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FinTech in Nigeria:

Enabling Growth Through Regulation

From the market trader using Paga for her money transfers to the busy doctor paying his bills on Quickteller, FinTech is causing a major revolution in Nigerian financial services. In the past few years, technology and innovation have increasingly changed the delivery of financial services globally. Nigeria remains Africa's biggest revenue opportunity given its status as the largest economy and the most populous country on the continent. Several factors such as good infrastructure, data security, socio-cultural issues and a sound regulatory framework contribute to the development of the FinTech ecosystem in Nigeria. A regulatory framework which enables innovation and competition in addition to protecting consumers can secure the success of FinTech services. In light of this, we consider the regulatory challenges FinTech is facing in Nigeria and recommend various approaches which the regulator can adopt to facilitate development in various areas of FinTech.

A Tailored Regime

The swiftly changing face of financial services comes with an urgent need for the regulator to catch up, if FinTech is to attain its maximum potential in Nigeria. There is currently no single framework for FinTech services in Nigeria, although to date, emphasis has been placed on regulating the payments space to the neglect of other FinTech areas. Because FinTech services vary widely, Nigerian regulators need to customise their approach to regulating various areas of FinTech. Let's take crowdfunding as an example; a method of financing using social media or online platforms to generate small amounts of capital from a large number of people to fund a venture. Crowdfunding can provide a funding solution for small and medium sized enterprises (SMEs), which may not be able to source funds easily from investors and banks. While crowdfunding exists informally in Nigeria, legislative restrictions and the lack of a tailored regulatory framework to support this new mode of financing have held back its progress. The money put into a crowdfunding pot is akin to an equity or debt investment in a company. In the dearth of tailored legislation, this similarity makes crowdfunding apparently subject to the same laws that would govern company investments, that is, the Companies and Allied Matters Act (CAMA) and the Investment and Securities Act (ISA)

The CAMA regulates the formation of all types of company and enterprise in Nigeria and along with the ISA places restrictions on invitations to the public to make investments in a company. As the scheme involves inviting donations or investments from the public, the result of applying the provisions of these Acts to crowdfunding is that the Securities & Exchange Commission has informally indicated that crowdfunding is prohibited in Nigeria.

This illustrates the problems of regulating new models of financial services with existing rules which did not contemplate such services and highlights the need for the regulator to move with the times. The risks associated with crowdfunding such as fundraising scams and exploitation are said to be higher in the Nigerian market and therefore the importance of regulation cannot be overemphasised. That said, a prohibition on all forms of crowdfunding in Nigeria based on a misfit between existing legislation and modern services is draconian. Regulators such as the UK Financial Conduct Authority have differentiated various forms of crowdfunding, such as investment/equity crowdfunding from donation and reward based crowdfunding, with the latter not being subject to regulation. The SEC in Nigeria could consider this option to empower SMEs instead of adopting a 'one size fits all' approach.

Same Rules, New Models

While other FinTech services still suffer from scanty or a non-existent regulatory framework market, the area of payments is currently the most regulated in Nigerian FinTech. The Central Bank of Nigeria (CBN) has issued various guidelines relating to electronic and mobile payments. Mobile money is a payment service performed from a mobile phone which enables users to access financial services without the need for a traditional bank account. With a large unbanked population and high mobile penetration in Nigeria, mobile money could go a long way in achieving the CBN's goal of a cash-less economy and greater financial inclusion. However, mobile money in the country has not achieved its potential due to the regulatory models adopted by the CBN. In its "Guidelines on Mobile Payments Services in Nigeria", the CBN creates two models of mobile money services (bank led and non-bank led) and establishes the requirements for obtaining a mobile money license. Under the bank led model, banks act as lead initiator managing the core infrastructure and providing mobile money services alone or in partnership with other approved organisations. The non-bank led model on the other hand permits licensed corporate organisations (such as Interswitch) to act as lead initiators instead of banks or telcos. Telcos are precluded from being licensed for mobile money services.

Comparing this to the Kenyan model which is telco led, it becomes evident that the Kenyan regulatory approach to the mobile payments is instrumental to the monumental success of the country's biggest mobile money transfer service, M-Pesa. Kenyan regulation at the time of M-Pesa's introduction were minimal and facilitated market innovation. The same FinTech service when introduced into South Africa experienced a dismal failure for various reasons, one of which is the strict banking regulations in the country.

The CBN's decision to preclude telcos despite (and because of) their size and market reach appears to be based on concerns around a loss of control (the CBN does not have regulatory oversight of telcos) and preventing anti-competitive practices by telcos. The model employed in Nigeria has made mobile money less attractive to telcos who consequently have less incentive to develop the country's infrastructure. In addition to this, banks simply do not have the large customer base or penetration that telcos have in Nigeria. These factors together slow the pace of financial empowerment across all demographics in Nigeria. Until the CBN takes an approach which is favourable to the players who can reach the masses, Nigeria is unlikely to maximise its opportunities in the mobile payments space.

A Proactive versus Reactive Approach

As new innovations emerge, a proactive instead of reactive stance from the regulator is ideal to protect the public and the country's economy. If any lessons were learnt from the global financial crisis, it is the importance of understanding and regulating innovative financial services. Recently, there has been much talk in Nigeria about a relatively new form of currency, Bitcoins. Bitcoins are digital or virtual currencies, similar to physical currencies but distinct in that they are only internet based and are generally unregulated by any central bank or government. As they can be bought on the internet anywhere in the world and exchanged for physical currencies without any regulatory constraints or substantial remittance costs, Bitcoins or other virtual currencies could prove a very valuable tool for international money transfers in Nigeria given the dollar crunch. However, the CBN has issued warnings to the public against the use of these currencies because of the anonymity of virtual transactions and their potential for terrorism financing and money laundering. Evidently, the risks associated with virtual currencies make regulation imperative. Such regulation could be in the form of KYC and AML requirements for players offering Bitcoins. Even in more developed countries, virtual currencies remain unregulated but their perks in the Nigerian economy are a good reason for the CBN to take the bulls by the horn.

Where to?

As with all technology, FinTech innovation is moving faster than the regulators can. As FinTech stems from traditional financial services which are heavily regulated, regulators have to find a balance between maintaining a secure financial system while encouraging innovation. Nigerian regulators can consider various approaches to achieve this including:

- The CBN collaborating with the Nigerian Communications Commission (NCC), other regulators, and stakeholders: The convergence between finance and other regulated industries such as the interplay between the financial services sector and telecommunications in relation to the licensing of mobile payments and value added services by the CBN and NCC respectively, creates a need for regulators of various sectors to collaborate in order to ensure regulatory consistency and harmonisation. The CBN can also bring stakeholders together in forums or workshops for information sharing and knowledge exchange, in addition to drawing on the experience of regulators in other jurisdictions such as the UK which is the vanguard of FinTech regulation.

- Creating regulatory sandboxes for FinTech firms as done by the UK's Financial Conduct Authority and the Monetary Authority of Singapore: These sandboxes are best described as contained experiments which allow firms to innovate without regulatory constraints and to receive appropriate feedback on which to build on their innovations.

- Adopting lean regulation or minimal regulation as with the M-Pesa in Kenya: The CBN and other relevant regulators can collaborate with FinTech firms in their incubation phase and keep the requirements on them to a minimum. Regulations can develop gradually as the market matures and there is better understanding of the risks involved.

- Ensuring regulatory flexibility so that complex regulations do not create barriers to entry for start-ups or smaller firms: The rules that apply must be balanced against the size and capabilities of the players affected as the demands for coping with regulations designed for a large financial institution would crush a start-up especially when costs (such as those that relate to licensing, capital requirements or corporate governance) and manpower are considered.

- Providing support in the form of tax and other government incentives: This can include granting FinTech players pioneer status. Although not currently designated as a pioneer service for tax purposes, the President has a discretion under the Industrial Development (Income Tax Relief) Act to designate an industry pioneer. This would attract and incentivise players in the industry and by so doing further enable innovation.

Nigerian regulators should have a proactive and tailored approach to the regulation of FinTech services, rather than a reactive and uniform one in order to enable the industry to reach its maximum potential. A call for better regulation does not necessarily mean heavier regulation or even deregulation. What is required however, is finding a balance and achieving policy goals in the most efficient way possible.

About Templars

Templars *is at the forefront of developments in the Nigerian FinTech industry. We have a dedicated FinTech team that cuts across our finance, corporate/commercial and regulatory compliance teams. The team has advised numerous local and international clients on licensing, investments in FinTech and regulatory issues.*

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