

## Regulatory Sandbox: History, Uses & Key Takeaways

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### Regulatory Sandbox

In simple terms, a regulatory sandbox is a program for new-age technology innovation which creates a relaxed atmosphere that is less severe in terms of rules for a certain time period. Sandboxes are especially important in the fintech industry, where there is a rising need to build regulatory frameworks for new business models. This less-regulated environment allows them to test all of their functions and potentials while operating under the supervision of the highest authority and allows the regulators to do a complete risk analysis of the proposed business model.

### History of The Sandbox

The Financial Conduct Authority first implemented the concept of a sandbox in the United Kingdom in 2015. [1] It offered fintech enterprises a less rigorous environment to explore their possibilities while being adequately supervised. Setting up the sandbox cleared the path for other governments to take more permissive actions to advance these innovative technologies. For instance, Singapore's Monetary Authority of Singapore (MAS) took one of the more liberal approaches by establishing the 'FinTech and Innovation Group' to better oversee and address these technological advancements. [2]

It implemented a regulatory sandbox to provide companies with a time limit to work with relaxed constraints. A critical step MAS took was abandoning the idea of front-running the innovations. This implied that innovation should only be subject to particular rules after a careful examination of probable dangers and any loopholes. In other words, only when the threats exceed a specific level should safety standards be applied. This seeks to minimise existing risks while preventing the emergence of new hazards in the future.

Indian regulatory bodies (RBI, SEBI, etc.) have since worked to launch their sandboxes along similar lines.

### RBI's Sandbox

In 2016, the Reserve Bank of India (RBI) established a working group to research the fintech sector in India to assess and respond to the regulatory framework necessary for the industrial developments occurring in the fintech business. [3] One of the key recommendations was for the central bank to implement an appropriate framework for a regulatory sandbox with a well-defined space and duration. Through this, the financial sector regulator will

provide the necessary regulatory guidance to increase efficiency, manage risks, and create new consumer opportunities.

It was recognised that the primary objective of a sandbox under such framework was to offer an environment for creative technology-led enterprises to conduct limited-scale testing of a new product or service that may or may not include some relaxations in a regulatory requirement before a larger-scale launch. RBI's primary focus has been to nurture innovation in areas where:

- a) There is a void in regulatory frameworks.
- b) There is a need to temporarily ease the rules to facilitate the planned innovation.
- c) The suggested invention has the potential to improve the delivery of financial services significantly.

The entire lifecycle of a product under a sandbox involves five steps, as described below:

- The preliminary screening phase is to select candidates and determine if they match the qualifying requirements.
- Test design phase to finalise the test design through iterative collaboration with candidates.
- Application assessment phase to review the product and propose regulatory modifications, if any.
- Test phase – when the product will be formally tested.
- Evaluation to assess the feasibility of the final result of the testing based on the predicted criteria.

The RBI has also taken proper care to limit the potential damage in case the innovation fails. Under this, the innovations will be subjected to certain conditions that include:

- Limited-time periods
- Identifying and serving to the specific target group
- Cap on the number of customers
- Limited cash holdings
- Limited customer losses

#### SEBI's sandbox

The Security Exchange Board of India (SEBI) released a circular introducing the Regulatory Sandbox Framework (RS framework). [4] Under this framework, registered businesses such as financial market players and intermediaries will be able to test 'financial technology' (fintech) innovations on a small number of clients in a live and regulated setting for a short period. SEBI anticipates that this action will improve the security markets' efficiency, fairness, and transparency. The goal is to boost financial market growth by encouraging and simplifying the adoption and use of new fintech solutions. SEBI has also stressed the need for a proper strategy to protect the intellectual property rights (IPR) associated with the inventions. It has been clearly stated that no claims relating to the IPR of the sandbox framework would be relevant, as several applications with identical concepts may exist in the innovation sandbox. As a result, it is recommended that candidates consider entering into an appropriate confidentiality agreement to protect their associated intellectual property.

#### Sandboxes Around The Globe

In May 2016, the Australian Securities and Investments Commission (ASIC) issued a comprehensive regulatory framework allowing qualifying fintech

enterprises to test some specified services in an RS without possessing an AFS or credit license in Australia. Qualifying enterprises can inform the regulator and begin testing without fulfilling a licensing procedure. Furthermore, these regulators have innovation hub partnerships and fintech bridge agreements. The FCA Innovation Hub, for example, has a relationship with the ASIC Innovation Hub. The United Kingdom (HM Treasury and the Financial Conduct Authority) and Singapore (MAS) also signed a 'FinTech Bridge' agreement in which they agreed to exchange information and facilitate the admission of fintech start-ups from other jurisdictions into their respective regulatory sandboxes.

In the United Arab Emirates (UAE), Abu Dhabi unveiled the first regulatory sandbox in the Middle East and North Africa (MENA) area, ADGM RegLab, in November 2016. Following that, both the Dubai Financial Services Authority (DFSA) and the Central Bank of Bahrain (CBB) established their regulatory sandboxes in the Dubai International Financial Centre (DIFC). [5]

Other Middle Eastern countries have also created their regulatory sandboxes. For example, Saudi Arabia unveiled the design of its regulatory sandbox in 2019 and has been using it since then. The Central Bank of Kuwait (CBK) introduced its regulatory sandbox framework in 2018. Other Gulf Cooperation Council (GCC) nations, like Qatar, with the Qatar Central Bank (QCB), have launched their regulatory sandbox journeys, while Oman has taken the first steps towards the same.

#### Key Takeaways

It can be acknowledged that regulatory authorities have made several important strides in support of innovation by setting up the sandboxes. The liberal method of allowing start-up founders to test their innovations through actual market experience is expected to enable regulators to take an empirical approach to fintech innovation.

In contrast, regulators and participants may learn through sandbox testing to improve existing legislation and fintech solutions. Furthermore, the sandbox has the potential to enhance consumer outcomes by expanding the range of products and services available, lowering costs, and increasing financial inclusion.

However, sandboxes are expensive to run. While a primary motivation indicated by regulators to use a sandbox is the driving need to keep up with global financial trends and attract innovators, data from a 2019 World Bank Group survey shows that running a sandbox is highly resource-intensive, with costs running up to USD 1 million. [6] While sandboxes are fast-becoming primary vehicles for providing testable, evidence-based understanding in terms of incremental and regulatory developments for the fintech industry, it remains to be seen if, in India, the benefits outweigh the costs.

1. <https://www2.deloitte.com/>
2. <https://www.bakermckenzie.com/-/media/files/insight/publications/>
3. <https://www.rbi.org.in/Scripts/>
4. <https://www.sebi.gov.in/legal/>
5. <https://thefintechtimes.com/>
6. [Running a Sandbox May Cost Over \\$1M, Survey Shows \(cgap.org\)](#)

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