

## Regulatory Sandbox Framework

### Introduction – The Need to Have a Regulatory Sandbox

The pace of change in the financial services industry has been accelerating because of the technological advances that have caused paradigm shifts in the sector. The global Financial Technology (FinTech) industry attracted over US\$ 22 billion investment in 2015 and it is growing exponentially. A number of tech startups have successfully challenged large incumbent financial institutions in various segments of their business, disrupting business models and taking market share. Regulators have cautiously welcomed this trend but have expressed concern regarding the reliability of the various technologies as well as the financial soundness of the FinTech companies.

A Regulatory Sandbox (Sandbox) is a framework and process that facilitates the development of the FinTech industry in a calculated way. It is defined as “a safe space in which businesses can test innovative products, services, business models and delivery mechanisms without immediately incurring all the normal regulatory and financial consequences of engaging in the activity in question.” Financial products/services based on new technologies, or new permutations of existing technologies, can be tested in the Sandbox without the burden of heavy regulations and licensing. Those that are successful (i.e. that meet the predefined experimentation criteria to the satisfaction of the regulator) can apply for the relevant license subsequently while others have to leave the Sandbox after a defined time period. This allows both existing licensed financial institutions and newcomers to the market to experiment with innovative financial services for a specified period of time in an environment where actual products and services are rendered to customers, but where the risks to said customers and to the local financial system as a whole are clearly defined and mitigated.

Bahrain is an established financial sector hub in the GCC / Middle East region. It is positioning itself to be the FinTech hub of the region as well, including Shari’ah compliant FinTech solutions. The CBB has made a conscious decision to initiate a Regulatory Sandbox in order to promote effective competition, embrace new technology, encourage financial inclusion and improve customer experience. This is being done in a manner that ensures continuation of CBB policy safeguards on consumer protection, anti-money laundering and level playing field to all market players.

### Key Features of the Regulatory Sandbox

- The Sandbox will be a virtual space for both CBB-licensed financial institutions and other firms to test their technology-based innovative solutions.
- The Sandbox will be open to existing solutions that have been already technically tested in a lab environment, as well as ideas yet to be developed and tested.

- The Sandbox application process will be open to both existing CBB licensees (financial institutions with FinTech initiatives) and other companies (local + foreign). The latter may include financial sector companies as well as technology and telecom companies intending to test an innovative product or service, professional service firms which partner with or service financial institutions, or any other type of applicant working within the financial services industry deemed acceptable by the CBB.
- The testing of a product or service may be limited in terms of the number of volunteer customers and/or the amount (to be decided by the CBB on a case by base basis). The Applicant's or participating bank's staff can also be engaged as volunteer customers. The duration of the Sandbox is 9 months with a maximum extension of three months.
- It must be emphasized that the Sandbox is not intended to be a means to avoid the legal and regulatory requirements already in place.

### Eligibility Criteria

- The Sandbox's eligibility criteria includes the following:
  - **Innovation:** The solution should be truly innovative or significantly different from existing offerings, or offer a new use for existing technologies, as evidenced by market research showing that there are few or no comparable offerings in the Bahrain market, and a comparison of the key features of the Applicant's technology or operating methodology against competitors.
  - **Customer benefit:** The solution should offer identifiable direct or indirect benefits to customers (e.g. customer research showing improved security, customer experience, efficiency, quality of product, lower prices, a combination of any of the above, etc.) These should be supported with quantifiable estimations or demonstrations where possible.
  - **Technical Testing for existing Solutions:** In case of existing solutions, results of the technical testing should be made available to the CBB, alternatively, an independent external validation from a reputed third party of the technical soundness of the solution should be obtained.
- The Applicant must demonstrate eligibility to the satisfaction of the CBB by showing clear evidence as outlined above or in any other applicable way acceptable to the CBB.

- **Readiness for regulatory testing:** The Applicant must show well-developed regulatory testing plans and sufficient safeguards to protect customers. Key risks of the solution and how they can be mitigated must be separately highlighted. The Applicant will be required to report on the test progress, on achieved milestones, and likelihood of achieving target outcomes to the CBB on a pre-agreed schedule, followed by a final report within one month of completion of the test. To the extent possible, the reporting format will be kept simple and concise.
- **Deployment post-testing:** The Applicant has the intention and ability to deploy the proposed solution in Bahrain. The Applicant must share a proposed Sandbox exit strategy (including plans for scale-up and deployment).
- To clarify, the Sandbox may not be suitable in cases such as the following:
  - The FinTech solution is assessed by the CBB to be similar to those already offered in Bahrain;
  - The Applicant fails to satisfy the CBB that it has done sufficient due diligence and technical testing of the proposed solution in a lab environment or has obtained external third party validation for the solution;
  - The Applicant has no intention to deploy the solution in Bahrain on a broader scale after exiting the Sandbox.

### **Filing Requirements**

1. A brief description of the Applicant organization, including its financial standing, technical and business domain expertise.
2. A brief description of the financial service to be experimented on in the Sandbox.
3. A description of how the Applicant has met the Eligibility Criteria described above, with supporting evidence.
4. A disclosure of the boundary conditions for the Sandbox such as start and end dates, target customer types, customer limits, transaction thresholds, cash holding limits, and so on.
5. An assessment of the Applicant's readiness for testing which shall include customer safeguards and testing plans as described above. Test scenarios should include a quantification of the maximum potential direct and indirect losses and impact of the experiment.

6. A description of the volunteer customer communications plan which shall include risk disclosures and material information about the company and the Sandbox.
7. A description of the targets and key performance indicators which will be used to determine the success of the experiment.
8. A description of cyber security and other relevant measures taken by the Applicant to ensure maintaining safety of the solution.
9. A description of any third party outsourcing arrangement including the due diligence conducted by the Applicant on the third party to ensure cyber security.
10. An assessment of the exit plan, scale-up and deployment strategy, along with an assessment of the timeline and gaps if any in meeting any heightened legal and regulatory requirements after exiting the Sandbox.

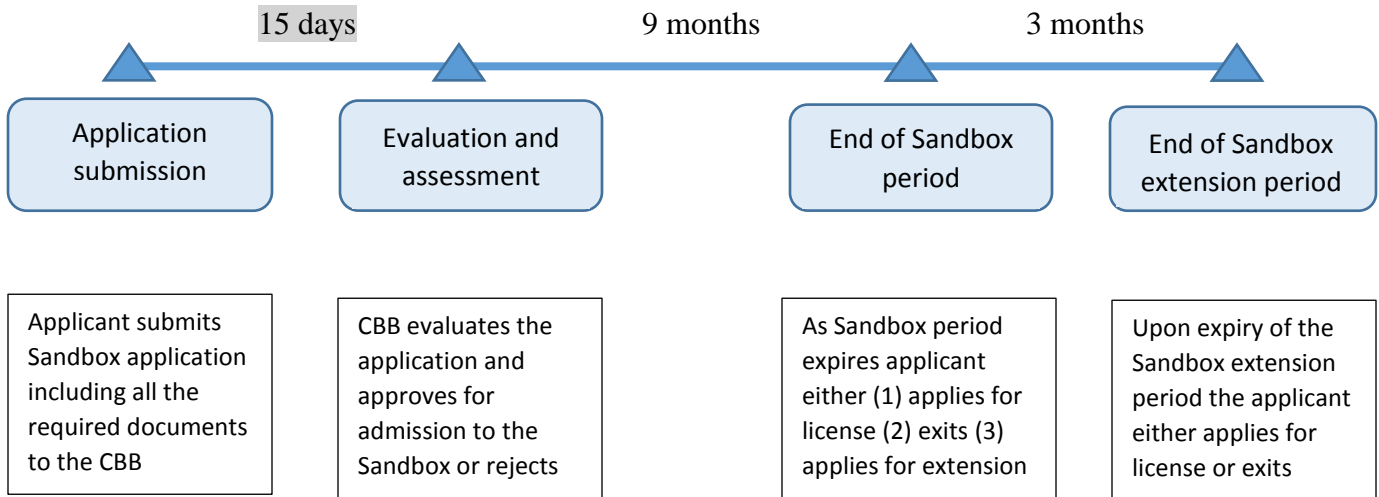
A standard template will be available to potential Applicants for submission of the above information.

### **Application and Approval Process**

- The CBB shall endeavor to respond within 15 days to the Applicant, with this 15 days period commencing after the submission of all required documents and information by the firm or individual Applicant.
- The CBB will consider relaxing certain legal and regulatory requirements while maintaining others. Depending on the case of the Applicant, the CBB will determine which requirements will be relaxed and to what extent.
- The Applicants must adhere to the relevant CBB regulations on confidentiality of customer information, Know Your Customer (KYC), Anti Money Laundering (AML) and Countering Financing of Terrorism (CFT) at all times.
- The Applicants will follow measures designed to provide appropriate levels of disclosure and risk mitigation to their volunteer customers as described in their filing requirements and as approved by the CBB.
- The Sandbox entry application fee for an Applicant is BD 100.

- CBB may ask a firm for an early exit from the Sandbox if it determines that the intended test outcome as per the filing requirement plan has not been and is unlikely to be achieved and the progress is unsatisfactory, or a critical flaw (i.e. a flaw that causes the risk to customers or the financial system to outweigh any benefits of the service, as determined by the CBB) has been discovered in its product/service that cannot be resolved during the Sandbox period.
- The CBB may also terminate the Sandbox trial upon discovery of any material breach of the conditions on which the Sandbox application was approved.
- The Applicant may choose to discontinue the Sandbox trial at any time during the Sandbox period after giving one month notice to the CBB.
- The Applicant can apply for a maximum extension of up to three months as the 9-month Sandbox period comes to an end. The Applicant must be able to present a persuasive case for why it needs the extension. Such extension will be granted on a case by case basis.
- During the Sandbox period, the Applicant may apply to change filing requirements and the Sandbox terms and conditions. Such an application should provide details of the changes with reasons and supporting evidence. CBB approval will be required before changes may be implemented.
- After exiting the Sandbox, the Applicant can apply for the relevant license as per the CBB rules.
- The CBB shall assign a point person to each of the Applicants. Similarly, each Applicant shall assign a contact person to coordinate with the CBB.

## Regulatory Sandbox Timeline



## Miscellaneous

- Applicants will entrust CBB-licensed retail banks with any handling of customers' moneys and/or assets through escrow account arrangement.
- Applicants will follow appropriate disclosure, protection and compensation requirements related to their customers. In case of any losses during the Sandbox period (including investment losses) to the volunteer customers the Applicant will compensate them and must demonstrate that they have the resources to do so.
- Applicants must communicate the key risks to the volunteer customers who agree to participate in the regulatory testing during the Sandbox period, and obtain confirmation from them that they fully understand and accept these risks. The communication should be clear and in writing, informing the volunteer customers of the objective of the testing and what is expected of them. It should also inform the volunteer customers of the compensation they should expect to receive in case they suffer a monetary loss (for no fault of their own) during the regulatory testing.
- The Intellectual Property (IP) rights of the technology / service developed by the Applicant before or during the Sandbox period belong to the Applicant. Also, Applicants must not violate other people's/firms' IP rights.
- Any cases of disputes between the Applicant and their volunteer customers or other companies during the Sandbox period should be covered within the bilateral contract / understanding between the two parties.
- CBB reserves the right to publish relevant summary information about successful Applicants on its website or any other public information channel.
- Applicants must respect the related CBB regulations about customer data confidentiality. In particular, any volunteer customer data used for regulatory testing must not be used for any other purpose during or after the Sandbox period.

- Successful Applicants must submit fortnightly progress reports to the CBB, signed by the senior management, according to a pre-designed template (to be provide later). Such periodic reports should also include operational incidents and steps taken to address the same.
- CBB reserves the right to accept two Applicants offering the same / similar service or solution.
- CBB may receive the volunteer customers' complaints about the Applicants' service / solution. However, the CBB will not provide any formal redressal mechanism, neither will it interfere in any legal action.
- If the CBB terminates the Sandbox period for an Applicant before the expiry of the 9-month term, the Applicant has a right to appeal to the CBB if it is not satisfied with the decision. The CBB appeal committee will look into such cases.
- The Applicant shall fulfill its existing obligations towards its volunteer customers and/or other parties in case of early termination of the Sandbox period by the CBB or by the Applicant itself.
- If more than one FinTech firms are jointly involved in an innovative project they may apply jointly for the Sandbox or with one firm taking the lead.