



Analytical Report

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**REGULATORY SANDBOXES  
REGULATION AS A SERVICE**

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Russian Electronic Money Association

October 2016



Dear readers,

We are now observing a real transformation of the retail financial services, which remained largely unchanged for hundreds of years. Since 2010 more than 6,500 fintech companies have emerged which, to date, have attracted more than \$22,5 bln investment. In twenty years this case will probably be included in every textbook on economics and finance.

Ironically, it was the drive for stricter financial market regulation post-2008 crisis that served as a catalyst for fintech boom. Banks are now under pressure: the number of rules, standards and specific requirements is growing. This atmosphere is basically stifling innovations. But while banks held their ground, clients and their habits kept changing. Today consumers want fast, user-friendly and safe services. They don't understand why sending money has to be more complicated than sending a message on Facebook. As traditional players couldn't meet the demand, big and small IT-companies started to fill this space.

Here we usually discuss how hard it is for banks to compete with a huge number of more flexible and more innovative players. But how do regulators feel? I suppose, they are no less stressed than bankers. Indeed, standard rules are poorly applied to robo-advising, P2P lending, crowdfunding, blockchain and many other technologies yet to come. It is tempting to treat fintech-companies as if they were a nail and to implement prohibitive regulations, but this will lead to problems in the future: dependence on foreign technologies, business models, instruments and services. This is why regulators have to evolve as well.

In this Report we present the analysis of the genuine regulatory innovation of the last years: regulatory sandboxes. They are not just a set of rules, but a reflection of various challenges, which regulators face in this fintech age - rapid growth of new smaller players, lack of relevant rules and regulations for innovative products, need for consumer protection and financial stability. We were also intrigued why some regulators decided that they have to change at all - and this is maybe the most important issue for the finance market for the next decade. Hope you enjoy reading this Report, and that you find it stimulating and thought-provoking.

Dr. Victor Dostov

President of the Russian Electronic Money Association

# Table of contents

Executive Summary	4
1 What is Fintech?	7
2 Why Fintech?	11
3 What is a Regulatory Sandbox?	15
4 Why do we need Regulatory Sandboxes?	16
5 National Projects on Regulatory Sandboxes	19
5.1 The United Kingdom of Great Britain	19
5.2 Singapore	25
5.3 Australia	29
5.4 The United Arab Emirates (Abu Dhabi)	34
Conclusion	39
Appendix 1 Brief Summary of Sandbox Features	41
Appendix 2 Application criteria	45
Appendix 3 Default Testing Standards Overview - the UK approach	48

## Executive Summary

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The increasing popularity of smartphones, emergence of mobile ecosystems and new effective ways of data processing set the stage for financial innovations. Since 2014 we are using the term ‘fintech’ to refer to the innovative solutions for traditional financial services.

This is not unheard of. Something similar happened on many other markets. Amazon and Aliexpress have changed our perception of e-commerce, AirBnb founders created more efficient and safe rental market, and Uber with Yandex.Taxi completely transformed taxi industry. Just the same, in the financial sector new business models (e.g. P2P lending) and new mechanisms for interaction with customers (via special aggregators) are emerging, and all these change customer experience radically.

However, innovations do not fit in existing financial regulation well. Creation of new models, products and services is always test-and-learn approach. Companies test dozens or even hundreds of different approaches to find the best possible solution. As a result, historically inflexible regulatory requirements make financial market an actual minefield for innovators. Both large and small companies are risking to face sanctions for violation of rules, which were previously developed for traditional services, without innovations in mind.

Historically inflexible regulatory requirements make financial market an actual minefield for innovators. Regulators can take punitive actions against new market players because modern technologies, products and business models do not fit in traditional legislation.

Regulators are now challenged by the difficult task. They cannot constantly modify legislation in response to every innovation, because this will eventually lead to regulatory chaos. However, they also cannot ignore new technologies, since lack of decision-making may have a negative impact on financial stability and consumer protection.

In this Report we look at perhaps the most promising solution of this problem - regulatory sandboxes. Regulatory sandbox is a special set of rules, which allow innovative companies to test their products and services in a safe limited environment without violating financial regulation. They should be distinguished from standard general reliefs/exemptions, which exist in some jurisdictions for certain types of business (e.g. small electronic money service providers in the European Union), because they are typically based on some rigid rules and do not cover innovations and new business models.

Regulatory sandboxes are a special set of rules, which let innovative companies test their products and services in a safe live environment without violating financial regulation.

We have had a closer look at regulatory sandboxes and similar projects that are either live or currently under discussion in Great Britain, Singapore, Australia and The United Arab Emirates (Abu Dhabi Global Market). However, the list of jurisdictions that embarked on creating the local sandboxes is constantly growing – Malaysia, Hong Kong and Thailand being the latest examples.

Main Findings of the Analytical Report are:

1. Regulatory sandboxes are always initiated by the regulator, therefore private sector involvement in their management is limited. In the UK market players were offered to create their own regulatory sandboxes in addition to the public one. In Australia industry organizations are given the role of a gatekeeper for the local sandbox.
2. Generally, both start-ups (or unlicensed business) and incumbents can test their products in regulatory sandboxes. Testing of products and services in limited environment is usually available to both types of companies.
3. In most cases, rather than create a universal sandbox, regulators establish separate unique sandboxes for each particular project. Normally, terms of product testing are discussed with applicants on a case-by-case basis.
4. Regulators have to screen sandbox applicants, as some businesses may try abusing the opportunity, i.e. evaluate commercial potential instead of dealing with the legal uncertainty. Hence an applicant should prove the need to test the innovation on real customers and in a sandbox, while also demonstrating that innovation is unique and ground-breaking.
5. There is no single approach to regulatory sandbox testing parameters. The restrictions may include: limits on number of clients, limits on risk exposure, requiring informed consent and other.
6. Regulatory sandboxes benefits are different as well. In some cases, participants are exempted from all the regulatory requirements. However, more common are limited legal relaxations: when regulator allows sandbox companies not to follow obsolete or obviously irrelevant rules. In some cases, existing rules can be modified.

7. On average, a testing period in the regulatory sandbox lasts for 6-12 months. In some cases, it is up to two years (in UAE). When the testing is over, companies either deploy their product on the market, complying with the usual licensing obligations, or discard the solution. Participants inform the regulator about their progress throughout the testing period.
8. Broadly, all these complex features make regulatory sandboxes more of a regulatory service, rather than a separate project. They are not only about exemptions from some legal requirements, but also about counseling, information sharing and support. In fact, regulators become consultants for innovative companies. This helps them understand new trends in the market better, and, as a result, implement more effective legislation.

There are few countries, which released consultation papers on regulatory sandboxes, and fewer yet, which have successfully completed beta testing. But this first experience is likely to be the most valuable and will eventually lay the basis for the best market practices for the next decade.

In the first part of the Report, we review the concept of fintech and its significance. Then we discuss the idea of regulatory sandbox, and some examples of local implementation. The appendix provides aggregated information on regulatory sandboxes and includes some relevant documents.

The information provided in this Report is correct as of September 1, 2016.

# 1 What is Fintech?

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There is no common definition of 'fintech'. Therefore, this term is usually used to refer to a variety of phenomena. In its strict sense, fintech refers to startups that provide financial services. More broadly, fintech includes all financial innovations developed by large and small companies.

In our opinion, fintech refers to new business models and solutions aimed to improve the efficiency of financial services. And for this reason it is fair to say that fintech has existed long before 2014. First bank cards were certainly considered as a breakthrough technology of that time. The same can be said about the mobile-, and later, online banking, mobile apps and so on. Nowadays we take all these technologies for granted, but just several decades ago they completely revolutionized the retail finance industry. In 1986 Merton H. Miller from the University of Chicago wrote in his article on financial innovation: 'No word is more overworked these days than "revolution." Yet in its original sense of a major break with the past, the word revolution is entirely appropriate for describing the changes in financial institutions and instruments that have occurred [...] just a short twenty years ago [...] Can any twenty-year period in recorded history have witnessed even a tenth as much new development?'<sup>1</sup>

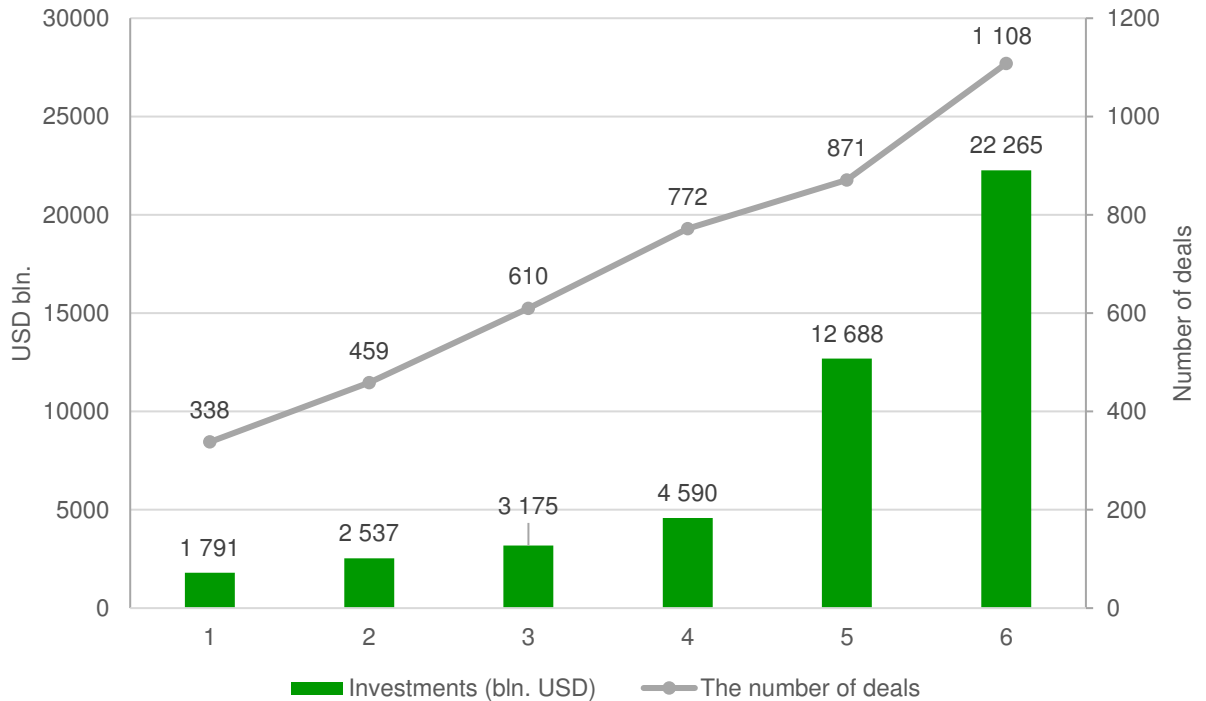
It is fair to say that fintech has existed long before 2014. First bank cards were certainly a breakthrough technology of that time.

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<sup>1</sup> Miller M.H., Financial Innovation: the Last Twenty Years and the Next // The Journal of Financial and Quantitative Analysis. Vol. 21. No. 4. 1986. Pp. 459-460.

**Figure 1**

## Global investment in fintech companies



*Fintech and the Evolving Landscape: landing points for the industry // Accenture. 2016.*

However, current stage of fintech growth started in different circumstances than those, when ATMs and credit cards first appeared. Firstly, today's ever increasing regulatory burden makes traditional players less flexible, hence new models often emerge outside the regulation perimeter. Secondly, new technologies have significantly lowered the entry threshold for smaller companies. We have Facebook and Twitter, cell phones, and tons of other technologies at our fingertips, which allow to try on the role of a journalist or a literary critic. Likewise, companies do not necessarily need to establish an office or hire a staff of account managers to provide financial services. New financial providers operate in a fully online environment that significantly decreases their costs.

## Box 1 – Sandbox eligibility criteria - The UK approach

Criteria	Key questions
<i>Is it genuine innovation?</i>	Is the innovation ground-breaking or constitutes a significantly different offering in the marketplace?
<i>Is there a consumer benefit?</i>	Does the innovation offer a good prospect of identifiable benefit to consumers (either directly or via heightened competition)?
<i>Is the firm ready for testing?</i>	Is the business ready to test their innovation in a live environment?

*For the full version see Appendix*

*FCA Project Innovate: Call for input Feedback Statement // Financial Conduct Authority. October 2014.*

Fintech is becoming an umbrella term for several types of technologies. Term 'regtech' is used to define new technological solutions aimed at reducing the cost of compliance and regulatory oversight. 'InsurTech' refers to innovations in the insurance industry. We will probably see the emergence of many other similar '-tech' concepts.

### **Regtech – new technologies in compliance**

According to Deloitte company, Regtech is a 'new fintech'<sup>2</sup>. This category includes solutions that aim to reduce the cost of regulatory compliance, which are implemented by a regulator and private companies. Typically, these innovations are imperceptible for customers, but they help reduce financial and operational risks, and also simplify the interaction between the public and the private sector.

A good example of regtech introduced by regulator is an implementation of XBRL format (eXtensible Business Reporting Language) into business reporting. Today the financial providers have to prepare redundant reports and sometimes in different formats for each regulator. As a result, these data is difficult to aggregate, analyze and to react on quickly. Providing data in XBRL format helps solve these problems and reduce the market costs, allowing regulator to effectively analyze information and improve the quality and transparency of supervisory control.

*Find out more about the Central Bank of the Russian Federation project on the collection and processing of business reports in XBRL format:*

[http://www.cbr.ru/finmarkets/?PrtlId=format\\_xbrl](http://www.cbr.ru/finmarkets/?PrtlId=format_xbrl).

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<sup>2</sup> RegTech is the New FinTech. How agile regulatory technology is helping firms better understand and manage their risks // Deloitte. 2016.

## 2 Why Fintech?

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Many countries around the world pay attention to fintech, because new technologies may help solve a variety of problems that could not be addressed by conventional means.

The first goal is to improve competition on the market. As innovative companies are more flexible and adaptive, they successfully compete with traditional market players, leading to lower fees and the development of new products and services. This pushes more conservative financial institutions away from dominant paradigm of incremental, minor innovation<sup>3</sup>. This also increases the competition within the banking sector: smaller players can successfully compete with the incumbents.

Fintech helps make financial market more efficient and decreases the costs for the whole ecosystem: consumers, market players and regulators.

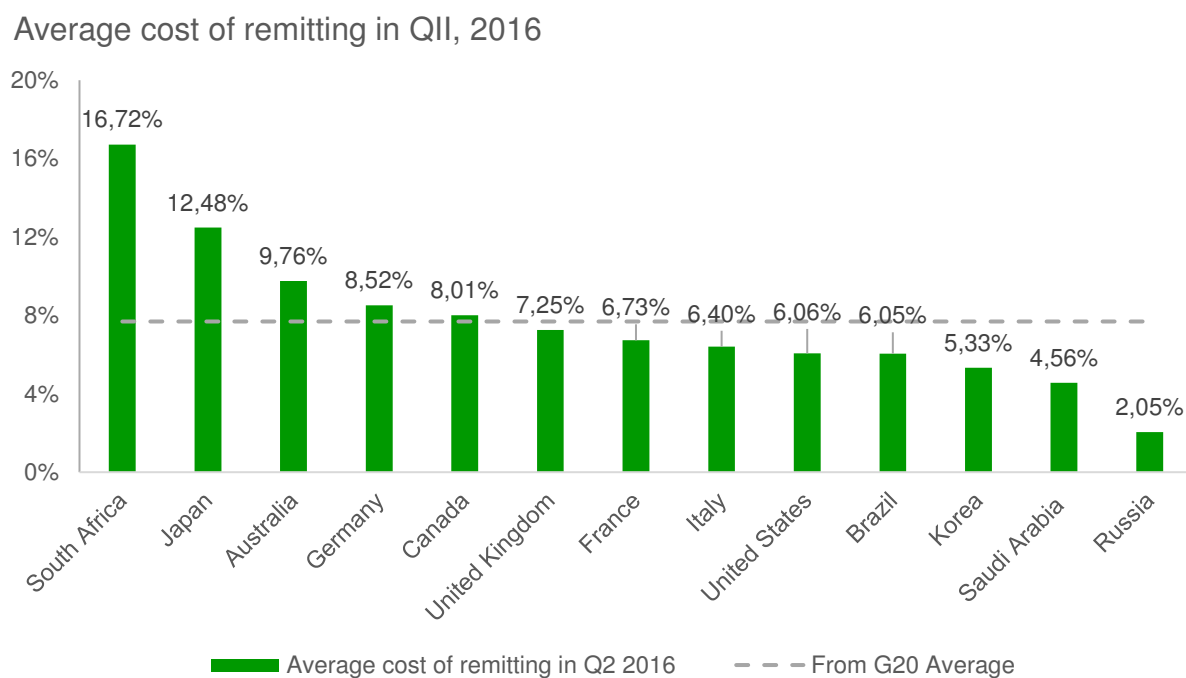
The second is the reduction of financial services costs and fees. The emergence of new technologies helps reduce the cost by making brick-and-mortar offices unnecessary and using digital channels to communicate with customers and regulators. Coupled with the effective competition, this leads to lower fees. Russia is an exemplary case: due to constant innovations, Russian market players offer the lowest remittance prices among G20 countries<sup>4</sup>.

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<sup>3</sup> Breaking the Rules: Achieving breakthrough innovation in financial services // PwC FS Viewpoint. April 2014. [www.pwc.com/fsi](http://www.pwc.com/fsi).

<sup>4</sup> Remittance Prices Worldwide // The World Bank. Issue no. 18. June 2016.

Figure 2



*Remittance Prices Worldwide // The World Bank. Issue no. 18. June 2016.*

The third is to achieve higher financial inclusion by introducing remote financial services and lowering entry threshold for consumers. Financial exclusion is a sign of the ineffective market. Consumers are often not satisfied with the quality of financial services, or with the way these services are provided. And financial institutions do not serve some groups of consumers due to their low profitability. New technologies help expand a financial product range and raise their relevance for the customers.

Finally, the fourth goal is higher economic transparency and the effectiveness of anti-money laundering and combating the financing of terrorism measures. Methods criminals use are constantly evolving. To be one step ahead, financial institutions and regulators have to advance steadily and keep approaches to customer identification and identifying suspicious activity up to date. Traditional AML/CFT measures<sup>5</sup>, e.g. using data from identity documents, are becoming a source of additional costs for law-abiding customers, but usually have limited effect on identifying criminals. Big data analysis and information on activity patterns helps preventing illegal activity more effectively, without imposing additional burdens on law-abiding citizens.

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*‘We are just interested in what works. We are more than happy to see innovative [anti-money laundering and combating the financing of terrorism] methods being deployed by financial services firms. If we [as regulators] are doing anything that creates barriers to this, we want to know, so that we can stop’*

*Rob Gruppeta,  
Head of the Financial Crime  
Department, FCA.*

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## Regulation issues

Introduction of new technologies really puts the regulatory challenge into perspective. Current standards and rules are generally tailored to already existing products, services and business models. And for exactly this reason they sometimes establish irrelevant or obsolete requirements for new solutions. As innovative companies use test-and-learn approach to develop new products and services, adapting legislation to each specific innovation is too tedious and inefficient. At the same time, regulator cannot lose control over the risks, since it is responsible for the financial stability and consumer protection.

In this sense, regulators have to innovate just as their supervised entities: they are inventing and experimenting with new regulation models, to find the most effective one.

However, some countries fall into a "risk mitigation trap". The desire to reduce the risks by any means leads to stricter legislation. Inadvertently, these rules favor conservative, inflexible, big players. Such firms are vulnerable to external shocks, slow to react to the changing conditions, and, all in all, make the risks higher, not lower. All this is conducive to 'de-risking': when financial institutions, being under the pressure of regulations, push consumers to unregulated areas. In extreme cases, government has to use public money to save large banks from prudential instability. In retrospective, such jurisdictions lose

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<sup>5</sup> Anti-Money Laundering/Combating the Financing of Terrorism.

competitive edge: as new technologies cannot appear locally, states would have to import them from abroad. The 'risk mitigation trap' is known for quite a long time: there are several examples of countries, which had this problem at the dawn of the Motor Age.

### **Traditional regulation and new technologies**

In 1886 the legislature of Pennsylvania endorsed a law on rules for "horseless carriages" drivers: "Any motorist who sights a team of horses coming toward him:

- must pull well off the road, cover his car with a blanket or canvas that blends with the countryside, and let the horses pass.
- If the horses appear skittish, the motorist must take his car apart, piece by piece, and hide it under the nearest bushes".

The Governor vetoed the law.

There is no universal approach to supporting innovation. For decades, economists have been putting their mind on this problem, and financial regulators have only begun to explore possible solutions. Effective measures to support new technologies should include establishing conditions which would encourage competition and innovating, while at the same time discourage dishonesty. Put simply, we need to create effective institutions. But this recipe only seems simple, and it can be implemented in many different ways in practice.

In this Report we consider one of the most promising and groundbreaking projects of this kind - regulatory sandboxes. Unlike innovation hubs, they are not about specific innovative projects, but rather reflect a completely new approach, aimed to minimising legal uncertainty and creating a special environment where new technologies could grow.

## 3 What is a Regulatory Sandbox?

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The concept of a 'sandbox' came from programming, where it is used to refer to isolated environment to run potentially unsafe code. For example, if launched in the sandbox, virus code behavior can be studied without negative impact on the entire system<sup>6</sup>, almost like in Petri dish.

Later the term 'sandbox' began to be used in other fields as well. For many years there have been a hearsay about the "Google Sandbox", an algorithm, which does not allow new sites to get to the top of the web search results. To minimize the effect of spam websites on search quality, Google is rumored to isolate new web pages for some time and not show them among the search hits.

Special "sandboxes" are also used in medicine to refer to trials with new methods of treatment. For example, doctors test genetic analysis on an isolated group of patients to establish procedures and principles for a mass clinical practice<sup>7</sup>.

Thus, sandboxes are generally useful when it is impossible to determine whether a solution works or not theoretically. They also help develop rules for innovative solutions by testing them in a safe-space environment.

*Regulatory sandbox is a special set of rules that enables innovative companies to test their products and services in a controlled environment, without risks of breaking financial regulations.* Conditions of a 'sandbox' include full or partial exemption from certain regulatory requirements. After tests in a 'sandbox', solutions can be either discarded as unsuccessful or introduced in an unrestricted environment, i.e. offered to the mass consumer.

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<sup>6</sup> Blasig L., Batyuk L., Schmidt A.-D., et al., An Android Application Sandbox System for Suspicious Software Detection // IEEE Papers. 2010.

<sup>7</sup> Aziz A., Kawamoto K., Eilbeck K., Williams M.S., et al., The Genomic CDS Sandbox: an Assessment among Domain Experts // Journal of Biomedical Informatics. Vol. 60. 2016. Pp. 84-94.

## 4 Why do we need Regulatory Sandboxes?

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In the financial market implementing new ideas is costly, as specific regulations prescribe almost every step of financial institutions. However, there is also a big potential for improving efficiency and reducing costs by introducing new technologies.

How can sandboxes help?

- Reducing Uncertainty for Market Players

Existing financial regulation is rather difficult to understand, while at the same time establishing severe penalties for violations. Therefore, large organizations sometimes prefer not to introduce any innovations out of fear of being sanctioned. Reputational risk is evident, while the success of an innovation is not.

Small companies face similar difficulties, although for a different reason. They struggle to understand the regulatory requirements and have to hire expensive consultants or keep a large compliance department.

In some cases, the law simply does not take into account the emergence of new technologies, or just aimed at minimizing risks that are no longer relevant.

The sandbox regulatory regime allows large and small market players to be sure, that they will not be punished for breaking the rules, which are not entirely relevant to certain innovation, model or practice or if the breach does not lead to negative consequences: no harm, no foul.

- Developing Rules for New Technologies

By observing testing of new business model or practice, regulator gets an opportunity to develop proportional and adequate rules for it. Tests in a sandbox allow regulator to learn how new tools and services work, their specific risks and possible ways of risk mitigation. This looks more sustainable than just blindly expand the old rules to new solutions.

- Reducing Time-to-Market Cycle

Traditionally, every new solution that financial institution wants to implement, must undergo several stages of approval. First, technical, then by corporate lawyers. As new services may not fall within the existing regulatory framework, additional coordination/approval of the regulators might be required. All this is detrimental to the time-to-market cycle, making the innovation process rather costly and burdensome.

Exemptions from some regulatory requirements in sandboxes allow companies to reduce time-to-market cycle. Hence, market players can be sure that their foreign competitors will not create a similar product while they seek approvals from regulators.

- Increasing Investments

Investors do not like to finance companies which are not regulated or which could potentially violate the law. At the same time, small firms may not have enough resources to carry out an in-depth analysis of legal requirements without enough investments. Regulatory sandboxes can break the cycle and considerably increase legal certainty, thereby making companies more predictable and more attractive for investors.

- Faster Abandonment of Unsuccessful Solutions

Innovation is a constant test-and-learn process in a search of the one solution that really works. Thomas Edison had tested 2,774 prototypes to develop the light bulb<sup>8</sup>. It took Thomas Dyson no less than 5,127 different tests to invent a working bagless vacuum cleaner<sup>9</sup>.

**2 774**

prototypes had been tested  
by Thomas Edison to develop  
the light bulb

Fintech firms also needs to try different options to find ‘the one’ solution. Traditional mechanisms of advance approval do not allow to swiftly test multiple different solutions - sandboxes do.

- Regulators Retain the Control

Regulatory sandboxes allow regulator to retain oversight over all projects in testing. This differs from cases when new technologies develop in unregulated environment, companies use the loopholes or follow unspecific legal requirements. In such situations, regulator cannot respond to possible legal breaches rapidly, while market participants have to deal with regulatory risks due to legal uncertainty.

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<sup>8</sup> The Edisonian // Vol. 9. Fall. 2012.

<sup>9</sup> Dowling S., Frustration and Failure Fuel // BBC. 14.03.2013.

Innovators learn the basics of the financial market. Regulators get important information about new business models, their advantages and disadvantages in comparison with existing solutions.

In a broader sense, sandboxes are useful for both regulators and companies. Innovators learn the basic rules and may benefit from the supervisor's advice on risk and their mitigation. Regulators receive valuable information about new business models, their advantages and disadvantages in comparison with the existing alternatives. By the end of testing, the private sector will already understand the basic requirements for financial services, and the regulator will be able to offer proportional and adequate legislation. The

sandboxes also decrease the costs of failures which are incremental part of the innovative process.

## 5 National Projects on Regulatory Sandboxes

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### 5.1 The United Kingdom of Great Britain

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The United Kingdom became the first country, which decided to create a regulatory sandbox for the financial market. In October 2014, the Financial Conduct Authority (FCA) launched Project Innovate which helps innovative businesses understand ever-changing demands of regulation and bring innovative ideas to the market.

FCA's Project Innovate assists innovative financial businesses through authorisation process. This involves proactive engagement and support on preparing documents, advance warnings on possible difficulties and informing about the specifics of the registration process. Project Innovate also includes the Innovation Hub, that supports authorized companies through providing advice, additional formal and informal FCA guidance (see box below) and organizing meeting with the relevant FCA departments.

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*'Innovation is not a license to cut corners'*

*Bob Ferguson,  
The Head of the FCA's  
Project Innovate*

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### **Innovation Hub - the UK experience**

Innovation Hub is not a usual accelerator, because it provides support only on regulatory issues, and does not offer commercial advice or lend offices.

Every Hub resident has a designated officer who act a contact point from the FCA side. The FCA rules allow regulator to provide guidance in two major ways:

- Individual guidance is guidance on how the rules and general requirements apply in company's particular circumstances. It can be provided on the company's request or by the FCA's own initiative. Since an individual guidance is a formal document, it should be agreed by all the FCA's departments<sup>10</sup>;
- Informal steers are provided by the FCA based only on the preliminary assessment of the situation. Companies may rely on informal steers at their own risk. Since formal internal coordination with the FCA's departments is not required, informal steers are provided rather swiftly. This tool will probably be used to answer questions that could be resolved easily and are not related to uncertainty or ambiguity of norms.

In 2015 the FCA decided to expand Project Innovate and introduce a regulatory sandbox, a 'safe space in which businesses can test innovative products, services, business models and delivery mechanisms without immediately incurring all the normal regulatory consequences of engaging in the activity in question'<sup>11</sup>.

Sandbox's aims are:

- reducing the time and, potentially, the cost of getting innovative ideas to market;
- enabling greater access to investments;
- increasing number of products that are introduced to the market.

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<sup>10</sup> SUP 9. Individual Guidance // FCA Handbook. Release 8. July 2016.

<sup>11</sup> Regulatory Sandbox // Financial Conduct Authority. November 2015.

## Who can participate?

The FCA allows both authorised and unauthorised firms to take part in sandbox testing.

The FCA chooses applicants for a sandbox according to the following criteria:

- Is the firm looking to deliver innovation which is either regulated business or supports regulated business in the UK financial services market?
- Is the innovation ground-breaking or constitutes a significantly different offering in the marketplace?
- Does the innovation offer a good prospect of identifiable benefit to consumers (either directly or via heightened competition)?
- Does the business have a genuine need to test the innovation on real customers and in the FCA sandbox?
- Is the business ready to test their innovation in a live environment?

The FCA allows both authorised and unauthorised firms to take part in sandbox testing.

As the FCA has no strict formal rules for choosing projects for testing, this is a subjective judgment. Regulator needs to figure out if an innovative project really needs special protection, and if an applicant tries to use this restricted environment to assess

and minimize possible business risks. Another factor is the lack of regulation that can already be applied to the service.

Applications will be approved in stages. Firms could apply to the first cohort of the regulatory sandbox from 9 May 2016 until 8 July 2016. The second application period will last from the mid-November 2016 until mid-July 2017<sup>12</sup>. Successful applicants should send the FCA a detailed sandbox plan, which includes<sup>13</sup>:

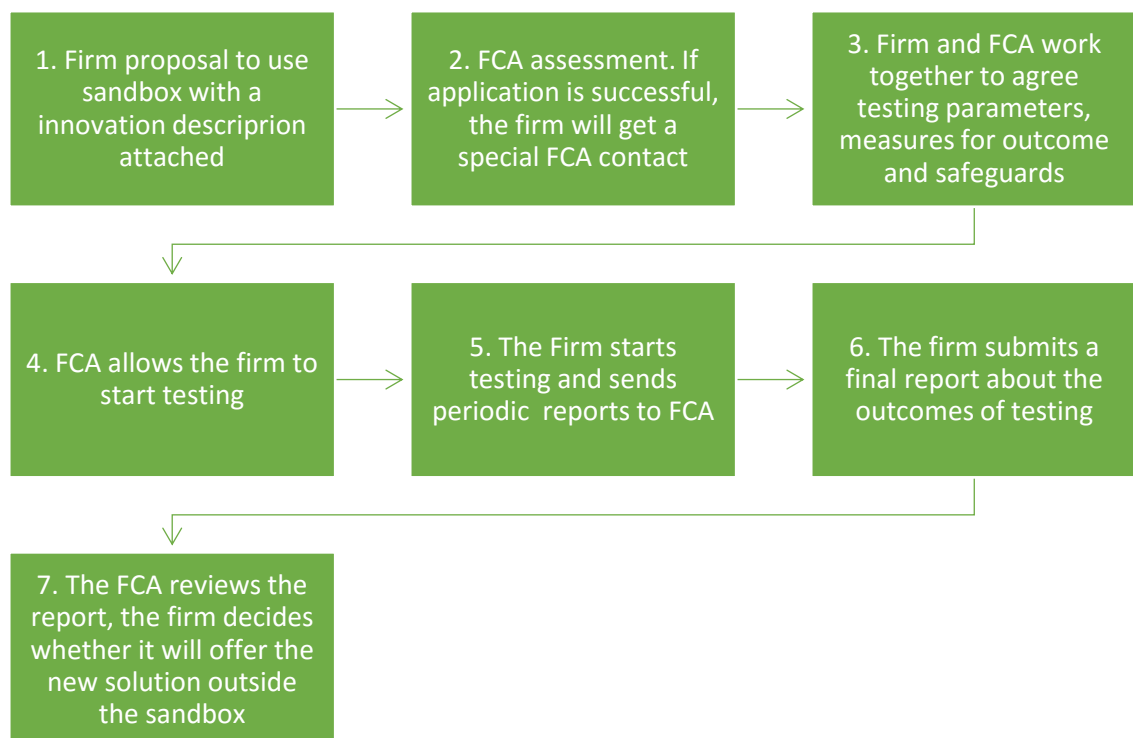
- A plan for testing in the sandbox setting out the timeline and key milestones;
- Methods to measure the success;

<sup>12</sup> Regulatory Sandbox | FCA // Financial Conduct Authority. 27.06.2016. <https://www.the-fca.org.uk/firms/project-innovate-innovation-hub/regulatory-sandbox>.

<sup>13</sup> Default Standards for Sandbox Testing Parameters // Financial Conduct Authority. 20.04.2016.

- Testing parameters (duration, customer/transaction limit);
- Customer safeguards;
- Risk assessment;
- Exit strategy.

**Figure 3 - Admission process for Sandbox Testing (the UK)**



*Regulatory Sandbox // Financial Conduct Authority. November 2015, P. 11.*

## Sandbox parameters

The main goal of a sandbox is to provide 'safe space' for testing new products and business models. Therefore, different sandboxes will be created for each project with their own parameters and limitations.

The FCA will discuss the terms of product testing with applicants on an individual basis depending on the type of the project, testing goals and existing risks.

Sandbox residents will be able to carry out planned testing, observing the restrictions below (see Appendix 3)<sup>14</sup>:

- Testing duration is usually up to 3 to 6 months;
- Audience should be big enough to obtain statistically relevant data whilst managing the risks to customers and practicalities of obtaining the customers for the testing period;
- Retail consumers should always have the right to complain to the firm, then to the Financial Ombudsman Service and have access to the Financial Services Compensation Scheme if a firm fails;
- Qualified customers should consent to limiting their claim for compensation ('informed consent');
- Additional safeguards may be necessary, depending on the size, scale and risks of the trial.

All limitations will be discussed with the sandbox participants on individual basis, depending on the type of a project, testing purposes and risks.

## Sandbox benefits

Both authorised and unauthorised firms can apply for a FCA sandbox.

The FCA set up a tailored authorisation process for unauthorised firms that want to join the sandbox. Successful firms will be granted restricted authorisation that only allows them to test their ideas. These firms will still need to apply for 'light' authorisation and meet threshold conditions, but only for the limited purposes of the sandbox test.

During sandbox testing the FCA will provide firms with<sup>15</sup>:

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<sup>14</sup> Default Standards for Sandbox Testing Parameters // Financial Conduct Authority. 20.04.2016.

<sup>15</sup> Woolard C., Speech at Innovate Finance Global Summit // Financial Conduct Authority. 09.05.2016.

- Individual guidance;
- Waivers or modifications to the rules. Depending on the nature of the particular project, FCA may decide to modify or even waive some of its rules. Scope of these exemptions/waivers will be discussed on individual basis. The FCA will waive or modify rules where they are unduly burdensome or not achieving its purpose, as some technologies have not even existed at the time when particular legislation was developed;
- No enforcement action letters. Some business models and products are not regulated by any law, being in a 'grey' zone. In these cases, regulator can use a 'no enforcement action' letter. This tool is used to show that the FCA has no complaints against the products or business model and is not going to take disciplinary action, as long as a firm deals with regulator openly, agrees with testing parameters and treats customers fairly. However, these letters do not bind the FCA with any obligations.

The FCA also offered private sector stakeholders to consider setting up their own sandboxes. However, none of them has not been implemented so far.

**Box 2 - FCA proposals for private-led sandboxes**

Virtual sandbox	Sandbox umbrella
<p>Virtual sandbox is an environment that allows firms to test their solutions <i>in silico</i>, without entering the real market.</p> <p>Conditions in a virtual sandbox should be close to real environment. Regulator suggests to use data available to private sector and the FCA to emulate real conditions.</p>	<p>Sandbox umbrella may be created under the non-profit organization that will receive the FCA authorisation. Companies willing to test their solutions can act as its representatives.</p>



## 5.2 Singapore

For a long time, Singapore competes with its neighbors for the title of the Asian innovation center. In 2014 the government launched 'Smart nation' initiative, a program to extensively use new technologies in multiple spheres from transportation to administration.

**19,2%**

of worldwide fintech  
investments flow to Asia.

To use the existing advantage, Singapore's authorities started to think about state's own regulatory sandbox system. Monetary Authority of Singapore (MAS) published consultation paper on the subject in June 2016.

The goals of creating sandbox in Singapore are not much different from a similar project in the UK. Singapore regulator would like to provide innovative companies with the opportunity to test their products and business models in a small, isolated part of the real market. While now firms need to be authorized even for limited testing, the sandbox regulator may waive the authorization requirement, subject to certain conditions.

### Who can participate?

Just like other countries, the MAS is expected to be a gatekeeper of the sandbox, to prevent it from being used to circumvent rules.

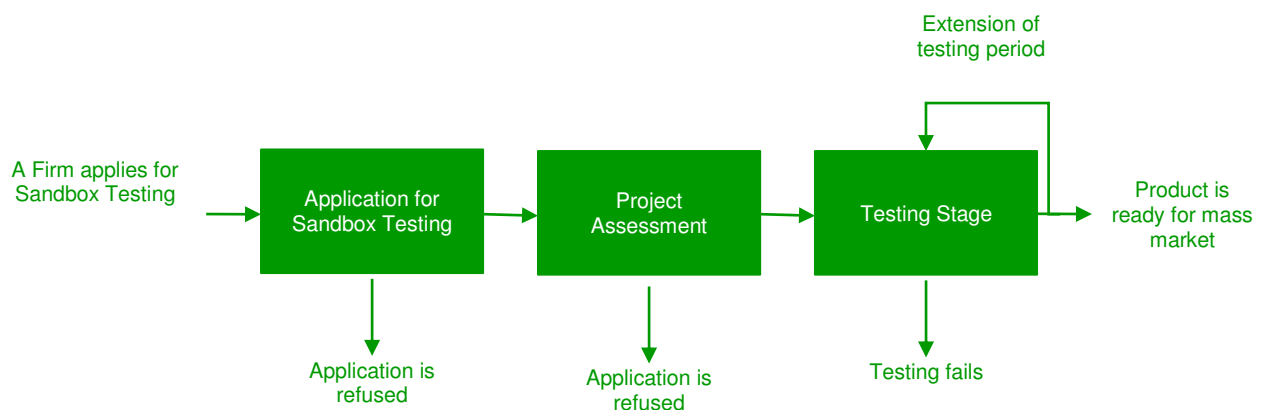
Preliminary criteria for sandbox testing are<sup>16</sup>:

- The fintech solution is a real innovation;

<sup>16</sup> Consultation Paper on Fintech Regulatory Sandbox Guidelines // Monetary Authority of Singapore. 06.06.2016.

- The solution addresses a specific problem or brings benefits to consumers and/or industry;
- The applicant has the intention and ability to deploy the fintech solution in Singapore on a broader scale after exiting from the sandbox.

**Figure 4 - Admission process for Sandbox Testing (Singapore)**



*Consultation Paper on Fintech Regulatory Sandbox Guidelines // Monetary Authority of Singapore. 06.06.2016.*

The applicant also needs to assess the risks, outline the testing parameters and define an exit strategy (in case the testing fails).

Both startups and authorised financial institutions can apply for regulatory sandbox, if they can prove that they need it. Unlike the UK, in Singapore the startups may not need even a limited authorization at all. Here the MAS has more wiggle room, as it has no need to follow supranational law like the UK does (Great Britain must comply with the requirements of European Union law, at least until 2017).

MAS also requires that the applicant provides the service in Singapore upon the successful end of testing. It is unclear how the MAS will control this, however. Yet, this seems reasonable: it would be irrational to provide local market as a test platform for foreign companies, whose interests lie outside of Singapore or the Asian region.

## Sandbox parameters

It is expected that the sandbox would allow companies to assess not only legal, but also operational and prudential risks. Instead of one big sandbox with default parameters, the regulator would establish individual sandboxes for each individual project.

Instead of one sandbox with default parameters, MAS will create separate sandboxes for each project.

Functional limitations in the sandbox may include:

- Limit on the number of customers;
- Transaction thresholds and cash holding limits;
- Limits on maximum liabilities.

Applicants would need to apply customer protection measures and assess the potential knock-on effects.

Testing duration will be established for each company individually: it should be long enough for risk assessment, but not for getting any competitive advantages. A company will always have an opportunity to ask about extensions.

Throughout the testing, the company would need to inform the regulators about its progress. Depending on the results of the experiment, product or business model would be implemented in real market or withdrawn.

Testing can also be terminated before the scheduled date: upon the company request or by the decision of regulator, in case terms of the testing were not complied with.

## Sandbox benefits

Sandbox parameters will be discussed with each firm individually. The MAS will relax specific regulatory requirements which an applicant would otherwise be subject to. For example, a company might be required to comply with the legislation on the data privacy, but could be exempted (either partially or in full) from minimum capital requirement.

### Box 3 - Example of regulatory sandbox exemptions, Singapore

Unmodified legal requirements in the sandbox	Requirements that could be modified in the sandbox
1. Confidentiality of customer information	1. Asset management requirement
2. Fit and proper test for management	2. Board of Directors requirements
3. Safeguarding customers' funds and other assets	3. Cash reserves
4. Prevention of money laundering and countering the financing of terrorism	4. Credit rating
	5. Financial soundness
	6. Fund solvency and capital adequacy
	7. License fees
	8. Management experience
	9. MAS Guidelines, such as technology risk management guidelines
	10. Minimum liquid assets

*Consultation Paper on Fintech Regulatory Sandbox Guidelines // Monetary Authority of Singapore. 06.06.2016.*

It is expected that the conditions in Singapore sandbox will be dynamic. If necessary, they can be changed during the testing. There are no plans yet to provide special guidance or legal advice to the sandbox residents.



### 5.3 Australia

Australia is also trying to gain a reputation of a regional fintech hub. It aims to export its solutions to the rapidly growing Asian economies. Therefore, Australia decided to create its own regulatory sandbox, though very different from similar projects elsewhere.

Australian Securities and Investment Commission (ASIC), a government body that enforces relevant laws and regulates financial companies to protect Australian consumers, investors and creditors, published a consultation paper on proposed regulatory sandbox in June, 2016.

**40%**

of profitable fintech startups export their services abroad.

There is already a flexible system of financial supervision in Australia. It includes modular licensing system, which allows to vary license requirements depending on the business model and the type of applicant<sup>17</sup>. The ASIC also has a right to exempt the company from certain requirements and publish no action letters, where it confirms that the ASIC has no intention to prosecute the company for violation of certain rules.

<sup>17</sup> AFS Licensing Kit: Part 1 – Applying for and varying an AFS license // Australian Securities and Investments Commission. July 2015.

**Australian practice: Applications for relief**

Australian regulations allow for three types of applications for relief:

- Standard applications—seeking relief in accordance with published ASIC policy and pro forma instruments;
- Minor and technical applications—applying existing policy to new situations; in effect, they involve the application of existing policy to new situations, either legislative or administrative (e.g. where there is an existing policy, but it needs to be adapted to cover new situation)
- New policy applications—requiring ASIC to formulate substantive new policy. They raise policy considerations which are entirely new, involve more than minor and technical variations of existing ASIC policy; or involve a significant change to, or reversal of, existing ASIC policy.

Every application that is neither standard nor minor or technical is a new policy application.

*Regulatory Guide 51. Application for Relief //  
Australian Securities and Investments Commission. December 2009.*

There is also ASIC's Innovation Hub, which assists fintech companies<sup>18</sup>.

Reasons for creating regulatory sandboxes in Australia are similar to those in Singapore and the United Kingdom. With the help of this tool the regulator plans to help companies quickly introduce their innovative products, attract investments and new companies to the market.

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<sup>18</sup> Innovation Hub // Australian Securities and Investments Commission. <http://asic.gov.au/for-business/your-business/innovation-hub/>.

## Who can participate?

It is expected that the Australian sandbox will be opened to companies that offer following services<sup>19</sup>:

- giving financial advice in relation to listed or quoted Australian securities;
- giving financial advice in relation to listed or quoted Australian securities;
- giving financial advice in relation to simple managed investment schemes and deposit products;
- arranging for other persons to deal in the products mentioned above.

In Australia only unauthorised companies that plan to provide services on the investment market, will be able to apply for a sandbox regime.

Participation in the sandbox for other types of companies is not planned yet. Other investment services are related to longer-term investments; hence the limited testing may not be appropriate for them. Small and functionally limited payment projects may already be exempted from authorisation requirements under the existing regulations.

Regulatory sandbox will be available only for the unauthorized companies. Companies that are already authorized would not be able to benefit from the sandbox – however, they can apply for waivers on an individual basis. Sandbox, on the other hand, would provide certain exemptions by default.

Companies that would like to test products in sandbox, shall comply with the following requirements:

- the company has adequate compensation arrangements in place (e.g. by obtaining professional indemnity insurance to compensate retail client losses);
- company is a member of an ASIC-approved external dispute resolution scheme;
- company discloses that the financial services are being provided in a testing environment;
- company provides internal dispute resolution procedures.

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<sup>19</sup> Further measures to facilitate innovation in financial services. Consultation Paper 260 // Australian Securities and Investments Commission. June 2016.

Additionally, the testing business should be 'sponsored' by a non-profit organization ('sandbox sponsor') recognized by ASIC. In effect, industrial bodies will be a gatekeeper to the sandbox, by assessing applicants' projects and their risks. ASIC allows that such assessment be conducted on a fee basis (depending on the decision of the non-profit organization).

Unlike the UK or Singapore, Australia does not plan to create separate sandboxes for each individual project. Here companies will be provided with general, pre-defined waivers.

### **Sandbox parameters**

Sandbox participants will be able to test their products and business models at the stage of early development and experiment with technology concepts.

Sandbox parameters will be the same for all participants:

- the company provides services to no more than 100 retail clients;
- maximum exposure limit for each client is \$10,000 AUD;
- the total exposure of all clients (wholesale and retail) is less than \$5 million AUD.

Businesses can test their solutions for no more than six months. Sandbox residents should give ASIC report upon the completion of the test. If successful, company should obtain a license to provide the services on the market. And if the testing failed, project should be shut down (if technically possible, company may continue to provide services to its first hundred clients). The same project could not be admitted to the sandbox twice.

ASIC will have the power to withdraw the project from the test if specific risks have arisen or the company has been involved in malpractice.

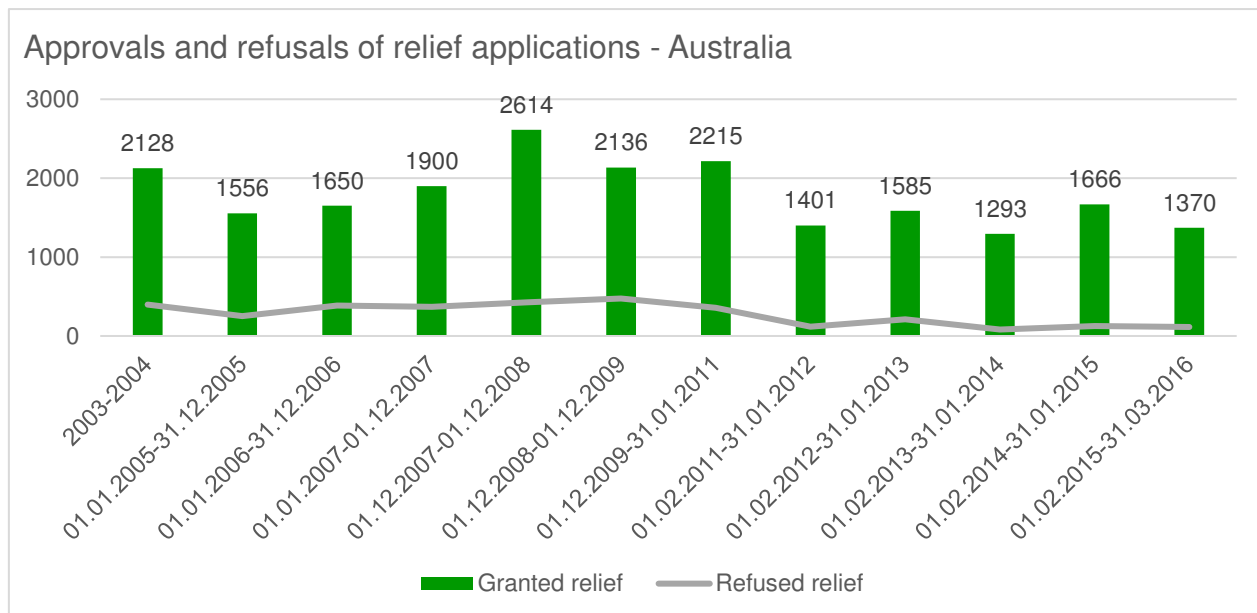
### **Sandbox benefits**

While Singapore and the UK create individual sandboxes for each project, in Australia there will only be one large sandbox with standard conditions for all participants. What are the benefits of the Australian sandbox?

Companies may already ask ASIC for some individual exemptions from certain regulatory requirements. This tool has already been actively used (ASIC has been approving on average 142 applications a month in 2004-2016, see Figure 5). However, applying for relief may take quite a long time, especially for new business models. ASIC examines each such case individually, hence this approach does not work for quick introduction of new products.

In order to benefit from the regulatory sandbox, the company will only be required to go through the industrial body ‘gatekeeper’ and notify the regulator, no formal approval from the ASIC is necessary.

**Figure 5**



*Reports of Relief Applications // Australian Securities and Investments Commission.  
Last updated 23.06.2016.*

Regulatory sandbox would allow companies to provide services without a license. Sandbox residents will also be exempt from:

- Information disclosure (except that the service is provided in a testing environment);
- Prejudicial dispute resolution;
- Fit-and-proper tests.

There will not be special individual guidance for companies in Australian sandbox.

ASIC has planned to present draft regulatory guidance and/or licensing exemption by September, 2016. And to finalize the regulations by December, 2016.



## 5.4 The United Arab Emirates (Abu Dhabi)

In 2013 one of the newest international financial centers was founded in Abu Dhabi (Abu Dhabi Global Market, ADGM). It is managed by three independent authorities: the Registration Authority (RA), the Financial Services Regulatory Authority (FSRA) and ADGM Courts<sup>20</sup>.

One of the FSRA objective is to oversee all the development and oversight of the financial regulations in Abu Dhabi Global Market<sup>21</sup>. As Abu Dhabi defining feature is expected to be an innovative approach to regulation, legal and administrative procedures, in May 2016 FSRA published a consultation paper on measures to support fintech. This document also includes proposals to implement regulatory sandbox.

**50 years**

period of the zero-tax regime in  
Abu Dhabi Global Market.

FSRA calls this new tool a 'Regulatory Laboratory (RegLab)'. According to FSRA, it will lower entry thresholds for the businesses, establish the risk-based approach, and also encourage the development of groundbreaking business models.

<sup>20</sup> Abu Dhabi Global Market // ADGM. April 2016. <http://www.adgm.com/media/66448/adgm-brochure-update-april-2016-final-brochure.pdf>.

<sup>21</sup> ADGM | Structure & Functions // ADGM. <http://www.adgm.com/doing-business/financial-services-regulatory-authority/structure-functions/>.

## Who can participate?

Both authorised and unauthorised firms will be able to take part in the Regulatory Laboratory. Only products and services that meet the following criteria would be allowed to benefit from the sandbox<sup>22</sup>:

- The solution should be novel and innovative, in terms of the business application and deployment model;
- The project has the potential to:
  - promote significant growth, efficiency, or competition in the financial sector;
  - promote better risk management solutions and regulatory outcomes for the financial industry;
  - improve the choices and welfare of consumers

FSRA may also refer the applicant to its external expert partners. Such partners may provide guidance for participant to further develop its product: the participant will consult and update FSRA on its progress regularly. When the project is in a sufficiently advanced stage of development to mount a live test, the participant may apply for authorisation under the RegLab. If the application is approved, the product or model may be tested in

Company has to register a commercial entity in ADGM or operate through the local affiliated branch.

a sandbox. Company will have to register a commercial entity in ADGM or operate through the local affiliated branch. In special circumstances FSRA may provide exceptions from this rule on a case-by-case basis.

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<sup>22</sup> Consultation Paper. No. 2 of 2016. Policy Consultation on a Regulatory Framework to Support Participants Deploying Innovative Technology within the Financial Services Sector // ADGM. 10 May 2016.

## Sandbox parameters

Testing parameters will be set on individual basis. Depending on the project, different rules or limitations may apply.

When applying for testing, the company should explain the need for it, outline company risks management measures, and describe the exit strategy.

It is expected, that the testing duration will not exceed two years. In special circumstances, this period may be extended.

## Sandbox benefits

Regulatory Laboratory residents can enjoy full or partial exemptions from regulatory requirements. In some cases, special rules that would fit the specifics of the business model or technology could be introduced as well.

The regulator may also relegate some regulatory requirements to the fintech company's partners: for example, the developers of robo-advising systems may not implement AML/CFT measures, if their financial institution partner already has them in place.

Compared to other regulators, FSRA has a considerable advantage: within the ADGM framework, it does not depend from the established national practice. In fact, Regulatory Laboratory is 'a sandbox within a sandbox': Abu Dhabi creates unique environment for business development (it is the only territory in the Middle East where English civil and corporate laws are directly applicable) and special conditions for the fintech within it.

Abu Dhabi Regulatory Laboratory is a sandbox within a sandbox: the emirate creates unique environment for business development, and special conditions for fintech within it.

An interesting feature of the ADGM Regulatory Laboratory is that it is not aimed at supporting fintech solutions for the local market only. The main goal is to nail down successful business on ADGM territory, so as it can provide its services globally afterwards. This is one more proof that fintech regulation is more about competition, not about technologies or markets.

## **Regulatory sandboxes - beta version: 'letters of no objection'**

Some countries have long tried to reduce the legal uncertainty for innovators without creating special sandboxes. Typically, they use letters of no objection. In these instruments the regulator informs a company that it has no objection against this specific business model or service, even if they are in the 'grey area' (i.e. the practice is neither permitted nor prohibited).

### **The United States of America**

Bureau of Consumer Financial Protection approved the rules for the granting No-Action letters (NALs) in February, 2016.

A NAL would advise the recipient that, subject to its stated limitations, the staff has no present intention to recommend initiation of an enforcement or supervisory action against the applicant with respect to a specified matter. It may be conditioned on particular undertakings by the applicant with respect to product or service usage and data-sharing with the Bureau.

No-Action Letters is one component of the Bureau's Project Catalyst initiative for consumer soundness.

*Read more: Policy on No-Action Letters //  
Bureau of Consumer Financial Protection. 02.02.2016.*

### **Tanzania**

For a long time, Tanzania did not have specific electronic payment regulations. Mobile operators were not directly prohibited to participate in m-commerce, although there was no permit either, and that created legal uncertainty. Bank of Tanzania has offered mobile operators to conclude an agreement with a local bank, which was then sent a letter of no objection stipulating that the launch of m-commerce project would not be a reason for sanctions per se. The letter was sent confidentially and is not yet public.

*Read more: Castri S.D., Gidvani L., Enabling Mobile Money in Tanzania //  
GSM Association. February 2014.*

## Kenya

One of the most well-known mobile payment systems in the world, M-Pesa, has also appeared due to the letters of no objection. Just like in Tanzania, there was no special legislation on m-commerce in Kenya that would directly allow payments via the mobile operator. In February, 2007 the Central Bank of Kenya (CBK) sent a letter of no objection to Safaricom to run a project in cooperation with commercial banks. One of the main requirement was periodic reporting to the regulator.

*Read more: Enabling Mobile Money Transfer.  
The Central Bank of Kenya's Treatment of M-Pesa. Case Study //  
Alliance for Financial Inclusion. February 2010.*

## Conclusion

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Regulatory sandboxes are a rather new phenomenon. But their emergence is something to be expected. Financial services market is changing, new players come, completely new products, services and business models are being developed.

Legislation turned out to be out of line with these rapid changes. Therefore, regulators are now facing a choice: to change along with the market, or to insist on their status quo. Many countries are yet to decide which way to choose. And we are seeing a growing interest towards new regulatory models and approaches worldwide. Perhaps, regulators have to go through the transformation that is no less painful than the one that awaits banks.

Our brief overview of the regulatory sandboxes shows that this is more of a story about regulators, rather than about fintech startups or traditional financial institutions. Usually, when new innovative technologies appear on the market, regulator examines them first, and then develops new legislation or modify existing standards step-by-step. It seems that this model doesn't work anymore. New projects emerge and disappear so rapidly that the regulator does not always understand what is worthy of support, and what is not.

Perhaps, regulators have to go through the transformation that is no less hard than the one that awaits banks.

The regulatory sandbox goal is to reduce legal uncertainty not only for innovators but for regulators as well. As they provide an opportunity for limited testing, the regulator can keep a finger on the pulse of the market, without necessarily expanding the existing regulatory framework or developing a new one. At the end of the day, sandboxes help regulator no less than fintech companies.

This is why these are regulators that initiate the creation of sandboxes. Although in some cases private firms can reduce legal uncertainty themselves, implementation of such 'private sandboxes' is not up to the task yet. In the UK the FCA only hint on such a possibility. In Australia, non-profit associations only play 'gatekeeper' role for local sandbox.

Global practice also shows that startups are not the only source of fintech innovations and incumbents are not always extremely conservative businesses. Big financial institutions also develop new solutions, and for them legal uncertainty is a source of a higher risks than it is for startups, because they already have something to lose. In all of examples reviewed in this Report, both authorised and unauthorised companies have an access to regulatory sandboxes. The only exception is Australia: here, authorized firms

may benefit from limited waivers from regulatory requirements: in 2003-2016 regulator granted more than 21,500 such reliefs!

Regulatory sandboxes are sometimes seen as only a safe space for testing fintech solutions. However, it is more appropriate to call them new 'regulatory service'. Their functionality includes not just individual easing of some legal requirements, but also providing advice, information support and training. The regulator tries on the consulting function that previously was limited to issuing formal letters within a month of the company's request.

Global practice shows that startups are not the only source of fintech innovations, incumbents are innovating as well.

Another question is why support new financial technologies anyway? There are several reasons for that. Obvious explanation is that new technologies would allow consumers to get better and more affordable services, service providers – to lower costs of business and compliance, and

regulators – to improve the effectiveness of the oversight as the market becomes more complicated.

However, regulators are driven by deeper considerations as well. Financial innovation has become the subject of fierce competition. Only a few decades ago, the Internet and software were considered expensive and narrow market. Today only one of the five largest companies in the world is in oil and gas, the rest are in information technology. This is what may happen in finance as well.

Countries are realizing that this decade is the turning point for financial innovations. And today the jury is out on who will become a global role-model in this domain, and be able to reap the benefits of their foresight and export local technologies abroad in the future. Regulatory sandboxes are one of the clearest manifestations of this race.

## Appendix 1 Brief Summary of Sandbox Features

### Great Britain

Regulator	Financial Conduct Authority (The FCA)
Potential Sandbox participants	Authorised and unauthorized firms
Which segment of financial market is in the focus?	Any segment of financial market
Is authorization required to be admitted?	Unauthorised firms have to get through tailored authorization process
Is there individual approval of applications?	Regulator assess each application on an individual basis
Potential law relaxation for sandbox residents	Full or partial exemption from regulation with individual guidance
Duration	Testing duration should be long enough to enable statistically relevant data to be obtained from the test.
The stage of regulatory sandbox implementation	First application period started on 9 May 2016 until 8 July 2016. The second application period will last since the mid-November 2016 until mid-July 2017

## Singapore

Regulator	Monetary Authority of Singapore (MAS)
Potential sandbox participants	Authorised and unauthorized firms
Which segment of financial market is in the focus?	Any segment of financial market
Is authorization required to be admitted?	No need in special authorisation
Is there individual approval of applications?	Regulator assesses each application on an individual basis
Potential law relaxation for sandbox residents	Full or partial exemption from regulations
Duration	There is no default limits, testing period can be extended several times
The stage of regulatory sandbox implementation	Consultation paper was published on 6 June 2016, consultation finished on 8 July 2016.

## Australia

Regulator	Australian Securities and Investment Commission (ASIC)
Potential Sandbox participants	Only unauthorized firms
Which segment of financial market is in the focus?	<ul style="list-style-type: none"> <li>• Giving financial advice in relation to listed or quoted Australian securities;</li> <li>• Giving financial advice in relation to simple managed investment schemes and deposit products;</li> <li>• Arranging for other persons to deal in the products mentioned above.</li> </ul>
Is authorization required to be admitted?	No need in special authorisation
Is there individual approval of applications?	No. Companies will be provided with general, pre-defined waivers after project assessment by sandbox sponsor
Potential law relaxation for sandbox residents	Exemption from authorisation process
Duration	No longer than 6 months, without extension period
The stage of regulatory sandbox implementation	ASIC published Consultation paper in June. ASIC has planned to present draft regulatory guidance and/or licensing exemption by September, 2016 and to finalize the regulations by December, 2016.

**The United Arab Emirates  
(Abu Dhabi Global Market, (ADGM))**

Regulator	Financial Services Regulation Authority, (FSRA)
Potential Sandbox participants	Authorised and unauthorized firms
Which segment of financial market is in the focus?	Any segment of financial market
Is authorization required to be admitted?	No need in special authorisation
Is there individual approval of applications?	Regulator assesses each application on an individual basis
Potential law relaxation for sandbox residents	Full or partial exemption from regulation, modification of requirements on an individual basis
Duration	Up to two years, company may ask for extension period
The stage of regulatory sandbox implementation	Consultation paper was published on 10 May 2016, consultation finished on 13 June 2016.

## Appendix 2 Application criteria

### Sandbox eligibility criteria - The UK approach (FCA)<sup>23</sup>

Criteria	Key question	Positive indicators	Negative indicators
Is the firm in scope?	Is the firm looking to deliver innovation which is either regulated business or supports regulated business in the UK financial services market?	<ul style="list-style-type: none"> <li>• Innovation appears to be intended for the UK market</li> <li>• The firm's relevant activity is regulated by the FCA or is intended for firms regulated by the FCA</li> </ul>	<ul style="list-style-type: none"> <li>• Innovation does not appear to be intended for use in the UK</li> <li>• The firm's relevant activity is not within the scope of the FCA's regulatory regime or intended for FCA regulated firms</li> </ul>
Is it genuine innovation?	Is the innovation ground-breaking or constitutes a significantly different offering in the marketplace?	<ul style="list-style-type: none"> <li>• Desk research produces few or no comparable offerings already established on the market</li> <li>• Internal experts believe that it constitutes a genuinely innovative technology/ approach/ product or service</li> <li>• Step-change in scale.</li> </ul>	<ul style="list-style-type: none"> <li>• There are numerous examples of similar offerings already established on the market</li> <li>• Internal expertise believes it is not particularly innovative</li> <li>• It looks like artificial product differentiation.</li> </ul>

<sup>23</sup> Sandbox Eligibility Criteria // Financial Conduct Authority. 2016.

Criteria	Key question	Positive indicators	Negative indicators
Is there a consumer benefit?	Does the innovation offer a good prospect of identifiable benefit to consumers (either directly or via heightened competition)?	<ul style="list-style-type: none"> <li>• The innovation is likely to lead to a better deal for consumers directly or indirectly e.g. through higher quality services or lower price due to enhanced efficiency</li> <li>• The business has identified any possible consumer risks and proposed mitigation</li> <li>• The innovation will promote effective competition</li> </ul>	<ul style="list-style-type: none"> <li>• Likely detrimental impact on consumers, markets or the financial system</li> <li>• It looks designed to circumvent regulatory or fiscal obligations</li> </ul>
Is there a need for a sandbox?	Does the business have a genuine need to test the innovation on real customers and in the FCA sandbox?	<ul style="list-style-type: none"> <li>• The innovation does not easily fit the existing regulatory framework, thus making it difficult or costly to get the innovation to market</li> <li>• There is a clear need for a sandbox tool in order to test this product in a live environment</li> <li>• The business has no alternative means of engaging with the</li> </ul>	<ul style="list-style-type: none"> <li>• Live testing is not necessary to answer the question that the firm is seeking to answer (to achieve the testing objective)</li> <li>• The firm is able to undertake the test easily without the support of the FCA</li> <li>• A dedicated supervisor or the Innovation Hub could answer the query</li> </ul>

Criteria	Key question	Positive indicators	Negative indicators
		<p>FCA or achieving the testing objective</p> <ul style="list-style-type: none"> <li>The full authorisation process would be too costly/burdensome for the purposes of a short test of the viability of a particular innovation</li> </ul>	
Is the firm ready for testing?	Is the business ready to test their innovation in a live environment?	<ul style="list-style-type: none"> <li>Testing plans are well developed with clear objectives, parameters and success criteria</li> <li>Some testing has been conducted to date</li> <li>The firm has the tools and resources required to enable testing in the sandbox</li> <li>The firm has sufficient safeguards in place to protect customers and is able to provide appropriate redress if required.</li> </ul>	<ul style="list-style-type: none"> <li>Unclear objectives for testing and/or plans for testing are underdeveloped</li> <li>Little to no testing has been conducted on the innovation to date</li> <li>The firm does not have the required resources available to conduct the sandbox test</li> <li>The proposed customer safeguards are inadequate and/or appropriate redress cannot be provided by the firm</li> </ul>

## Appendix 3 Default Testing Standards Overview - the UK approach

Default standards for sandbox testing parameters - The UK approach (FCA)<sup>24</sup>

Duration	Sandbox is intended for testing for a limited duration. Testing duration should be long enough to enable statistically relevant data to be obtained from the test. The majority of stakeholders at our sandbox event agreed that 3 to 6 months was an appropriate duration for testing.
Number of customers	Sandbox is intended for small scale testing and we will set a strict limit to the size of the test. Customer sets should be big enough to enable statistically relevant data to be obtained whilst managing the risk to customers and practicalities of obtaining the customers for the testing period.
Customer selection	We expect firms to source customers themselves for testing in the sandbox. The type of customers should be appropriate for the type of innovation and the intended market, but also to the type of risks they are exposed to.
Customer safeguards	The FCA will ensure that firms have appropriate customer safeguards in place. We will agree on customer safeguards on a case-by-case basis within the below standards:

<sup>24</sup> Default standards for sandbox testing parameters // Financial Conduct Authority. 2016.

	<ul style="list-style-type: none"> <li>• Retail consumers –this type of customer should not bear the risks of sandbox testing, thus, they should always have the right to complain to the firm, then to the Financial Ombudsman Service and have access to the Financial Services Compensation Scheme (FSCS)<sup>25</sup>, if a firm fails;</li> <li>• Sophisticated customers –depending on the specifics of the trial, and if legally possible, we could consider tests that only engage with sophisticated customers who have consented to limiting their claim for compensation ('informed consent');</li> <li>• Additional safeguards –depending on the size, scale and risks from the trial, additional safeguards may be necessary, e.g. disclosure about being involved in a sandbox test to retail consumers.</li> </ul>
Disclosure	For those customers who are engaging in the sandbox under informed consent, firms should disclose information about the test and the available compensation to them (including in the event of firm failure).
Data	The FCA is not responsible for the provision of data to firms testing in the sandbox.
Testing Plans	<p>Testing plans should include:</p> <ul style="list-style-type: none"> <li>• A plan for testing in the sandbox setting out the timeline and key milestones</li> <li>• Measures for success for testing</li> </ul>

<sup>25</sup> The Financial Services Compensation Scheme (FSCS) is the UK's statutory compensation scheme for customers of authorised financial services firms.

- Testing parameters (duration, customer/transaction limit)
- Customer safeguards
- Risk assessment
- Exit strategy.

Russian Electronic Money Association was founded in 2010 and it now represents 14 largest e-money and fund transfer companies in Russia.



REMA is a widely recognized think-tank on latest payment technologies, financial regulation, financial inclusion, financial innovations in Russia and abroad. We provide advice to the public and private sector, share our unique expertise to stimulate implementation of best practices and ensure the sustainable development of the e-money and fund transfer market that benefits everyone.

For more information, please visit our website: [www.npaed.ru/en](http://www.npaed.ru/en)

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