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Fintech Industry the Market, the Legal & Regulatory Framework, and Intellectual Property Protection

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Introduction

Fintech (Financial Technology) is the new technology and innovation that aims to compete with traditional financial institutions in the delivery of financial services.[1] In other words, Fintech companies leverage on technology to deliver services similar to that offered by conventional financial institutions (e.g. banks), usually with added benefits and ease. Some, examples are ALAT Nigeria's first digital bank, supported by Wema Bank and Paylater, an indigenous online-loan provider. Fintech may broadly classify into Fintech startups and established financial institutions that leverage on technology to enhance the scope of their financial services. I'll be focusing on Fintech startups.

[1] Financial Technology, Wikipedia

Fintech has been applied in disrupting the delivery of asset management, mobile payments, loan transfers and loans. For instance, M-Pesa◎a Fintech provider based in Kenya◎allows Kenyans without bank accounts to transfer cash, buy airtime, pay bills, and purchase goods and services without the use of cash. M-Pesa does this by simply transferring a value from one phone to another from a float balance.

Though relatively new, Fintech is a high-growth sector. From 2008 to 2014, global investments in Fintech grew from $930 million to $12 billion annually.[2] In other words, the Fintech industry grew by an average of $2 billion each year. According to the Office of the Mayor London, 40% of the London workforce is employed in the Fintech sector. But those are not the only things surprising about the Fintech industry. According to the 2017 Report of the Global Payments Innovation Jury, Africa is the 3rd most lucrative market because of the difficulty encountered by traditional banking institutions in reaching the entire market. Africa is behind Asia and Europe in this regard, but ahead of North America, South America, and Australia. Nigeria's share of this investment for the past years has exceeded $200 million.[3] The same report anticipates that the Fintech industry would grow to well over $45 billion.

The Fintech industry is growing rapidly and the growth is global, but as would be expected of technology-driven innovations, there are massive opportunities just as there are threats. Let's use a SWOT (Strength, Weakness, Opportunities, and Threats) analysis to take a closer look at Nigeria's Fintech industry.

SWOT Analysis of the Fintech Industry

Strengths

1. Compared to traditional financial institutions, Fintech startups deliver better quality . This is largely due to their virtual setup which significantly cuts the large recurrent costs that traditional financial institutions are typically burdened

[2] 'The Boom in Global Fintech Investment', Accenture, 2014, https://www.slideshare.net/CBInsights/accenture-globalboominfintechinvestment
[3] 'KPMG Highlights Nigeria's Million Dollar Fintech Industry' Aleppo A, 3 December 2016, btc.ng/market-news/kpmg-idintifies-nigerias-million-dollar-fintech-industry

with. According to Emeka Emetarom, Executive Director of AppZone Group◎a Nigerian Fintech startup◎digital-only financial institutions operate at a tenth or less of the cost of traditional banks.[4] This translates into their ability to transfer enhanced benefits to customers. For instance, Activehours, a Fintech startup based in Palo Alto, California gives workers loans based on how many hours they have worked in a month (though they charge a fee for this advance).[5]

2. Fintech is capable of supporting other businesses financially without the hassles associated with conventional banking institutions. One of such Fintech services is CircleUp, a San Francisco-based crowdfunding site. CircleUp connects entrepreneurs developing new consumer products with potential distributors and financial backers. With this technology, entrepreneurs can obtain loans in minutes or days from people they don't know, depending on the quality of their pitch.
3. Fintech delivers on more openness and transparency in the financial sector. AppZone finely exemplifies this open and transparent way of delivering financial services. One of its products is called BankOne. BankOne is a cloud service for microfinance banks that gives them access to electronic channel services such as debit cards, mobile, and internet banking. It also allows them compute their daily costs to determine their profitability on a daily basis, rather than operating blindly. Before this, only commercial banks could afford this service. It would therefore not be farfetched to say that the entry of Fintech startups is creating a level-playing ground for both big and small financial institutions.

Weaknesses

1. A weakness of Fintech startups in Nigeria◎though not their doing◎is the lack of regulatory framework specially designed for them. Amongst other challenges, this affects their credibility and ability to source for investments. Sheer innovation and entrepreneurial spirit may be enough to drive growth, but to

[4] "Disruption in Fintech sector, good for economy – Emetarom, AppZone boss" Prince Osuagwu, June 21, 2017, Vanguard (www.vanguardngr.com/2017/06/disruption-fintech-sector-good-economy-emetarom-appzone-boss/
[5] "The Fintech 50: The Complete List 2016" Samantha Sharf, 2016 (November 7,2016)

build the level of credibility and trust that customers and investors need, a strong regulatory framework is critical.[6] It is not an all-comers Fintech industry in Nigeria though. The Central Bank of Nigeria (CBN) has approved regulations for mobile money operators in Nigeria.[7] CBN also requires mobile money service operators to comply with the provisions of the Know Your Customer (KYC) Guidelines. This is in line with global best practices. In other climes such as Europe, the EU has enacted the Payment Services Directive 2, which will be enforced from 2018. The Directive provides for the regulation of Fintech providers and gives them a level playing ground with traditional financial institutions.

2. Data protection and privacy in the Fintech space need serious work in Nigeria. The Banks and Other Financial Institutions Act is grossly inadequate in a data-driven and privacy-sensitive Fintech space. Nigeria's lack of a comprehensive data-protection and privacy law is also not helping matters. To adequately protect people who buy Fintech products and services, Nigeria needs data-protection and privacy law and regulations. In this regard, the National Information Technology Development Agency (NITDA) should review and approve the NITDA Guidelines. Proposed since 2013 to regulate Nigeria's IT space, there is no evidence that the Guidelines have been approved, thus they do not apply.[8] Also, having released guidelines for electronic payments, CBN need to come up with a regulation on data protection and privacy, rather than wait for the National Assembly to enact a law regarding this. The Nigeria's digital environment needs to be as safe as possible, encouraging more Nigerians to embrace Fintech without any fear of compromising sensitive information and privacy. As a self-help measure, Fintech startups need to also have Terms of Service that protects user's data and privacy.

[6] KPMG, 'Fintech in Nigeria: Understanding the Value Proposition', November 2016, 20
[7] Guidelines on Mobile Services in Nigeria approved by CBN, http://www.cbn.gov.ng/Out/2015/BPSD/Guidelines%20on%20Mobile%20Money%20Services%20in%20Nigeria.pdf
[8] David Oluranti, 'Data and Privacy Laws in Nigeria', Nigerian Law Today, http://nigerianlawtoday.com/data-privacy-laws-nigeria/

Opportunities

In the KPMG's report[9], 7 areas were raised that are opportunities that Fintech startups can leverage on. The 4 most relevant areas to Nigeria are discussed below:

1. **Next Generation Payments:** compared to all other Fintech endeavors, payment systems are the most prominent, both in Nigeria and globally. Banks have realized this and are very willing to partner with Fintech startups in this sector. An example is Access Bank and PayWithCapture, a Fintech startup that uses Near Field Communication or contactless payment and QR code generation to provide electronic payments between consumers and retailers. Globally, it has been estimated that this payment method will reach 939 million users by 2019.[10]

   Next Generation Payment of Fintech is supported by the Nigerian government and its agencies as evidenced by its Payment Systems Vision (PSV) through which the cashless policy was borne.[11] The CBN took this step further by licensing mobile-payment operators in Nigeria. Some of these operators include Amplify, Etranzact, Paga, PayWithCapture, and Quickteller. Buoyed by the success of other startups in this aspect of Fintech, the Nigerian Inter-Bank Settlement Scheme (NIBSS) has launched mCash, a payment provider for low-income buyers and sellers who ordinarily rely on cash. Also, Peach Payments, a South African payment startup, has already expressed its intent to expand into the Nigerian market.

2. **P2P Lending:** Peer-to-peer lending is another lucrative sector for Fintech startups. According to Statista, the global market for P2P lending is projected to grow from $9 billion in 2014 to $1 trillion by 2025. P2P Fintech operators offer loans to businesses that are sourced from hedge funds, banks, and crowdfunding. This alternative funding scheme is ideal for funding the growth of SMEs in Nigeria, a sector that has been described from several quarters as the

[9] Aleppo A., 'KPMG Highlights Nigeria's Million Dollar Fintech Industry', 3 December 2016, http://btc.ng/market-news/kpmg-idintifies-nigerias-million-dollar-fintech-industry
[10] Global mobile proximity payment users to surpass 1 billion by 2019, Ovum http://ovum.com/press_releases/global-mobile-proximity-payment-users-to-surpass-1-billion-by-2019
[11] KPMG Payments Development in Africa, 2015

bedrock of Nigeria's development.. Most small-business owners lack the collateral and requisite documentation to obtain loans from banks. And even when they do, the interest rates in the country are too steep. P2P lending in Nigeria is like an upgrade of the popularly known *Esusu*, used by 56% of Nigerian traders to source loans usually not exceeding #30,000.[12] A unique feature of this form of lending is that there is no one-size-fits-all approach to it. For instance:

- Surecredit gives voucher financing at select retail outlets to allow customers make purchases, repayable from their salaries. This is based in Nigeria.
- Aella Credit also Nigerian, helps individuals as a personal money lender without the hassle of collateral or providing referees.
- Social Lender by Sterling Bank grants existing customers of the bank small loans based on their social-media profiles and a reputation score derived from it, based on certain predefined parameters.

3. **Blockchain:** Blockchain has been described as a way of initiating and verifying transactions in a distributed environment.[13] The entry of blockchain into the financial industry has been reputed as having the capacity to reduce fraud incidence and cut down transaction cost and time. The most popular use of Blockchain technology is in cryptocurrencies the first and most popular being the Bitcoin. Since the creation of the Bitcoin, over 700 alternate cryptocurrencies have been created using the Blockchain technology. According to the Coin Telegraph issue of 11 August 2015, global investment into blockchain has exceeded $1 billion and this is expected to increase four-fold by 2019.[14] It is also on record that Nigeria is ranked 7th out of 178 countries likely to adopt cryptocurrencies[15] largely due to poor access to banking services and high cost of cross-border remittances. Bitcoin-remittance firms charge an average of 3%

[12] 'Access to Financial Services in Nigeria', EFinA, December 2014, http://efina.org.ng/assets/documents/EFinA-Access-to-financial-services-in-Nigeria-2014-survey-key-findings.pdf
[13] Page 27, KPMG "Fintech in Nigeria: Understanding the Value Proposition" November 2016
[14] 'USD1 Billion Invested so far in Bitcoin and Blockchain Infrastructure', Coin Telegraph, 11 August 2015
[15] Garrick Hilleman, Bitcoin Market Potential Index, London School of Economics 2015

compared to 7-10% by traditional players[16]. When both sets of fact are juxtaposed, it becomes clear that Nigeria is a fertile ground for blockchain-based Fintech startups. Some early pioneers are Stellar, BitX, NairaEx, BitPesa, and ICE3X, all of whom facilitate Bitcoin storage, exchange, transfer, and transactions.

4. **Financial Inclusion:** Financial inclusion is defined as a process or situation which allows for ease of access to, or availability of and usage of formal financial systems by members of the economy. It describes a process where all members of the economy do not have difficulty in opening bank account; can afford to access credit; and can conveniently, easily, and can consistently use financial system products without difficulty.[17] Most developing countries are trying to deal with the challenge of delivering banking services to their rural (and mostly illiterate) population. Statistics show that this is not going to be a walk in the park. In high-income developed countries, 94% of adults above 15 have an account with a formal financial institution. At the other end of the spectrum is the Middle East & North Africa region with just 14% of the adult population banked. Sub-Saharan Africa is slightly better with 34 %. Nigeria, with up to 185million people, has 44% of the population banked.[18] By leveraging on the widespread use of mobile phones, Fintech can fill in this gap and help Nigeria achieve the UN/World Bank goal of universal financial inclusion by 2020. Some pioneers in the Nigerian market are Stellar, a blockchain-based, instant-payment transfer network servicing microfinance institutions in rural areas and IroFit Payments, a system that allows merchants accept card payments through an all-purpose card reader without internet connectivity.

Some other opportunities available to Fintech startups in Nigeria are:

[16] How Bitcoin Could Revolutionize Remittance in Africa, http://fintechranking.com/2015/04/13/how-bitcoin-could-revolutionize-remittance-in-africa/
[17] PCC Financial Inclusion Strategy, 2009
[18] World Bank Global Findex

5. **Deduction for Research & Development (R & D):** R & D qualifies for tax incentive. Section 26 of the Companies Income Tax Act (CITA) provides that companies and other organizations that engage in research and development activities for commercialization are to enjoy a 20% investment-tax credit. In other words, they will enjoy a 20% deduction on their taxable profits. Fintech startups, by creating, developing, and deploying new financial methods can be said to qualify and can benefit from this. A lower tax liability means more profit.
6. **Pioneer Status:** Since Fintech is still a relatively young sector in Nigeria, Fintech startups qualify to be classified as pioneer industries by the Federal Government. The implication is that the company will not be liable for tax for the first3 years. When the 3-year period expires, it may be renewed for 1 year, and then another year, when the first expires. Nigeria's pioneer-status regime is governed by the provisions of the Industrial Development (Income Tax Relief) Act and administered by the Nigerian Investment Promotion Commission (NIPC). Also, the Federal Government recently increased the number of industries to benefit from its pioneer-status policy to 27. But to qualify, the applicant must be a new startup.[19]
7. Fintech startups can also get funding from the Bank of Industry through the bank's Youth Entrepreneurship Support Fund and the National Youth Service Fund, both of which are available to technology companies. The BOI also has a partnership with the Lagos State Government to provide funding for mobile-based payments company.[20]

[19] Ademola Adeyoju, 'Pioneer Status to 27 Industries in Nigeria: A Quick Insight into the Policy and How You Can Benefit from It', Infusion Lawyers, http://www.infusionlawyers.com.ng/wp-content/uploads/2017/08/Pioneer-Status-to-27-Industries-in-Nigeria-by-Ademola-Adeyoju.pdf

[20] International Comparative Legal Guides (ICLG) Nigeria Fintech 2017, http://iclg.com/practice-areas/fintech/fintech-2017/nigeria

Threats

As promising as the Fintech industry is, there are many threatening factors which if not dealt with could prevent the Fintech industry from reaching its full potential. The major threats include:

1. **Government Regulation:** It is not that there are no regulations, but the problem is that such regulations hardly envisage how disruptive the Fintech industry will be. Authorities in most climes have either had to find new ways to interpret these regulations to accommodate disruptive innovation the result of which are not always beneficial or outrightly prohibit them. An example of such regulation in the US is the Bank Secrecy Act of 1970 (or Currencies and Foreign Transactions Reporting Act) which requires financial institutions to keep records of transactions in excess $10,000, and to report suspicious activity that may suggest money laundering, tax evasion, or other criminal activities. This law has been enforced to extract massive penalties from offending banks. There is reason to suspect that it may soon be enforced on Fintech startups if the available precedents are anything to go by.Given that Fintech startups usually have few staff with little or no regulatory experience and little capital, especially at the early growth stages, being subject to the strict rules of such an Act would mean incurring significant financial and administrative costs that could tell on their survival and quality of service delivery.

   In Nigeria, regulators have, for instance, has expressed displeasure over crowdfunding a form of P2P lending because of some of the restrictive provisions in certain legislations relating to finance and securities such as the *Banks and Other Financial Institutions Act, Investment and Securities Act,* and CBN regulations. Section 67 of the *Investment & Securities Act 2007* prohibits private companies from offering their securities whether shares or debentures to members of the public. The Securities and Exchange Commission (SEC) has interpreted section 67 to mean a restriction on crowdfunding.

2. **Access to Funding or Investment:** Though Financial Technology reported in 2016 that over $13 billion in funding came to the Fintech industry, the bulk of

this money does not come in the critical early years of a Fintech startup. According to the Global Jury[21], 50% of these monies come in the later or mature stage of the life of a Fintech startup in the form of private equity, when it is already well established and has overcome its early challenges. Only 20% comes in the early stages and just 10% comes in the growth stages. This may be because investors are understandably taking a cautious approach to funding startups, since they are not sure of a startup's viability. But this is actually the point where startups need the funds to even have a shot at viability. Unlike other forms of Fintech companies, payment startups take longer to reach profitability and are also more capital-intensive. Payment startups therefore relatively have a larger pool of funds in their formative years. This ensures they do not slip into what has been termed the "funding valley of death". But this is just the global picture. Coming back home, the Global Jury[22] puts funding for Fintech startups in the Middle East and Africa at the formative stages at a dismal 8%. By way of suggestion, Fintech startups could overcome this by seeking collaborations with established financial institutions like banks.

Legal and Regulatory Requirements for Setting up a Fintech Business

Apart from just registering with the Corporate Affairs Commission (CAC) as a company, there are several laws and regulations that Fintech startups must comply with, if they will not be charged of legal infractions that come with stiff penalties.

- A Fintech intending to operate as marketplace lender will have to register as a bank or other financial institution, in accordance with the *Banks and Other Financial Institutions Act.* CBN oversees this process. The Fintech will also require license in each of the respective states they intend to operate under the *Money Lenders Laws* of the state.
- If the Fintech startup will operate as mobile payment operator, it has to register with the CBN in accordance with CBN's Guidelines on Mobile Money Services in Nigeria 2015. The Guidelines defines a mobile money operator as an entity

[21]Pg.13, Global Payments Innovation Jury 2017
[22] Pg.14, ibid

that provides "[t]he infrastructure for the mobile payment systems for the use of participants that are signed-on to their scheme".

- Fintech startups are also required to register with the Nigerian Communications Commission (NCC) if their services involve the use of mobile phones. NCC'she *License Framework for Value Added Service* applies.
- Fintech startups are also required by the *Cyber Crime (Prohibition, Prevention) Act 2015* to verify the identity of all customers carrying out financial transactions on their platforms, observe adequate "know-your-customer" processes, keep all traffic data and subscriber information as NCC may require for a period of 2 years.
- Fintech startups must also safeguard the privacy of customers' data, adopt data-protection measures, and implement staff training programs to prevent unauthorized disclosure of data. These are required under CBN's *Consumer Protection Framework* and NCC's *Consumer Code of Practice Regulations 2007*.[23]

The Relevance of Intellectual Property (IP) to Fintech Businesses

As a child of disruptive innovation, IP is the bedrock of Fintech. The Fintech industry mostly relies on technological innovations to deliver solutions. From the examples given so far of Fintech startups, one underlying element is their often unique business models and processes.

- **Trade Secret, Patent, and Copyright:** Apart their unique models and processes which could pass for *trade-secret* protection, they also often develop new inventions that could qualify for *patents*. When Fintech businesses are not developing new inventions, they may be developing new software programs eligible for copyright protection.
- **Trademark and Industrial Design:** To have distinctive brands, Finetech businesses need to connect their products and services with their brand names, logos, and other devices. This is where *trademark* protection comes in. And when these FinTech businesses design hardware with any unique 3-dimensional forms, they may have proprietary rights in *industrial designs*.

[23] International Comparative Legal Guides (ICLG) Nigeria Fintech 2017 iclg.com/practice-areas/fintech/fintech-2017/nigeria

Therefore, from trade secrets to patents; copyright to trademark and industrial designs, IP protection and exploitation is critical to the growth and expansion of Fintech businesses. IP is relevant to Fintech. Fintech businesses must take IP protection seriously. They also need to have a comprehensive IP strategy to ensure that they are not only protecting their IPs but also exploiting their IP as assets for business growth and expansion. This is vital.

Although Rhydian Lewis, CEO and Founder of P2P ender, RateSetter, believes that since banks don't know how to [or don't easily] incorporate innovation into their normal businesses, then Fintech startups generally don't have to worry about having their ideas copied or stolen by banks,[24] it is always safer to mitigate than to embark on damage control when the deed has been done.

A comprehensive IP strategy for a Fintech startup would therefore involve the full deployment of all the above-mentioned IPs to protect different aspects of the business.[25] Developing an IP strategy for a Fintech business is critical to long-term growth and expansion. Fintech businesses should consult an IP firm that can help with that, without breaking the bank.

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[24] 'Fintech Startups – is IP Important? www.Thefintechtimes.com/fintech-startups-ip-important/
[25] Senator Iyere Ihenyen, 'Developing IP Strategy for SMEs', Nigerian Law Today, http://nigerianlawtoday.com/developing-ip-strategy-for-smes/

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