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The Three-Pronged Approach to Innovation and the Regulatory Incubation Initiative of the Securities and Exchange Commission

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Recently, the Securities and Exchange Commission (**SEC**) adopted a three-pronged approach to regulating innovation in the country. These include ensuring the safety of the investors and integrity of the capital market, providing market deepening opportunities through the introduction of new useful products and services and providing solutions to existing problems in the capital market in compliance with existing rules.

In that regard, on 16 June 2021, the SEC released the Regulatory Incubation Guidelines for Specific Category of FinTech Entrepreneurs (the **Guidelines**). The Guidelines introduces a Regulatory Incubation Program (the **RI Program**) which will commence in the third quarter of the year. The Guidelines provide qualifying fintech entities with an opportunity to operate in the Nigerian Capital Market under the basic rules prescribed by the SEC to ensure the safety of the capital market and boosts investor confidence in the market and financial products pending the consideration and determination of the suitability of the new operational models within the Nigerian capital market.

Highlights of the SEC RI Program

The Guidelines prescribes the pre-qualification for the admission of FinTech entrepreneurs (FinTech E) into the RI program. An eligible FinTech E must be such that (i) uses innovative technology to offer a new type of product or service or applying innovative Fintech to an existing product or service; and (ii) profers solution to existing problems in the operational model of a financial service; and (iii) provides a potential benefit to the investors and the capital market as a whole.

It is also worthy of mention that, in addition to the above, the activities of the FinTech must be such that would qualify as a financial service that is regulated by the SEC, where such business was carried out in or from Nigeria.

At the Initial Assessment Phase, an eligible FinTech E will complete the Fintech Initial Assessment ("FIA") Form by which the SEC determines whether a regulatory framework already exists for the regulation of the applicant's proposed service offerings. If it is determined that a regulatory framework already exists for the proposed fintech solution, the SEC will provide to the fintech entity the requisite guidance for compliance and operation. If none exists, the FinTech E completes and submits the Regulatory Incubation (RI) Form for admission into the RI program together with an Implementation Plan for the product or service, which must contain necessary details including a full description of the business and the proposed innovative product, service or business model, including the type of technology involved; proposed target customers and plans to make the model comprehensible to its target customers, implementation plan and exit plan where registration is not achieved; risk management framework highlight the main identified risks and the management approach.

Following the consideration of the application, the FinTech E may be granted an immediate admission or at a future date. In the alternative, the application may be declined by the SEC, stating the reasons for rejecting the innovation and the next steps to take. A qualifying FinTech E is deemed to possess relevant skills in financial services and/or technology and deemed fit to render such skills in the Nigerian Capital Market. The FinTech E is also required to give an undertaking to act with diligence and transparency both to the SEC and the capital market and comply with the relevant laws and regulations. The qualifying FinTech E is also required to have an office in Nigeria and will provide monthly reports of its operations to the SEC.

During the Regulatory Incubation phase, a qualifying FinTech E a. must not conduct any other investment business except as presented to the SEC;b. must not release any financial promotions (or advertisements) which guarantee returns, whether through any notice, circular, letter or other written or electronic media of communication; must not provide information containing any untrue or misleading statement; and must have the capacity to onboard a maximum of 100 clients who must be fully informed of the service or product prior to onboarding, although the fintech operator may, subject to the SEC's appraisal and approval, on-board additional clients if the need arises. Importantly, fintech operators that are already in operation must maintain their existing clients and cease onboarding new ones.

The Guidelines stipulate that fintech operators admitted into the RI Program will receive feedback on their product or service from the RI Team at the end of every quarter. Also, by their 10th month in the program, the SEC will issue the fintech operator guidance on the applicable regulatory regime and regulatory requirements for setting up its business operations.

At the end of one year period of the program, participants will exit from the program with clear directives from the SEC on the next steps to take. The successful fintech operators may then register to commence operations as an SEC-registered entity in line with the registration requirements issued by SEC after the end of the program or terminate business where it fails to register as stipulated.

Conclusion

According to the SEC itself, the emergence globally of modern innovations aimed at enhancing financial products and services through the application and utilization of digital technology, etc. necessitates the creation and adoption of adequate processes and tools for the Commission to satisfactorily deliver on its mandate. Indeed, Nigeria has recently experienced an explosion in not only the number of fintech products hitting the market but also the amount of foreign investment attracted into the country by virtue of that sector, and so the introduction by the SEC of the Regulatory Incubation Program is a step in the right direction which will no doubt signal to consumers and potential investors that Nigeria is very much a country conducive to innovative technologies and a potential hotbed for their venture capital investments. We hope that existing and aspiring financial services tech disruptors will take advantage of this new regulatory approach to fintech innovations in Nigeria to navigate whatever uncertain terrains they may encounter in the structuring of their investments and the products and services they plan to offer to consumers in the Nigerian financial industry.

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