

Blueprint of Fintech Regulatory Sandbox Law / Preparing for the Future of Fintech Innovations (A Covid-19 Update)

The ongoing COVID-19 pandemic has unleashed a systemic shock throughout the society, leading to a change in the way we interact and conduct business. As the Indian economy gradually reopens, we will witness a new social order marked by physical distancing. This is likely to further embed digitisation into our daily lives and will accentuate the role of financial technology (fintech). For instance, many believe that concerns relating to fear of viral transmission through bank notes (whether justified or not) is likely to change payment behaviour bringing digital payments to the fore. Similarly, a decline in the physical visits to bank branches and growth in virtual interactions for banking and other financial services has brought into focus the digital capabilities of financial institutions to provide seamless consumer experiences. Irrespective of how the pandemic finally plays out, we are likely to witness a change in consumer behaviour and preferences, with perhaps expectations on re-bundling of financial services. Such financial institutions and fintech companies that are able to pivot and continuously adapt to meet the changing needs of consumers will thrive. This changed reality can drive technological adoption in unanticipated ways. This in return may pave the way for boosting financial inclusion priorities of the government and solve the credit challenges that have plagued the micro, small and medium enterprises.

This calls for a focused policy attention to create a regulatory ecosystem that can leverage the potential of fintech innovations. Such initiatives can already be witnessed in jurisdictions such as United Kingdom and Singapore. For instance, the Financial Conduct Authority (“FCA”) has announced its decision to launch a digital sandbox that will enhance the FCA’s existing innovation services (such as Innovation Hub and Regulatory Sandbox) and allow innovative firms to test and develop proofs of concept in a digital testing environment. Some of the proposed features of the sandbox include access to data assets, developing a platform to enable businesses to share APIs and other solutions to enable greater interoperability, etc.

In India, three financial regulators i.e. the Reserve Bank of India, Insurance Regulatory and Development Authority of India and recently the Securities and Exchange Board of India have launched their separate regulatory sandboxes. While such regulations are a welcome move to promote innovation in the financial market, the design of the existing regulatory sandbox testing framework spread across different financial regulators is not well equipped to harness the potential of fintech to meet consumer demands.

Why the existing regulatory sandbox framework in India fails to harness the potential of fintech innovation?

- The existing framework with each regulator operating its regulatory sandbox in silo, fails to account for the disruptive nature of fintech innovation. Driven by new and emerging technologies and shifts in consumer demand, fintech innovation may cut across a wide array of financial services segments. However, the existing regulatory framework that looks at fintech innovations within the traditional silos of banking, securities, pension, and insurance fails to take into account the disruptive and cross-sectoral nature of fintech innovations as highlighted in the figure below.



- The current framework only covers regulatory barriers traceable to the concerned regulator, disregarding barriers across regulators. Such a framework is likely to inhibit the development of potentially useful cross-sectoral innovations that best serve consumer needs, but do not necessarily adhere to individual regulators’ boundaries.

- A review of the different framework for sandbox testing in India indicates that there is no uniformity in the regulatory approaches adopted by different regulators on key features such as eligibility, minimum consumer protection requirements, duration, etc. This patchwork of regulatory framework with no coordination between different regulators is likely to create uncertainty for businesses and stifle the growth of such innovations.
- Businesses desirous of developing cross-sectoral innovations will have to separately approach each regulator to seek different exemptions, in addition to meeting varied prescriptive criteria. This is an inefficient process as it is likely to involve high compliance costs and increases time to take a product to the market.

Against this background, in March 2020, the Vidhi Centre for Legal Policy had released a report on 'Blueprint of a Fintech Regulatory Sandbox Law | Preparing for the Future of Fintech Innovations'. We argue that the existing framework for issues discussed above fails to leverage the potential of the regulatory sandbox model for reasons discussed above. Therefore, the Report recommends a unified legal framework that amongst other things seeks to develop a co-ordination framework between the four financial sector regulators for cross sectoral fintech regulatory sandbox testing in India. Please note that this report was drafted at a time when India was not grappling with the fallout of the pandemic and accordingly, it does not discuss the same. However, we do believe that the recommendations of this Report will be relevant to India's long term policy response to the pandemic. Implementing the legal framework proposed in this Report is an essential step towards harnessing the many benefits of fintech.

Executive Summary

Advances in technology are transforming the financial services sector at an unprecedented rate. This calls for a governance framework to accelerate the positive and inclusive impacts of such technologies and contain or eliminate negative externalities. This concept paper envisages a legal framework for India that will be instrumental in defining the future of fintech innovations in India. It recommends that India should enact a law viz. 'Promoting Innovation in Financial Services Act' to design a unified legal framework that will empower the existing financial sector regulators in India to: (a) operate a regulatory sandbox to test fintech innovations that fall solely within their respective regulatory domains; and (b) operate and participate in an inter-regulatory sandbox to test innovations that fall within the regulatory domain of more than one regulator.



Value Proposition of the Proposed Law



Why do we need the Proposed Law?

Current Approach	Issue	Proposed Solution
Four financial regulators operating their own separate sandboxes in silos	Only such innovations within the purview of an individual regulator stand to make it to the market	Regulators continue to operate their own sandbox and participate in cross-sectoral fintech sandbox testing
No express statutory authority to operate a sandbox and grant regulatory exemption	Concerns about legal sanctity of sandbox testing	Proposed law will grant express authority to the regulator to operate its own sandbox, participate in cross-sectoral sandbox testing, and grant regulatory exemptions
No framework for facilitating sandbox testing of cross-sectoral fintech products	Businesses have to separately approach each regulator for cross-sectoral fintech innovations, which is inefficient and costly	Sets up a co-ordination committee consisting of relevant financial sector regulators
Lack of uniformity across the existing sandbox framework on common features such as eligibility criteria, duration, and consumer protection safeguards	Siloed framework with lack of uniformity across common features creates uncertainty for businesses.	Create a framework with common minimum requirements and safeguards, allowing regulators enough flexibility to develop bespoke requirements for testing