

SESSION 2

REGULATORY SANDBOX CONCEPT: MODELS, BENEFITS AND RISKS

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16 APRIL 2019

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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