

# SESSION 2

## REGULATORY SANDBOX CONCEPT: MODELS, BENEFITS AND RISKS

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# OUTLINE

1. Innovation promotion as regulatory objective
2. What is a 'regulatory sandbox'
3. Regulatory sandbox models
4. Alternatives to a regulatory sandbox
5. Benefits and risks

# PROMOTING INNOVATION

- Bali FinTech Agenda
- Innovation in financial services
  - Can reduce the cost of financial services
  - Can improve transparency
  - Can expand financial inclusion
- BUT
  - Innovation can lead to new risks
  - Regulatory uncertainty
  - ‘Stay under the radar’ mentality

# 'SANDBOX' CONCEPT

- Originated in software development
- Testing facility isolated from the rest of the network
- Allows testing of new code in a secure fashion



Source: [Pixabay](#)

# SANDBOX ... WHICH SANDBOX?

- Regulatory sandbox
- Industry sandbox
- 'Pseudo-sandbox'

# REGULATORY SANDBOXES VS INDUSTRY SANDBOXES

- A regulatory sandbox
  - Creates a ‘safe space’ for businesses
  - Developed by the regulator for the industry
  - ‘On-market’ - businesses interact with consumers/clients
- An industry sandbox
  - Creates a ‘safe space’ for businesses
  - Developed by the industry for the industry
  - ‘Off-market’ - businesses do not interact with consumers/clients

# REGULATORY SANDBOXES

- Key objectives
  - Improvement of the financial services market (products, RegTech)
  - Regulators that understand the new technology
  - Firms that understand the regulatory requirements
- 2 main models
  - Authorisation model
  - Notification model

# AUTHORISATION MODEL

- Benefits
  - Flexibility (regulators can design their own approaches)
  - Regulator's approval of a sandbox application can attract investors
  - Absence of fixed restrictions would be attractive for firms
- Challenges
  - Firms require individual authorisation/waivers/relief
  - Regulator's flexibility may be limited by legislation/international rules
  - Changes to regulations can take time to enter into force
  - Activities outside the scope of a specific regulator's mandate are not eligible



# NOTIFICATION MODEL

- Benefits
  - Does not require a special ‘sandbox’ regime
  - Requires fewer resources
  - Class waivers do not require regulators to assess the level of innovation of each project
- Challenge
  - Class waivers can be very limited in scope
  - Class waivers are less interactive (no knowledge exchange)

# AUSTRALIA'S SANDBOX

- Existing exemptions from licensing requirements
- Fintech licensing exemptions
- Individual exemptions by ASIC

# TWO FORMS OF FINTECH FACILITATION

## Regulatory sandbox

- **Controlled space** to test innovative solutions with the support of a regulator for a limited period of time
- Tailored supervision, may require legal changes
- To date, “supported” around 100 firms globally (UNSGSA 2019)
- Requires more staff to be useful

## Regulatory consultation

- **Institutional arrangement** where firms engage with regulators to **discuss** issues and **seek clarification** on the conformity of business models with regulation
- Does not require legal change
- Much bigger numbers (UNSGSA 2019)
  - Netherlands: 600 (2016)
  - Singapore: 500
  - Australia: 380 (Dec 2018)
  - US CFPB: 100 a month;
  - US CFTC: 200 a year (2018)

# REGULATORY CONSULTATION FORMS

- Office hours
- Dedicated phone line
- Dedicated website
- Case officers

# POTENTIAL BENEFITS

- Signalling
- Promote policy objectives
- Reduce regulatory uncertainty
- Improve regulatory capacity
- Support policy changes

# SIGNALLING

- Most useful when there are barriers to innovation
- Can change the attitude of firms to regulators
- Can overlap with Innovation Hub
  - BUT: Is more concrete action with more tangible outcomes

# PROMOTING POLICY OBJECTIVES

- Promote innovation in those sectors that are most useful for regulators
  - Eg financial inclusion
- Consumer protection
  - Eg pre-screening of projects, adequate capital
- Promote competition and introduction of new products / improve access to financial services

# REDUCE REGULATORY UNCERTAINTY

- Faster feedback between regulators and the industry
- Reduced legal costs
- Restrictions help minimise any negative impact of innovation and reduce the costs of enforcement action (for all parties)
- Access to funding: reassurance to investors due to (i) working with regulator, (ii) faster authorisation process
- Enhancing consumer protections
- Provides assurance to clients for new technologies outside usual best practices



# IMPROVING REGULATORY CAPACITY

- Better understanding the relevant technology, its benefits and risks
- Better understanding of broader market trends (outside regulator's formal jurisdiction)
- Facilitated by information sharing/dissemination

# SUPPORT POLICY CHANGES

- Source of empirical data for revising policy/regulations
- BUT most regulators have not provided waivers/exemptions

# WHY DO SOME REGULATORS REJECT SANDBOXES?

- France
  - “Although the term sandbox is confusing and misleading, it may **basically mean ‘sound regulation’**, which is actually the proportionate approach French regulators support and implement in France”
- Germany
  - “What we do is **supervision, not business development**. Both are important and sensible. They just should not be mixed up”

# POTENTIAL RISKS

- Uneven playing field
- Reputational risk
- Regulatory capture
- Misaligned expectations
- Insufficient staffing and resources

# UNEVEN PLAYING FIELD

- Benefits available to selected firms may be seen as unfair advantage
  - Regulators get to choose who gets in, and who doesn't
  - The irony of 'evening the playing field'
  - Funders may require sandboxing before they can work with start-ups
  - Acceptance seen as a 'stamp of approval'

# UNEVEN PLAYING FIELD

- Deloitte:
  - ...most firms acknowledged a further incentive to apply: getting the “**badge of honour**” of being accepted in the sandbox, and proving their business model in a live and regulated environment, increased their credibility with both customers and investors.
  - While the sandbox may be very successful in enabling FinTech innovation and competition, it can also **create an uneven playing field** between the start-ups which are accepted in the sandbox and those which are not.

# UNEVEN PLAYING FIELD

- Not relevant for Australia
- Solutions
  - Clear eligibility criteria
  - Objective selection criteria
  - Requirement of explicit disclosures to clients
  - Transparency of decisions concerning participation in the sandbox
  - Public consultations prior to launching the sandbox

# REPUTATIONAL RISK

- Inadequate identification of potential risks associated with a product or service
- Failed sandbox projects may be attributed to the regulator (due to its deep involvement)



# REGULATORY CAPTURE

- Risk of adopting excessively de-regulatory mindset that generates unjustified risk
  - In the long-run: race-to-the-bottom
- Solutions
  - Keep focus on policy objectives
  - Discipline with selection process
  - Transparency
  - Accountability

# MISALIGNED EXPECTATIONS

- Sandbox is not a cure-all solution
- Sandbox projects have limited scale
- Sandbox impact is limited without other supplementary initiatives
- Few sandboxes used to target specific policy objectives
- Novelty: no long-term assessment of sandboxes available
- Solution: Perform analysis of useful complementary measures

# STAFFING AND RESOURCES

- Required for all stages
  - Setting up the sandbox
  - Analysing applications
  - Monitoring
  - Analysing the outcomes
  - Post-exit supervision
- Affects
  - Personnel
  - Other resources
  - Sandbox capacity limit
  - Possibility of spreading the resource cost with other regulators

**THANK YOU**