Understanding Robo Advisory Services in Nigeria

Introduction

Robo advisory services have been gaining traction over time in Nigeria, with the operation of early version Robo Advisers such as PiggyVest. The growth has been attributed to Nigeria's growing middle class and increasing smartphone penetration. According to statistics, the projected assets under management in the robo advisory market in Nigeria are expected to reach US$4,720,000,000 (Four Hundred and Twenty-Seven Billion United States Dollars) this 2024.[1]

Below, we delve into the crux of robo advisory services, as well as the legal and regulatory mechanisms for the protection of investment in such non-face-to-face transactions that characterize robo advisory services.

[1] 'Robo Advisors – Nigeria', (Statista, August 2023), available at https://www.statista.com/outlook/fmo/wealth-management/digital-investment/robo-advisors/nigeria, accessed on 28th January 2024.

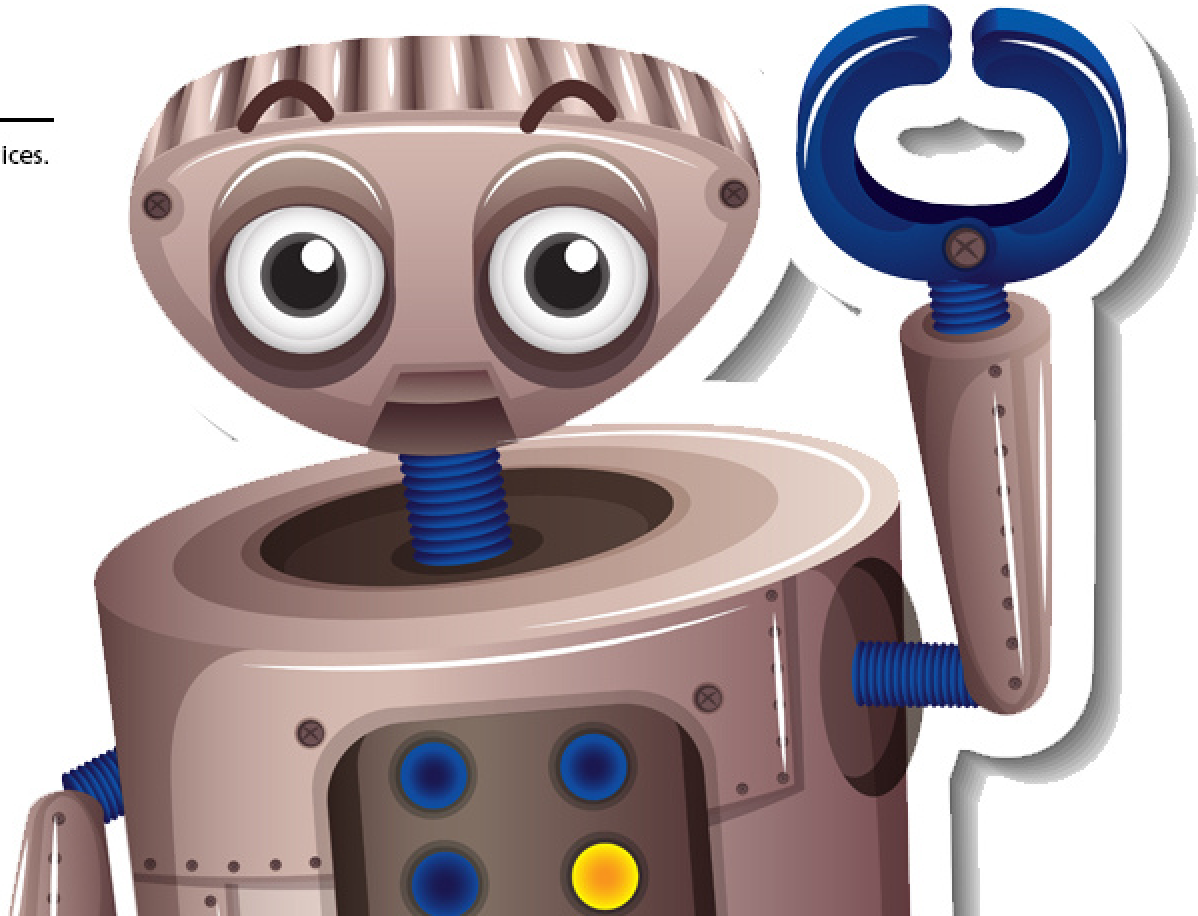
Who is a Robo Adviser?

A robo-adviser is a platform or other form of an automated financial advisor that provides algorithm-driven investment or wealth management services with little or no human intervention.

The Proposed Rules on Robo Advisory Services ("**Robo Advisory Rules**"), issued by the Securities and Exchange Commission ("**SEC**"), heralded robo-advisory activities in Nigeria. However, the Robo Advisory Rules focus on the person or entity providing the robo advisory services and not the platform or automated process itself.

Under the Robo-Advisory Rules, a Robo Adviser is a person who performs digital advisory services ("**Robo Adviser**").[2] Digital advisory service is defined as the provision of investment advice using automated, algorithm-based tools which are client-facing, with little or no human adviser interaction in the advisory process. Notwithstanding, the Robo Advisory Rules recognize the existence of fully automated Robo Advisers which require no intervention of a human adviser in the advisory process.

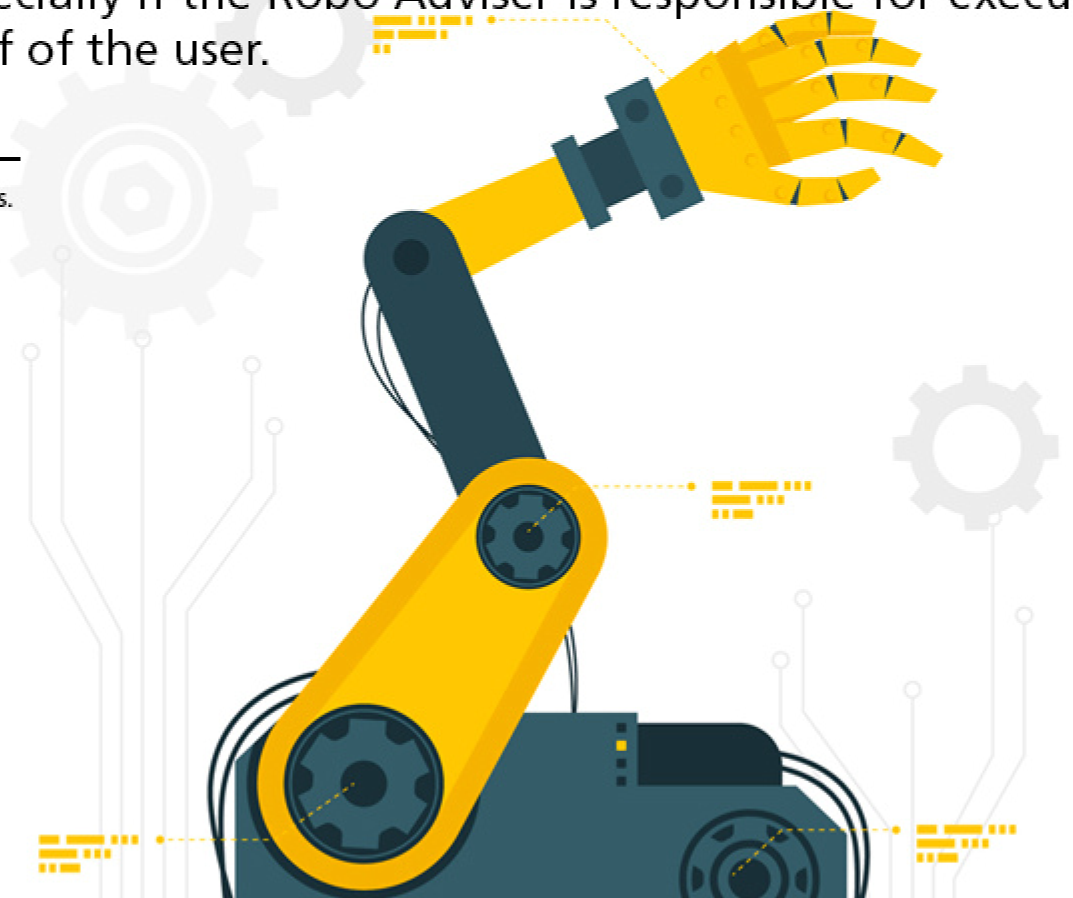
[2] Rule 1 of the Rules on Robo Advisory Services.



How Robo Advisory Works

Under the Robo Advisory Rules, the digital advisory process involves the following procedure:

1. A user interacts with the Robo Adviser’s platform by responding to a set of questions relating to their risk tolerance, investment objectives, time horizon, and investment amount.
2. The user's inputs are analyzed using algorithms, leading to the recommendation of a suitable investment portfolio.[3]
3. If the user accepts the recommended portfolio, the Robo Adviser will transmit the user's orders directly to the relevant capital market operator for execution, unless the Robo Adviser is licensed to execute transactions on behalf of user.
4. If a user modifies or rejects the recommended portfolio and wishes to adjust same, the Robo Adviser must seek explicit consent from the user to accept the revised portfolio, especially if the Robo Adviser is responsible for executing transactions on behalf of the user.



[3] Rule 4 of the Rules on Robo Advisory Services.

5. When a user desires to periodically rebalance their portfolio, the Robo Adviser will:

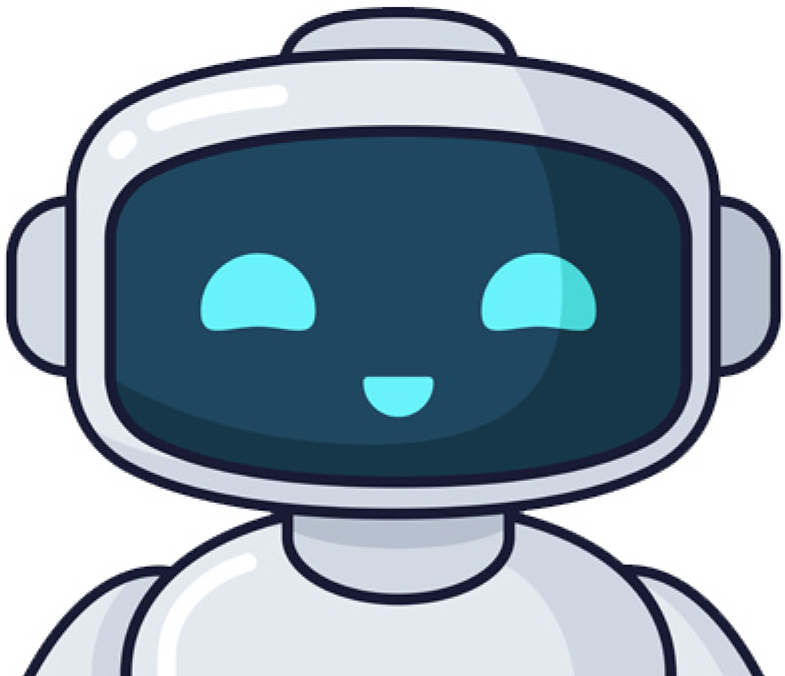
    (a) obtain prior written authorization from the user for rebalancing (for non-discretionary portfolios); and

    (b) establish a rebalancing policy for the investment portfolio, as agreed with the user. This policy will encompass, amongst others, the scope of rebalancing activities, including frequency and methodology, fees payable, and a stipulated period for providing advance notice before carrying out any rebalancing activities.

Collection of Information

Robo Advisers are required to take reasonable steps in collecting information. They shall take such information as is necessary to ensure that a recommendation takes into account a user's investment objectives. This information typically includes:

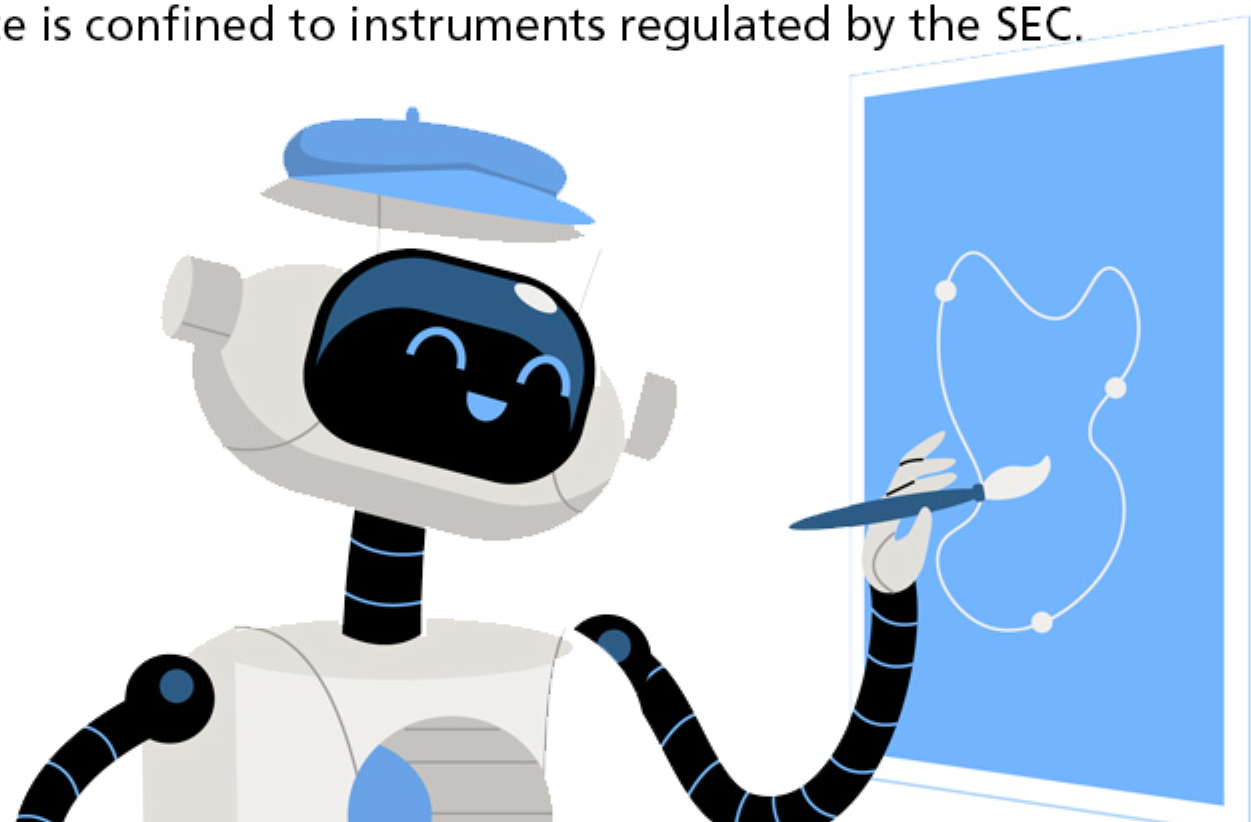
(a) the financial objectives of the client;
(b) the risk tolerance of the client;
(c) the employment status of the client;
(d) the financial situation of the client, including assets, liabilities, cash flow and income;



(e) the source and amount of the client's regular income; vi. the financial commitments of the client;
(f) the current investment portfolio of the client, including any life insurance policy; viii. whether the amount to be invested is a substantial portion of the client's assets; and
(g) any recommendation made in respect of life policies, the number of dependants of the client and the extent and duration of the financial support required for each of the dependants.

Fully automated Robo Advisers are however exempt from collecting the above information subject to the following conditions:

(a) The advice is fully automated, with no human intervention in the process, except for technical assistance.
(b) In-built "knock-out" questions are incorporated to eliminate unsuitable clients.
(c) Controls are in place to manage inconsistent client responses.
(d) A risk disclosure statement is provided to clients to alert them that where the recommendation doesn't consider their financial circumstances at the relevant time;
(e) the advice is confined to instruments regulated by the SEC.



Registration Requirement for Robo Advisory Services

Robo Advisers are subject to the same registration requirements for Investment Advisers under the SEC Rules and Regulations with necessary modifications. Essentially, Robo Advisers are to be registered with the SEC as either individual or corporate investment advisers.[4]

Additionally, Robo Advisers may provide portfolio management services. This is, however, subject to their registration with the SEC as a fund/portfolio manager.

Conclusion

There is increased reliance on automated financial solutions including using algorithm to make investment decisions. Thus, the rise of Robo Advisers in Nigeria's financial landscape presents both opportunities and challenges. While the automated nature enhances accessibility and efficiency, careful considerations must be made to ensure regulatory compliance, client suitability, and safeguarding the investor interests. To adapt to the evolving landscape, regulators need to regularly revise applicable laws and rules to keep up with technological advancements, and Robo Advisers must prioritize robust risk management, ongoing testing, and transparency. Striking this balance will not only foster the growth of the Robo Advisory sector but also protect the interests of investors in this digital era.

[4] Rule 2 of the Rules on Robo Advisory Services; Rule 97 of the Securities and Exchange Commission Rules and Regulations 2013.