



BOWMANS

THE VALUE OF KNOWING



**FINTECH IN AFRICA:
UNPACKING RISK AND
REGULATION**



Our Firm

Bowmans is a leading Pan-African law firm. Our track record of providing specialist legal services, both domestic and cross-border, in the fields of corporate law, banking and finance law and dispute resolution, spans over a century.

With six offices in four African countries and over 400 specialised lawyers, we are differentiated by our geographical reach, independence and the quality of legal services we provide.

We draw on our unique knowledge of the African business environment and in-depth understanding of the socio-political climate to advise clients on a wide range of legal issues. Our aim is to assist our clients in achieving their objectives as smoothly and efficiently as possible while minimising the legal and regulatory risks.

Our clients include corporates, multinationals and state-owned enterprises across a range of industry sectors as well as financial institutions and governments.

Our expertise is frequently recognised by independent research organisations.

Most recently, we won the Technology, Media and Telecommunications Team of the Year Award at the prestigious African Legal Awards hosted by *Legal Week* and the Corporate Counsel Association of South Africa in 2017.

The firm was also 'highly commended' in the African Law Firm of the Year - Large Practice and Litigation and Dispute Resolution Team of the Year categories.

We have been named leading African Legal Adviser by *DealMakers* for the last three consecutive years and South African Law Firm of the Year for 2016 by *Who's Who Legal*.



Introduction

On 25 May 2017, Bowmans hosted a conference in Johannesburg, South Africa, titled Fintech in Africa: Unpacking Risk and Regulation.

The conference was attended by more than 160 delegates and speakers from Kenya, Nigeria, South Africa, Uganda and the United Kingdom, including financial services regulatory lawyers, venture capitalists and representatives from financial service institutions, Fintech companies, research organisations, universities, and regulatory bodies.

Among the institutions that were represented, were the South African Reserve Bank, the South African National Treasury, the South African Financial Services Board, the South African National Credit Regulator, the South African National Roads Agency, the Uganda Communications Commission, the Centre for Financial Regulation and Inclusion and the Cambridge Institute for Alternative Finance.

The conference addressed the following themes:




- The African Fintech landscape in comparison with those of other jurisdictions
- Developments and trends in Fintech regulation
- Considering risk and managing fallout
- Regulatory developments in relation to crowdfunding
- Different jurisdictions' experiences in relation to payment systems
- Where to next for Blockchain?

The discussions were rich, varied and extensive. What follows is a high-level summary of key points discussed and priorities going forward.

We at Bowmans would like to thank the inspiring speakers who generously gave of their time and knowledge to contribute to this conference. Your willingness to collaborate, teach and learn made for a truly enriching experience!

Thank you: Dr Arif Ismail (SA Reserve Bank), Ashleigh Hale (Bowmans), Astrid Ludin (Strate), Barry Cooper (Cenfri), Cat Denoon-Stevens (Cenfri), Claire Harrop (Freshfields), Craig Kennedy (Bowmans), Cyrus Pocha (Freshfields), Danai Musandu (Goodwell Investments), Dare Okoudjou (MFS Africa), Daren Mudaly (Bowmans), David Geral (Bowmans), Hannine Drake (Findaba), Julius Mboizi (Uganda Communications Commission), Kamami Christine Michira (Bowmans), Kieran Garvey (Cambridge Centre for Alternative Finance), Kirsten Kern (Bowmans), Livia Dyer (Bowmans), Lorien Gamaroff (Bankymoon), Matthew Purchase (Bowmans), Dr Tumubweinee Twinemanzi, (Uganda Communications Commission) and Yinka Edu (Udo Udoma & Belo-Osagie).

To view the slide presentations used by speakers click here: **[Fintech in Africa Slides 2017](#)**

 Bowmans  @Bowmans_Law  Bowmans





Context

“New technological developments are real game-changers for the banking industry, in particular Fintech start-ups. As new entrants bring more innovative and cost-effective solutions, South African banks consider them a significant threat to their business. But traditional banks won’t be leaving the playing field any time soon – their trusted brands and existing customer bases are significant advantages that they can leverage to remain relevant. The PwC Fintech survey indicates that 46% of global banks CEOs are engaging or considering engaging with start-ups through partnerships. Even though Fintech remains a small market in Africa, investments are expected to rise significantly from USD 200 million in 2014 to USD 3 billion by 2020.”

– PwC Report entitled Africa’s Banking Industry Focuses on Client Centricity in the Wake of Technological Advances and New Entrants.

The growing impact of digital technology in various sectors of the economy, specifically the financial services sector (as Fintech) is squarely on the agenda for regulators and supervisory bodies across the globe. In February 2017, Fintech was mentioned in the Budget Review published by the South African National Treasury and acknowledged as a relevant factor in the transformation of the financial services sector in South Africa.

Noting that Fintech hubs have been established in Cape Town and Johannesburg, and that the Fintech industry caters for changing consumer demands (such as mobile payments) and promotes financial inclusion, National Treasury has indicated that a Fintech framework will form part of the much-anticipated Conduct of Financial Institutions (COFI) Bill, which may also include the introduction of a ‘regulatory sandbox’-type initiative to encourage innovation within a controlled environment.

The fact that regulators and supervisory bodies across the world are creating ‘regulatory sandboxes’ as controlled environments within which innovation can occur is evidence that they acknowledge that Fintech presents both opportunities and challenges. Some of these challenges arise in the areas of risk and regulation.

Africa's Fintech Landscape Compared to Other Jurisdictions

The discussions in this session considered how Fintech is developing in Africa in ways that are unique when compared to other jurisdictions. There appear to be four trends emerging in key African regions in relation to Fintech, these being 'formal meets informal', 'physical meets digital', technology convergence and sector convergence. It was noted that:

- Most African economies are informal, and 60% to 70% of the adult African population is unbanked. 'Formal meets informal' is evidenced through the linkages being established between banks and telecommunications to connect this large informal economy to the formal financial system. Most of this is happening through mobile money.
- Infrastructure development in Africa is expensive but the need to connect mass populations to the formal financial system (banks) is spurring the development of infrastructure such as networks that facilitate mobile interoperability across countries and across regions on the continent. In this way, we are seeing the physical meeting the digital.
- While it may be argued that technology in other parts of the world has developed in silos, in Africa one is seeing the technology convergence of 'big data', the cloud and the 'Internet of Things' in the world of Fintech. Many predict that the only way to serve the mass populations of Africa will be digitally.
- Africa is demonstrating sectoral convergence in the way in which Fintech is being used to deliver services and solutions in various sectors, for example energy-fin (finance meets energy), agri-fin (finance meets agriculture), edu-fin (finance meets education) and eCommerce (finance meets trading).

Data is a central component in the world of Fintech. What is interesting to observe in Africa is that data hubs are decentralised (i.e. data is being collected, mined and analysed at the same time by various players in the Fintech ecosystem for various purposes). This means that there are potentially a lot more players that can, and do, hold data, which is critical for Fintech operations.

Africa is also fertile ground for Fintech development due to the opportunities that exist given the real and relative size of its unbanked population which needs access to financial services. It was noted that the five main players to watch are:

- Fintech companies, that have the technology but not necessarily the cash to serve mass populations;
- Telecommunication companies, that have the customer data but not necessarily the track record or expertise in financial services;
- Banks, that have the depositories and know-how regarding financial services but not necessarily the technology;
- Messenger platforms, that have the engineering knowledge and the capital but also lack the track record or requisite expertise in financial services; and
- Online retailers, like Ali Baba, that have the reach and should not be overlooked.

It seems unlikely that any one category of player will be able to claim the unbanked space on its own. There is the space and opportunity for these players to leverage smart partnerships (e.g. Fintechs and telecommunication companies, or Fintechs and banks).



However, fragmented sector-specific regulation that is not 'fit for bigger purpose' can make it unduly difficult to set up these strategic partnerships. While the role-players will endeavour to navigate this space creatively and find ways to make it work, regulators have a crucial role to play.

Speaker: Danai Musandu, Investment Associate, Goodwell Investments .

Moderator: David Geral, Partner and Head of Banking & Financial Services Regulatory, Bowmans (SA).

Key take-away points: Africa's Fintech landscape compared to other jurisdictions

- Africa is fertile ground for Fintech development due to the opportunities that exist given the real and relative size of its unbanked population which needs access to financial services.
- There are four key trends emerging in Africa's Fintech development – formal meets informal; physical meets digital; technology convergence and sector convergence.
- In the world of Fintech, data is critical currency. Unlike in many other jurisdictions, in Africa data hubs are decentralised and data is being collected, mined and analysed at the same time by various players in the Fintech ecosystem for various purposes.
- Africa's Fintech space is occupied by Fintech companies, telecommunication companies, banks, messenger platforms and online retailers. Each has a different competitive advantage over the others in terms of reach, access, data, resources and track record.
- It is unlikely that any one category of player will be able to claim the unbanked space on its own. There is the space and opportunity for these players to leverage smart partnerships.
- Critical to enabling these partnerships is regulation. Fragmented regulation that is not 'fit for purpose' makes these strategic partnerships harder to facilitate. While the role-players will endeavour to navigate this space creatively and find ways to make it work, regulators have a crucial role to play.



Developments and Trends in Fintech Regulation

This session explored approaches to regulating for Fintech in parts of Asia, Australia, the UK and USA, as well as various African jurisdictions like Kenya, Nigeria and South Africa.

The key imperative on the regulatory agenda (in relation to Fintech) must be how to regulate effectively without stifling innovation. Too much regulation could result in innovation being stifled; too little regulation could result in harm to end-consumers and possibly to the financial system at large. It is a fine balance but the focus needs to be not only on how much one regulates, but also on what one regulates and how.

Indications are that regulators are by and large aware of this, but are at varying stages of thinking and implementation. It was noted, for example, that:

- The European Union recently published its policy on Fintech and announced the creation of a Fintech taskforce.
- The Australian regulator has signed a ground-breaking MoU with Indonesian regulators to create connections in that region.
- A challenge that regulators are dealing with is where to assign responsibility for Fintech regulation as it cuts across so many areas of regulatory supervision. One sees this playing out to some extent in the USA and with it comes the challenge of ensuring that appropriate Fintech regulation does not fall through the cracks along the way.

Regulators are also approaching matters differently from one another and identifying differing priorities. The UK, for instance, is placing emphasis on opening greater competition in financial markets and has indicated that it is willing to give new entrants information and

advice. For many Asian regulators, on the other hand, a key driver seems to be financial inclusion in an effort to widen access to financial services across the population.

Regulating for Fintech also means regulating differently in some respects from the way things have been done before, and there is a big learning curve for regulators to understand and keep pace with new technologies and innovations in this space. Some regulators are creating 'regulatory sandboxes', which allows them to observe and learn more about the Fintech space in a controlled environment. Other regulators (e.g. in the UK) are using opportunities like 'themed weekends' to create focussed and open dialogue around specific topics.

While regulators need to rethink the manner in which they have traditionally approached regulation, the Fintech companies themselves need to rethink the manner in which they engage with regulators. Big established players (be they financial services institutions or bigger Fintech companies) may be more accustomed to regulator engagement, but there is some reticence among start-ups. While the temptation to remain under the proverbial radar is understandable, the cost and related burden of adapting products and services later on must also be considered.

There is a general sense that regulators across jurisdictions are in 'listening mode' to understand how to facilitate Fintech for financial inclusion and to understand the risks. Finding creative and effective ways to facilitate engagement and learning for regulators and Fintechs alike is important.



FINTECH IN KENYA

The payment system M-Pesa has seen phenomenal success in Kenya, but there has been less success in other jurisdictions like South Africa. M-Pesa has largely grown in Kenya as a result of people having limited access to credit and from a very real social need to transfer money from urban to more rural areas securely, privately, quickly and cheaply. It is also an interesting example of how important the regulatory environment can be in creating the space for innovation.

Traditional banks in Kenya are regulated by the Central Bank, but when M-Pesa was launched, its initiator, Safari Telecom, sought approval from the Kenyan telecommunications authority. This was because, at the time, the Central Bank chose not to get involved, considering M-Pesa to be more appropriately falling within the domain of the telecommunications authority. Some are of the view that had the Central Bank intervened, Kenya may not have the M-Pesa system it has now, or it may have something that looks very different because of the specific regulatory environment in which the Central Bank operates.

Key points that were discussed about the current regulatory environment in Kenya include the facts that:

- Smaller lending entities are not regulated in Kenya, only deposit-taking entities are. This creates some tension between established regulation and newly developing regulation, and the regulators are trying to determine how best to reconcile these.
- Data privacy and concerns around consumer protection have also been placed in the

spotlight. While previously regulated through fragmented pieces of legislation, a new Consumer Protection Act has recently been enacted to strengthen regulation in this space.

- Competition is also critical as there are a lot of players in the market and Kenya's Competition Authority is very active in this regard.
- There is currently a general initiative to update and rationalise financial services regulation in Kenya in areas such as capital markets, insurance and retirement schemes. There is also an attempt to create greater coherence in the legislative framework and a move away from the traditional approach of legislative instruments developing in silos, which can cause these instruments to not speak effectively to one another.

Some of the regulatory challenges identified included that the pace of Fintech development has been extremely rapid, outpacing the capacity for regulators to adapt. Regulators now have to consider how they can become as 'real time' as the market. They also need to revisit their skills base, which traditionally has been economics-focused, but which must now also include technology.

While there are statements to the effect that the Central Bank and the Kenya Communications Authority will work together to regulate Fintech, many are waiting to see how this will pan out in practice.

FINTECH IN NIGERIA

From the Nigerian perspective, it was discussed that some Nigerian regulators have concerns about the position that M-Pesa holds in the Kenyan economy and the risk that comes from its seeming monopoly in the payment systems space. Nigeria's focus has been on managing risk and the Central Bank has not permitted the Communications Commission to regulate mobile money.

A factor that makes Fintech imperative for Nigeria is that, out of a population of approximately 191 million, there are about



90 million adults and about 90 million active users of mobile lines but only 37 million bank accounts. This means that there is a large unbanked population in Nigeria that is still largely cash-driven.

The Nigerian Reserve Bank is currently focused on the systemic impact of Fintech (e.g. from Bitcoin and Blockchain) although it recognizes that Fintech is important in improving financial inclusion. It was noted that telecommunication companies have all the requisite consumer data that could improve financial inclusion to the unbanked as more people own mobile phones than those that have bank accounts. Telecommunication companies, therefore, have better reach than the banks, which in turn creates an industry for mobile money products and payment platforms.

CHALLENGES OF REGULATING FOR FINTECH

Many see in Fintech the potential to make financial services more efficient and accessible. However, it was noted in the discussions that the legislative and regulatory processes are slow and cumbersome, and are arguably not well suited (in current form) for Fintech which, by its very nature, is agile and developing rapidly. Speakers commented that current legislation and legislative processes have no chance of keeping pace with Fintech as it develops but this is what is needed if Fintech is going to be given the chance to truly enhance financial inclusion.

A heavy regulatory burden can stifle the development of Fintechs. Speakers noted that in some jurisdictions, Fintechs operate within the 'grey areas' of the legislation and prefer to ask for forgiveness after the fact rather than to ask for permission at the outset. In the worst-case scenarios, people do not try to innovate because of the regulatory burden. There were discussions around the need for Fintech development to be guided by principles and not by hard-and-fast rules so that there is sufficient certainty regarding the parameters balanced with adequate flexibility to adapt to new innovations. Madagascar was highlighted as a useful case study in this respect with Fintech legislation that is well drafted.

One speaker noted that the ideal would probably be principles-based regulation that is technology neutral and which also enhances inter-agency harmonisation and inter-country consistency.

It was discussed that in their quest to protect consumers, regulators need to be careful not to regulate consumers out of the market. Consumers should be aware of risk when adopting new products, but they should not be denied the choice to try new products. Open engagement between regulators and Fintechs is critical, and initiatives such as effective sandboxes have an important role to play here. Rather than taking the 'wait and see' approach, Fintechs should bear in mind that sometimes 'early movers' can shape the status quo.

When people talk about Fintech, they often imagine start-ups but many of those who are venturing into this space are established financial services providers or institutions who are looking to launch either existing products or adaptations of existing products in a different way and to a new market. Comments were that they may also be looking to 'leap frog' themselves by launching innovative products or investing into licence-holders in other jurisdictions.

The focus is often on the extent to which the regulatory environment supports Fintech start-ups and venture capitalists, yet discussions highlighted that the focus should also be on the extent to which existing banking and financial regulation restricts the ability of the traditional large and established financial institutions to innovate despite having the capital and human resources to do so.

Care also needs to be taken to give regulators the right mandates, as well as sufficiently open or fluid mandates that not only ensure the protection of currency but also enable regulators to address issues like financial inclusion and Fintech in particular. Speakers noted that consumer protection and financial inclusion should both be built into regulatory mandates alongside financial stability. This, it was said, will enable the regulators to build regulatory frameworks that are agile, that hold space for innovation, and that are better able to keep pace with innovation.



Speakers discussed that in the absence of an effective regulatory framework for Fintech, many Fintechs develop at financial risk at an entrepreneurial level and without sufficient guidance, and then potentially also without legitimacy for funding.

It was noted that it is an attempt to do the impossible if one is trying to trying to regulate or legislate for Fintech without some kind of principles-based system (as opposed to a purely compliance-based system) in which one understands risk and aims to mitigate that as best as possible.

Recent South African principles-based regulatory developments like the Financial Sector Regulation ('Twin Peaks') Act, Treating Customers Fairly (TCF) and the Retail Distribution Review (RDR) show a somewhat different approach to regulation in South Africa, and it remains to be seen how South African market conduct regulators adapt to the capacity and learning challenges that a new approach presents.

Speaker: Cyrus Pocha, Senior Associate, Freshfields(London).
Kamani Christine Michira, Partner, Bowmans (Kenya).
Yinka Edu, Co-Head and Partner, Udo Udoma & Belo-Osagie (Nigeria).
Barry Cooper, Director, Cenfri.

Moderator: David Geral, Partner and Head of Banking & Financial Services Regulatory, Bowmans (SA).

Key take-away points: Developments and trends in Fintech regulation

- The pace of Fintech development has been extremely rapid.
- Regulators have to look at how they can become as 'real time' as the market, and to revisit their skills bases, which have traditionally been economics-focused, to now also take into account technology and the agenda of financial inclusion.
- The key imperative on the regulatory agenda (in relation to Fintech) must be how to regulate effectively and appropriately without stifling innovation. It is a fine balance and the focus needs to be not only on how much one regulates, but also on what one regulates and how.
- Fintech development needs to be guided by principles and not by hard-and-fast rules so that there is sufficient certainty as to the parameters, but also sufficient flexibility to adapt to new innovations. What appears most appropriate is a principles-based system that provides the kind of regulatory agility that is needed to keep pace with something as fast-developing as Fintech; a system in which risk is understood and mitigated as best as possible.
- Care also needs to be taken to give regulators the right mandate, as well as a sufficiently open or fluid mandate that not only ensures protection of currency, but that also enables regulators to address issues like financial inclusion and Fintech in particular.
- While regulators are considering new approaches to regulation, Fintech companies themselves need to think about whether and how they engage with regulators. While the temptation to stay under the radar is understandable, the cost of adapting products later on in the face of unclear or inappropriate regulation must also be considered.
- Established, regulated financial institutions like banks and insurers are already 'on the radar' and have little to lose from detailed and regular early-stage engagement with regulators. This puts them in a position to influence regulatory approaches. Fintechs, whose strategy is more than developing product for sale to banks, insurers and similar large institutions may need to revisit regulatory relationships with this dynamic mind.



Crowdfunding

The conference heard that there has been a marked growth in crowdfunding investment in Africa. In 2013, the total value of this type of alternative finance investments in Africa was USD 44 million, rising to USD 83.2 million in 2015.

East Africa was the largest regional market (USD 34 million in 2015), followed by West Africa, Southern Africa, and then Central Africa and finally North Africa (which showed very little activity). By country, Kenya was the market leader in 2015 (USD 16.07), followed by South Africa at USD 15.06 million.

South Africa has leapt from only USD 2.48 million in 2013 to USD 15.06 million in 2015, and is expected to have been the market leader across Africa for 2016. Interestingly, 90% of total funding is on platforms actually based outside Africa. (Research reports by Cambridge Institute for Alternative Finance)

Most countries in Africa have no bespoke crowdfunding regulation, but may have general financial services regulations that apply in part to crowdfunding activities. Furthermore, most crowdfunding activity is based on non-return models, that is, funders are donors, not investors seeking a financial return.

By contrast, American and Asian models indicate that 90% of crowdfunding is debt-based. Debt or return-based models of crowdfunding are more readily regulated than non-return models. This is not surprising given that returns-based models of crowdfunding carry greater risk for all parties involved.

The cost of understanding country-specific regulation, industries and risks deters service providers from venturing into certain developing markets. The most important requirement for growth is clarity on regulation. In time, it may be the case that better regulation could create more of an appetite for returns-based crowdfunding in African countries.

The conference heard from a newly established cross-border crowd-lending start-up that one of the first difficulties they faced in setting up was the absence of enabling 'fit-for-purpose' legislation in the crowdfunding space. Another complication for this cross-border enterprise was navigating onerous exchange control regulations. It was also discussed how barriers to entry can shape the business model. This company decided to rule out equity in the short term and to rather focus on lending. There was more of a risk appetite for this amongst prospective lenders, who saw it as more of a known product or business model.

Speakers: Kieran Garvey, Policy Program Manager, Cambridge Centre for Alternative Finance (UK). Hannine Drake, Partner, Findaba (SA).

Moderator: Kirsten Kern, Partner, Bowmans (SA).

Key take-away points: Crowdfunding

- Crowdfunding investment is growing in Africa. The total value of alternative finance investments in Africa was USD 44 million in 2013, rising to USD 83.2 million in 2015.
- Most crowdfunding activity is based on non-return models.
- Most countries in Africa have no specific or bespoke crowdfunding regulation but may have general financial services regulation that apply in part to crowdfunding.
- The cost of understanding country specific regulations, industries and risks can deter service providers from venturing into certain developing markets.
- The most important requirement for growth is clarity on regulation.
- Barriers to entry can shape the business model. Navigating onerous exchange control regulations, for example, can make it more difficult for crowdfunding companies to operate across borders. Lack of clarity in regulation can cause companies to adopt 'safer', more familiar business models (e.g. lending rather than equity).





Considering Risk and Managing Fall-Out

Speakers discussed three of the key risks arising for, and from, Fintech, these being data and information risk, harmful lending practices and cybercrime. There was also discussion on the risk environment in Uganda.

DATA AND INFORMATION RISK

Data protection is on the African and international agenda, albeit at differing stages and in different forms. For example:

- In South Africa, the Protection of Personal Information Act (POPIA) was signed into law in 2013, but most of its substantive provisions have not yet come into effect. Prior to this, data protection was largely regulated at a sector level and in terms of the common law. Going forward, it will still be important to be aware of sector-specific regulation such as that falling under the National Credit Act, the Financial Advisory and Intermediary Services Act and the Regulation of Interception of Communication and Communication-Related information. This is because of the principle that if sector rules are stricter than the general rules, then the stricter sector rules will apply.
- Ghana has the Data Protection Act of 2012, while Uganda has the Data Protection and Privacy Bill. Nigeria and Kenya do not currently have comprehensive data protection legislation.
- The European Union's General Data Protection Regulations come into effect on 25 May 2018. These are much stricter rules for the protection of data and will apply to all EU members. They are important to track because many jurisdictions look to the EU's standard on data protection for guidance.
- In the USA, data protection is still sector-specific, as South Africa was until the advent of POPIA, so businesses need to

be aware of the sector-specific data protection laws that may apply to them.

Data protection rules are important to Fintechs because of how data-intensive their business operations are. It was noted that new entrants should take advantage of being able to build compliant systems from the ground up, rather than having to adapt existing systems (sometimes inadequately and at great cost) to new data protection compliance requirements.

Cross-border Fintech companies need to be aware that, as data is moved between jurisdictions, the data protection rules applicable in different countries need to be considered.

It was noted that while data protection laws are based on principles such as accountability, processing limitations, openness, security, and data subject participation, the reputational risk and its effect on consumer confidence in a system is also critical. Fintechs, whose products are developed for integration into regulated entities, will need to be alert to the regulations that enable or frustrate the ability of clients and investors to take up innovative products or stakes in Fintechs.

HARMFUL LENDING PRACTICES FROM A CONSUMER PROTECTION PERSPECTIVE

Fintech has fuelled a proliferation of online lending. South Africa has an activities-based regulation model and its National Credit Act is widely considered to be the 'gold-standard' in Africa, being heavily consumer-based.

There is often a perception that Fintech innovators are not being subjected to the same rules that apply to larger, more traditional lending institutions. It was discussed that from a pure lending perspective, however, Fintech



companies are subject to the same provisions of the National Credit Act as those to which any other lenders (including banks) are subject.

It was discussed that in many instances, the harmful online lending practices that have surfaced occurred not because the lenders were not subject to proper and appropriate regulation but rather because of business practices being employed that seek to 'cut through the red tape' in order to provide speedier services that are more consumer friendly. It was noted that consumers might think that obtaining a quick, online loan is a great and efficient way to borrow money, without being aware of the fact that corners may be being cut, including, for example, in relation to the manner in which affordability assessments are carried out in ostensible compliance with the Affordability Assessment Regulations of 2015.

Prior to 2015, the precise manner in which affordability assessments were to be carried out by NCR-registered lenders was at the discretion of each lender and there was no statutory uniformity in approach. It was noted that the Affordability Assessment Regulations that have since been put in place are administratively intensive, which might appear inimical to Fintechs, which aim to offer speedier, more seamless services to their customers.

It was discussed that the key is how to give large sectors of the population access to much-needed finance that they would not otherwise qualify for through traditional financial institutions. Too stringent affordability assessments have the potential to 'regulate the consumer out of the market', while a lack of proper affordability assessments exposes these vulnerable consumers to financial risk. It is a fine balance that needs to be struck between the consumer's very real need to access properly regulated credit and the importance of protecting that consumer from financial risk. It is a balance that the National Credit Regulator may not have gotten right yet.

In South Africa, the National Credit Regulator has made it clear that reckless lending is a significant concern for the regulator, so Fintech lenders will need to be cautious.

FINTECH FRAUD RISK AND MITIGATION

According to the American Bank Association, 73% of people now prefer to do their banking via the internet and mobile phone banking. This is a 34% increase over six years. It was noted that a similar increase in fraud would be expected, but the FBI estimates that cyber fraud has grown at 55%, outstripping growth in usage. It was noted that one in 10 people in the UK fall victim to cybercrime, which is now the most common crime in the UK.

These same trends are evident in South Africa and the rest of Africa – and are sometimes worse. According to the Nortons Cybersecurity Insights 2016 Report, 67% of Africans surveyed said they had been affected by online fraud. In South Africa, cybercrime is costing about ZAR 3 billion a year. While the Cyber Crime and Security Bill provides a draft legislative framework to address some of this, it has not yet been enacted. Effective management of cybercrime also requires proper resource capacitation and implementation.

It was highlighted that prevalent species of online crime and fraud include identity theft, phishing, vishing, hacking, data breaches, malware, SIM swops and email. Everyone is at risk, from consumers and small companies to major corporates. For larger institutions, a challenge is the demand for real-time transactions, which creates a very real risk.

It was discussed that consumers also contribute to risk, for example by engaging in 'loan stacking' (i.e. when a consumer takes out multiple loans without a lender's knowledge) and 'shot-gunning' (i.e. when a consumer applies for multiple loans for the same home simultaneously for a total amount greatly in excess of the actual value of the property). There is also often collaboration between employees and external syndicates.

For companies, it becomes critical as lenders to 'know your client' (KYC) and to properly identify clients. In South Africa, the operational cost of a data breach is estimated at ZAR 20 million. Steps to mitigate fraud and cybercrime include vendor vetting and monitoring, data and network security, real-time fraud detection, customer identification and incident response.



The need for tighter, smarter, faster security mechanisms and their availability for distributed ledger technology creates opportunities for Fintechs.

UGANDA

Considering Uganda as a case study, it was noted that there is no specific legal regime governing Fintech and businesses have to work within existing financial and sometimes non-financial regimes. The Central Bank is the main regulator for financial services but depending on the nature of the business, a Fintech in Uganda could be subject to at least nine laws across the financial, securities, telecommunications and insurance industries. It could also be subject to oversight by at least eight different regulatory bodies.

Speakers noted that the Central Bank has issued guidelines on consumer protection (data protection, and compliance mechanisms) and, in 2011, regulation was enacted to enhance cybersecurity. The Privacy and Data Protection Bill is also on the cards.

A key regulatory concern in Uganda is the potential for regulatory arbitrage and unfair competition as the Fintech companies are not currently subject to the same requirements as traditional players. Also of concern is the unauthorised disclosure of customer information, third-party risk through outsourcing (as data is often stored outside of the country), the need to enhance interoperability and information systems reliability, availability and recoverability.

Speakers: Kirsten Kern, Partner, Bowmans (SA).
Livia Dyer, Partner, Bowmans (SA).
Matthew Purchase, Partner, Bowmans (SA).
Julius Mboizi, Legal Affairs – Communications Commission (Uganda).

Moderator: Ashleigh Hale, Partner and Co-Head, Corporate, Bowmans (SA).

Key take-away points: Considering risk and managing fall-out

- Data protection rules are important to Fintechs because of how data-intensive their business operations are. New entrants should take advantage of being able to build compliant systems from the ground up, rather than having to adapt existing systems (sometimes inadequately and at great cost) to meet new compliance requirements.
- Fintechs need to be aware that, as data is moved between jurisdictions, the data protection rules applicable in different countries need to be considered.
- While data protection laws are based on principles such as accountability, processing limitations, openness, security, and data subject participation, the reputational risk and its effect on consumer confidence in a system is also critical.
- With respect to harmful lending practices, South Africa has an activities-based regulation model and its National Credit Act is widely considered to be the 'gold-standard' in Africa, being heavily consumer-based. Purely from a lending perspective, Fintech companies are subject to the same rules and regulations as those to which other lenders are subject.
- In South Africa, the National Credit Regulator has made it clear that reckless lending is a material concern for the regulator, so Fintech lenders will need to be cautious. In many instances, the harmful online lending practices that have occurred were not because of inadequate regulation but because of business practices that seek to 'cut through the red tape' in order to provide a speedier service to customers. Consumer education around risk is critical.
- The rules concerning affordability assessments need to be finely balanced. If they are too stringent there is a risk of 'regulating the consumer out of the market'. If they are too lax or non-existent, you expose the most vulnerable members of society to financial risk, which they can least afford.
- Internet and mobile phone banking has and continues to increase, making larger sectors of the population more susceptible to fraud and cybercrime.
- In South Africa, cybercrime is costing about ZAR 3 billion a year. While the Cyber Crime and Security Bill provides a draft legislative framework to address some of this, it has not yet been enacted. Effective management of cybercrime also requires proper resource capacitation and implementation.
- Steps to mitigate these risks include better vendor vetting and monitoring, data and network security, real-time fraud detection, customer identification and incident response.
- The need for tighter, smarter, faster security mechanisms and their availability for distributed ledger technology create opportunities for Fintechs.



Payment Systems

In this session, panellists and delegates discussed developments in relation to payment systems and currencies. It was noted that two of the newest payment system disrupters are cryptocurrencies (which are currencies not issued by a central bank) and E-fiat (a digital instrument issued by a central bank).

Unlike cash which transfers 'hand to hand', cryptocurrencies are often bought and traded on platforms (exchanges) set up by providers. The provider then, through its platform, acts as an intermediary for buy, sell and withdrawal orders. The systems through which currency or value are transferred are more complicated if they involve multiple parties, multiple jurisdictions and real-time settlement requirements. Interoperability between such systems is critical and the regulatory frameworks that enable or inhibit this are as important.

The question of whether it is necessary to regulate cryptocurrencies was hotly debated. Some felt that whether or not cryptocurrencies needed to be regulated is linked to what those currencies are being used for.

Currently cryptocurrency is not legal tender, but if large volumes of financial activity start taking place or being housed within a cryptocurrency system, then questions will naturally arise as to how the concomitant risk is to be managed. Attention then turns, almost inevitably, to the legal framework underpinning that system.

There were discussions around whether, and how much, the strength and vibrancy of the formal banking system influences how much space and opportunity there is for mobile money to take root. It was discussed that in several examples from Africa, Fintech successes have been the products of a social need coupled with a lack of, or inefficiencies in, the public

financial infrastructure (e.g. banks, insurance, medical care and funeral benefits). That combination has allowed Fintech developments, especially in mobile payment systems to gain significant traction and market share in the absence of established alternatives.

On the demand side, important issues to consumers are how accessible, convenient and cheap a product is, while on the supply side, the important issues include the business case and interoperability. One speaker commented that *'if the supplier and customer can find the spot which is neither too hot nor too cold, it will work - call it the Goldilocks spot'*.

There was much discussion around interoperability - both the need for it and the challenges around achieving it. A theoretical advantage of interoperability is that the benefits of the payment system would become more widely accessible across countries and regions. The barriers to entry would be lowered and there could be more entrants into the market. Some African countries have fairly efficient mobile money systems. Building on what is working and enhancing interconnectedness would allow businesses to go regional, making it easier for Africa to trade with the rest of the world. It would also create economies of scale which will then bring down costs, for instance, in the case of money remittances.

Effective payment systems are premised, however, on there being collaboration between the parties to that system and sometimes this is complicated, for example between competing entities.



There needs to be caution about over-estimating the risks of new technology in the short run and underestimating such benefits in the long run. It was suggested that the stereotyping of Fintechs as flouting regulation to cut corners may be exaggerated or simplistic. Managing the risks should not derail the agenda to enhance financial inclusion and this also needs to be firmly on the agenda of the applicable regulators.

Speakers: Cat Denoon-Stevens, Senior Research Associate, Cenfri.
Dr Arif Ismail, Divisional Head: Oversight, South African Reserve Bank.
Dr Tumubweinee Twinemanzi, Director Industry Affairs and Content - Communications Commission (Uganda).
Dare Okoudjou, CEO, MFS Africa.

Moderator: Francisco Khoza, Partner, Bowmans (SA).

Key take-away points: Payment systems

- Unlike cash which transfers 'hand to hand', cryptocurrencies are often bought and traded on platforms (exchanges) set up by providers. The systems through which currency or value are transferred are more complicated if they involve multiple parties, multiple jurisdictions and real-time settlement requirements. Interoperability between such systems is critical and the regulatory frameworks that enable or inhibit this are as important.
- A critical step to improving financial inclusion is to digitise cash as a first step. Mobile money does that and telecommunication companies are key to improving financial inclusion through Fintech services. They are also perceived as being more willing to take on as customers, large sectors of the population that the established banks regard as too risky. For this reason a feature of African Fintech is that while it is positively 'disruptive' for the affected groups, it has not been as disruptive of the established financial sector as it has been in more developed financial systems.
- The advantage of interoperability is extending the benefits of a certain industry to the broader public who may not be part of that interoperable system.
- Interoperability between networks is critical in allowing businesses to become regional, national and international. Interoperability (especially, in payment systems) reduces the cost of money remittances, of generally doing businesses nationally and regionally, and can also make it easier for Africa to trade with the rest of the world.
- There needs to be caution about over-estimating the risks of new technology in the short run and underestimating its benefits it in the long run.





Blockchain – Where to Next?

The panel noted that Blockchain and Bitcoin are different things. Blockchain is an example of Distributed Ledger Technology (DLT). It is a neutral technology that can be used for many purposes while Bitcoin has entered the scene with other specific objectives. Speakers discussed Bitcoin's use as a payment system and also as a digital asset and 'storer of value' which, some argued, can also function as a hedge against hyperinflation. It was noted that regulators in the USA treat Bitcoin as a commodity and it is possible to trade it as a derivative instrument.

There was discussion about possible DLT 'use cases' that regulators are considering. The sandbox exercise of the UK's Financial Conduct Authority (FCA), for example, had resulted in a paper on DLT in April 2017 that identified possible areas for DLT application. One area is welfare benefits. Owing to the fact that many welfare beneficiaries are unbanked, fraud is a problem and about GBP 200 million is lost to fraud each year. Other possibilities identified include using DLT to give SMEs better access to IP registers and patents, as well as in dealing with tax avoidance, especially VAT avoidance. Another possibility is the use of smart contracts to conclude transactions with donors, as well as insurance and reinsurance contracts.

It was noted that the Bank of England has been actively investigating DLT since 2014 and has a Fintech accelerator hub. The bank was considering basing settlement on Blockchain, but decided against this for now because of security issues.

In South Africa, possible use cases have also been identified by Strate. For example, while conceding the risks in a high trading environment, it was also discussed that Blockchain can instantly settle

transactions thus making it unnecessary to retain a register of shareholders. DLT could also be a solution for proxy voting and electronic voting and this could be in place at Strate as early as 2018.

There was discussion around cryptocurrencies as a new asset class. While many see Bitcoin as a unique kind of digital asset with its own intrinsic value, it was noted that Bitcoin is not treated consistently across jurisdictions. In the US, for example, it is a commodity while in the Netherlands, for example, it is regarded as a currency.

There were interesting debates around benefits and uses of private and public Blockchains, and the fact that, due to it still being relatively 'young', Bitcoin is quite expensive to on-ramp and off-ramp. In time, as costs reduce, what is now only 'possible' might become more 'feasible'. Speakers discussed that while the Bitcoin protocol or system by which it functions can't be regulated, the business around it can.

The current financial system is costly. One speaker noted that according to the World Bank website, Africa has the most expensive remittances (the rate from South Africa to Botswana or Malawi, for example, is 28%). Once the scale issues are resolved, Bitcoin can offer solutions. Mainstream investors are already exploring its application in hedge funds and exchange-traded funds.

Speakers: Lorien Gamaroff, CEO, Bankymoon.
 Claire Harrop, Associate, Freshfields (London).
 Craig Kennedy, Partner, Bowmans (SA).
 Daren Mudaly, Head of Innovation, Bowmans (SA).
 Astrid Ludin, Research and Strategy at Strate.
Moderator: Francisco Khoza, Partner, Bowmans (SA).





Key take-away points: Where to next for Blockchain?

- Blockchain, a digital ledger technology (DLT) is neutral technology which is not designed specifically as a financial technology and which can be used for many purposes. Bitcoin is a powerful example of harnessing the Blockchain DLT and it seems to have entered the scene with two objectives – first, as a payment system and second as a digital asset and ‘storer of value’, which some commentators feel can also function as a hedge against hyperinflation.
- Regulators and agencies are looking at various possible DLT test use cases and some examples identified in the UK and South Africa include the payment of welfare benefits (to combat fraud); enhancing SME access to IP registers and patents, dealing with tax avoidance (especially VAT); the use of smart contracts to conclude transactions with donors; insurance and reinsurance contracts; as well as proxy and electronic voting.
- With respect to Bitcoin, it was noted that it is still expensive to on and off-ramp but as costs reduce and scale issues are resolved, the potential for Bitcoin is enormous, for example in relation to money remittances and possible investment products.





Concluding Observations

In the context of the African continent, payment systems operators are the early movers in the adoption of Fintech for purposes of facilitating regional and cross-border payments. More broadly, the key players in the Fintech space include banks, telecommunication companies, Fintechs, message services providers and also online retailers.

The challenge presented by the early players in the Fintech space is that they are regulated by different sector-specific regulation and are supervised by different sector supervisors. There is currently nowhere in Africa where there is a common set of regulations that allows all of the key players to innovate and develop Fintech products and systems within an enabling and guiding context.

The advent of Fintech presents some challenges regarding its integrity as a secure and stable means of delivering various services. With this in mind, the Fintech sector will have to deal strongly and without compromise with data protection and the increasing incidents of cybercrime. These concerns will apply to developers of Fintech as well as to investors and customers, and therefore will have an impact on product regulation as well as commercial activity such as M&A, private equity, public offerings and so on.

At the same time the need for tighter, smarter, faster security mechanisms and the availability of distributed ledger technology also creates opportunities in themselves for Fintechs with regard to financial security technology innovation.

Another operations challenge will arise from Fintech platforms established in different jurisdictions but operating on a cross-border basis. Apart from different regulations, one of the questions is how the challenge of interoperability is going to be addressed.

Within the context of payment systems and the recognition and use of cryptocurrencies, it is clear that central banks will play a role in the future of Fintech. Currently, some regulators and central banks (such as the FCA in the UK, the Monetary Authority in Singapore, Bank Negara in Malaysia and the Australian Securities and Investments Commission (ASIC) have created sandboxes to allow Fintechs to experiment with use possibilities. This is giving central banks an opportunity to learn and understand what Fintech really means and what role they might play in the new Fintech world.

There is a need to continue exploring how the State, as the sovereign, should respond to Fintech. In this regard, it is clear that decentralization of financial and banking services may pose a challenge to the power of the State to control a number of activities from which it derives revenue – for example, how will states deal with cross border transactions and movements of currency? How do they deal with peer-to-peer transactions that may compromise the state's ability to levy taxes? There are aspects of the financial services space which, in the national and security interest, may appropriately need to be supervised by a state agency (e.g. currency control/exchange control in the case of South Africa). At the very least, states are likely to raise and defend such arguments, and so Fintech therefore signals interesting challenges in the areas of constitutional, administrative and public law.

It is also clear that Blockchain and its uses will explode. We are clearly still in the early stages but there are signs that Blockchain will, in future, form the backbone of infrastructure that will be used for delivering financial services.





There is a lot that central banks and players in the Fintech space will be learning from the sandboxes which have been set up in various jurisdictions. The financial services industry in Africa has a lot to learn from developments in other parts of the world. It is clear, however, that the African continent is not standing still and in some respects, particularly in the payment services space, it is well ahead in terms of the use of Fintech. The promise of an efficiently regulated Fintech boom across Africa and the positive consequences for financial inclusion, job creation, corporate activity in research and development, investment, M&A and financing, reduction in inequality and the like need to be considered critically by policy makers who in turn need to guide and facilitate regulators. The potential benefits at a macro-economic level need to be weighed against classical risk issues at an individual consumer level, but neither set of considerations should trump the other.

What is clear is that, right now, the Fintech space is an entrepreneur's paradise.



About Us

The Bowmans Banking and Financial Services Regulatory Practice is a full service team. We help our clients to understand and navigate the 'rules of the game' for their participation in the financial services environment and the financial products they create and sell in the market.

Our service offering includes formation of financial service businesses and licensing/ reviewing of products; regulatory compliance; regulator engagement; investment regulation; dispute resolution; and corporate activity involving regulated entities (e.g. due diligence, de-risking, acquisitions, public offerings). We advise the full spectrum of financial institution, including banks, insurers, collective investment schemes, asset managers, pension funds, medical schemes, hedge funds and regulators.





Key Contacts

KENYA



KAMAMI CHRISTINE MICHIRA

Partner
Nairobi, Kenya

T: +254 20 289 9000
E: kamami.christine@bowmanslaw.com



ANGELA WAKI

Partner
Nairobi, Kenya

T: +254 20 289 9000
E: angela.waki@bowmanslaw.com



JOHN SYEKEI

Partner
Nairobi, Kenya

T: +254 20 289 9000
E: john.syekei@bowmanslaw.com



DOMINIC INDOKHOMI

Senior Associate
Nairobi, Kenya

T: +254 20 289 9000
E: dominic.indokhomi@bowmanslaw.com



EDDAH KIAI

Associate
Nairobi, Kenya

T: +254 20 289 9000
E: eddah.kiai@bowmanslaw.com

SOUTH AFRICA



DAVID GERAL

Head of Banking and Financial
Services Regulatory
Johannesburg, South Africa

T: +27 11 669 9514
E: david.geral@bowmanslaw.com



KIRSTEN KERN

Partner
Johannesburg, South Africa

T: +27 11 669 9553
E: kirsten.kern@bowmanslaw.com



TASHIA JITHOO

Of Counsel
Cape Town, South Africa

T: +27 21 480 7847
E: tashia.jithoo@bowmanslaw.com



ASHLEIGH HALE

Co-Head of Corporate
Johannesburg, South Africa

T: +27 11 669 9342
E: ashleigh.hale@bowmanslaw.com



CRAIG KENNEDY

Co-Head of Technology, Media
and Telecommunications
Johannesburg, South Africa

T: +27 11 669 9349
E: craig.kennedy@bowmanslaw.com

TANZANIA



WILBERT KAPINGA

Managing Partner, Tanzania
Dar es Salaam, Tanzania

T: +255 76 898 8640

E: wilbert.kapinga@bowmanslaw.com



CHRIS GREEN

Partner
Dar es Salaam, Tanzania

T: +255 76 898 8640

E: chris.green@bowmanslaw.com

UGANDA



DAVID F.K. MPANGA

Head of Banking and Financial
Services Regulatory
Kampala, Uganda

T: +256 31 226 3757

E: david.mpanga@bowmanslaw.com



BRIAN KALULE

Partner
Kampala, Uganda

T: +256 31 226 3757

E: brian.kalule@bowmanslaw.com



To view profiles of our lawyers,
please visit www.bowmanslaw.com

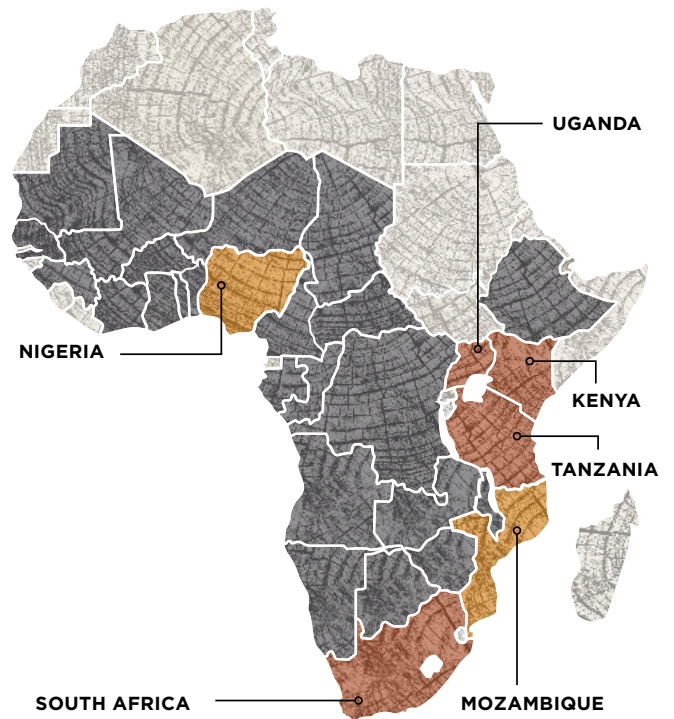
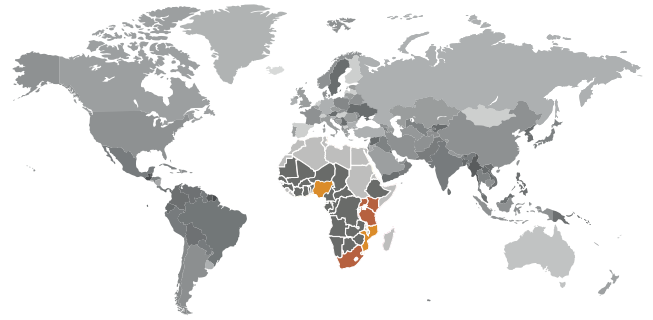


Our Footprint in Africa

We provide integrated legal services throughout Africa from six offices (Cape Town, Dar es Salaam, Durban, Johannesburg, Kampala and Nairobi) in four countries (Kenya, South Africa, Tanzania and Uganda).

We work closely with leading Nigerian firm Udo Udoma & Belo-Osagie, and Mozambique-based boutique firm, Taciana Peão Lopes & Advogados Associados. We also have strong relationships with other leading law firms across the rest of Africa.

We are representatives of Lex Mundi, a global association, with more than 160 independent law firms in all the major centres across the globe. This association gives us access to the best firms in each jurisdiction represented.



-  Bowmans offices
-  Relationship firm
-  Significant transaction or advisory experience





BOWMANS

THE VALUE OF KNOWING

Cape Town

T: +27 21 480 7800

E: info-cpt@bowmanslaw.com

Dar es Salaam

T: +255 76 898 8640

E: info-tz@bowmanslaw.com

Durban

T: +27 31 265 0651

E: info-dbn@bowmanslaw.com

Johannesburg

T: +27 11 669 9000

E: info-jhb@bowmanslaw.com

Kampala

T: +256 41 425 4540

E: info-ug@bowmanslaw.com

Nairobi

T: +254 20 289 9000

E: info-ke@bowmanslaw.com



Follow us on Twitter:

@Bowmans_Law

www.bowmanslaw.com

