

REGULATORY REQUIREMENTS FOR OBTAINING A DIGITAL SUB-BROKER LICENCE; SEC RULES & FINTECH IN NIGERIA

Over the last decade, technology has continued to disrupt the financial sector while regulators have struggled to keep up. The capital market sub-sector has not been spared as fintech companies facilitate transactions in Nigerian and foreign listed securities through digital platforms.

In a move to maintain oversight over all activities within the Nigerian capital market, the Securities and Exchange Commission ("SEC") obtained an order from the Investment and Securities Tribunal directing Chaka Technologies Limited (a Fintech company that offers Nigerians the opportunity to purchase Nigerian and foreign quoted shares through a digital platform) to refrain from facilitating investment in securities. Consequently, on April 22, 2021, the SEC issued the Major Amendments ("Amendment") to the Securities and Exchange Commission Rules and Regulations, 2013 ("Rules"), making significant changes to the provisions relating to Sub-Brokers.

Who is a Sub-Broker?

The Rules define a Sub-Broker as a person or company who is not a member of an Exchange but acts as an agent of a sponsoring broker/dealer or assists investors in buying and selling securities through the sponsoring broker/dealer. The Amendment now recognises that a Sub-Broker may utilize a digital platform to engage investors and interact with sponsoring brokers ("Digital Sub-Broker" or "Sub-Broker Serving Multiple Brokers Through A Digital Platform").

In effect, Digital Sub-Brokers such as Chaka, Bamboo and Rise now fall within the ambit of the Rules and are required to be registered with the SEC, provided the requirements for registration are complied with.

What can a Sub-Broker do?

A Sub-Broker may purchase and sell securities on behalf of investors through the sponsoring broker. The Sub-Broker is required to remit any fund, certificate and warrants supplied to it by the investor to the sponsoring broker within two (2) working days of receipt.

What are the obligations of a Sub-Broker?

Records of transactions

Under the Rules, a Sub-Broker is required to keep adequate records of transactions for and on behalf of investors. The records should include: (i) the mandate form; (ii) proof of payment for the purchase of shares; (iii) all communications with the investors, amongst others.

Risk Management

Specifically, all Digital Sub-Brokers are required to implement a risk management practice which includes the implementation of the following:

- i. procedures and controls to monitor and test the algorithms on a regular basis;
- ii. internal policies to address technology risks;
- iii. adequate cyber-security mechanism;

- iv. an anti-money laundering/combating financing of terrorism (AML/CFT) policy in line with applicable regulation;
- v. operational and technical controls systems to manage the risks;
- vi. ensuring that all electronic communication is digitally signed, encrypted and secured with a backup stored in soft and secured form;
- vii. a complaint management policy in compliance with SEC Rules; and
- viii. complying with the SEC technology risk guidelines, amongst others.

What are the requirements for obtaining a Digital Sub-Broker licence?

In addition to fulfilling all the requirements applicable to a Sub-Broker, Rule 67(4) of the Rules, specifically contains provisions that are clearly tailored towards fintech businesses. Some of the requirements for obtaining the Digital Sub-Broker license include:

- i. providing a detailed description of the technology infrastructure to be used by the proposed Sub-Broker;
- ii. evidence of adequate KYC processes in respect of investors;
- iii. evidence of notice of potential risks and obligations of parties issued to investors; and
- iv. evidence of minimum paid-up capital of Ten Million Naira and current fidelity insurance bond covering twenty per cent (20%) of the minimum paid-up capital.

Conclusion

The development of fintech in Nigeria has provided the average Nigerian with multiple investment opportunities within the capital market sub-sector and consequently, required regulators such as SEC to provide adequate protection for investors through regulation. This effort is indeed commendable. Chaka Technologies Limited became the first company to obtain the Digital Sub-Broker licence as announced in its public statement of June 23, 2021.

In anticipation of continuous innovation and disruption, a holistic review of the SEC Rules to include, where applicable, provisions permitting digital involvement is advised. In addition, an integration of all current amendments into the Rules will prove most helpful and unambiguous to investors seeking to penetrate the Nigerian market.