



United Nations Secretary-General's
Special Advocate for Inclusive Finance for Development

UNSGSA

Briefing on Regulatory Sandboxes

By the UNSGSA's Fintech Sub-Group
on Regulatory Sandboxes

What is a regulatory sandbox?

- A regulatory sandbox is a regulatory approach, typically summarized in writing and published, that allows live, time-bound testing of innovations under a regulator's oversight. Novel financial products, technologies, and business models can be tested under a set of rules, supervision requirements, and appropriate safeguards.
- A sandbox creates a conducive and contained space where incumbents and challengers experiment with innovations at the edge or even outside of the existing regulatory framework.
- A regulatory sandbox brings the cost of innovation down, reduces barriers to entry, and allows regulators to collect important insights before deciding if further regulatory action is necessary.
- A successful test may result in several outcomes, including full-fledged or tailored authorization of the innovation, changes in regulation, or a cease-and-desist order.
- The first regulatory sandbox was launched in 2015 in the U.K. and generated great interest from regulators and innovators around the world. At the beginning of 2018, there were more than 20 jurisdictions actively implementing or exploring the concept.

Why does it matter for financial inclusion?

- Regulatory sandboxes may open space for improvements in financial inclusion through innovations—for example, biometric ID, alternative credit scoring, e-KYC, blockchain-based remittances, and new business models serving marginalized clients.
- This is important because the success of financial inclusion largely hinges on the capacity of the financial sector to innovate. Innovation can address traditional barriers to financial inclusion such as legal

Case study

In May 2017, the London-based remittance service provider WorldRemit and three other fintechs were permitted to use Bank Negara Malaysia's (BNM) sandbox to test a solution for remote customer identification. WorldRemit's technology allows customers to submit identification remotely via mobile phone by sending photos of themselves with their official IDs. Previously, this approach to customer identification was not allowed by the legal and regulatory framework in Malaysia. After successful testing in the regulatory sandbox, BNM allowed WorldRemit to implement the innovation, with the effect of expanding access to the service in remote areas. Subsequently, BNM drafted e-KYC guidelines that allow other providers to implement similar technology and compete with WorldRemit.

(e.g., AML/CFT requirements), operational (e.g., costs associated with brick-and-mortar branches), and physical (e.g., limitations of traditional distribution channels). This has been illustrated by the success of mobile money in Africa. Regulatory sandboxes may also encourage competition and cooperation between incumbents and challengers to the benefit of excluded and underserved customers.

- In addition, regulatory sandboxes may **strengthen the capacity of regulators**. By facilitating a more open and active dialogue with innovators, sandboxes can help break down regulatory barriers to financial inclusion.

How does it work in practice?

- The concept of the regulatory sandbox keeps evolving into distinct models determined by several factors. A significant common feature is that a **regulatory sandbox facilitates the necessary dialogue between market participants and regulators to inform regulatory actions that strike the right balance between facilitating innovation and mitigating (new) risks**. The key differences between models concern eligibility criteria, safeguards and testing requirements, organizational structure, and operational details (e.g., testing in cohorts vs. rolling).

- However, regulatory sandboxes are new and neither their utility nor their impact on financial inclusion have been sufficiently proven yet. The impact of a regulatory sandbox likely varies depending on multiple factors: legal environment (e.g. common law vs. civil law jurisdictions), regulatory framework (e.g., tiered KYC regulations), and openness to innovation.

What can governments do to promote regulatory sandboxes?

- **Governments should give thoughtful consideration to whether the innovations being tested in a sandbox have the potential to improve access to and usage of financial services by the poor**. When considering a regulatory sandbox, regulators should clearly define the objectives and the challenges that need to be addressed. They also need to dedicate sufficient resources to support implementation. It is crucial to engage the industry early in the process to get its perspective and secure buy-in.
- While there is no universal blueprint or set of best practices to follow, regulators can consult publicly available resources. Those include jurisdictions with a regulatory sandbox in place, international development organizations, other regulators through peer learning platforms for financial inclusion policymaking, and private consulting firms.
- **A sandbox is not a panacea for all regulatory challenges brought about by innovation, nor is it the only solution**. Other options include a test-and-learn approach to try out new ideas under ad hoc circumstances in a live environment (e.g., agent banking in Indonesia, Kenya, Philippines, Rwanda) or a wait-and-see strategy that allows for informal monitoring of new trends before any formal intervention is performed (e.g., P2P lending, cryptocurrencies). Compared to those approaches, regulatory sandboxes are more structured, objective-driven, and publicized, but also more formalistic, costly and resource-intensive.

Annex: Resources

Programs

Selected jurisdictions with a regulatory sandbox in place.

- ASIC, Australia
- BNM, Malaysia
- FCA, UK
- MAS, Singapore

The Alliance for Financial Inclusion can facilitate peer learning between countries within its network.

Organizations involved in technical assistance and/or funding of relevant activities

- Aspen Institute
- Bill and Melinda Gates Foundation
- Cambridge Center for Alternative Finance
- CGAP
- FSD Africa
- Omidyar Network
- UNCDF
- World Bank

Selected Experts

- Schan Duff, Aspen Institute
- Ivo Jenik, CGAP
- Philip Rowan, Cambridge Center for Alternative Finance

Recommended Readings

Duff S. 2017. *Modernizing Digital Financial Regulation*. Washington, D.C.: Aspen Institute.

GPFI. 2017. *Digital Financial Inclusion: Emerging Policy Approaches*. Washington, D.C.: GPFI.

Jenik I, Lauer K. 2017. *Regulatory Sandboxes and Financial Inclusion*. Washington, D.C.: CGAP.

Mueller J. 2017. *FinTech: Considerations on How to Enable a 21st Century Financial Services Ecosystem*. Washington, D.C.: Milken Institute.



This note was drafted by Ivo Jenik of CGAP under the guidance of the office of the UNSGSA and with support from the Alliance for Financial Inclusion, De Nederlandsche Bank, International Finance Corporation, Monetary Authority of Singapore, and Omidyar Network.