

# How should Nigeria regulate its fintech industry?

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### **Introduction**

The financial services and products offered in Nigeria have changed significantly in recent years as a result of scientific and technological innovation and ever-evolving consumer behaviour and needs. In turn, this has resulted in a proliferation of new fintech companies.

'Fintech' generally refers to the various technologies and innovations used to provide financial services to consumers in competition with traditional banking services. The term also refers to companies that employ technology, software and algorithms to create innovative financial products that provide consumers with access to cheaper, faster and more efficient financial services. Such companies are essential if Nigeria is to achieve 100% financial inclusion, as they:

- provide financial services to the unbanked part of society;
- offer new and alternative products and services to consumers; and
- offer new investment opportunities to entrepreneurs.

Due to the value of the fintech sector and the impact that fintech companies and products have had on society, financial services regulators worldwide have been left to determine how best to regulate this industry in a way that encourages innovation while protecting consumers, investors and the economy. Areas of concern include data protection, cybersecurity, cross-border transactions, principles of contract, exchange control, taxes, money laundering, fraud and terrorism financing.

### **Current regulatory framework**

Like many other countries, Nigeria must decide how to regulate its growing fintech sector. The Nigerian regulators have reiterated their commitment to encouraging innovation and recognise that fintech could be a major driver of economic growth as well as job and wealth creation. As such, they have been cautious in their approach to regulation. For example, in response to the significant interest in cryptocurrencies in 2015 and 2016, the Nigerian Securities Exchange Commission and the Central Bank of Nigeria (CBN) issued public statements and circulars advising the public to take care when investing in cryptocurrencies and barring Nigerian financial institutions from engaging in cryptocurrency transactions. In addition, the Nigerian Securities and Exchange Commission has suggested that crowdfunding activities could be illegal.

The most popular fintech products and services in Nigeria are:

- payment solutions;
- online lending;
- personal saving solutions;
- mobile money and fund transfers; and
- online betting.

There has also been significant interest in crowdfunding, blockchain, cryptocurrency and digital banking.

The CBN has issued various regulations that set out the licensing regime pursuant with which businesses offering the above products and services to clients must adhere. For example, in 2014 the CBN issued the International Money Transfer Services Guidelines to regulate indigenous and international money transfer service operators in Nigeria. Further, in 2018 it issued the Guidelines for the Licensing and Regulation of Payment Service Banks.

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Nigeria's regulatory framework can, at best, be described as *ad hoc* and is still dependent on regulations and legislation that were passed during the Third Industrial Revolution to regulate traditional financial services institutions and products. The principal laws that regulate the financial services and securities sectors, as well as the associated businesses and products, are the Banks and Other Financial Institutions Act 1990 and the Investment and Securities Act 1999, both of which were enacted before these technologies and products gained traction in Nigeria.

The challenge with Nigeria's existing regulatory environment is that most of the existing laws, regulations and licensing regimes that apply to fintech companies and their products and services were initially designed for traditional financial services and are not fit for the purpose for which they are now sought to be used.<sup>(1)</sup> Thus, while the current laws offer some protection and regulatory guidance to consumers and market participants, they do not adequately cover legal issues that may arise from fintech products, such as crowdfunding, blockchain technology, cryptocurrencies and robo-advisers.

For instance, fintech companies in the payment service space must maintain a minimum capital requirement and implement infrastructure which, depending on the type of licence sought, can be significant and expensive.<sup>(2)</sup> As such, start-ups are often discouraged from the outset. In addition, to deliver their services and products, companies must apply for a variety of licences or partner with traditional financial institutions in order to deploy their products and services.

### **Possible approaches**

There is a clear need for a dynamic approach and rethinking of the Nigerian legislative framework to regulate products and businesses of the Fourth Industrial Revolution. The CBN has decided to use the fintech sector to realise its commitment to improving and promoting financial inclusion and digital innovation in Nigeria. In collaboration with the Nigerian Interbank Settlement System (NIBSS), the CBN has announced that it will create a joint regulatory sandbox to facilitate the development of the sector through an innovative approach to regulation. The Financial Service Innovators Association of Nigeria (FSI) was recently created to facilitate the implementation of a regulatory sandbox.<sup>(3)</sup>

### **Regulatory sandboxes**

Regulatory sandboxes have been adopted by several countries (eg, the United Kingdom, India, Australia, Canada and Denmark). The UK regulatory sandbox generally refers to a limited test ground or environment for new business models that are not protected by existing regulations or are seeking authorisation to operate within the United Kingdom.

Regulatory sandboxes enable participants to test products and services on a small scale in a controlled environment, reducing innovation costs and barriers to entry. They also allow regulators to collect important information about innovative products before deciding which regulatory action to take. Thus, Nigeria's regulatory sandbox will facilitate the necessary dialogue between market participants and regulators to develop regulatory actions that strike the right balance between facilitating innovation and mitigating new risks.

If the regulatory sandbox is implemented properly, companies and entrepreneurs will have access to an environment in which to test their products and work with regulators to design the necessary regulations and consumer protections. This will help to create a much-needed balance in the Nigerian regulatory environment and provide the CBN with a better understanding of the fintech products to be introduced to the market.

Other regulators, such as the Nigerian Securities and Exchange Commission, are also taking steps to set up a regulatory sandbox that offers a safe space for start-ups and other businesses to test innovative products, services, business models and delivery mechanisms relating to capital markets in a live environment without having to immediately satisfy existing regulatory requirements.<sup>(4)</sup> The Nigerian Securities and Exchange Commission's action will no doubt help fintech companies to design products that can be deployed in areas such as asset management and crowdfunding. The question is whether there is a need for multiple regulatory sandboxes or whether it would be advisable for the Nigerian Securities and Exchange Commission and the CBN to jointly establish and oversee a single sandbox.

### **SRO structure**

Another approach that the regulators may consider is a self-regulatory organisation (SRO) structure. Although this concept might be of interest to fintech companies, it is unlikely that the Nigerian regulators will pursue it. An 'SRO' is a private organisation which can create and enforce standalone industry and professional regulations and standards. SROs often regulate part of a given market and often have a narrower focus than national regulators. Where an SRO approach is adopted to regulate fintech, there is a risk that the regulations may be lopsided and favour fintech companies more than their consumers and counterparties. Because these regulations will be formulated by key

participants in the industry with a clear understanding of the various products and the associated risks, they will be better designed to formulate appropriate regulations that address issues such as cybersecurity, data protection and consumer protection.

The Nigerian regulators may wish to consider the SRO approach in conjunction with the regulatory sandbox. This would foster fintech innovation while creating a balance with respect to consumer protection.

## Comment

Whatever the solution, it is clear that the present regulatory environment is not conducive and that the relevant regulators are taking necessary steps to address the concerns of the industry, consumers and business counterparties of fintech companies. The regulators have recognised that the current regulatory framework is inadequate and made a strong commitment to ensuring that these promising innovations can develop, potentially making Nigeria the fintech capital of sub-Saharan Africa.

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## Endnotes

(1) Further information is available [here](#).

(2) The different types of fintech licence (and how they apply in Nigeria) are as follows:

- Payment licences – these depend on the actual services provided (see list below). Licensees include payment service banks (PSBs), payment solution service providers (PSSPs) and payment terminal service providers (PTSPs).
- Online lending licences – the exclusive legislative list in the Constitution 1999 (as amended) does not provide for online lending, which is distinct from banking. The CBN has also confirmed that an institution that disburses loans only to its customers and does not engage in deposit taking is not under the supervisory purview of the CBN. On the other hand, the concurrent legislative list provides for states to make laws with respect to the commercial development of the state which, although broad, is likely to cover consumer loans. Thus, a company seeking to engage in online lending can do so pursuant to a licence granted at the state level under the moneylending, cooperative society or pawnbroking laws of the various states. If the proposed activities are broad enough, the institution can also obtain a finance company licence pursuant to the Banks and Other Financial Institutions Act and other relevant regulations issued by the CBN. Permissible services for finance companies include the provision of consumer and business loans to individuals and micro, small and medium-sized enterprises, fund management, asset finance, project finance, local and international trade finance, debt factoring, debt securitisation, debt administration, financial consultancy and loan syndication.
- Personal savings solution licences – issued to microfinance banks (MFBs) and deposit money banks (DMBs). Separate licensing could be avoided if the entity uses the services of existing banks.
- Mobile money licences – issued to mobile money operators (MMOs).
- Money transfer licences – issued to money transfer services operators (MTSOs).
- Online betting licences – licences are issued by the National Lottery Regulatory Commission (NLRC) pursuant to the National Lottery Act, which vests in the NLRC nationwide jurisdiction with regard to the regulation of lotteries and related activities, including sports betting. The Lagos state government has, through the state Lotteries Law, established a separate licensing regime for lottery operators within the state. As part of its mandate, the Lagos State Lotteries Board is empowered to grant licences, set appropriate standards, monitor and inspect lottery operators and impose penalties thereon in Lagos state. In a bid to protest this dual licensing regime, the NLRC took Lagos state to court in 2005 (*NLRC v Attorney General of Lagos State*, Suit FHC/ABC/CS/07). The court was called on to determine which party had the power to license lottery businesses in Nigeria. In reaching its decision, the Federal High Court considered Item 62(a) of the Exclusive Legislative List of the Second Schedule to the Constitution (as amended) and held that national lotteries fall within the purview of 'interstate trade and commerce', over which the federal legislature has legislative competence. The court further stated that any grantee of a national licence can carry on trade between states without having to obtain additional approval or another licence from the relevant state government. The Lagos state government filed an appeal, but swiftly withdrew it. Nonetheless, several media publications have reported that lottery operators in Lagos state with NLRC permits

have decried the alleged actions of Lagos state government officials who have claimed that they are illegal gaming centres as they do not possess a Lagos state lotteries licence.

- Crowdfunding licences – unavailable. The Nigerian Securities and Exchange Commission has warned that reward or equity crowdfunding is in breach of the Investment and Securities Act.
- Cryptocurrency licences – unavailable. The CBN has discouraged cryptocurrency business.

Types of financial service provider in Nigeria are as follows:

- MFBs – smaller banks which provide microfinance services, such as savings, loans, domestic fund transfers and other financial services to micro, small and medium-sized enterprises.
- DMBs – financial institutions which are licensed by the CBN to mobilise deposits from the surplus unit and channel the funds through loans to the deficit unit and perform other financial services activities.
- PSBs – these provide financial services to the last mile by facilitating connectivity and payments through physical points or digital interfaces, including mobile or internet-enabled platforms. PSBs are permitted to accept deposits, carry out payment and remittance services, issue debt and pre-paid cards, operate electronic wallets and carry out retail payments and international transfers, among other things.
- MMOs – service providers that develop and deploy financial services primarily through mobile phones and networks. Any non-bank institution providing infrastructure for mobile payment systems must be licensed by the CBN and obtain a unique short code from the NCC, as well as unique scheme codes from the NIBSS.
- PSSPs – service providers that design and develop the underlying e-payment infrastructure for financial institutions in Nigeria.
- PTSPs – these deploy, customise, support and maintain point-of-sale terminals on behalf of banks (acquirers).
- Card schemes – payment networks that are linked to payment cards, such as debit or credit cards, which banks and other eligible financial institutions can join.
- Super agents – agents that have been contracted by the principal and can subcontract other agents in a network while retaining overall responsibility for the agency relationship.
- Switches – switching companies facilitate the electronic circulation of money and the exchange of value between individuals and organisations.
- Third-party processors – companies that help to facilitate payments for small businesses.
- MTSOs – no person or institution can provide international money transfer services unless they have been duly licensed by the CBN. Permissible activities include the acceptance of funds for the purpose of transmitting them to persons resident in Nigeria or another country and cross-border personal money transfer services.

(3) Further information is available [here](#).

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