

SESSION 5

TESTING, MONITORING AND SUPERVISION OF SANDBOX ENTITIES

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OUTLINE

1. What happens in the sandbox?
2. Testing parameters
3. Restrictions
4. Ongoing obligations
5. Regulatory flexibility and its limitations

WHAT HAPPENS IN THE SANDBOX?

- (If applicable) an agreement between the regulator and the sandboxed entity
- Issuing registration numbers to participants (Arizona)
- Trialling a product/service in a live market
- Protecting third parties against risks from engaging with a sandboxed entity

DOCUMENTING SANDBOX RELATIONSHIPS: BSL CASE STUDY

- “BSL will enter into a legal agreement with the successful applicant by signing a **Memorandum of Understanding (MoU)** during the duration of the Sandbox pilot”
- “This legal agreement, governed under the **laws of Sierra Leone**, will **stipulate and clarify the responsibilities** of the applicant towards committing adequate resources to undertake the testing and implement risk mitigation solutions”
- “This legal agreement will not hold BSL liable for any losses”

DO EXISTING LAWS APPLY? ARIZONA STUDY

Arizona uses white-listing approach:

- “A sandbox participant is **deemed to possess an appropriate license** under the laws of this state for purposes of any provision of federal law requiring state licensure or authorization”
- “Except as otherwise provided in [the sandbox rules], a sandbox participant is **not subject to state laws** that regulate a financial product or service”
- “The attorney general **may determine that certain state laws** that regulate a financial product or service **apply to a sandbox participant**”

TESTING PARAMETERS

- Maximum duration
- Key Performance Indicators (KPI) or other measures to determine success/failure
- Identify areas that require further action
- Agreed restrictions/ongoing obligations
- Exit strategy
- Transition plan for product deployment once outside the sandbox

MAXIMUM DURATION

- 6 months
 - FCA (two 6-month test periods per year)
- 9 months
 - Bahrain (possible extension up to 3 months)
- 12 months
 - BNM (possible extension by application no later than 30 calendar days before the expiry of the testing period)
 - Kenya (can be extended by up to further 12 months)
- 24 months
 - Abu Dhabi (can be extended ‘in exceptional circumstances only’ by an unspecified period)
 - Arizona
- Individually set for each participant
 - Netherlands (the “length ... may differ on a case-by-case basis”)

KEY PERFORMANCE INDICATORS (KPI)

- Set individually
- Can reflect policy objectives (eg financial inclusion)
- Subject to periodic reporting
- Not applicable to sandboxes with automatic admission (eg Australia)

RESTRICTIONS AND ONGOING OBLIGATIONS: BNM CASE STUDY

- **“Risk and failure are an integral part of innovation. Given that a regulatory sandbox (sandbox) operates in a live environment, failure may result in financial loss or other risks to the sandbox participants and their customers. It is therefore imperative for the sandbox to incorporate appropriate safeguards to manage the risks and contain the consequences of failure.”**

RESTRICTIONS AND ONGOING OBLIGATIONS: BNM CASE STUDY

“In assessing the risks and evaluating the proposed safeguards, the Bank will give due regard to:

- (a) preserving sound financial and business practices consistent with **monetary and financial stability**;
- (b) promoting the **fair treatment of consumers**;
- (c) preventing **money laundering** and **countering terrorism financing**;
- (d) protecting the **confidentiality** of customer information;
- (e) promoting the safety, reliability and efficiency of **payment systems** and payment instruments;
- (f) ensuring innovative solutions for Islamic financial services are consistent with prevailing **Shariah standards**; and
- (g) encouraging healthy **competition** for financial products and services.”

RESTRICTIONS AND ONGOING OBLIGATIONS: BNM CASE STUDY

“The safeguards ... may include, but are not limited to:

- (a) providing adequate **disclosure** of the potential risks to customers participating in the sandbox and **confirmation** from such customers that they fully understand and accept the attendant risks;
- (b) **limiting** the **number of customers** participating in the sandbox and/or the aggregate **value** or **frequency** of transactions;
- (c) **restricting** the **participation of customers** to a certain segment or profile of customers;
- (d) **limiting** the **duration** of the testing period;
- (e) providing a **consumer redress mechanism**, including the possibility for financial compensation claimable against the sandbox participants under clearly specified circumstances; and
- (f) committing **adequate and competent resources** to undertake the testing and implement **risk mitigation** solutions that have been proven to be effective in containing the consequences of failure”

RESTRICTIONS AND ONGOING OBLIGATIONS

- Key benefit - legal certainty
- Can be set:
 - Individually in each case
 - Uniformly for all (Australia)
 - In a mixed format: basic (core for all) + bespoke (individual)
 - Differently for different types of sandboxes within the jurisdiction

RESTRICTIONS

- Number of customers
- Types of customers
- Number of transactions
- Volume of transactions
- Frequency of transactions

RESTRICTIONS

- Types of marketing permitted
- Geographical restrictions
- Overall exposure
- No right to hold client funds
- No activities against public interest
- No right to participate in own market as principal

ONGOING OBLIGATIONS

- Disclosure for customers
- Informed consent from customers
- Handling and protecting client information
- Information that must be included in agreements with customers

DISCLOSURE REQUIREMENTS: ARIZONA

- “A. Before providing an innovative financial product or service to consumers, a sandbox participant must disclose to consumers all of the following:
 - 1. The **name and contact information** of the sandbox participant, including the registration number provided by the attorney general...
 - 2. That the innovative financial product or service is authorized pursuant to the **regulatory sandbox** and, if applicable, that the sandbox participant **does not have a license or other authorization** to generally provide products or services under state laws that regulate a financial product or service that is outside the regulatory sandbox.
 - 3. That this state **does not endorse or recommend** the innovation.
 - 4. That the innovative financial product or service is a **temporary test** that may be discontinued at the end of the testing period, including the **expected end date of the testing period**.
 - 5. That consumers may contact the attorney general to **file complaints** regarding the innovative financial product or service being tested and provide the attorney general's telephone number and website address where complaints may be filed.
- B. The notifications prescribed by subsection A of this section must be provided to consumers in a **clear and conspicuous form** in both **English and Spanish**. For internet or application-based innovative financial products or services, consumers must acknowledge receipt of these notifications before completion of a transaction.”

ONGOING OBLIGATIONS

- Periodic reporting
 - MAS: “...the sandbox entity should report to MAS on the test progress based on an agreed schedule”
 - MAS: this requirement is not relaxed even in the ‘Sandbox Express’ (reports due every **2 months**)

PERIODIC REPORTING: BNM CASE STUDY

- “The participant must submit interim reports to the Bank on the progress of the test, which includes information on the following:
 - (a) key performance indicators, key milestones and statistical information;
 - (b) key issues arising as observed from fraud or operational incident reports; and
 - (c) actions or steps taken to address the key issues ...”
- “The frequency and specific details to be included in interim reports will be agreed between the Bank and the participant, taking into account the duration, complexity, scale and risks associated with the test”

ONGOING OBLIGATIONS

- Financial obligations
 - capital requirements
 - adequate resources to compensate customers
 - adequate resources to mitigate other risks
 - BSL: safeguards in the form of “committing **adequate resources** to undertake the testing and implement risk mitigation solutions that **have been proven to be effective** in containing the consequences of failure”
 - maintaining a certain level of insurance

ONGOING OBLIGATIONS

- Maintain records of all executed transactions
- Testing of cybersecurity/technology systems
- Secondary review of robo-advice by a human adviser
- Maintaining certain dispute resolution arrangements

ONGOING OBLIGATIONS

- AML/CFT requirements
- Mandatory partnership with an incumbent financial institution
- Compliance with extra risk-management/mitigation duties

ADDITIONAL CUSTOMER PROTECTIONS/RISK MITIGATION TOOLS

- Regulator publishes information about sandbox entities
 - MAS: “For the purpose of **transparency** and provision of information to customers, relevant information of **all approved sandbox applications** such as the **name** of the applicant, and the **start and expiry dates** of the sandbox experimentation, will be published on MAS’ website”.
- Regulator reserves the right to impose additional restrictions

RESTRICTIONS AND ONGOING OBLIGATIONS: AUSTRALIAN SANDBOX

- Have no more than 100 retail clients (unlimited wholesale clients)
- Have total customer exposure of no more than \$5 million
- Have adequate compensation arrangements (such as professional indemnity insurance)
- Have dispute resolution processes in place
- Meet disclosure and conduct requirements

RESTRICTIONS AND ONGOING OBLIGATIONS: AUSTRALIAN SANDBOX

- Deposit products: maximum \$10,000 balance
- Payment products: maximum \$10,000 balance
- General insurance: maximum of \$50,000 insured
- Liquid investments, for listed Australian securities or simple schemes: maximum \$10,000 exposure
- Consumer credit contracts with certain features + loan size between \$2,001 and \$25,000

RESTRICTIONS AND ONGOING OBLIGATIONS: 'MAJESTIC' CASE STUDY (CANADA)

- Individual decisions are rarely published

REGULATORY FLEXIBILITY

- Individual guidance
- Waivers or modifications of own rules
 - Abu Dhabi FinTech Laboratory Guidance (section 4.7): “...the Regulator will work with the applicant to identify those Rules (or Rulebooks, as the case may be) that are not relevant to the applicant's FinTech Proposal. The Regulator may then waive or modify any of these Rules or Rulebooks (in part or entirely, as appropriate) by way of a waiver or a modification notice”.
- No enforcement action letters

CASE STUDY: FCA SANDBOX TOOLS

- ‘Sandbox tools’
 - Individual guidance (cf Innovation Hub)
 - Informal steers (cf Innovation Hub)
 - Restricted authorisation
 - Waivers and modifications of FCA rules
 - No enforcement action letters

CASE STUDY: MAS FLEXIBILITY

- Asset maintenance requirement
- Board composition
- Cash balances
- Credit rating
- Financial soundness
- Fund solvency and capital adequacy
- Licence fees
- Management experience
- MAS Guidelines, such as technology risk management guidelines and outsourcing guidelines
- Minimum liquid assets
- Minimum paid-up capital
- Relative size
- Reputation
- Track record

CASE STUDY: MAS FLEXIBILITY

- NEW ‘Sandbox Express’
 - Insurance brokerage express sandbox: ‘exempted from registration as an insurance broker’
 - RMO express sandbox: ‘exempted from the requirements to be recognised as a RMO’
 - Remittances express sandbox: ‘will be granted a remittance licence’, and exempted from a requirement to hold SGD 100,000 security deposit for each place of business

REGULATORY FLEXIBILITY: LIMITATIONS

- Modifications/waivers outside the regulator's competence
- Integrity and honesty requirements
- AML/CFT
- Customer protection issues (eg data protection)
- Other requirements

CASE STUDY: MAS INFLEXIBILITY

- **Confidentiality** of customer information
- Fit and proper criteria particularly on **honesty and integrity**
- Handling of **customer's moneys and assets** by intermediaries
- Prevention of **money laundering** and countering the financing of terrorism

CHANGES TO THE TESTED PRODUCT/SERVICE

- Major changes may require regulator's prior approval
 - MAS: changes to the service generally permitted - but approval from MAS is required for 'material changes'

THANK YOU