Regulatory Sandbox

Discussion Paper

Issued on: 29 July 2016

BNM/RH/DP 030-1

Bank Negara Malaysia (the Bank) is enhancing its regulatory approach to facilitate the development and adoption of innovative financial technology (fintech) solutions. In this regard, the Bank plans to introduce a regulatory sandbox (the Sandbox) framework, under which financial institutions regulated by the Bank (financial institutions) and fintech companies may be granted certain regulatory flexibilities to experiment with fintech solutions in a production or live environment. These flexibilities will be accompanied by appropriate safeguards to preserve financial stability and promoting fair treatment to consumers. The aim of these flexibilities is to encourage innovation and improve the delivery of financial services.

This discussion paper sets out the key principles and proposed approach in operationalising the Sandbox. The Bank invites written comments on the specific questions set out in this discussion paper as well as any general comments on the proposals, including suggestions for particular issues/areas to be clarified or elaborated further and any alternative proposals that the Bank should consider. To facilitate the Bank's assessment, please support each comment with a clear rationale, accompanying evidence or illustration, as appropriate.

In addition to providing general feedback, financial institutions, fintech companies and the public are requested to respond to the specific questions set out in this discussion paper.

Responses must be submitted by 30 August 2016 to:

Pengarah
Jabatan Pembangunan Sektor Kewangan
Bank Negara Malaysia
Jalan Dato' Onn
50480 Kuala Lumpur
Email: fintech@bnm.gov.my

Electronic submission is encouraged. Submissions received may be made public unless confidentiality is specifically requested for the whole or part of the submission.

Any queries may be directed to:

Nadiah Tajuddin nadiah@bnm.gov.my or 03 2698 8044 (ext.8799)
Azril Ikram Amiruddin azril@bnm.gov.my or 03 2698 8044 (ext.8417)

Issued on: 29 July 2016

TABLE OF CONTENTS

PART A OVERVIEW

1 Objectives, principles and operationalisation of the regulatory sandbox

1.1 Advances in financial technology have led to the introduction of new business models and solutions that have contributed to the enhancement of value and customer experience as well as financial institutions' efficiency and risk management.

1.2 Given the important role that innovation plays in enhancing the financial landscape, the Bank seeks to provide a regulatory environment that is conducive for its deployment. This includes reviewing and adapting regulatory requirements or procedures that may unintentionally inhibit innovation or render them non-viable. As part of this process, Sandbox approach is being proposed to enable innovation to be deployed and tested in a live environment, within specified parameters and timeframes.

1.3 Risk and failure are an integral part of innovation. Given that a Sandbox operates in a live environment, failure may likely result in financial loss or other risks to the participating institutions and their customers. It is therefore imperative for the Sandbox to incorporate appropriate safeguards to manage the risks and contain the consequences of failure. In this regard, a Sandbox may be deployed for testing for a period not exceeding twelve (12) months.

1.4 A Sandbox is intended to facilitate testing in a contained environment and cannot be used to circumvent existing laws and regulations. A Sandbox is therefore not suitable for proposed activities or solutions that are already appropriately addressed under prevailing laws and regulations.

1.5 If this is not the case, the Bank may consider one or a combination of the following approaches –

(a) **Informal steer**: the Bank will provide guidance and advice to the financial institutions or fintech companies on the modifications that can be made to their proposed business model or solution to fit prevailing laws and regulations. This approach is suitable where the modified business model or solution does not significantly diminish the value proposition of the original proposal.

(b) **Regulatory sandbox**: financial institutions or fintech companies will be allowed to test their innovation in a controlled environment, subject to fulfilling the eligibility criteria specified by the Bank. The Bank may provide guidance and support in the form of regulatory flexibilities during the testing period where appropriate.

1.6 This regulatory approach provides flexibility in terms of specific regulatory requirements and procedures. However, certain intended outcomes are important to ensure integrity and acceptance of fintech initiatives. These outcomes may include, but are not limited to –

(a) preserving safety and soundness of individual financial institutions that will promote monetary and financial stability;
(b) promoting fair treatment of consumers;
(c) preventing money laundering and countering terrorism financing;
(d) protecting the confidentiality of customer information;
(e) promoting the safety, reliability and efficiency of payment systems and payment instruments; and
(f) ensuring innovative solutions for Islamic financial services are consistent with prevailing Shariah standards.

1.7 In considering an application to deploy and participate in Sandbox and the types and extent of regulatory flexibilities that may be accorded to the financial institutions or fintech companies operating in a Sandbox, the Bank will take into account, among others, the following:

(a) the potential benefits of the proposed product, service or solution;
(b) the potential risks and mitigating measures; and
(c) the integrity, capability and track record of the financial institutions or fintech companies.

1.8 Priority will be accorded to applications for the deployment and operation of a Sandbox received from financial institutions and/or fintech companies that intend to collaborate with financial institutions. In addition, priority will be accorded to fintech companies with presence in Malaysia and with potential to contribute meaningfully to the creation of high value added jobs in Malaysia.

2 Applicability

2.1 The requirements in this discussion paper are applicable to –

(a) Financial institutions as defined in paragraph 3.2; and

(b) Fintech companies intending to carry out any approved business as defined in Financial Services Act 2013 (FSA) and Islamic Financial Services Act 2013 (IFSA) or money services business as defined in the Money Services Business Act 2011 (MSBA).

3 Interpretation

3.1 The terms and expressions used in this policy document shall have the same meanings assigned to them in the FSA, IFSA, Development Financial Institution Act (DFIA) and MSBA, as the case may be, unless otherwise defined in this policy document.

3.2 For the purpose of this policy document-

“applicant” refers to a financial institution or fintech company that utilises or plans to utilise fintech in the provision of financial services;

“fintech” refers to technological innovation applied in the provision of financial services;

“fintech company” means a company[1] that utilises or plans to utilise fintech;

“financial services” means financial intermediation activities, including banking and insurance services which leverage on technological innovation;

“Islamic financial services” means Islamic financial intermediation activities, including Islamic banking and takaful services which leverage on technological innovation;

“financial institution” refers to –

(a) a licensed person, approved person and a registered merchant acquirer under the FSA;

[1] Incorporated as local company with Companies Commission of Malaysia (SSM) or registered as foreign company in Malaysia with SSM.

(b) a licensed person under the IFSA;
(c) a licensee under the MSBA; and
(d) a prescribed institution under the DFIA.

“participating institution” refers to financial institution which has been approved by the Bank to participate in Sandbox;

“participating fintech company” refers to a fintech company which has been approved by the Bank to participate in Sandbox;

“participants” refers collectively to participating institutions and participating fintech companies.

PART B POLICY REQUIREMENTS

4 Eligibility criteria

4.1 An applicant seeking the Bank's approval to participate in a Sandbox must demonstrate the following -

(a) the product, service or solution is genuinely innovative, i.e. it is novel and not similar to those already available in the Malaysian market;

(b) the product, service or solution has clear potential to -

i. contribute to the development of Malaysia's financial sector. This may include greater accessibility, efficiency, security, reliability or effectiveness in the provision of financial services;

ii. bring about enhancement to the Malaysian financial institution's efficiency or risk management and controls; or

iii. significantly benefit the Malaysian economy and/or consumers.

(c) the applicant has conducted an adequate and appropriate assessment to demonstrate the usefulness and functionality of the product, service or solution and understands the associated risks;

(d) the applicant has the necessary resources to participate in Sandbox, mitigate and control potential risks and losses arising from the offering of such product, service or solution;

(e) the applicant's business plan to deploy the product, service or solution on a commercial scale in Malaysia after exit from the Sandbox; and

(f) the provision of the new product, service or solution is otherwise -

i. not allowed due to any prohibition or restriction under existing laws or regulations administered by the Bank; or

ii. either wholly or partly incompatible with applicable regulatory requirements currently imposed by the Bank;

However, in cases where the proposed product, service or solution possesses strong value propositions, the Bank would adopt an 'open' mind approach which includes granting flexibilities in complying with existing rules and regulations.

Question 1
Please provide comments on the adequacy, appropriateness and practicability of the proposed eligibility criteria.

5 Application requirements

5.1 Subject to meeting the eligibility criteria set out in paragraph 4.1, the applicant is required to submit the following to the Bank –

(a) an application letter signed by the Chief Executive Officer (CEO) or Deputy CEO of the applicant;

(b) the application form, in the format set out in Appendix I; and

(c) relevant documents to support the information provided in the application form.

5.2 The applicant must identify the potential risks to financial institutions and financial consumers that may arise from the testing of the product, service or solution in the Sandbox and propose appropriate safeguards to address the identified risks.

5.3 The safeguards referred to in paragraph 5.2 may include, but are not limited to –

(a) providing adequate disclosure of the potential risks to customers participating in the Sandbox and confirmation from such customers that they fully understand and accept the attendant risks;

(b) limiting the number of customers participating in the Sandbox and/or the aggregate value or frequency of transactions;

(c) restricting participation of retail customers to certain segment of customers;

(d) limiting the duration of the testing period;

(e) availability of consumer redress mechanism, including the possibility for financial compensation under clearly specified circumstances; and

(f) availability of adequate resources to undertake the testing, develop solutions to mitigate risks and contain the consequences of failure.

5.4 In addition to the safeguards proposed by the applicant, the Bank may impose additional safeguards as the Bank sees fit.

5.5 The applicant must include the key outcomes that the testing is intended to achieve and the appropriate indicators to measure such outcomes.

6 Minimum standards and requirements

6.1 Participants are required to fulfil the minimum standards and requirements set out in paragraph 6.3, taking into consideration the nature, size and complexity of their operations.

6.2 Participating institutions are responsible for ensuring that the fintech companies they collaborate with fulfil the minimum standards and requirements set out in paragraph 6.3.

6.3 The minimum standards and requirements are as follows -

(a) a board of directors and management consists of people with credibility, integrity and fulfil the fit and proper criteria as stipulated in Appendix II;

(b) maintain adequate oversight and control arrangements including clearly defined management and organisational structure arrangement and operational safeguards and where appropriate, obtain views of Shariah experts should the innovations relate to Islamic financial services;

(c) maintain appropriate risk management systems and processes including adequate confidentiality and security controls as well as contingency arrangements to address fraud and operational disruptions;

(d) have in place appropriate customer protection safeguards including consumer redress mechanism and adequate disclosure of potential risks to customers;

(e) has adequate financial capability to undertake the testing, mitigate and control risks as well as absorb potential losses including compensation to customers when required; and

(f) have in place adequate measures to counter the risk of money laundering and financing of terrorism.

> Question 2
>
> What are the challenges that financial institutions and fintech companies may face in meeting these minimum standards and what clarifications are required? Please comment and suggest alternative, additional or modification to the minimum standards to be applied.

6.4 Given that each testing will be different from one another, additional conditions may be imposed by the Bank on the participants taking into account risks peculiar to the respective test. This is to ensure that risks to consumers and the overall financial system are appropriately contained.

7 Testing parameters and exit strategy

7.1 The Bank will consult the participants on the details of the testing parameters such as the scope and duration of the test, regulatory flexibilities accorded, key performance indicators and frequency of reporting.

7.2 The Bank will consult the participants in developing an exit strategy should the test fail or be discontinued, and a transition plan for the deployment of the product, service or solution on a commercial scale upon successful testing and exit from the Sandbox.

8 Reporting requirements

8.1 The participants are required to submit document or any information relating to the test as and when required by the Bank, including the interim reports and final report as set out in paragraphs 8.3 to 8.6.

8.2 The participants must ensure proper maintenance of records during the testing period to support review of the test by the Bank.

Interim reports

8.3 The participants may be required to submit interim reports to the Bank on the progress of the testing which include the key performance indicators, key milestones, statistical information and key issues including fraud incidents and customer complaints arising from the testing as well as actions taken to address them.

8.4 The frequency and details of the interim reports will be agreed between the Bank and the participants taking into account the duration, complexity, scale and risks associated with the test.

Final report

8.5 The participants are required to submit the final report to the Bank within 30 calendar days of the end of the testing period. This among others is to ensure 'time-to-market' expediency. The final report should include the outcome, key performance indicators and findings of the test and an account of the list of fraud incidents and resolution of customer complaints. In the event of a failed test, the final report should include lessons learnt from the test.

8.6 The interim and final reports must be endorsed by the CEO of the participants. In a situation of joint testing by a participating fintech company and participating institution, the endorsement must be provided by participating institution's CEO.

9 Expiry and revocation of approval

9.1 Unless extended by the Bank in writing, any approval or regulatory flexibility accorded by the Bank to the participants in relation to a Sandbox shall automatically expire at the end of the agreed testing period, which will not exceed twelve (12) months.

9.2 To extend the testing period, a written application must be submitted by the participants to the Bank no later than 30 calendar days before the expiry of the testing period. The application should include additional time required, reason for the extension and action plan by the participants.

9.3 Upon the completion of the testing, the Bank will decide whether to allow the innovative solution to be introduced in the market on wider scale. Where appropriate, the Bank may amend existing regulations to facilitate this. In the event of an unsuccessful testing or where the Bank determines that the risks outweigh the benefits associated with the solution and such risks have not been effectively mitigated, the Bank may prohibit its deployment in the market.

9.4 The Bank may revoke the approval for the deployment of and participation in a Sandbox at any time before the end of the testing period if the participant -

(a) fails to comply with the minimum standards and requirements set out in paragraph 6.3 and additional conditions imposed by the Bank;

(b) submits a false, misleading or inaccurate information, or has concealed or failed to disclose material facts regarding its company or the testing;

(c) contravenes any provision of the law or regulation;

(d) undergoes or has gone into liquidation;

(e) breaches data security and confidential requirements;

(f) carries on its business in a manner detrimental to customers or the public at large; or

(g) any technical defect, flaw, vulnerability in the product which gives rise to a persistent level of service disruptions or fraud incidents.

9.5 Before revoking an approval to participate in Sandbox, the Bank shall –

(a) give the participants 30 days' notice in writing of its intention to do so; and

(b) require the participants to show cause why the approval should not be revoked within such time as may be specified in the notice.

9.6 Upon revocation of an approval, the participants must –

(a) immediately cease to supply the financial services to new and existing customers;

(b) provide notification to customers informing them of their rights;

(c) compensate any customers who had suffer financial losses during the testing period in accordance with the approved safeguards submitted by the participants under paragraph 5.3(e) above; and

(d) submit report to the Bank on the outcome of paragraphs 9.5(a) - (c) within 30 days after revocation.

APPENDICES

APPENDIX I: Application form *(fill up where applicable)*

A. Contact details	
Applicant 1: Fintech company	
Name of company	
SSM registration number	
Website URL	
Name designated officer[2] (e.g. CEO)	
Email address	
Phone number	
Mailing address	
Shareholders	
Describe the nature and scale of your operations in Malaysia	*(Please keep the response below 200 words)*
How many technology-related jobs did your company create in Malaysia? Please provide number and description	
Applicant 2: Financial institution	
Name of FI	
Name designated officer (e.g. Head of Innovation)	
Email address	
Phone number	
Mailing address	

[2] Please include the curriculum vitae of the designated officer

B. About the product, service or solution	
Name of product, service or solution	
Type of product, service or solution	
Describe the product, service or solution	*(Please keep the response below 200 words. Additional information may be provided as supporting documents)*
Explain how the product, service or solution is innovative	*(Please keep the response below 200 words. Additional information may be provided as supporting documents)*
Describe how the viability of the product, service or solution has been assessed and/or tested	*(Please keep the response below 200 words. Additional information may be provided as supporting documents)*
State the Bank's regulations or policy that prohibit or restrict the provision of the product, service or solution	
Explain how the product or service: i. Contributes to development of financial sector; or ii. Enhance financial institution's efficiency or risk management or controls; or iii. Significantly benefit the consumers at large	*(Please keep the response below 200 words. Additional information may be provided as supporting documents)*
Demonstrate that the product, service or solution is ready to be tested in a live environment through the sandbox	*(Please keep the response below 200 words. Additional information may be provided as supporting documents)*
Explain the source of funding for the testing	

Explain the expected duration of the test	
State the location where the IT infrastructure resides	
Explain the plan for the product, service or solution to be offered on wider commercial scale	*(Please keep the response below 200 words. Additional information may be provided as supporting documents)*
Describe and explain the regulatory flexibility needed to undertake the test	*(Please keep the response below 200 words. Additional information may be provided as supporting documents)*
Describe the risks associated with the testing, and identify approriate risk mitigation measures	*(Please keep the response below 200 words. Additional information may be provided as supporting documents)*
Any other information that may support the application	

C. Details of the collaboration between financial institution and fintech company	
Overview of the collaboration between financial institution and fintech company	*(Please keep the response below 200 words. Additional information may be provided as supporting documents)*
Details on the nature and arrangement of the collaboration (e.g. outsourcing of service, equity stake participation, joint venture etc.)	*(Please keep the response below 200 words. Additional information may be provided as supporting documents)*

APPENDIX II: Fit and Proper Criteria

The following criteria should be taken into consideration in determining if an individual is ‘fit and proper’ to hold position of director or management:

a) His probity, diligence, competence and soundness of judgement;
b) His reputation, character, integrity and honesty;
c) His history of offence(s) involving fraud, dishonesty and violence;
d) Whether he had engaged in deceitful, oppressive or improper business practices which would discredit him;
e) Whether he had engaged, associated or conducted himself in a manner which may cast doubt on his fitness, competence and soundness of judgement;
f) Whether he had contravened any provision made by or under any written law appearing to the Bank to be designed for protection members of the public against financial loss due to dishonesty, incompetence or malpractice; and
g) Whether he has been declared a bankrupt.

The Bank may specify other criteria as and when necessary.