

# RBI issues draft regulatory sandbox framework for ‘start-ups’ in FinTech space

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## Summary

The Reserve Bank of India (RBI) had set up an Inter-Regulatory Working Group in 2016 to review and suggest changes in the regulatory framework for evolving the FinTech space in the country. The working group, among other things, recommended introduction of a regulatory sandbox framework to increase efficiency, manage risks, and create new opportunities for consumers.

Based on the above recommendation, the RBI has issued<sup>1</sup> a draft framework for regulatory sandbox. The regulatory framework enables FinTech start-ups to test their financial products, services or technology in a controlled regulatory environment before actual launch. Further, it covers principles and roles of the proposed sandbox, eligibility criteria, the sandbox process and other key considerations for setting up the regulatory sandbox. The final operational guidelines encapsulating entire operational framework in India are yet to be released.

## Background of the regulatory sandbox

A regulatory sandbox usually refers to live testing of new products or services in a controlled regulatory environment, wherein the regulators may permit regulatory relaxations for testing purposes. The underlying objective behind setting-up a regulatory sandbox is to allow the regulator, innovators, financial service providers and customers to conduct field tests to collect evidence on the benefits and risks of new financial innovations, while carefully monitoring and containing inherent risks.

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<sup>1</sup> 19 April 2019

## Focus of the regulatory sandbox

The focus of the sandbox is to encourage innovations through new or emerging technology, or use of existing technology in an innovative way where:

- there is absence of governing regulations
- there is a need to temporarily ease regulations for enabling the proposed innovation
- the proposed innovation shows promise of easing/effecting delivery of financial services in a significant way.

In this regard, the regulatory sandbox shall undertake thematic testing based on different parameters such as financial inclusion, payments and lending, digital KYC etc. Accordingly, the RBI would shortlist 10-12 start-ups meeting the eligibility criteria through a comprehensive selection process for the purpose of end-to-end testing in the sandbox.

## Eligibility criteria for participating in the regulatory sandbox

The applicants should be a FinTech company incorporated / registered in India and should meet the conditions prescribed<sup>2</sup> for start-ups by the government. Additionally, the participants should satisfy following conditions:

<b>Related participants</b>	<ul style="list-style-type: none"><li>• The net-worth of the participants should be at least INR 50 lakh as per its latest audited balance sheet</li><li>• The conduct of its bank accounts should be satisfactory</li><li>• It should demonstrate compliance with the extant laws on consumer data protection and privacy</li><li>• It should have a robust IT infrastructure and managerial resources</li></ul>
<b>Related promoters/ directors</b>	<ul style="list-style-type: none"><li>• They satisfy the 'fit and proper' criteria</li><li>• The conduct of their bank accounts should be satisfactory</li><li>• They have a satisfactory CIBIL or equivalent credit score</li></ul>
<b>Related products/ services</b>	<ul style="list-style-type: none"><li>• Provide results of proof of concept (incl. relevant prior experience)</li><li>• The products/services are technologically ready for deployment in the broader market</li><li>• The proposed solution should highlight an existing gap in the financial ecosystem and should demonstrate how it would address</li></ul>

<sup>2</sup> An entity would be considered as a 'start-up' if it meets the following conditions:

- (i) Period of seven years has not lapsed from the date of its incorporation / registration;
- (ii) Its turnover in any of the financial years since incorporation/registration has not exceeded INR 25 Crore;
- (iii) It is working towards innovation, development or improvement of products or processes or services

	<p>the problem, or bring benefits to consumers or perform the same work more efficiently</p> <ul style="list-style-type: none"> <li>• It should demonstrate presence of a relevant regulatory barrier that prevents deployment of the product/service at scale, or a genuinely innovative and significantly important product/service/solution is proposed for which relevant regulation is necessary but absent</li> </ul>
<b>Related technology</b>	<ul style="list-style-type: none"> <li>• Adequate safeguards are built in IT systems to ensure that it is protected against unauthorised access, alteration, destruction, disclosure, dissemination of records/data</li> <li>• Significant risks arising from the proposed solution be assessed and mitigated</li> </ul>
<b>Related testing</b>	<ul style="list-style-type: none"> <li>• Clearly defined test scenarios and expected outcomes of sandbox experimentation</li> <li>• Clearly defined exit and transition strategy in the event that the proposed solution has to be discontinued, or has to be deployed on a broader scale after exiting the regulatory sandbox</li> </ul>

## Eligible and ineligible products/services/technology

The framework presents following illustrative list of innovative products/services /technology which may be considered for testing under regulatory sandbox. Further, it also proposes certain products/services which are excluded from sandbox testing.

<b>Eligible products/services/technology</b>	<b>Ineligible products/services/technology</b>
<p>Products/service/technology would be eligible for the regulatory sandbox if:</p> <ul style="list-style-type: none"> <li>• A different technology is being gainfully applied, or</li> <li>• The same technology is being applied in a more efficient and effective manner</li> </ul>	<ul style="list-style-type: none"> <li>• Products/service/technology would be ineligible for regulatory sandbox if the proposed service is similar to the one that is already being offered in India</li> </ul>
<p><b>Eligible products/service</b></p> <ul style="list-style-type: none"> <li>• Retail payments</li> <li>• Money transfer services</li> <li>• Marketplace lending</li> <li>• Digital KYC</li> <li>• Financial advisory services</li> </ul>	<p><b>Ineligible products/service/technology</b></p> <ul style="list-style-type: none"> <li>• Credit registry</li> <li>• Credit information</li> <li>• Crypto currency/crypto assets services</li> <li>• Initial coin offerings</li> <li>• Chain marketing services</li> </ul>

<ul style="list-style-type: none"> <li>• Wealth management services</li> <li>• Digital identification services</li> <li>• Smart contracts</li> <li>• Financial inclusion products</li> <li>• Cyber security products, etc.</li> </ul>	<ul style="list-style-type: none"> <li>• Trading in crypto assets, and</li> <li>• Any product / service banned by regulators / Government of India.</li> </ul>
<p><b>Eligible technologies</b></p> <ul style="list-style-type: none"> <li>• Mobile technology applications;</li> <li>• Data Analytics</li> <li>• API services</li> <li>• Applications using block chain technology</li> <li>• Artificial intelligence</li> <li>• Machine learning applications, etc.</li> </ul>	

## Stages of regulatory sandbox

The framework proposes that the detailed end-to-end sandbox process including the testing shall be overseen by the FinTech Unit of the RBI. Further, it outlines following stages of a regulatory sandbox:

Stage	Name of stage	Time period (weeks)	Agenda of the stage
I	Preliminary screening	4	Applications to be evaluated and shortlisted
II	Test design	3	Test design to be finalized and outcome metric to be identified for evaluating benefits and risks
III	Application assessment	3	Test design and proposed regulatory modifications to be evaluated
IV	Testing	12	Empirical evidences to be generated to assess the tests by close monitoring
V	Evaluation	4	Final outcome of the tests to be assessed
	<b>Total</b>	<b>26</b>	

## Other key aspects

- The RBI may consider relaxing some of the regulatory requirement for applicants for the duration of regulatory sandbox. However, some regulatory requirements such as privacy, data protection, secure storage of data etc. have to be maintained mandatorily.
- Entities entering the regulatory sandbox must notify test customers of potential risks and the available compensation and obtain their explicit consent. Further, upon RBI approval, the applicant becomes the entity responsible for operating in regulatory sandbox.

## Our comments

The regulatory sandbox framework proposed by RBI is in line with that implemented by other foreign regulators. The regulatory sandbox seeks to provide a structured avenue for the regulator to engage with the financial ecosystem and to develop innovation-enabling regulations in the FinTech space. It aims to give a better understanding to the regulator and the innovator on evaluating the necessary changes that would be required for its practical implementation in the Indian regulatory environment. This should not only improve the pace of innovation and technology absorption, but also that of financial inclusion. While the framework would provide impetus to start-ups, it fails to adopt the revised definition of 'start-up' wherein both the turnover as well period criteria have been relaxed.

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