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THE CBN FRAMEWORK FOR REGULATORY SANDBOX OPERATIONS

Introduction

On 23rd July, 2020, the Central Bank of Nigeria (**CBN**) released a draft Framework for Regulatory Sandbox Operations aimed at establishing a controlled environment where disruptive technology in the financial services can be tested under the supervision of the CBN.

The CBN has now issued an approved Framework for Regulatory Sandbox Operations (**the Framework**), in line with the global trend, with a view to ensuring new and more flexible ways of engaging the fintech industry given increasing consumer demand for payment solutions and emerging disruptive technology in the financial services.

The Framework defines the establishment, the rules and operations of a Regulatory Sandbox for the Nigerian Payments System. The essence of the Framework is to promote effective competition, embrace new technology, foster innovation by providing a structured regulatory environment where innovative products and services within the payment systems space can be deployed and trailed, encourage financial inclusion and improve customer experience, with a view to engendering public confidence in the Nigerian financial system.

This Newsletter examines the key provisions of the Framework.

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What is a Regulatory Sandbox?

A Regulatory Sandbox is a formal process through which firms are able to conduct live test of new innovative products, services or business model in a controlled environment with regulatory oversight. The sandbox will benefit stakeholders in the fintech space, commercial banks proposing new financial products, telecom companies seeking entry into the financial sector through innovative offerings and other companies seeking to provide innovative financial products using emerging technologies.

Benefit of Regulatory Sandbox to Entrepreneurs

- Entrepreneurs in the sandbox will be provided with support in filing their applications for licence (where applicable) and advising on options for addressing identified risk issues by CBN.
- It facilitates dialogue between CBN and entrepreneurs in the financial sector, which will better equip the CBN with the ability to anticipate, and better prepare regulations, which facilitate innovation.
- It provides entrepreneurs with an opportunity to test their product in a controlled and licensed environment before release of the product to the public at large.
- The CBN reserves the right to support participants in the sandbox by relaxing specific regulations, which apply to the participants within the period of operations of the sandbox, thus, enabling entrepreneurs test their product with less regulatory rigour.
- It gives entrepreneurs the opportunity to build strategic partnerships with other sandbox participants.

Objectives of the CBN Framework

The CBN has recognized that the introduction of the CBN regulatory sandbox will:

- Reduce time to market for innovative products by allowing developers and the CBN to simultaneously monitor the pre go-live product testing in the sandbox thereby shortening approval timeline.
- Ensure customer protection safeguards as prescribed by CBN are adhered to.
- Promote adequate regulation and an enabling environment for innovation without compromising consumer safety.
- Encourage innovative solutions that will advance financial inclusion.

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- Define the roles of different stakeholders within the sandbox ecosystem and the bigger payment systems industry.

- Provide a communal environment for continuous engagement between fintech innovators, developers and the CBN.

Scope of the Framework

The Regulatory Sandbox provided for under the Framework will be open to proposed products, services or solutions that are either not contemplated under the prevailing laws and regulations, or do not precisely align with existing regulations. In addition, innovative products or services previously rejected by the CBN will also be considered for sandbox trials on a case-by-case basis. This commendable provision by the CBN provides flexibility to the Framework and ensures that the innovations are used to assist regulators in considering the need to review existing policies that may inadvertently stifle innovation. However, this flexibility will not be extended to products and services that are unlawful under the laws of the Federal Republic of Nigeria.

Eligibility of Sandbox Participants

The Framework permits CBN licensees and local companies (including financial sector companies and telecom companies) to participate in the sandbox operations. Innovators whose proposed payment solution involves technologies which are currently not covered under existing CBN regulations are also welcome to participate.

Entities that apply to participate in the sandbox operations must comply with the following eligibility criteria:

- Possession of an innovative product, service or solution that can potentially enhance management of risks, address gaps, create new opportunities or improve quality in the provision of financial services.

- Provision of the proposed project within a limited transaction (value and volume) for better risk management and mitigation.

- Completion of adequate and appropriate assessment(s) to demonstrate functionality of the project and identification of the associated risks.

- Possession of necessary resources, including risk management, to support testing in the sandbox.

- Possession of a business plan demonstrating that the project can be successfully deployed after exit from the sandbox.

Application and Approval Requirements

The CBN will invite applications to the sandbox process with an invitation placed on the CBN website, and local newspaper

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advertisements. The publications will set out the minimum eligibility criteria to shortlist applicants who qualify for the sandbox. Application for Sandbox will be to the CBN through the Regulatory Sandbox online application platform which can be accessed via the CBN's official email address - Sandbox@cbn.gov.ng.

Notably, receipt of application shall be acknowledged to applicants within five (5) working days after submission. The application must be submitted with a cover letter signed by an authorised signatory of the entity and addressed to the Director, Payments System Management Department, Central Bank of Nigeria, Abuja. Each applicant will be informed of its eligibility and approval to participate in the sandbox within forty-five (45) working days after the closure of the application window. Further, a Letter of Approval would be issued to the innovator, which would allow Sandbox participants to test their innovation upon entry into the sandbox.

Sandbox Cohorts

The CBN will only accept one cohort each year for participation in the Sandbox and the number of participants in each cohort will be determined based on the CBN's resource capacity to support innovators. Each cohort will be named after the year in which the cohort was accepted. Application windows for a given cohort as well as the list of the firms included in that cohort would be published on CBN's website.

Operational Requirements

The CBN operational requirements of the Sandbox would cover, at least, the following phases:

- Filing requirements
- Reporting requirements while in the Sandbox
- Exit conditions and approval for expiration
- Evaluation and Review of an approval.

Filing Requirements

After the issuance of Letter of Approval, the CBN will engage the admitted participants on testing parameters, yardsticks, and a possible exit strategy in the event of failure and probable next steps in the event of success.

Furthermore, participants must include descriptions of the participant's organization, including its financial standing, technical and business domain expertise; the financial service to be experimented on, in the Sandbox; and how the participant has met the eligibility criteria with supporting evidence in addition to other information prior to their entry to the Sandbox.

Reporting Requirements while in the Sandbox

Sandbox participants will be subject to making periodic reports to the CBN and ensure that measures are implemented to limit risks to the financial system and consumers. Furthermore, the participating entities must ensure proper

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maintenance of records during the testing period for a maximum of five (5) years, to support reviews of the test by the CBN.

Conditions For extension and exit from the Sandbox

At the time of the application, each applicant must state their proposed timeline for the initial testing, in months. Extension of testing timelines will be at the discretion of the CBN and a written application, no later than thirty (30) calendar days before the expiry of the testing period. Upon the completion of a sandbox test, the CBN will decide whether the product, service or solution should be introduced into the market or may prohibit deployment of the product, service or solution in the market upon the completion of the testing i.e in the case of unsuccessful testing or in the face of unintended negative consequences.

To discontinue participation in the sandbox, the participant must apply in writing for CBN's consent to discontinue its participation. The CBN will take into consideration the effective closure of any outstanding regulatory obligations and consumer related matters that may have arisen from the participant's sandbox operations.

Evaluation and Review of an Approval

Following the issuance of a written notice of forty-five (45) days evincing intention, the CBN may review or withdraw an approval to participate in the sandbox at any time before the end of the testing period if the participant;

- Fails to comply with prescribed safeguards
- Submits misleading information
- Conceals or fails to disclose material information
- Contravenes any applicable law which impacts directly on applicants integrity or reputation
- Goes into liquidation
- Breaches data security or confidentiality requirement
- Compromises consumer safety
- Fails to address identified risks, technical flaws or vulnerabilities.

The CBN will give the participant an opportunity for the participant to respond on the grounds for review, further to which, it may reinstate the approval. Following review and evaluation of an approval, the participant must immediately implement its exit plan, provide notification to customers, comply with obligations imposed by the CBN to dispose of all confidential information and submit a report to CBN within thirty (30) working days.

Confidentiality

Participants are required to keep confidential all information disclosed in any form, by one party (the Disclosing Participant) to the other participant (the Receiving Participant) during Sandbox events, whether or not expressly stated

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to be confidential. The Framework provides that confidential information is not to be used without consent and recognizes ownership of intellectual property (IP) arising in any confidential information. However, it does not provide detailed parameters for data privacy protection, neither does it prescribe penalties for possible breach of confidentiality, and as such is not likely to posit a cogent deterrent.

In addition, Participants are encouraged to reserve detailed disclosures relating to processes or specifications until the IP is registered and protected.

Responsibilities of parties in a Sandbox Operations

The parties involve in a sandbox operation are the CBN, Participants, and Consumers. Each party has a role to play except for the consumers whose protection is solely the responsibilities of the CBN and the participants.

Some of the responsibilities of the CBN include but not limited to: issuance of the Regulatory Framework for Sandbox Operations; admitting all eligible participants into the Sandbox process; issuance of Letter of Approval (LoA) for entry into the sandbox; issuance of an Approval-in-Principle (AIP); conducting oversight on Sandbox participants' operations and systems; monitoring other stakeholders to ensure compliance; issuing circulars to regulated institutions on the operations of the Sandbox; applying appropriate sanctions for non-compliance where needed.

The responsibilities of the participants include but not limited to: monitoring and supervising the activities of its operations and staff; monitoring effective compliance with set limits; taking all other measures to enable it to operate strictly within the requirements of this Framework; leveraging APIs available from other CBN licensed institutions innovation sandboxes.

Conclusion

The issuance of the framework is a step in the right direction as it institutionalizes the regulatory sandbox concept and provides a detailed and documented guide to its operations. While its scope is limited to payment services, it provides an example for other regulators to follow in terms of setting up similar frameworks in their respective sectors, and for the CBN (and other financial service authorities) to build on in terms of further enabling innovation within that space.

The framework is a welcome development because it came at a time of rapid technological innovation of the Nigerian financial market and will enhance both the CBN's desire to encourage and enable innovation, as well as the need to maintain stability and consumer protection. The Framework is a plus for financial innovation in Nigeria as it shows that the CBN has taken proactive steps towards ensuring more flexible ways of engaging with operators in the fintech space.

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