its infrastructure for transactions;
- Notice to potential clients of the features, risks, responsibilities, obligations and liabilities associated with the use of its infrastructure;
- Before the execution of an order, proof that the client is fully aware of and understands the risks associated with the service being offered;
- Confirmation that it would not delegate its function to another sub-broker without the written permission of the SEC;
- Adequate KYC requirement and processes.
- Binding legal agreements with potential clients taking into consideration certain provisions as contained under the Rules.

Upon registration and by the provisions of **Rule 68 of the Consolidated SEC Rules**, the Sub-Brokers/Sub-Brokers Serving Multiple Brokers through a Digital Platform will be able to perform the following functions through their sponsoring broker/dealer;

- Purchase of securities
- Sale of Securities
- Receiving payments from clients in relation to sale or purchase of securities
- Making payments to clients in relation to sale or purchase of securities
- Other service ancillary to sale, purchase, and payments of securities

Record of Clients' Transactions

The Amendments require sub-brokers to keep a record of transactions with clients. Under the amendments, a sub-broker is required to maintain proper and adequate records of transactions for and on behalf of each client, which records

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shall include among others, proof of execution of trade on behalf of a client, money transfer receipt confirmation, all communications with the client through the dedicated communication channel, all transactions carried out on the platform and all parties related to every transaction carried out on its platform.

Risk Management

To protect investors/users of these digital platforms from preventable loss, the Amendments require the platforms to, amongst other things, have adequate cyber- security protection against cyber-attacks, comply with the SEC's Technology Risk Guidelines, and establish an Anti-Money Laundering/Combating Financing of Terrorism (AML/CFT) mechanism in compliance with the relevant AML/CFT regulation for Capital Market Operators.

Implications of the new requirements on Fintechs and End-users

As much as the directives may hinder certain advancements within the sector, the companies involved can make use of this time to seek the relevant approvals and pursue proper registration with the SEC. The position of the SEC is to regulate the operation of capital market organizations, and as such exercise the right to enforcement of its policies. However, innovation does not have to suffer on the altar of regulation and that is where the role of compliance and stakeholder alliances comes into play.

The SEC needs to develop a framework that guides the activities of fintech companies currently in contravention of these laws, with a view to removing grey and blurry areas of regulations, which will allow for the introduction of fresh players in the sector.

While end-users and fintech companies have been advised to seek clarification from the SEC via its official channels, the companies affected have also begun to seek the required approvals and clarification surrounding their operations.

Chaka Technologies Limited has received a license from SEC to operate its digital platform for buying and selling of stocks in Nigeria after complying with the SEC new licence requirements for digital stock trading. The tech company becomes the first to acquire the digital sub-broker license introduced by SEC in April after it was initially barred from offering its services in Nigeria.

Until now, Chaka's operations were based on a partnership with Citi Investment Capital Ltd, a Lagos-based broker licensed by the SEC. However, this official license now places Chaka directly under SEC's supervision.

Chaka's app hosts over 4,000 stocks from publicly traded companies in Nigeria and the United State of America. Founded in January 2019 by Osibodu and Olaolu as the chief technology officers, the tech company bills itself as an "investment passport" which powers borderless investing for users. Anyone with an internet-enabled smartphone can download the app, sign up and begin investing with $2 or ₦1,000.

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Conclusion

Innovators and existing companies, who leverage on digital platforms to offer shares to Nigerians, should examine the amendments to see whether their business structure requires them to register as a Sub-Brokers Serving Multiple Brokers through a Digital Platform.

The SEC is doing what it believes to be the best way of protecting the Nigerian population from bad actors in the capital market space. In fact, the SEC's current position could be amended to allow Nigerians take advantage of the chang ing global financial Landscape. As much as the agency seeks to safeguard Nigerians, it is important for there to be a viable framework guiding the operations of fintech companies. Also, the Central Bank of Nigeria (CBN) established a regulatory sandbox providing developers with access to tools. The SEC can consider adopting one for capital market operations.

As much as the SEC aims to protect the Nigerian investing public, it is also vital that it is able to adapt to changes brought about by advances in technology while ensuring that Nigerians remain ahead of the curve. At the end of the day, fintech companies are positioned to solve hard problems using technology that can greatly improve customers' access to essential services.

The SEC is now clear on its position regarding the licensing of Digital Sub-Brokers and the Rules resolve certain controversies regarding the operations of many platform operators in the Nigerian capital market.

Considering the risks of non regulation, it is quite encouraging that the SEC has responded swiftly and in an innovation-friendly manner to the rise of these platforms in Nigeria. This is a demonstration that the SEC is well positioned and prepared to regulate the capital markets to ensure the protection of investors, maintain fairness, efficiency and transparency, and reduce systemic risk.

There is no doubt that proper innovation-centric regulation like this will go on to spur even more innovation in the country, encourage new business models, promote alternative financial intermediation channels, and facilitate the delivery of a wider range of financial products and services to the market in a more efficient way.

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