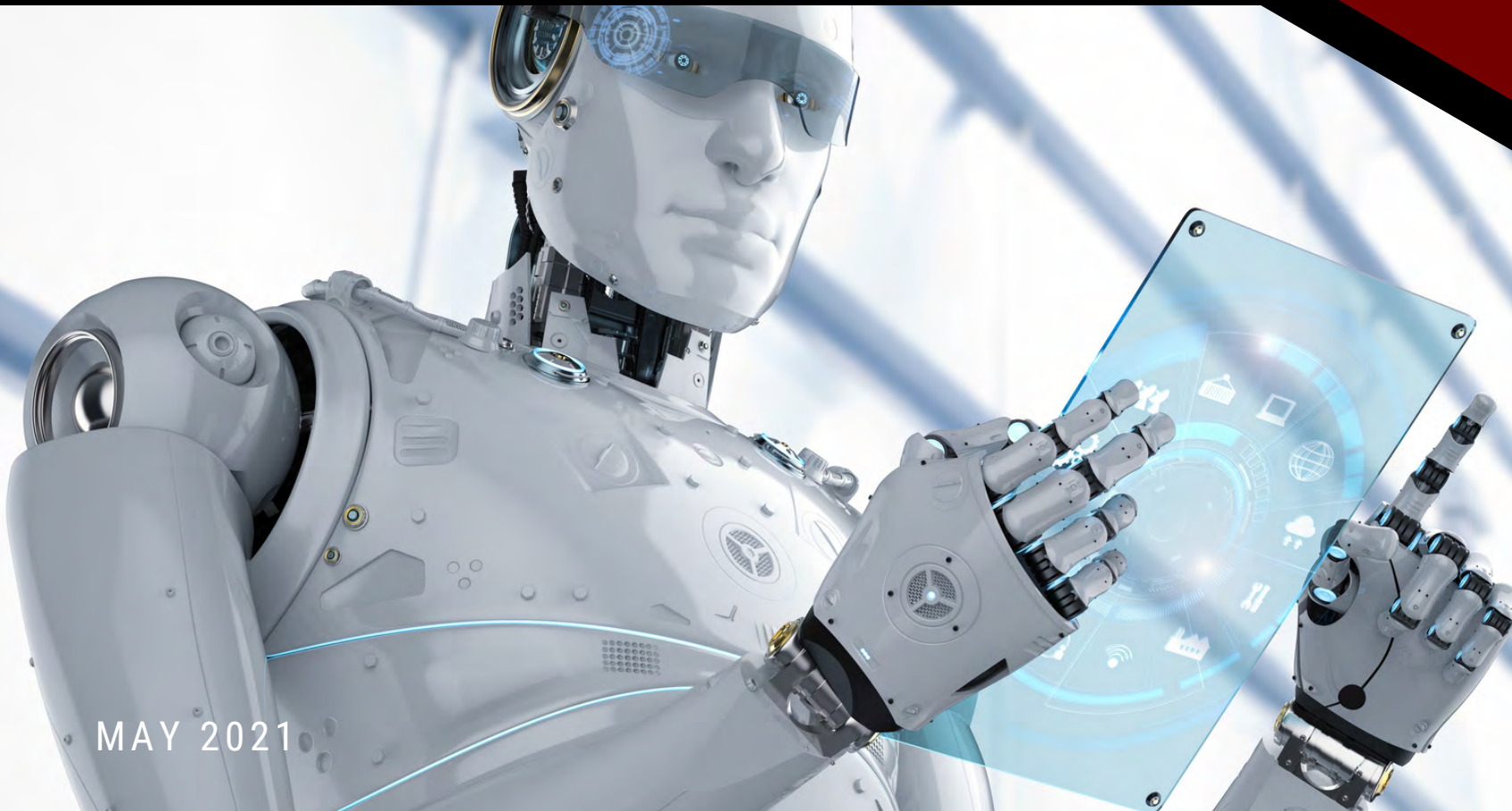


ARTICLE SERIES

FINTECH INNOVATION – A EXAMINATION OF SEC’S PROPOSED RULES ON ROBO-ADVISORY SERVICES



MAY 2021

www.aelex.com

INTRODUCTION

Robo-Advisors (sometimes spelt as Robo-Advisers) are digital investment advisory platforms that provide automated, algorithm-driven financial planning services with little to no human supervision. A typical Robo-Advisor collects information from investors about their financial situation and future goals and then uses the data to offer advice and also automatically invest its client assets in stocks and other financial instruments [1]. Statistics released in 2020 showed that Robo-Advisors managed more than \$460 billions [2] leading analysts to predict that Robo-Advisory services will become a \$1.2 trillion industry by 2024 [3]

Advantages

Robo-Advisors offer investment advice for lower costs and fees than traditional advisory programs, and in some cases, require lower amounts to open an investment account with them than traditional investment advisers [4]. These advantages have led to the widespread adoption of Robo-Advisory services among millennials [5] and Generation Z [6] (“Gen Z”) who believe that using such services are easier and less onerous than approaching institutional investment advisers.

SEC release Draft Rules on Robo-Advisory

Although Robo-Advisors are on the rise [7] in many parts of the world, there are no prominent Robo-Advisory service providers in Nigeria as most ‘wealth tech’ or ‘investment tech’ solutions are focused on providing platforms that allow Nigerian’s save, manage wealth and make financial plans by enabling access to savings and investment products.

In a bid to match the global evolving investment tech ecosystem that is garnering a lot of following and usage, Nigeria’s Security and Exchange Commission of Nigeria (“SEC”), on 5 May 2021 [8], released an exposure draft on its Proposed New rule on Robo-Advisory Services (the “Proposed Rules”) for comments from the public.

Innovations Under the Proposed Rules

Definitions - The Proposed Rules define the following terms:

a. Digital Advisory Services - the provision of advice on investment products using automated, algorithm-based tools which are client-facing, with little or no human adviser interaction in the advisory process;

[1] “Robo-Advisor”, Investopedia, accessed 10 May 2021. <https://www.investopedia.com/terms/r/roboadvisor-roboadviser.asp>.

[2] “Why robo-advisors are striving toward a ‘hybrid model,’ as the industry passes the \$460 billion mark” by Nathaniel Lee for CNBC, accessed 10 May 2021. <https://www.cnbc.com/2021/04/12/why-robo-advisors-may-never-replace-human-financial-advisors.html>.

[3] “Why robo-advisors are striving toward a ‘hybrid model,’ as the industry passes the \$460 billion mark” by Nathaniel Lee for CNBC, accessed 10 May 2021. <https://www.cnbc.com/2021/04/12/why-robo-advisors-may-never-replace-human-financial-advisors.html>.


[4] “Robo-Advisor” by Investor.gov US Securities and Exchange Commission, accessed 10 May 2021. <https://www.investor.gov/introduction-investing/investing-basics/glossary/robo-adviser>.

[5] Persons born between 1981 - 1996.

[6] Persons born between 1997 - 2012.

[7] “Robo-Advisory Services Market - Growth, Trends, Covid-19 Impact, and Forecasts (2021 - 2026)” by Mordor Intelligence, accessed 15 May 2021. <https://www.mordorintelligence.com/industry-reports/robo-advisory-services-market>.

[8] “Proposed New Rules and Sundry Amendments to The Rules and Regulations of The Commission” by SEC accessed 10 May 2021. <https://sec.gov.ng/proposed-new-rules-and-sundry-amendments-to-the-rules-and-regulations-of-the-commission/>.



b. Robo Adviser - a person who provides digital advisory services; and

c. Fully Automated Robo Adviser as a Robo Adviser with no human adviser intervention in the entire advisory process [9].

Regulatory compliance: The Proposed Rules mandate that apart from complying with Rule 96 of the Securities and Exchange Commission Rules and Regulations, 2013, which provides for registration requirements of Corporate and Individual Investment Advisers, the Robo-Advisor is required to comply, on an ongoing basis, with all the applicable business conduct requirements set out in the Investment and Securities Act (“ISA”) and the Rules and Regulations, Notices and Guidelines issued pursuant to the ISA.


Where a Robo-Advisor outsources the maintenance of their Client Facing Tools (“CFT”) (software that interacts with the client directly) to a third-party, the Proposed Rules do not require the third-party to register with SEC. However, Robo-Advisors that intend to include portfolio management in the services they offer to their users must apply to SEC to be registered as a Fund/Portfolio Manager [10]

Furthermore, apart from mandating compliance with the Anti-Money Laundering and Combatting the Financing of Terrorism Act of 2013, the Proposed Rules demands that CFTs must be monitored, tested, and compliance checks on the quality of advice provided by the client-facing tool must be conducted frequently.

Experience of the principal officers: The Proposed Rules specify that Robo-Advisors must ensure their principal officers have experience with fund management and technology, and they carry out assessments on clients to see if they possess the relevant knowledge and experience to invest in complex instruments through the Customer Knowledge Assessment (“CKA”) or Customer Account Review (“CAR”).

The Proposed Rules also describe what is accepted as a typical Robo-Advisory transaction and what the Robo-Advisor is required to do in certain instances. For example, according to the Proposed Rules, if a client seeks to change a portfolio they revised or tinkered with to a recommended portfolio (referred to as rebalancing), the Robo-Advisor must take certain steps such as obtaining a one-time prior written authorization from the client to rebalance the portfolio [11]

[1] The Proposed Rules can be accessed here.
[1] The Proposed Rules can be accessed here.
[1] The Proposed Rules can be accessed here.



Trading in foreign securities: The Proposed Rules permit Robo-Advisors to provide portfolio advice to Nigerians about foreign securities; however, they must provide a risk warning statement to their clients at the point of account opening and when advising them on overseas-listed investment products. The Robo-Advisors must show the merits of the foreign securities, as well as the client's investment objectives, financial situation and particular needs. They shall also ensure that they are not in violation of any applicable laws and regulations.

Disclosure of material information: The Proposed Rules direct Robo-Advisors to disclose material information in clear and simple language about the investment options available to them, and also information about the algorithm the Robo-Advisor uses such as the assumptions, limitations and risks of the algorithms, and the circumstances under which the Robo-Advisors may override the algorithms or temporarily halt the Robo-Advisory service.

OUR TAKEAWAY

With barely 2% of the country's population—investing in the stock market [12],

few Nigerians have access to investment opportunities with a number of Nigerians disinterested in taking advice from traditional investment advisors because of the large amounts they charge for investment advice.

Robo-Advisors may change the landscape with cheaper fees for investment advice and lower amounts required for opening investment accounts. An inclusion of Robo-Advisory services in the portfolio of what investment tech companies in Nigeria offer is in line with their objective of providing access to investment products to Nigerians.

We also opine that SEC believes Robo-Advisory services may soon be available to Nigerians with the plethora of wealth tech companies in the ecosystem who are constantly innovating. Therefore, SEC may be seeking to create a regulatory environment in which Robo-Advisors can thrive and collaborate with the apex securities regulatory body in Nigeria to foster an adoption of technology-driven products by Nigerians.

[1] Africa Prudential, a stock market registrar and digital technology services firm, reveals that there's an estimate of just three million people (both local and foreign). "Why Nigeria's stock market may need more than technology to thrive" by Emmanuel Paul for Techpoint Africa, accessed 15 May 2021. <https://techpoint.africa/2020/07/16/nigerias-stock-market-technology/>.



Oluwapelumi Omoniyi

For further information, please contact:



Davidson Oturu
(doturu@aelex.com)



Frances Obiagio
(fobiagio@aelex.com)



Florence Bola-Balogun
(fbola-balogun@aelex.com)



Oyeyosola Diya
(odiya@aelex.com)



Opeyemi Adeleke
(oadeleke@aelex.com)



Kehinde Takuro
(ktakuro@aelex.com)

ÆLEX is a full-service commercial and dispute resolution firm. It is one of the largest law firms in West Africa with offices in Lagos, Port Harcourt and Abuja in Nigeria and Accra, Ghana. A profile of our firm can be viewed [here](#). You can also visit our website at www.aelex.com to learn more about our firm and its services.'

COPYRIGHT: All rights reserved. No part of the publication may be reproduced, stored in a retrieval system or transmitted in any form or by any means without the prior permission in writing of ÆLEX or as expressly permitted by law.

DISCLAIMER: This publication is not intended to provide legal advice but to provide information on the matter covered in the publication. No reader should act on the matters covered in this publication without first seeking specific legal advice.

CONTACT DETAILS

LAGOS, NIGERIA

4th Floor,
Marble House
1, Kingsway Road, Falomo
P. O. Box 52901, Ikoyi
Lagos, Nigeria

Telephone: (+ 234 1) 2793367; 2793368
4736296, 4617321-3;
Facsimile: (+ 234 1) 2692072; 4617092
E-mail: lagos@aelex.com

ABUJA, NIGERIA

4th Floor,
Adamawa Plaza
1st Avenue, Off Shehu Shagari Way
Central Business Area
FCT Abuja, Nigeria

Telephone: (+234 9) 8704187, 6723568,
07098808416
Facsimile: (+234 9) 5230276
E-mail: abuja@aelex.com

PORT HARCOURT, NIGERIA

2nd Floor,
Right Wing UPDC Building
26, Aba Road
P.O. Box 12636, Port Harcourt
Rivers State, Nigeria

Telephone: (+234 84) 464514, 464515
574628, 574636
Facsimile: (+234 84) 464516, 574628
E-mail: portharcourt@aelex.com

ACCRA, GHANA

7th Floor, Suite B701
The Octagon
Accra Central, Accra
P.M.B 72, Cantonment Accra, Ghana

Telephone: (+233-302) 224828, 224845-6
Facsimile: (+233-302) 224824
E-mail: accra@aelex.com