

ARTICLE SERIES

**EXAMINING THE IMPACT OF THE RULES ON
ROBO-ADVISORY SERVICES IN NIGERIA**



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INTRODUCTION

On 30 August 2021, the Security and Exchange Commission (“SEC”) unveiled rules applicable to persons who provide Robo Advisory Services in Nigeria (“the Rules”). This was preceded by the SEC earlier publishing, proposed rules on Robo Advisory Services. The Rules signify the developments the SEC has continued to undertake in strengthening financial advisory services in Nigeria.

In this article, we examine the provisions of the Rules and consider how it impacts on the financial advisory market in Nigeria.

What are Robo Advisors?

Robo Advisors are digital platforms that provide automated, algorithm-driven financial planning services with little to no human supervision. A typical Robo Advisor collects information from clients regarding their financial situation and future goals through an online survey and then uses the data to offer advice and automatically invest client assets. [1]

What are Robo Advisory Services?

By the Rules, Robo Advisory Services are defined as providing investment advice using automated, algorithm-based tools that are client-facing, with little to no human advisor interaction in the advising process.

Although the technology is not novel and has been used by wealth managers since the 2000s, the introduction of the modern Robo Advisory has resulted in direct interaction with consumers. It can handle complicated instructions, including investment selection, retirement planning and tax-loss harvesting. The industry has also experienced explosive growth as a result, with client assets managed by Robo Advisors reaching nearly \$1 trillion in 2020 and expected to exceed \$2.9 trillion worldwide by 2025. [2]

Robo Advisors v Traditional Service Providers

For decades, investment advisory was carried out by professionals such as financial advisors, brokers and investment advisers.

[1] Jake Frankenfield, 'Robo-Advisor' (Investopedia, November 16 2021) <https://www.investopedia.com/terms/r/roboadvisor-roboadvisor.asp#:~:text=What%20is%20a%20Robo-Advisor%3F%20Robo-advisors%20%28also%20spelled%20robo-adviser,planning%20services%20with%20little%20to%20no%20human%20supervision.> accessed 1 February 2022

[2] Admin, '15+ Exciting Robo Advisor Statistics [2021 Update]' (Digital In The Round, June 23, 2021) <https://digitalintheround.com/robo-advisor-statistics/> accessed 1 February 2022



These professionals provided financial advisory services that involved the purchase and sale of stocks for investors. They are usually entitled to a commission of the investment made on behalf of their clients, which served as an additional motivation aside from the ethical obligations to the investor.

These advisors, referred to as traditional advisors, were attractive to investors for many reasons. Firstly, they were believed to have a "human" touch, and investors felt more comfortable getting their complaints resolved by interacting face-to-face or through the phone with their advisors. They were also be considered a little more "effective" as they kept their investment strategy aligned with the changing financial aspirations. It was most suited to investors willing to invest a large amount of money, partake in all stages of investment and be interested in strategic risk-taking investment [3]. However, as most traditional investment advisories imposed restrictions on the minimum amount to invest, it was not suitable for a wide range of investors.



Furthermore, there were variables in place that even the most advanced and experienced advisors may not be able to foresee or predict.

With the advent of modern technology, algorithms were developed to aid financial advisory and, these may ultimately replace traditional advisors. Unlike traditional advisors, these technology backed advisors used automated, algorithm-based tools in the advising process with little to no human interaction.

Indeed, Robo Advisors gained acclaim due to certain functions that differentiated it from the traditional advisors. They were convenient, easily accessible and always available, limiting investors from the rigours of booking appointments with advisors. Investors could also make complaints and have them quickly resolved, and it catered for a wide range of investors. Generally, they are suited to investors who are unwilling to invest a large amount of money, are more comfortable interacting through online platforms rather than in-person, and are not particularly concerned about investment strategies.



[3] Anuja Diwikar, 'Modern/ Robo- Investment Advisors Vs Traditional Investment Advisors' (Purnartha News, 18 May 2018) <http://www.purnarthawealth.com/modern- robo- investment- advisors- vs- traditional- investment- advisors/> accessed 11 February 2022.



Who can provide Robo Advisory Services in Nigeria?

Characteristically, Robo Advisory services are provided when a client answers a series of questions on his risk tolerance, investment objectives, investment time horizon, inputs an investment amount, the input is analysed using algorithms, and a portfolio is recommended to the client.

Consequently, all Capital Market Operators (“CMO”) and persons (Individual & Corporate) who are offering or seeking to offer Robo Advisory services in the Nigerian Capital Market are to abide by the Rules.

Registration as a Robo Advisor


The provisions of the Rules on registration as a Robo Advisor is as follows;

1. Registration as a corporate or individual investment advisor in line with the SEC guidelines with all the necessary modifications.

2. A 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.

3. A third party in charge of the development and maintenance of a Robo Advisory client-facing tool is not required to be registered by with the SEC; however, a Robo Advisor shall nonetheless subject the third party provider to appropriate due diligence processes to assess the risks associated with the outsourcing arrangement.

It is important to note that where a Robo Advisor also provides portfolio/fund management services to a client and the client decides on an alternative investment decision contrary to the recommendation of the Robo Advisor, the Robo Advisor shall rely on the client’s decision and obtain a written mandate from the client, highlighting in writing that investment decision the client is aware of their responsibility of the investment outcome and suitability of his/her



The Rules further differentiate a Robo Advisor from a Fund/Portfolio Advisor. A Robo Advisor who wishes to perform portfolio management function shall apply to SEC to be registered as a Fund/Portfolio Manager and shall comply with the applicable Rules and Regulations governing Fund/Portfolio Management Function. Hence, a Robo Advisor cannot ordinarily perform the functions of a Fund/Portfolio Advisor unless it has been registered as such with the SEC.

Adequate Governance and Supervisory Arrangements


The Rules also provide that a Robo Advisor put adequate governance and supervisory arrangements to mitigate any fault or bias in the algorithm. This is done with the combined effort of the Board and senior management supervising the remainder of the staff who must be adequate and have the expertise and skill to develop and review the methodology of the algorithm. They must also ensure adequate security arrangements to identify and prevent unauthorized access to the algorithm.

It is to be noted that the Board and Senior Management will be responsible and accountable for the proper development, monitoring and testing of the client-facing tools.

The Client-Facing Tool

The Rules provide that the Robo Advisor shall ensure that the client-facing tool is robust enough to cater to the client's needs. It must collect all necessary information and sufficiently analyse same to make suitable recommendations, including having proper mechanisms to identify and resolve contradictory or inconsistent responses from clients and be sufficiently tested and ensure that error or bias in the algorithm are effectively managed and the risk profiles generated by the algorithm are in line with its risk profiling methodology.

The Robo Advisor must also have policies, procedures, and controls to monitor and test the algorithms regularly to ensure that they are performing as intended. This will include compliance checks on the quality of advice provided, dedicated customer care help desks and notices to clients of any scheduled maintenance or upgrade of the system.



Robo Advisors must also implement internal policies and procedures to address technology risks and meet the requirements set out in SEC's Guidelines on Technology Risk Management ("TRM"), file a quarterly report to SEC on its Compliance and refer to the TRM Guidelines for industry best practice which they are expected to adopt and also file. They also perform a gap analysis against the requirements set out in the TRM Guidelines to ensure that all gaps are adequately mitigated before the launch of the client-facing tools and also when changes are made to these tools

Compliance with the Anti-Money Laundering and Combating the Financing of Terrorism Act


The Rules mandate Robo Advisors to have in place adequate policies, procedures, and controls to mitigate against money laundering and terrorism financing risk and take steps to address specific risks associated with Non-Face-To-Face ("NFTF") business relations with a client.

In this regard, Robo Advisors shall employ additional checks to mitigate the risk of impersonation when on-boarding clients through NFTF means.

Disclosure of Information

The Rules mandate the Robo Advisor to disclose certain information, including where a conflict of interest lies from any connection to or association with any product provider, including any material information or facts that may compromise their objectivity or independence in writing to the clients. The Rules of the SEC on the Code of Conduct for Employees of Capital Market Operators must also be complied with.


In addition, sufficient information must be disclosed to their clients to enable them make informed investment decisions and be presented in plain English and in clear simple language. This will include a risk warning statement to clients at the point of account opening and when advising them on overseas-listed investment products.



Moreover, Robo Advisors must, regardless of whether the client is self-directed or not, assess if a client possesses the relevant knowledge and experience to invest in complex instruments through the Customer Knowledge Assessment (“CKA”) or Customer Account Review (“CAR”). There must also be an effective framework to collect information from clients to enable them conduct CAR or CKA for product suitability.

CONCLUSION

The Rules on Robo Advisory is a welcome development to the finance space in Nigeria. It has already been described as the first phase of larger regulatory frameworks that could include digital assets, offerings, and intercontinental, borderless trading on emerging securities[4].



The Rules are comprehensive and suited for the unique nature of Robo Advisory, the process for registration is not fraught with regulatory bottlenecks typical of the Nigerian business climate, and it is backed with a technical framework that provides for the intricacies associated with the Robo Advisory technology.

The rules can increase confidence in the financial market, facilitate quality-based competition and introduce more active players into the Nigerian financial space as Robo Advisors continue to grow into a major force in the world market.

[4] Olisa Agbakoba Legal, 'Robo-Advisors In Nigeria: The Regulatory Framework For Robo-Advisory Services In Nigeria' (Mondaq, 19 August 2021) <<https://www.mondaq.com/nigeria/new-technology/1103128/robo-advisors-in-nigeria-the-regulatory-framework-for-robo-advisory-services-in-nigeria#:~:text=The%20SEC%20Proposed%20Rules%20for%20Robo-Advisory%20Service%20in,to%20the%20proper%20function%20of%20economies%20and%20societies.>> accessed 1 February 2022

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