The regulatory FinTech sandbox: a global overview

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A regulatory FinTech sandbox ("Sandbox") provides a framework for businesses within the financial technology ("FinTech") industry for testing and creating innovative and dynamic products, technologies and business models around the globe. Sandboxes have been evolving over the past five years and regulatory approaches towards developing and operating Sandboxes differ between jurisdictions and markets. Each jurisdiction's criteria, application process and testing periods will vary depending on amongst other things, the resources of the regulator and the financial market in question. There has also been increased global cooperation between regulators and related organisations with the intention to facilitate and improve methods for regulatory collaboration and the creation of an environment for cross-border testing.

Sandbox participants (otherwise known as applicants) include a full host of financial services firms offering products and services relating, for example, to consumer credit, investment advice, cryptoassets and insurance.

With an increased focus on technology and a greater shift towards a mobile app-based environment, it is no surprise that at the time of writing this article, there are over 45 Sandboxes in operation or in the process of being developed. This article provides an insight into some of the Sandbox regimes that are available across the globe.

United Kingdom

The United Kingdom is a leader in the FinTech space, with London being a booming and thriving market for FinTech activity. Manchester, Birmingham and Leeds are also emerging as key players in the industry by offering digital and FinTech infrastructure which in itself is attracting FinTech start-ups and enterprises from around the world.

The Financial Conduct Authority ("FCA") pioneered the first Sandbox in November 2015, as part of Project Innovate. Its Sandbox is an environment in which FinTech businesses can test innovative products, services, business models and delivery mechanisms that stem from engaging in regulated activities. Since launching the Sandbox and opening it up for applications in June 2016, the Sandbox has helped over 100 firms test their innovations with real customers in a live market environment under controlled conditions. The Sandbox has helped the FCA achieve many of the initial objectives, including a reduction of time and cost of getting innovative ideas to the market, facilitating greater access to finance for innovators, enabling products to be tested and introduced to the market and ensuring appropriate consumer protection safeguards are built into innovators' products and services.

The FCA's Sandbox takes two cohorts a year and has just completed the application process for its sixth round of Sandbox testing. The nature of Sandbox participants has changed across each cohort, with a heavy focus on e-money, payments and insurance products in early cohorts whilst more recent cohorts have been expanding more into regulatory technology ("RegTech"), banking, automated advice and consumer credit. Firms testing blockchain-based ideas have increasingly been utilising the FCA's Sandbox. There has also been a shift towards the testing of products that are designed to give vulnerable consumers better access to financial services and markets. 26% of domestic applications have come from firms outside London whilst only 3% of Sandbox participants represent female founder-led projects. Interestingly, and according to the FCA's assessment of Project Innovate, the FCA has received limited applications from the asset management, pensions and retirement income sectors, despite proactive attempts to engage with these sectors.

Our view: The FCA is largely regarded as one of the leading regulators embracing FinTech innovation. The FCA's commitment to innovation has broadened its scope considerably since first being established. In addition to the Sandbox, the FCA has launched an Advice Unit to support firms looking at innovations in investment advice, and the RegTech Initiative for the development of technologies to help overcome regulatory challenges in financial services. The FCA has helped pioneer the Global Sandbox (see below) and has entered into cooperation agreements with regulators in a number of key jurisdictions around the world. It has also consulted on a cross-sector Sandbox as a 'single point of entry' for firms wishing to test innovative propositions with multiple regulators in a controlled environment; at the time of writing this article, the FCA is yet to publish its next steps on this initiative.

The FCA's continued focus on financial innovation has contributed to the success and popularity of its Sandbox. Attracting both start-ups and incumbents (who often partner with start-ups or launch their own projects) as well as national and international firms, we expect a strong interest in FCA Sandbox participation to continue.

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Global Financial Innovation Network

The Global Financial Innovation Network ("GFIN") was formally launched by the FCA in January 2019 and was built on the FCA's proposal in 2018 to create a Global Sandbox. Currently chaired by the FCA, GFIN forms a network of 50 financial authorities, central banks and international organisations spanning across the globe and committed to supporting financial innovation in the interests of consumers. GFIN aims to create a new framework for cooperation between financial services regulators on innovation related topics and is committed to sharing different experiences and approaches. It seeks to provide a more efficient way for innovative firms to interact with regulators, helping them navigate between countries as they look to scale new ideas. While financial services are typically regulated at national level, many financial services firms are looking to provide services internationally and GFIN is the first multinational organisation of its kind to provide a Global Sandbox for these purposes.

GFIN has three primary functions which are:

- to act as a network of regulators to collaborate and share experience of innovation in respective markets, including emerging technologies and business models, and to provide accessible regulatory contact information for firms;
- to provide a forum for joint RegTech work and collaborative knowledge sharing/lessons learned; and
- to offer firms an environment in which to trial cross-border solutions.

In January 2019, GFIN launched a pilot phase for cross border testing of its Global Sandbox. GFIN received 44 applications from participants across 17 jurisdictions. Each regulator participating in the pilot received at least one application and considered whether the proposed testing activity met the regulator's individual screening criteria, areas of interest, and the regulator's ability to support the activity. The nature of participants varied, with a high number of applications coming from firms offering retail investments, RegTech and cryptoasset related business models.

From 44 applications, eight firms passed the initial screening and were accepted into the next phase of the pilot. However, GFIN recently confirmed that it was unable, at this time, to take forward any of the eight firms to begin the development of testing plans for their cross-border trials. This is because none of the firms' testing plans satisfied each jurisdiction's criteria. GFIN is now exploring how it might be able to help these firms in other ways, either outside the GFIN framework or inviting them to re-engage with the network when they are ready to be tested.

Additionally, GFIN have also identified four solutions that they hope will address the challenges raised in the pilot, which are as follows:

- the creation of a GFIN website to communicate information about cross-border testing more effectively via a single source;
- the publication of a regulatory compendium with information on the types of activity regulators can support via a single source;
- the creation of a single online entry firm, which addresses the needs/criteria of specific regulators, removing the need for duplication of information across multiple forms. The new form process will launch in H1 2020; and
- the opening of applications for the first formal cohort of GFIN participants in H1 2020.

Our view: The facilitation of testing innovative ideas simultaneously across several jurisdictions is both an attractive initiative and necessary for businesses wishing to scale ideas internationally and offer products and solutions that can, by nature, be accessed anywhere. Safeguarding consumer interests effectively in a world where technology has created a borderless environment requires global consensus and means that cross-border cooperation is necessary and inevitable. However, with different levels of market sophistication and differences in Sandbox models, a conciliatory and collaborative approach between GFIN members will be key to enhance the development and success of the Global Sandbox in the long run. Furthermore, it will be interesting to see how many applications are submitted by firms that are fully operational and ready to undertake cross-border testing, and how the additional solutions help develop GFIN's framework.

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Europe

Over 21 European Union ("EU") member states and three EEA states have developed innovation hubs and six EU member states have developed Sandboxes, with many more in the pipeline. Many EU member states have also entered into cooperation agreements with their counterparts across Europe, Americas and Asia. The potential aftermath of Brexit, in addition to greater competition among EU member states/ EEA countries to become a pioneer in FinTech, will likely lead to the creation of further Sandboxes across Europe.

Having been available since 1 January 2017, the Dutch Sandbox set up by the Netherlands Authority for Financial Markets and DeNederlandscheBank Eurosystem is open to all innovators that stand to contribute positively to a stable financial sector. The purpose of the Dutch Sandbox is to offer a bespoke service enabling market operators to roll out their innovative financial products, services or business models without undue obstacles. The supervisory role is to review and fine-tune regulatory standards to accommodate innovation. Additionally, the Dutch approach uniquely allows firms to take advantage of partial authorisation, an authorisation with requirements or restrictions, or an opt-in authorisation.

Lithuania also has a Sandbox set up by the Bank of Lithuania ("BOL"), which opened for applications on 15 October 2019. It allows potential and existing financial market participants to test financial innovations in a live environment under the guidance and supervision of the BOL.

Denmark's Financial Supervisory Authority ("Finanstilsynet") also launched the FT Lab. This is specifically designed to offer selected companies a platform to test their technologies in a secure environment, and help FinTech start-ups access data and build more commercially robust products and services. The FT Lab also aims to enhance the Finanstilsynet's understanding of FinTechs and new technologies that may have a significant impact on Denmark's financial services industry.

Our view: With the European Supervisory Authorities encouraging innovation and development and ongoing work towards a common approach to regulation of FinTech across the EU, we are likely to see more Sandboxes and testing frameworks develop over the coming months. As each member states' market is different and has something unique to offer, the potential creation of a 'European Wide Sandbox', would not be something out of the ordinary.

Middle East and Gulf Cooperation Council

The development of Sandboxes, tech incubators/accelerators and government-driven initiatives has supported an evolving base of FinTech firms and regulatory frameworks in the Middle East and Gulf Cooperation Council ("GCC") area. Though FinTech investment is still limited in terms of overall investment into the region, the FinTech sector is forecasted to generate 8% of financial services revenue by 2022 driven by customer demand and increased investment in the sector. The United Arab Emirates ("UAE") alone has launched over five FinTech initiatives and many regulators within the Middle East and GCC have been signing FinTech pacts with other global regulators.

The launch of Sandboxes has emerged across the region. The Financial Services Regulatory Authority of Abu Dhabi Global Market has admitted its fourth cohort of firms into its Sandbox, known as the Regulatory Laboratory ("RegLab"). The fourth cohort focuses on Sustainable Finance and application programming interface ("API") economies whilst the previous three cohorts of around 26 FinTech firms have not had a specific focus. In addition, the neighbouring Emirate of Dubai has also launched its own Sandbox, known as the Innovation Testing Licence Programme ("ITL Programme").

The Dubai Financial Services Authority ("DFSA") ITL Programme, which runs two cohorts a year, attracts a wide variety of firms that offer a diverse range of products and services from across the globe. Firms who have formed part of the ITL programme have included those which test digitisations of Sukuk issuance, robo-advisory firms and the tokenisation of equities and debt. Sarwa, a robo-advisory start-up was the first firm to graduate from the ITL programme in November 2018 and raised $1.3 million in its Pre-Series A round earlier this year.

The Saudi Arabian Monetary Authority ("SAMA") also introduced a Sandbox in 2019 in order to create a FinTech eco system. In line with the Kingdom's Vision 2030, it is designed to transform the Saudi economy away from its reliance on oil and to a more technology driven modern economy. The 2019 cohorts saw 21 start-ups join SAMA's Sandbox with most firms being predominantly from the peer-to-peer payments industry.

Our view: The Middle East and GCC regions are becoming dynamic and growing financial markets through a mix of government and private sector initiatives. With increased foreign direct investment and a greater focus on open and friendly financial markets, FinTech may become the new oil in the region.

Asia

FinTech has disrupted the Asian markets resulting in increased economic and technological development. According to a report published by Accenture and FinTech hive, Singapore is home to over 500 FinTech start-ups and Indian FinTechs received $1.8 billion in venture capital funding across 97 investments in 2018. Additionally, four of the top 10 FinTech firms in the world are Chinese according to H2Ventures and KPMG whilst digital payments in Asia are expected to cross $1 trillion by 2025. A FinTech revolution is taking place in Asia and as part of this many regulators have created Sandboxes to help develop innovative FinTech offerings across the continent.

The Hong Kong model set up by the Hong Kong Monetary Authority ("HMKA") consists of three separate Sandboxes:

- FinTech Supervisory Sandbox ("FSS") - This allows banks and their partnering technology firms ("Tech Firms") to conduct pilot trials of their FinTech initiatives involving a limited number of participating customers without the need to achieve full compliance with the HKMA's supervisory requirements. Interestingly, this initiative is driven by the banking industry rather than FinTechs themselves. The Sandbox also has a chatroom service where supervisory feedback can be given to banks and Tech Firms at early stages to assist in the development of their technology.

- Securities and Future Commission ("SFC") Sandbox - The SFC Sandbox provides a confined regulatory environment for qualified firms to conduct regulated activities utilising financial technologies.

- Insurance authority ("IA") InsurTech Sandbox - The InsurTech Sandbox helps authorised insurers experiment with new InsurTech and other technology applications without the need to achieve full compliance with the IA's usual regulatory requirements.

The HKMA, SFC and IA have also launched the cross-sector FinTech product, which allows a firm to apply and seek access to the most relevant Sandbox. Here, the regulator will act as the primary point of contact and assist in liaising with the other regulators of the firm to access the Sandboxes concurrently.

The Monetary Authority of Singapore ("MAS") has also created a Sandbox to allow the testing of products for wider adoption in Singapore and abroad. The Sandbox is open to both financial institutions and FinTechs, and allows companies to experiment with financial products or services at the production stage within a contained environment for a limited duration. The 'smart financial centre ideology' allows firms to increase efficiency, better manage risks, create new opportunities and improve consumers lives. MAS also launched an accelerated scheme in August 2019, the Sandbox Express, for accelerated market testing of certain innovative financial products and services (insurance broking and establishing or operating an organised market).

> ***"The Sandbox is open to both financial institutions and FinTechs, and allows companies to experiment with financial products or services at the production stage within a contained environment for a limited duration"***

Our view: Asia is an attractive market for FinTech firms due to the increased focus and tailored approach to different forms of FinTech, by for example the rollout of digital banking licenses. The region has never been shy in showing its desire to be a leader in this industry, with Singapore being home to one of the largest government supported FinTech conferences, the Singapore FinTech Festival, and Hong Kong having an increased focus on virtual licensing, which allows banks to provide services under a non-traditional brick and mortar model. With a greater focus on cross-sector testing and a multitude of Asian countries collaborating on regional and international FinTech initiatives, the region provides an exciting environment for FinTech development.

Americas

The Americas has continued to develop its FinTech landscape, with countries across both the North American and South American continents creating frameworks to attract FinTech investment and build a FinTech ecosystem. Though slower than its European and Asian counterparts, Sandboxes have been created across the United States and Canada. There have also been initiatives on a federal level in the United States. The uptake of FinTech in Central and South America seems to be slower than its neighbouring countries in the north, with Colombia being the only country to have established a fully-fledged Sandbox. With multiple countries across the Americas being members of GFIN as well as the increased venture capital investments into the unbanked and underbanked population of Latin America, we expect that growing number of countries in the Americas will create Sandboxes for the testing of innovative FinTech product and services.

Only three states (Arizona, Wyoming and Utah) have launched Sandboxes in the United States. Similar to other Sandboxes, innovators have the opportunity to offer innovative products and services subject to minimum regulation and compliance with relevant applicable requirements of state law. On a federal level, the Consumer Financial Protection Bureau ("CFPB") created two Sandboxes: the Compliance Assistance Sandbox ("CAS") and the Trial Disclosure Sandbox ("TDS"). The CAS enables firms to test a financial product or service in order to seek clarity on how it is regulated, whilst the TDS provides legal protections to firms conducting trial programs to advance consumer benefits, in addition to testing new products.

The Office of the Comptroller of the Currency ("OCC") stated that they would start accepting applications for special-purpose national bank charters from financial technology companies that do not take deposits. This initiative has been met with a cold reception by state bank regulators who have brought legal action against the OCC's proposal. A Federal District Court in New York in October 2019 ruled that the OCC does not have the legal authority to grant special-purpose national bank charters to FinTech companies that do not take deposits, to which the OCC has filed an appeal against. We await further developments on the OCC's appeal.

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The Canadian Securities Administrator ("CSA"), the umbrella organisation of the Canadian provincial and territorial securities regulators, has launched a Sandbox to support FinTech growth in Canada. Available to both start-ups and established firms, it is open to business models that are innovative from a Canadian market perspective. In order to apply, firms must provide live environment testing, a business plan and a discussion of potential investor benefits. On submission of an application, the CSA will review these on an expedited basis and determine the limits and conditions that will apply to firms within the Sandbox.

Colombia has also taken a proactive approach by launching an innovation hub and a supervisory sandbox to facilitate innovation in the Colombian financial industry. Additionally, Mexico has established a FinTech law which will allow firms to obtain a special temporary authorisation to offer financial services subject to certain terms and conditions, through a Sandbox model.

Our view: With 62% of Canadian financial institutions stating that they are actively involved in partnerships with FinTech companies, along with the United States being a leading financial services market and an ever-growing appetite for financial products in Latin America, opportunities for FinTechs in the Americas are plentiful. To meet this growing demand, regulators will likely want to develop Sandboxes and other testing programmes to stay competitive with counterparts in Europe and Asia. An adversarial or risk adverse approach might well undermine the existing favourable market position certain states/countries are currently enjoying.

Conclusion

The creation of Sandboxes has boomed over the past few years to form key parts of nations' FinTech strategies. They clearly present a unique opportunity to enhance innovation and strengthen the development of products, services and business models in the FinTech space in a safe and contained environment.

The consensus view is that Sandboxes are mutually beneficial for both regulators and Sandbox participants who can learn from each other in many ways. In the case of regulators, the Sandbox helps by building an understanding and providing them with a live insight into the functioning and applications of emerging technologies which in turn informs regulators' policy work. In the case of Sandbox participants, the environment raises awareness of and educates them about the regulatory challenges their products and business models present, and allows them to discuss potential compliance approaches in close interaction with the regulator.

More importantly however, it remains to be seen what experiences regulators and participants can draw from Sandbox testing. Sandbox testing is not a means in itself but should be undertaken to road-test a wider launch to the market. An important exercise therefore will be for regulators to collate and analyse meaningful data on outcomes and post-exit experiences. Aspects for consideration are likely to include information on the percentage of participants who transition to full authorisation and project implementation; products and business models that are successfully adjusted to enable their launch (whether or not avoiding regulation); and projects that are aborted all together (and, if so, why).

So what makes a successful Sandbox? Will Sandboxes simply crystallise the divergence in the regulation of FinTech and highlight the relative attractiveness of certain jurisdictions for FinTech? Or will they also serve as a catalyst for the adoption of a common approach to regulation and creation of a level playing field between jurisdictions? In this regard the Global Sandbox seems to provide a suitable forum for comparative analyses of outcomes and an opportunity for enhanced cooperation between regulators.

Also, how many Sandboxes do we think will be in operation long-term? In light of various initiatives at European and global level (e.g. the EU FinTech Action Plan and OECD's work on digitalisation and innovation) designed to promote the development of common regulatory frameworks for FinTech and digital innovation, one would expect to see some consolidation around Sandbox testing.

In the meantime, Sandboxes provide an excellent platform for governments and regulators worldwide to further innovate and increase competition from within and outside their jurisdictions. At the same time, experience has shown that innovators benefit from greater access to potential investors and customers where they transition out of the Sandbox successfully and then proceed to market launch.

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