ÆLEX

ARTICLE SERIES

CATEGORISATION OF NIGERIAN PAYMENT SYSTEMS– WHAT IT MEANS FOR FINTECHS

DECEMEBER 2020

www.aelex.com

A NEW PATHWAY

The Nigerian financial technology (fintech) sector has made major strides over the last few years. However, one factor that has always befuddled investors and key stakeholders has been the absence of a comprehensive framework and licensing regime for fintechs in Nigeria.

What has been prevalent in the sector has been the introduction of multiple regulations and guidelines which makes it difficult for industry participants to easily identify the licences that apply to the activities they intend to provide.

However, this is set to change as on 10th December 2020, the Central Bank of Nigeria (CBN) issued a circular on "New License Categorisations for the Nigerian Payments System" (NPS Circular).

Before delving into the contents of the NPS Circular, we will briefly examine what payment systems are and why this circular may introduce some well desired changes to the fintech landscape.

WHAT ARE PAYMENT SYSTEMS?

Payment systems are mechanisms that facilitate the clearing and settlement of monetary and other financial transactions.

They are used in lieu of tendering cash in transactions and are a major service provided by banks and other financial institutions.

They include infrastructure consisting of institutions, instruments, rules, procedures and standards that are set up to effect the transfer of monetary value between parties discharging mutual obligations.

Typically, payment systems can be classified as traditional (physical) and electronic payment systems (EPS). Traditional payment systems are negotiable instruments (e.g cheques) and documentary credits such as letter of credits.

Conversely, EPS facilitate payments for electronic transactions without any need to use cash or cheques. It has many forms such as credit and debit cards, virtual cards, electronic funds transfers, e-wallets, mobile payments, internet banking, cryptocurrency, and ecommerce transactions.

Other than the convenience, and relative safety, of utilising EPS, they also have a significant number of economic benefits which include mobilising savings and reaching out to the unbanked community. Furthermore, an EPS can track individual spending to facilitate the design of products by banks and fintechs.

CATEGORIES OF LICENCES UNDER THE NPS CIRCULAR

The NPS Circular seems to target different areas in the EPS ecosystem as payments system licensing has been streamlined into four broad categories, namely:

- Switching and Processing
- Mobile Money Operations (MMos)
- Payment Solution Services (PSSs)
- Regulatory Sandbox

Each category is considered below.

SWITCHING AND PROCESSING

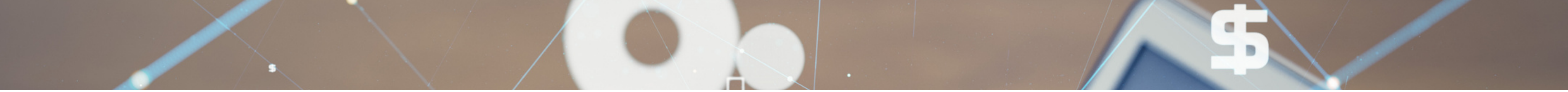
A switching licence is regarded as one of the most valuable licences a fintech can have in Nigeria.

Switching companies facilitate the exchange of value between financial service providers, merchants, customers and other stakeholders. They route payment transactions between multiple acquirers and payment service providers.

The NPS Circular provides that the minimum share capital requirement for a Switching and Processing Company is two billion Naira (N2,000,000,000). The permissible activities for switching companies are;

a) Switching;
b) card processing;
c) transaction clearing and settlement agents services; and
d) non-bank acquiring services.

Switching and Processing companies are now permitted to perform the activities covered under the Super-Agent, Payment Terminal Service Provider (PTSP) and Payment Solutions Service Provider (PSSP) licences.



MOBILE MONEY OPERATIONS (MMOS)

Mobile money is a technology that allows customers to receive, store and spend money using a mobile phone. MMOs develops and deploys financial services through **mobile** phones and **mobile** telephone networks. Some popular MMOs include Opay, Paga, Konga Pay and Palm Pay.

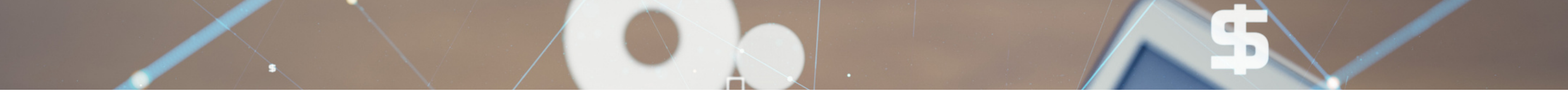
The NPS Circular provides that the minimum share capital for MMOs is two billion Naira (N2,000,000,000). MMOs are permitted to issue electronic money (e-money), create and manage wallets, and manage pool accounts. They are also permitted to carry out activities that can be performed with a Super-Agent licence.

PAYMENT SOLUTION SERVICES

Payment solution services provide bridging infrastructure, end-to-end electronic payment solutions, systems and services to stakeholders within the financial services space. Some of the operators that provide payment solution services are usually integrated into the card schemes and core banking systems.

The NPS Circular provides that anyone who obtains a Payment Solution Services (PSS) Licence would be entitled to carry out activities of Super Agents, Payment Terminal Service Providers (PTSP) and Payment Solutions Service Providers (PSSPs).

The NPS Circular then goes on to highlight the permissible activities and minimum share capital of Super Agents, PTSPs and PSSPs as follows:



LICENCE CATEGORY	PERMISSIBLE ACTIVITIES	MINIMUM CAPITAL
Super Agent	agent recruitment, management and other activities as specified in the Regulatory Framework for Licensing Super-Agents in Nigeria	N50,000,000 (fifty million Naira)
PTSPs	Point of Sale (POS) terminal deployment and services; own POS and Payment Terminal Application Developer (PTAD) and; train and support merchants/agents;	N100,000,000 (one hundred million Naira)
PSSPs	deploy payment processing gateway and portals; payment solution/application development; merchant aggregation and collection services	N100,000,000 (one hundred million Naira)

The implication of this categorisation is that applicants may choose to apply for PSS Licences which would enable them carry out all or some of the activities that are permissible for holders of Super-Agent, PTSP and PSSP Licences. Such companies must however have a minimum share capital of N250,000,000 (two hundred and fifty million Naira).

REGULATORY SANDBOX

CBN released a Draft Framework for Regulatory Sandbox Operations (the **"Draft Framework"**) on June 23, 2020 that is to serve as a guide in controlling how new tech-based financial products/services are launched into the Nigerian market.

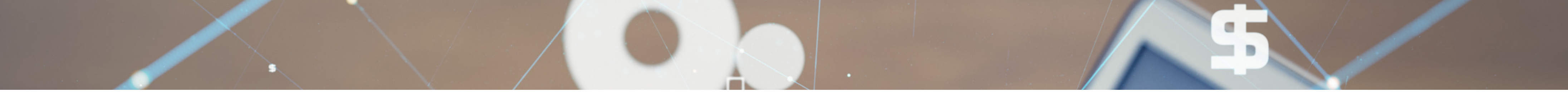
In a circular that accompanied the Draft Framework, the CBN explained that the regulatory sandbox will serve as *"a formal process for firms to conduct live tests of new, innovative products, services, delivery channels, or business models in a controlled environment, with regulatory oversight subject to appropriate conditions and safeguards."*

Although CBN is yet to finalise the Draft Framework, it appears that CBN is set to implement it as indicated in the NPS Circular. Subsequently, any company that intends to participate in the regulatory sandbox will apply to CBN with its products and solutions which will be reviewed.

Entities that are permitted to apply to participate in the regulatory sandbox include licensed institutions, fintechs, innovators and researchers. The CBN did not set a minimum share capital requirement for companies that can apply to participate in the sandbox.

OTHER NOTABLE PROVISIONS IN THE PAYMENT SYSTEMS CIRCULAR

In addition to setting out the categories of licences, the CBN also set out some additional matters that fintechs need to be aware of which include the following:



1)Only MMOs are permitted to hold customer funds

Due to the uncertainty surrounding the licensing of fintechs, holders of different licences were set up in a way that enabled them to hold customers funds.

However, with the introduction of the NPS Circular, it is now clear that other fintechs, such as PSSPs, can no longer hold customers funds.

2) Switching companies and MMOs can only operate under a holding company structure

Fintechs are now prohibited from combining switching and MMO activities under the same company. This is to prevent comingling of activities under the same entity. However, they may operate as different subsidiaries under a holding company and must have clearly delineated activities.

3) CBN Approval required for collaborations between fintechs and financial institutions

Fintechs operating in payments system sphere must now obtain the approval of the CBN before they can collaborate with other payment companies, banks and other financial institutions with respect to products and services.

4) Restriction to permissible activities in the memorandum and articles of association

Payment service providers must now ensure that the object clauses in their Memorandum and Articles of Association (MEMART)are limited to the permissible activities provided under their licences. So, for instance, a PTSP will not be permitted to have objects in the clause of its MEMART that imply it can operate as an MMO.

5) No-objection from CBN

All fintechs that hold any of the categories of licences covered under the NPS Circular, or that intend to acquire a new licence, are required to obtain a no-objection from the Payments System Management Department of the CBN.

6) Compliance expectations for companies

Companies with new licensing requests, as well as those that presently have Approvals-in-Principle from CBN, are required to immediately comply with the provisions of the NPS Circular.

However, companies that have already been licensed by CBN are expected to comply with the NPS circular no later than 30th June 2021.

OUR TAKEAWAY

The NPS Circular has implications for fintechs and it is expected that there may be some changes in how fintechs will be structured over the next few months. Some of these implications include the following:

1) with the loose licensing regime that has existed, some fintechs have collaborated with banks in rolling out new products and services and probably circumventing some of the regulatory restrictions that exist under their licences.

However, with the requirement for fintechs to seek the approval of the CBN before they can proceed with collaborations, CBN will be able to examine the proposed products and services and determine if they are suitable for the parties to operate with, taking into consideration the provisions of their respective licences.

2) The launch of the regulatory sandbox means that innovators and fintechs can now apply to have their new products and services tested in the sandbox environment.

With no share capital restrictions or limitations, it is indicative that start-ups and entrepreneurs would be able to take advantage of this and have their innovations reviewed by the CBN.

3) The permissible services that can be carried out by the different fintechs are now clearly identified and so this reduces the ambiguity around what sort of activities each fintech can undertake.

Furthermore, it is now clear that only MMOs can hold customers' funds and they are prohibited from setting up in a way that leads to them comingling their activities with switching services.

4) The minimum share capital requirement for the different fintechs have been set out in an explicit manner. Consequently, industry participants can determine if they want to recapitalise to acquire additional licences and meet up with the minimum share capital requirement for the category of licence(s) they intend to acquire.

5) By obtaining a PSS Licence, a fintech can carry out a range of activities that could position it as a strong player in the ecosystem.

CONCLUSION

Although EPS such as cryptocurrency and digital currencies were not addressed, the introduction of the NPS Circular by the CBN is commendable and introduces a level of certainty to the fintech landscape in Nigeria.

It is therefore hopeful that CBN will remain proactive in monitoring these policies, and also introduce progressive regulations, as the fintech ecosystem remains attractive to investors and other stakeholders in the financial sector.

ÆLEX

Davidson Oturu
(Partner, AELEX)

ÆLEX is a full-service commercial and dispute resolution firm. It is one of the largest law firms in West Africa with offices in Lagos, Port Harcourt and Abuja in Nigeria and Accra, Ghana. A profile of our firm can be viewed here. You can also visit our website at www.aelex.com to learn more about our firm and its services.'

DISCLAIMER: This publication is not intended to provide legal advice but to provide information on the matter covered in the publication. No reader should act on the matters covered in this publication without first seeking specific legal advice.

Contact us at:

4th Floor, Marble House,
1 Kingsway Road, Falomo Ikoyi,
Lagos, Nigeria

Telephone: (+234-1) 4617321-3, 2793367-8, 7406533,

Click here www.aelex.com

to follow our social media handles click below

@aelexpartners