TEMPLARS

PAYMENTS SYSTEM: THE NEW CBN LICENSING FRAMEWORK

The payments system cluster is perhaps one of the more sophisticated layers of the Fintech ecosystem in Nigeria, and is certainly one of the most active amongst users and most attractive to investors. From switching and payment gateway companies to mobile wallet operators and beyond, this segment of the market has multiple tentacles, all of which represent a critical pillar of the entire Fintech ecosystem.

On the 9th of December 2020, the Central Bank of Nigeria (‘**CBN**’) issued a circular (the ‘**PSP Circular**’) setting out a new licensing framework for payment service providers. Amongst other things, the PSP Circular sets out permissible activities that payments system companies can engage in, minimum capital requirements depending on the license category and generic regulatory requirements that apply to the entire payments system.

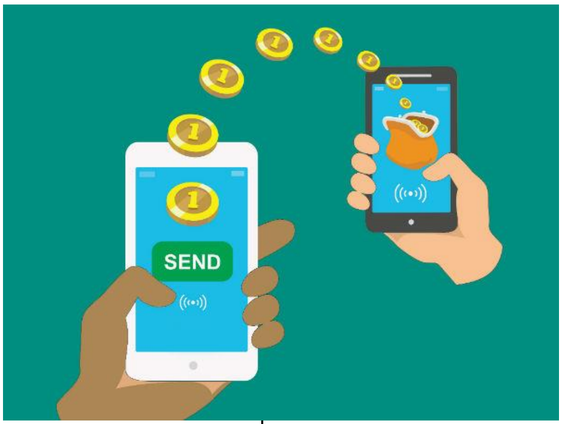
As the Nigerian fintech sector continues on its fast-paced growth trajectory with frequent innovations, regulation is often described as playing catch-up and the pertinent question now is how well will these new CBN licensing categories serve the reality of the sector?

NEW LICENSE CATEGORIES

The most significant change introduced by the Circular is the new license categorisation for the various players within the payments system.

As market watchers will recall, the CBN previously revealed its proposed guidelines on license tiering for payment service providers in October 2018 (‘**Draft Tiering Guidelines’**). The Draft Tiering Guidelines revealed the CBN’s plan to introduce a tiering framework for payment service providers (PSP), intended to provide regulatory clarity for the multiple players within the PSP space.

Although it is unclear whether the Circular is based on the Draft Tiering Guidelines or a final version of the Draft Tiering Guidelines is still expected, the Circular has effectively



introduced a great deal of clarity to the blurry lines of this particular corner of the Nigerian Fintech regulatory landscape.

Lack of clarity and regulatory uncertainty are some of the reoccurring challenges with Fintech regulation in Nigeria. However, what the Circular has achieved is to make it easier for market players to identify the type of license that will be required to offer their products and services including the range of permissible activities.

Below are the four new licensing categories:

Switching and Processing

The range of permissible activities under this category include switching, card processing, transaction clearing and settlement agent services, non-bank acquiring services and any other activities that super agents, PTSPs and PSSPs are permitted to undertake.

Mobile Money Operations (MMO)

E-money issuance, wallet creation and management and pool account management falls under the range of permissible activities for MMOs. Further, MMOs are also permitted to undertake super agents' permissible activities.

Payment Solution Services (PSSs)

Under the Circular, PSS have been sub-categorised into three (3) different categories: Super-Agents; Payment Terminal Service Providers ('PTSPs); and Payment Solutions Service Providers (PSSPs).

Super Agents are permitted to undertake agent recruitment management and other activities specified in the CBN Regulatory Framework for Licensing Super Agents in Nigeria.

Point of sale (POS) terminal deployment and services, POS terminal ownership and merchant/agent training and support are the range of permissible activities under the PTSP category while PSSPs are permitted to deploy payment processing gateway and portals; provide payment solutions and application development services; and provide merchant aggregation and collection services.

Regulatory Sandbox

Interestingly, the Circular also creates a regulatory sandbox category. Under this category, sandboxed Fintechs will be allowed to offer their products and services with some level of regulatory forbearance, albeit subject to the guidance of the CBN.

Whilst regulatory sandboxes provide a controlled environment to test new products and/or technology, under which regulators can keep alert to potential risks, one may not have expected this to be one of the categories for new payment systems licensing. The CBN had on 23 June 2020 issued a Draft Framework for Regulatory Sandbox Operations in Nigeria ('**Draft Sandbox Framework**'). However, the Draft Sandbox Framework is yet to come into force, and it is not entirely clear how the sandbox category under the Circular will be implemented, nor how it fits into the proposed Sandbox Framework. It is our expectation that the CBN will separately issue comprehensive guidelines on the sandbox regime including the selection criteria, eligible businesses and generic rules that will apply.

KEY DEVELOPMENTS

In addition to the new license categorisation, the Circular also sets out important regulatory guidance key rules that are applicable to all players within the payments system.

Most notably:

Minimum Capital Requirements

Similar to banks, payment service providers (with the exception of those falling with the regulatory sandbox category) now have minimum capital requirements. The Circular stipulates ₦50 million for Super Agents, ₦100 million for PTSPs and PSSPs and ₦2 billion for MMOs and Switching and Processing companies.

The introduction of the minimum capital requirements is bound to elicit mixed feelings in the market. One the one hand, it is a welcome development in view of the inherent risks associated with payments system and will bring some level of security (and inevitably, increased consumer confidence) to the sector. On the other hand, though, in a sector where the only asset of new entrants is often innovative technology and ideas, this will certainly heighten the barriers to entry. It is also arguable whether switching and processing companies should be subject to such requirements given that they are not permitted to hold customer funds.

Customer Funds

The Circular provides that only MMOs are permitted to hold customer funds. Therefore, other licensees such as PSSPs, payment processors and switching companies, are not permitted to hold customer funds. From a practical perspective, this corresponds to the nature of the underlying business of such entities and should not be restrictive.

HoldCo Structure

Companies seeking to combine activities under the switching and MMO categories are now required to adopt a HoldCo structure, such that each subsidiary of the HoldCo will be permitted to undertake a single activity to avoid comingling. One concern that was identified in the Draft Tiering Guidelines is the risk that a switch could prioritise the scheme of its related entity to the detriment of third party MMOs who are competitors of the switching companies related entity. This requirement does not eliminate that risk and indeed nothing in the Circular appears to address it. Either the CBN has decided to allow market forces play out or we are sure to see some regulation to prevent this risk in the near future.

Combination of Licenses

Payment system companies in the PSS category are permitted to hold any or all of the PSS licenses.

Requirement for Letter of "No Objection"

All payment service providers licensed under the new framework holding or seeking to obtain any other CBN issued licenses are now required to obtain a no objection letter from the Payment System Management Department of the CBN.

Restrictions on Constitutional Documents

CBN specifically requires that the objects clause in the memorandum and articles of association of a payment service provider now be limited to the permissible activities under their licensing authorisation.

This restricts the range of objects that could feature on the memart of a licensed payment service provider. The practical implication is that entities will find themselves updating their objects every time new products and a new business line is envisaged, rather than having the flexibility of a wider objects clause.

Collaboration Approval

All collaborations between licensed payment service companies, banks and other financial institutions in respect of products and services will now require CBN's prior approval without any stated exceptions.

The new requirement for CBN prior approval will have a significant effect on the adoption of strategic partnership structures within the market. Fintechs, depending on their business needs and expertise, usually enter into partnership or strategic alliance agreements with banks, card issuers and other financial institutions to bring their products to the market. Going forward, it appears that all of these types of collaborations will now be subject to scrutiny by the CBN and it may mean that some of them never make it to the market.

Timeline for Compliance

All new licensing requests (including applications with an approval in principle) are required to comply with the Circular immediately. Further, existing licensed payment companies are to comply with the new requirements set out under the Circular no later than June 2021.

CONCLUSION

The Circular has, to some extent, addressed the prevailing market concerns around clarity on licensing and which products and services may be offered under a particular license. It does not however, provide a comprehensive framework for certain key areas–(such as the implementation of the sandbox regime) which are considered vital to coherent operation and regulation of the fintech sector.

One thing is certain, the CBN continues to demonstrate a willingness to tackle the challenges inherent in navigating Fintech regulation and it is expected that the CBN will continue to engage market stakeholders and introduce appropriate regulations based on the demands of a fast-moving market.

CONTACTS

Zelda Akindele, Partner
zelda.akindele@templars-law.com

Victor Sameria, Associate
victor.sameria@templars-law.com