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SEC'S REGULATORY INCUBATION (RI) PROGRAM FOR FINTECH COMPANIES

Introduction

The Securities and Exchange Commission (SEC) issued a circular on June 16, 2021 notifying members of the public and capital market operators of the introduction of the Regulatory Incubation (the RI) program for FinTech companies seeking to provide innovative capital market services.

The RI program is an interim measure to aid the evolution of effective regulation, which accommodates the innovation by FinTechs without compromising market integrity and within limits that ensure investors' protection. The RI program is designed to address the needs of new business models and processes that require regulatory authorization to continue carrying out full or ancillary technology-driven capital market activities in Nigeria. This program will include both start-ups already operating and those still looking to enter into the FinTech sector.

Further to the Circular, SEC released the Regulatory Incubation Guidelines (the Guidelines), which sets out the regulatory landscape for the implementation of the RI program scheduled to commence in the third quarter of 2021. The RI program will operate by admitting identified Fintech business models and processes in cohorts for a one-year period. Participation in the RI program will encompass an Initial Assessment Phase and the Regulatory Incubation Phase. The categories to be admitted into each cohort will be determined based on submissions received through the FinTech Assessment Form.

This article examines the requirements and the process of participating in the SEC's RI program.

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Background To The RI Program

The SEC regulation of technological innovations in Nigeria's capital market in order to safeguard the interest of investors, has become increasingly challenging due to the influx of innovative products into the sector and these products' speed to market.

This mismatch between regulation and innovation has resulted in instances where Fintechs have seen their operations banned by SEC after committing significant capital to deployment, and SEC has issued belated warnings against investing in certain products to the public after a substantial number of investors have already invested and often times lost money. By way of an example, earlier in February 2021, SEC had promised to monitor developments in the cryptocurrency and FinTech space as it relates to the Nigerian capital markets and engage stakeholders in encouraging innovation and a safe and transparent capital market.

Subsequently, in May 2021, the Commission issued a circular, warning members of the public and capital markets operators against dealing, partnering or investing with "online investment and trading platforms" facilitating direct access to securities of foreign companies from Nigeria. Thus, the RI program seeks to plug the gap between regulation and innovation by allowing FinTechs and the Commission to collaborate in the deployment of innovative products where the product's model or process is ahead of the current state of regulations.

The Purpose of the RI Program

In the Guidelines, SEC stated that pursuant to Section 38 (2) of the Investment and Securities Act 2007 (ISA), it has the power to enable the deepening of the Nigerian capital markets through various methods such as the RI program. In the Guidelines, SEC also reiterated that Section 38 (1) of ISA prohibits any expert or professional from carrying out any activity in the Nigerian capital markets except it is registered by SEC.

Therefore, in a bid not to stifle products and services that require SEC's authorization, and to enable businesses that offer such products and services to continue carrying out technology-driven capital markets activities, the RI program was created as an interim measure to aid the evolution of effective regulation of FinTechs activities in Nigeria.

The RI Program serves as a sandbox environment for FinTechs, both startups already operating and those looking to operate in Nigeria's capital market, and whose operational model may warrant an amendment of extant SEC rules or the issuance of new rules to accommodate the proposed model of the Fintech. For the one year duration of the RI Program , SEC will have the opportunity to oversee the operations of these companies, after which SEC will determine whether the Fintech is eligible to offer its product to the public or should immediately discontinue its operations.

Under the RI program, participants will be required to undertake an Initial Assessment Phase and the RI Phase, before registration with the SEC.

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At the Initial Assessment Phase, the applicant will be required to fill the Fintech Initial Assessment ("FIA") Form and where the SEC determines (based on information in the FIA Form) that no regulatory framework exists for the regulation of the applicant's proposed FinTech solution, the applicant will then be directed to fill and submit the RI Form. Applicants admitted into the RI Program will participate in the RI Phase. Successful participants in the RI Phase may then commence operations as a SEC registered entity.

Eligibility For Participation in the RI Program

The Guidelines sets out the pre-qualification requirements for admission into the RI program as follows:

- applicant shall be using innovative technology to offer a new type of product or service or applying innovative Fintech to an existing product or service.
- the business, if carried on in or from Nigeria, shall involves a financial service (that is, it is within the scope of the activities that the SEC regulates).
- the applicant shall be ready to take-off with live customers and operate within the purview of the applicable SEC Regulatory Framework.
- the applicant shall commit to applying for registration as soon as Rules are provided by the SEC.
- the product or service shall be one that addresses a problem (compliance or supervision) or brings potential benefits to consumers or industry.
- the applicant shall ensure that the product is safe for investors.
- the applicant shall complete the FIA Form and discuss the proposal with the SEC at an early stage.

Requirements for Participation in the RI program

Once eligible to operate in the RI program, applicants are required to complete the relevant application form and pay a processing fee of N200,000.00 (Two Hundred Thousand Naira Only). The Guidelines provide that an applicant shall:

- be deemed fit and possess relevant skills in financial services and/or technology.
- undertake to act with integrity, due care and diligence and provide referee information.
- undertake to provide full information to clients and commit to send them regular feedback.
- undertake to provide full disclosure to the SEC on the business through an incubation implementation plan.
- undertake to provide procedure for holding and controlling client assets.

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- have an office in Nigeria.
- undertake to comply with Anti Money Laundering/Combating the Financing of Terrorism requirements.
- undertake to provide monthly reports to the SEC.
- undertake to comply with all relevant laws and regulations.

Conditions for Participations in the RI program

For continued participation in the RI program, paragraph 3 of the Guidelines imposes certain restrictions and conditions on the participating FinTech. The Participating Fintech shall not conduct any other investment business except as presented to the SEC. They are also prohibited from financial promotions, which guarantee returns - these include any notice, circular, letter or other written or electronic medium of communication addressed to any person. They shall not provide information containing any untrue or misleading statement. They shall have the capacity to on-board a maximum of 100 clients who shall be fully informed of the service or product prior to on-boarding.

Subject to the SEC's appraisal and approval, the firm may on-board additional clients if the need arises. Firms that are already in operation shall maintain their existing clients and cease on-boarding new ones.

They shall be under regulatory incubation only for a maximum period of one-year after which they shall apply for registration if found eligible or discontinue the activity.

Grounds for removal from the RI program

The Guidelines provide that a participating FinTech may be removed from the RI program under the following ground;

- If the participating FinTech is found no longer fit to participate in the process.
- If it has breached any restrictions or conditions imposed on its participation.
- If it has breached the Laws of the Federal Republic of Nigeria or the Guidelines.
- If it deviates from its implementation plan.
- If it has not promptly taken steps either to apply for registration or submit a notice of discontinuance after the one-year period of the regulatory incubation process.

Conclusion

SEC introduced the incubation program to accommodate innovation while ensuring investor protection and market integrity. The Guidelines did not come as a surprise as SEC had issued a number of

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directives in its attempts to regulate the fast growing industry.

SEC Regulatory incubation might be a way for regulation to evolve alongside the industry and its fast-changing technology. It echoes the Framework for Regulatory Sandbox Operations issued earlier this year by the Central Bank of Nigeria. SEC RI program and the CBN's regulatory sandbox seek to serve the same purpose that is facilitating the operation and launch of innovative and disruptive technology that is outside the contemplation of extant legal framework in a controlled environment under the supervision of the respective regulator.

While the CBN Framework tracks innovation that can improve the design and delivery of payment services, SEC's RI program caters for innovation pertaining to the deployment of financial services within the Nigerian capital market.

The introduction of the RI program in Nigeria is a welcome development and should be applauded. It is a win for innovation in Nigeria and shows a certain interest by regulators in development and innovation within their regulatory spaces. It also aligns with the SEC objective of regulating innovation and the Federal Government of Nigeria's Ease of Doing Business. The success of this program depends wholly on its implementation and the responsibility falls on the regulatory body to make the best of this opportunity.

SEC's issuance of the Guidelines is indicative of its inclination to foster the use of technology in the Nigerian capital market whilst ensuring market integrity, sifting out fraudulent persons who rely on the lack of regulation, and overall, ensuring the protection of the investing public. As these are early days, it remains to be seen whether the Commission will issue further clarificatory circulars and guidelines ahead of the prospective commencement period of Q3 2021.

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