

MARMORE

Cut to the Chase

Regulatory Sandboxes

WHAT is the Regulatory Sandbox?

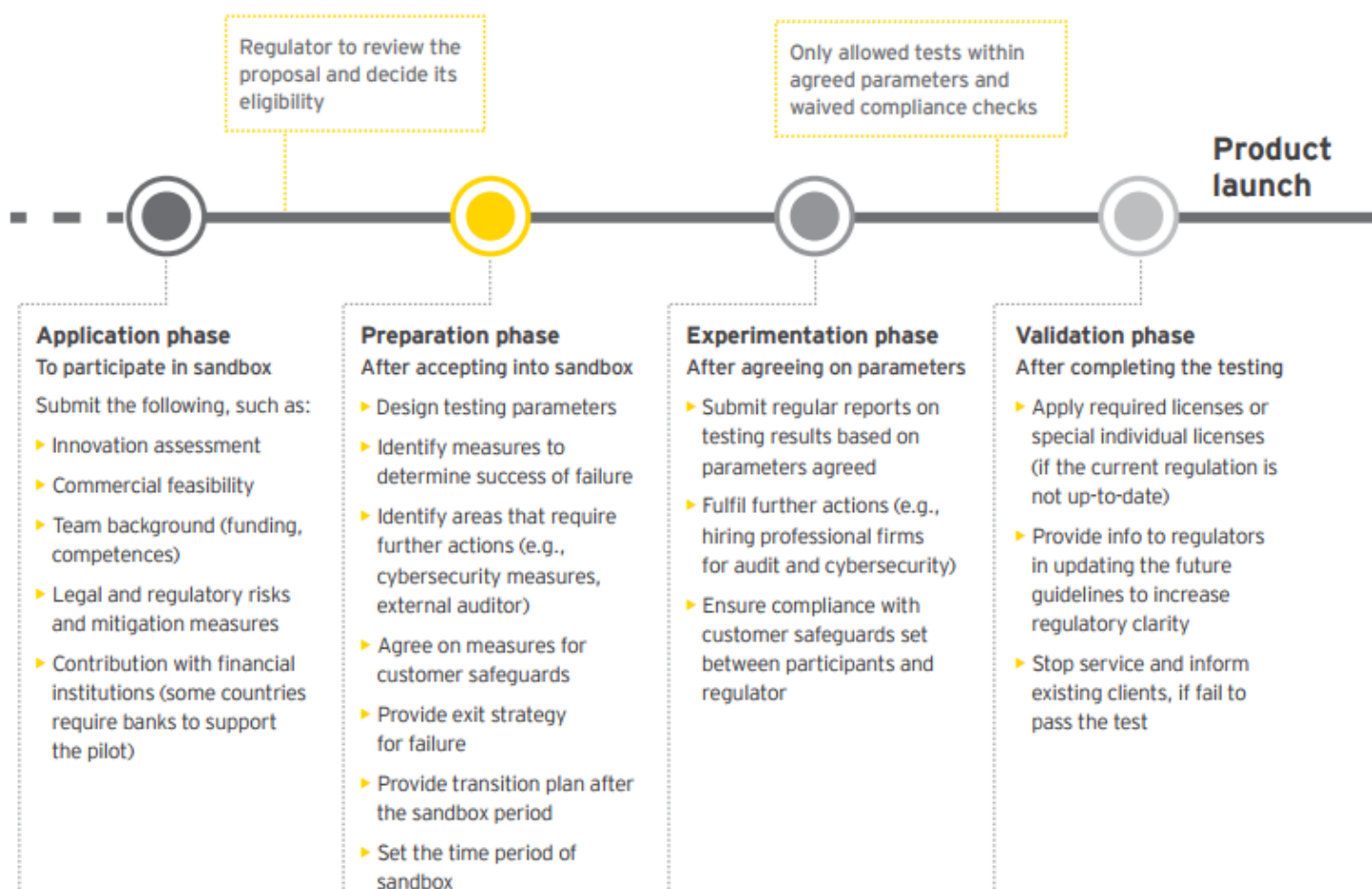
A Sandbox, in general is an isolated testing environment for safely experimenting with a new technology or software. The concept, which was commonly seen in the IT space has found its way into the fintech universe in the form of regulatory sandboxes. A regulatory sandbox is a closed environment set up by a fintech regulator to allow small scale, live testing of innovations by private firms in a controlled environment under the regulator's observation. The key objectives of introducing regulatory sandboxes are to encourage innovations, help regulators keep up with the change in technology and reduce the time and cost for

HOW regulatory sandboxes work?

Initially, fintech players with innovative products or services apply for their product to be tested in a regulatory sandbox. Once the regulatory authority approves the request based on the feasibility of the product, it goes through several phases of testing. Upon successful completion of testing, the products is ready for launch.

WHERE are they available?

In 2015, the Financial Conduct Authority (FCA) launched the world's first regulatory sandbox for FinTech startups in London. Regulatory sandboxes are now operational in several countries at the moment. In addition, several emerging markets have also announced the ir intentions to set-up such facilities to foster innovation and growth of fintech and subsequent regulations.

Figure: Inside the regulatory sandbox

Source: EY Report: As FinTech evolves, can financial services innovation be compliant?

Table: Countries with existing or proposed Regulatory Sandboxes

| | | |
|---|--|--|
| Operational Australia Bahrain Canada Hong Kong Malaysia Netherlands Singapore Thailand UAE (Abu Dhabi) UK USA | Established Brunei Indonesia Mauritius Sierra Leone | Announced Brazil China India Japan Jordan Kenya Mexico Republic of Korea Russia Sweden Switzerland Taiwan Turkey |
|---|--|--|

Source: CGAP Working paper: Regulatory Sandboxes and Financial inclusion; Note: As of Aug 2017

WHAT is its current state in the GCC?

Adoption of regulatory sandboxes in the GCC has been fairly quick, considering that they house two of the nine facilities with operational regulatory sandboxes in the world at the moment.¹ Abu Dhabi Global Market (ADGM) launched its Regulatory Laboratory (RegLab) in November 2016 and was the first in the region to launch a regulatory sandbox. The RegLab is designed to allow FinTech innovation to be tested without being subjected to the full suite of regulatory requirements that would otherwise apply to traditional financial services firms, by creating a regulated environment to contain the specific risks and impact of any particular test.

It was followed by introduction of a regulatory sandbox in July 2017 by the Central Bank of Bahrain (CBB) aimed at enabling firms to test and develop their products in a virtual space. It positioned Bahrain as only the second state within the GCC to implement such a framework.

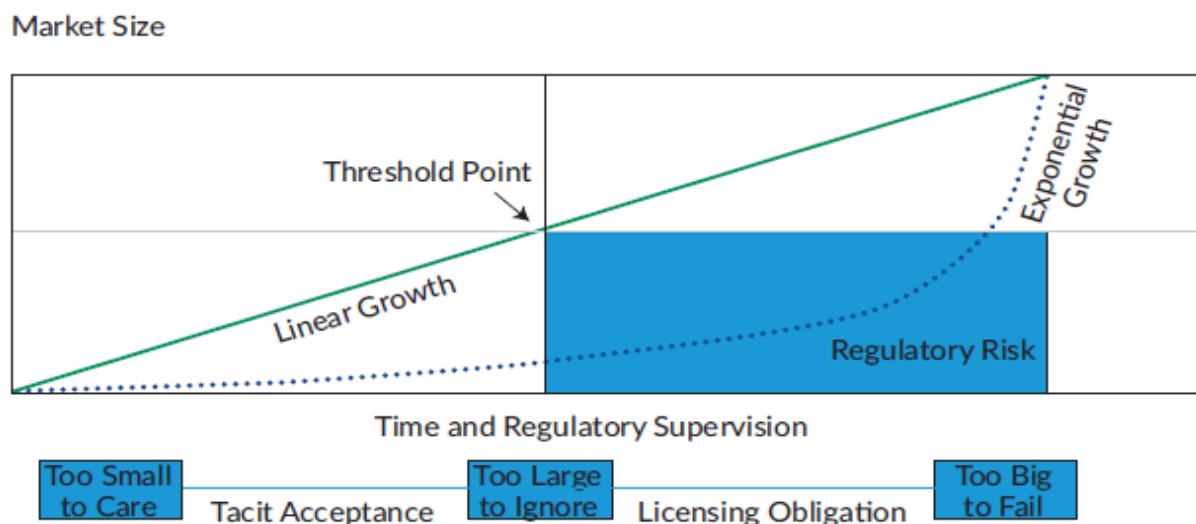
Recently, Abu Dhabi Global Market (ADGM) and the Bahrain Economic Development Board (EDB) signed a Fintech co-operation agreement in January 2018, the first of its kind in the MENA region which includes support for a new Fintech sandbox.

WHAT is the way forward for regulatory sandboxes?

Finance and technology have been evolving at a rapid pace in recent times, owing to factors such as increased smartphone penetration and change in consumer behavior. The immense potential carried by Fintech means that regulatory sandboxes will have a prominent role to play in the development of the financial industry. Regulators therefore, will come under pressure as they will have to develop policies that could encompass such disruptive changes in the market.

¹ CGAP Working paper: Regulatory Sandboxes and Financial inclusion

Figure: 2 Regulatory Stages and Company Growth Stages



Source: CFA Institute Research Foundation - *Fintech and Regtech in a nutshell, and the future in a sandbox*

The above figure gives an idea about how different stages of growth of companies require different regulatory approaches. As FinTech companies grow in significance, they will move from “too small to care” to “too big to fail,” creating a regulatory risk as regulators’ traditional monitoring thresholds fail to be triggered at an appropriate stage.²

In an age where fintech has been taking major leaps, regulators need to keep up and provide room for innovative solutions to flourish. Regulatory sandboxes are shaping up to play a key role in development of new regulatory practices. The fragmentation of the financial services sector and the rapidity of innovation are key drivers which promote the use of sandboxes. However, taking into account the multitude of avenues for innovation, a regulatory sandbox should not be considered as the only entry point to the financial sector for all innovations as it is not a one-size-fits-all solution. Despite the concerns, regulatory sandboxes are expected to be a vital tool in promoting innovative practices in the fintech universe.

² CFA Institute Research Foundation - *Fintech and Regtech in a nutshell, and the future in a sandbox*

References

1. [CFA Institute Research Foundation - Fintech and Regtech in a nutshell, and the future in a sandbox](#)
2. [CGAP Working paper: Regulatory Sandboxes and Financial inclusion](#)
3. [EY: As FinTech evolves, can financial services innovation be compliant?](#)
4. <http://fintech.adgm.com/regulatory-laboratory/>
5. http://www.cbb.gov.bh/page-p-regulatory_sandbox_en.htm

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