

# REGULATORY BLIND SPOTS: When Innovation Outpaces the Law

Private Capital Insights



**Summary:** Many startups typically innovate outside the scope of existing regulations, and in some cases, grow way beyond the confines of the licenses they hold. This creates a risk that can adversely impact the business model. While this risk cannot be entirely prevented, however, it can be managed by innovative product structuring, engagement with regulators and labeling under the Startups Act (where applicable).

It is typically the nature of innovation to precede regulation. Technology evolves quickly, often testing the boundaries of existing legal frameworks before legislators or regulators can respond. Crypto and digital assets are a crucial example. In Nigeria for example, Decentralised finance, tokenisation, and digital asset exchanges emerged rapidly, challenging traditional definitions of currency, securities, and payment systems.

Regulatory response was divergent: the Central Bank initially moved to restrict banks from facilitating crypto transactions, effectively stifling growth in the formal sector. However, the Securities and Exchange

Commission took a different path by recognising digital assets. The Investments and Securities Act 2025 has now formally recognised digital assets as securities in Nigeria.

For startups innovating outside the existing perimeter of regulation in fintech, edtech, health tech or other sectors, this creates what may be described as a '**regulatory blind spot**'. The product exists. The demand exists. The regulation, however, is unclear, fragmented, or evolving. In markets like Nigeria, where regulatory responses may sometimes lag behind innovation, this uncertainty becomes material.

## A. Framing the Potential Risks

The risks associated with regulatory blind spots can be profound for both startups and their potential investors.

### Heightened Uncertainty

Investors price risk into their investment models. Where the regulatory regime is unclear or non-existent, the associated risk cannot be efficiently priced. This may lead to delayed investment decisions from equity financiers, reduced valuations, or enhanced protective provisions in term sheets and definitive agreements. Regulatory ambiguity introduces uncertainty not only as to compliance costs but also as to the viability of the business model itself.

### Retrospective Licensing

A startup may initially obtain a licence for a defined business activity and structure its model to fit within that regulatory framework. As the business scales, however, a regulator may require it to obtain a different or higher-tier licence under a new regime. Such reclassification can materially alter the company's cost structure and, in some cases, its underlying value proposition.

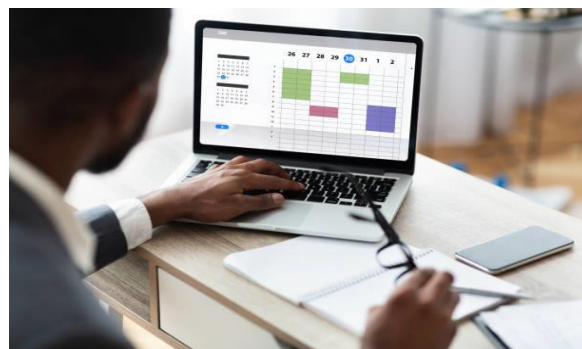
*A practical example can be drawn from Kuda's microfinance banking operations. Kuda initially operated under a unit microfinance bank licence (a category designed for small-scale microfinance banks with limited capital and operational scope). Leveraging digital infrastructure, Kuda scaled nationally. Eventually, the Central Bank was reported to compel the upgrade of its licence from unit to national status. The risk in such cases lies not in innovation itself, but in scaling beyond what the regulatory licence contemplates.*

### Increased Compliance Costs

This is a follow-on from the above. Where regulators subsequently clarify or expand oversight, startups may be required to obtain new licences, restructure operations, increase capital reserves, or enhance reporting mechanisms. These adjustments are rarely cost-neutral. In some cases, as in Kuda Bank and other MFBs that CBN upgraded their licenses, they may fundamentally alter the economics of the business.

## B. Navigating Regulatory Blind Spots

At AHL & Co., we typically advise that regulatory blind spots cannot be entirely prevented. However, through careful and innovative planning, it can be managed by:



### Product Structuring

One strategy is to analyse the scope of existing regulation and structure your product so that it clearly falls within, or in some cases deliberately outside, defined regulatory categories. This structuring exercise is often supported by a formal legal opinion. Usually, legal opinions assess whether a proposed business model triggers licensing requirements, identify areas of ambiguity, evaluate enforcement risk, and outline mitigation strategies (if any). For investors, such opinions assist in allocating risk, inform conditions precedent to financing and may be a significant comforting tool to any proposed transaction.

### Regulatory Sandboxes

Regulatory sandboxes allow startups to test innovative products within a controlled regulatory environment, subject to defined parameters and oversight. In Nigeria, both the Central Bank and the Securities and Exchange Commission have introduced sandbox frameworks in specific sectors. These regimes provide temporary authorisation to experiment under supervision, thereby reducing enforcement risk while regulators assess systemic implications of the startups product offering.

### Engagement with Regulators

Proactive engagement (whether through formal or informal channels) can reduce regulatory friction. Early dialogue may clarify interpretative ambiguities and demonstrate good faith. For example, the SEC's regulatory incubation framework for fintech operators allows entities to operate within a defined structure while progressing toward full compliance.

### **C. The Nigerian Startup Act 2022**

The Startup Act 2022 was enacted to provide a legal and institutional framework for the development of startups in Nigeria and to strengthen the ecosystem. Key provisions under the Startup Act include:

- The establishment of a Startup Support and Engagement Portal as a centralised platform for interaction with relevant government agencies.
- The creation of a “startup label”, which is granted to eligible companies that meet defined innovation and operational criteria.
- The provision of certain fiscal and tax incentives, including reliefs designed to encourage investment and growth.

In the context of startups, the labelling framework is particularly significant for providing comfort in managing regulatory blind spots to eligible startups. While it does not override sector-specific regulation, it however provides a degree of institutional recognition.

### **D. Lagos State Innovation Bill 2025**

Lagos, as Nigeria's primary commercial and technology hub, has introduced the Innovation Bill 2025 (currently in draft form) to further stimulate innovation within the state. The most current version of the Bill can be found [here](#). Notable provisions of the Bill include:

- Defining eligible innovation-driven entities within Lagos State.
- Proposing tax and fiscal incentives aimed at supporting technology-enabled enterprises.

As with the Startup Act, the Bill seeks to create a supportive ecosystem. However, until enacted and operationalised (which we will analyse subsequently), its practical impact remains prospective. It is envisaged that the effect may mirror the Startup Act in fostering regulatory coordination and improving investor perception.

### **E. Conclusion**

Innovation will often outpace regulation. The risk is not in innovating, but in innovating without a clear understanding of how the law may eventually respond. Regulatory blind spots introduce uncertainty, and uncertainty affects valuation, fundraising, and scalability. For founders building at the edge of existing frameworks, regulatory awareness is not merely a compliance exercise. It is a capital strategy.

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