

# **DO YOU PROVIDE ROBO ADVISORY SERVICES? YOU SHOULD BE AWARE OF THIS PROPOSED REGULATION!**



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The Securities and Exchange Commission (“SEC”) recently released an exposure draft of the proposed SEC Rules and Sundry Amendment to the extant SEC Rules which provides for the regulation of Robo Advisory services and also created a new category of advisers to be known as Robo Advisers<sup>1</sup> (“RA Rules”).

### Who does the RA Rules apply to?

The RA Rules are applicable to all Capital Market Operators and persons offering or seeking to offer Digital (Robo) Advisory Services in the Nigerian Capital Market<sup>2</sup>.

### Is there a requirement for Robo Advisers to register with a regulator?

Based on the RA Rules, anyone who wishes to provide Robo Advisory Services will be required to register with the SEC. In this regard, the RA Rules provide that the provisions of Rule 96 (1) and (2) of the SEC Rules and Regulations, which sets out the requirements for the application for registration as an Investment Adviser shall, with all relevant amendments, be applicable.

We have set out below the highlights of the RA Rules, with respect to the provision of Robo Advisory Services:

#### 1. Due Process

Under the RA Rules, Robo Advisers are required to reflect the following measures for due process in providing their services:

- a. comply, on an ongoing basis, with all the applicable business conduct requirements included in the Investment and Securities Act (ISA) and the Rules and Regulations, Notices and Guidelines issued pursuant to the ISA;
- b. where a Robo Adviser outsources the development and maintenance of its client facing tools to a third party provider, it shall subject the third party provider to appropriate due diligence processes;
- c. where a client decides on an alternative product or recommendation, which is different from a Robo Adviser’s recommendation, a Robo Adviser must honour the client’s order. Where a client chooses not to rely on the advice provided, a Robo Adviser shall document the decision of the client, highlighting to the client in writing that it is the client’s responsibility to ensure the suitability of his investment decision; and a Robo Adviser who wishes to perform the

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<sup>1</sup> A Robo Adviser means a person who provides digital advisory services. Also, Automated Robo Advisers means Robo Advisers with no human adviser intervention in the entire advisory process.

<sup>2</sup> Digital (Robo) Advisory Services means 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.



function of portfolio management shall apply to SEC to be registered as a Fund/Portfolio Manager and shall comply with Part C7 of the SEC Rules and the Regulations governing Fund/Portfolio Management Function.

## **2. Procedures for Rebalancing a Client's Investment Asset Allocation**

Under Rules 4 (a)(i) and(ii) of the RA Rules, a digital investment advisory process occurs where a client answers a series of questions on his risk tolerance, investment objectives, investment time horizon, inputs an investment amount and the input of the client are analysed using algorithms and a portfolio is recommended thereafter.

The RA Rules also sets out the steps to be taken by a Robo Adviser where a client seeks to revert from his/her revised portfolio to the portfolio that the Robo Adviser initially recommended. This is referred to as rebalancing. Where this occurs, a Robo Adviser shall:

- a. ensure that the rebalancing activity is carried out only for portfolios initially identified by the client;
- b. obtain a one-time prior written authorisation from the client to rebalance the portfolio; and
- c. provide a written disclosure to the client prior to obtaining the client's written authorisation referred to in (b) above and where there are changes in the scope of rebalancing activities; and notify the client prior to every rebalancing transaction.

A Robo Adviser is required to carry out a post-authorisation technology audit, conducted by an independent third party at the end of each operational year.

## **3. Governance and Supervision of Algorithms**

The Board and Senior Management of a Robo Adviser are charged with the responsibility of maintaining effective governance of the client-facing tools and ensuring that there are sufficient resources to monitor and supervise the performance of algorithms. This includes ensuring that the requirements set out in SEC's Guidelines on Technology Risk Management are complied with.

## **4. Key Points for Developing, Monitoring and Testing of the Client-facing Tool**

In developing the client-facing tools, Robo Advisers are required to, amongst others:

- a. ensure that the methodology of the algorithms behind the client-facing tool is sufficiently robust;



- b. ensure that the tool collects all necessary information and sufficiently analyses same to make a suitable recommendation;
- c. perform sufficient testing, prior to the launch of the tool and when changes are made to the tool, to detect any error or bias in the algorithms; and
- d. ensure that the algorithms correctly classify clients according to their risk profiles, based on inputs provided by the clients.

#### **5. Any Requirement to Comply with Anti Money Laundering Laws?**

Robo Advisers are required to implement internal policies and procedures to address technology risks. Robo Advisers are, therefore, required to satisfy the requirements set out in the SEC's Guidelines on Technology Risk Management (TRM) and also refer to the TRM Guidelines for industry best practices which they are expected to adopt.

In addition, Robo Advisers are required to comply with the the anti-money laundering and financial terrorism laws in Nigeria.

#### **6. Duty to Disclose Material Information**

Robo Advisers have a duty to provide sufficient information to their clients to enable them to make informed investment decisions. Disclosures to clients should be made in plain, comprehensible English and in clear simple language.

#### **7. Dealing with Conflicts of Interest**

Robo Advisers are required to comply with the existing disclosure requirements on conflicts of interest set out in the Code of Conduct for Employees of Capital Market Operators set out in SEC's Rules and Regulations. Particularly, Robo Advisers are required to disclose in writing to their clients, any imminent or actual conflict of interest arising from any connection to or association with any product provider.

#### **8. Risk Warning Statement for Overseas-listed Investment Products**

Robo Advisers are required to provide a risk warning statement to their clients at the point of account opening and when advising them on overseas-listed investment products.

#### **9. Offer tailor-made investment recommendations**

The RA Rules require Robo Advisers to have a reasonable basis for recommending any investment product to a person who may reasonably be expected to rely on the recommendation.



In order to ensure that a recommendation takes into account a client's investment objectives, financial situation and particular needs, Robo Advisers are required to take reasonable steps to collect and document the financial objectives of the client, the risk tolerance of the client, etc.

Robo Advisers are also required to 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").

## 10. Are there Exemption to Collecting Full Information from Clients?

The RA Rules provide that a fully automated Robo Adviser may exempt the collection of full information on a client's financial circumstances, provided that all of the conditions set out in the RA Rules are met.

Robo Advisers relying on the client's financial objectives and risk tolerance shall still take reasonable steps to collect information on the client's financial objectives and risk tolerance in order to satisfy themselves that the investment recommendation is suitable. Robo Advisers are also required to comply with the advertisement requirements of the Rules and Regulations of the SEC.

### Conclusion

It is commendable that the SEC has taken the first step to include and regulate the provision of Digital Advisory Services in Nigeria's capital market operations. It is expected that when the Proposed Amendment is incorporated into the existing SEC rules, it would create a framework for the development of this entirely distinct category of capital market advisory services in an increasingly technology driven market.

Please see the link to the SEC proposed amendment if you require further information: <https://sec.gov.ng/proposed-new-rules-and-sundry-amendments-to-the-rules-and-regulations-of-the-commission/>



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