



Regulating for innovation

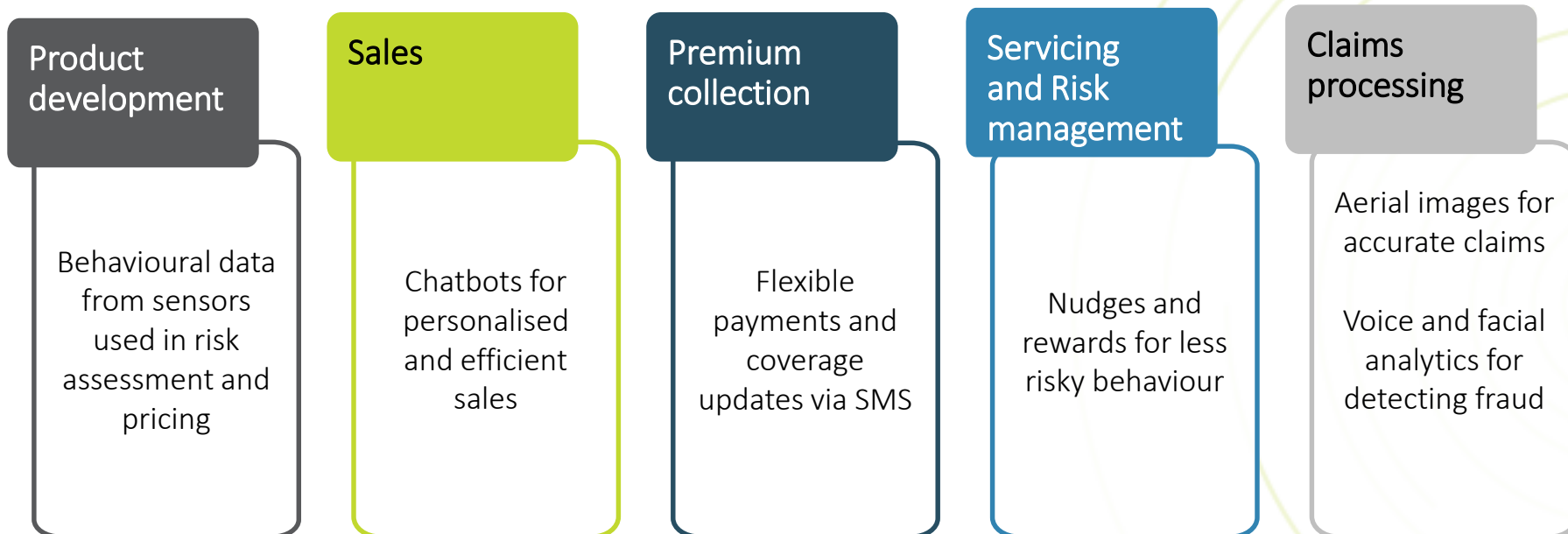
How to encourage responsible
market innovation?

23 October 2017



Innovation is changing the way
financial services are delivered in the
emerging world

Smart solutions across the insurance product cycle...



...and new models that challenge the very foundation of insurance

What is insurance?

P2P models without a licensed risk carrier

What can I regulate?

Models operating outside national jurisdiction
Use of cryptocurrency

Who is an intermediary?

New players that don't fit in traditional broker or agent categories
Robo advice and black box algorithms



teambrella



Supporting innovation is an opportunity for regulators to encourage market development, but with it comes new consumer protection and systemic risks



The concept of a regulatory sandbox is developed as a regulatory approach to creating a safe space to help regulators to tread this delicate balance. Enabling innovative ventures but limiting the size and scope of the risk to enter the market.

What is a sandbox?

- Sandboxes:
 - Explicit and transparent entry criteria for applicants
 - Each sandbox venture assessed individually with tailored safeguards implemented
- Test and Learn applies the same underlying principle.
 - Sandboxes tend to be more explicit, transparent and accessible to all potential applicants. Most test and learn models rely on the provider approaching the regulator unprompted.

The principle of a sandbox can take many different forms. In practice, no two sandboxes are the same

How does sandboxing fit within an inclusive insurance approach?

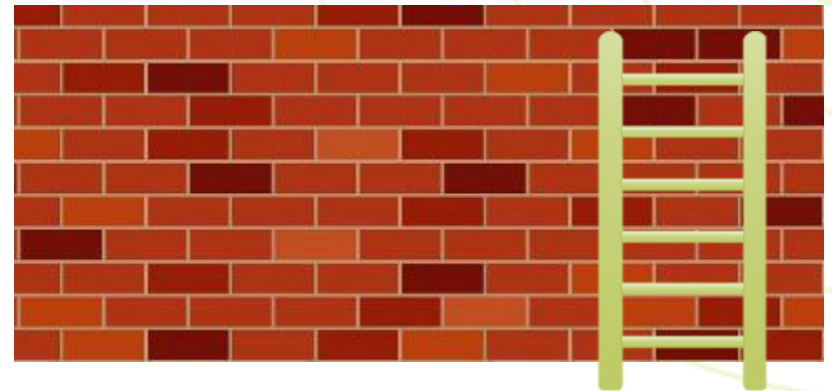
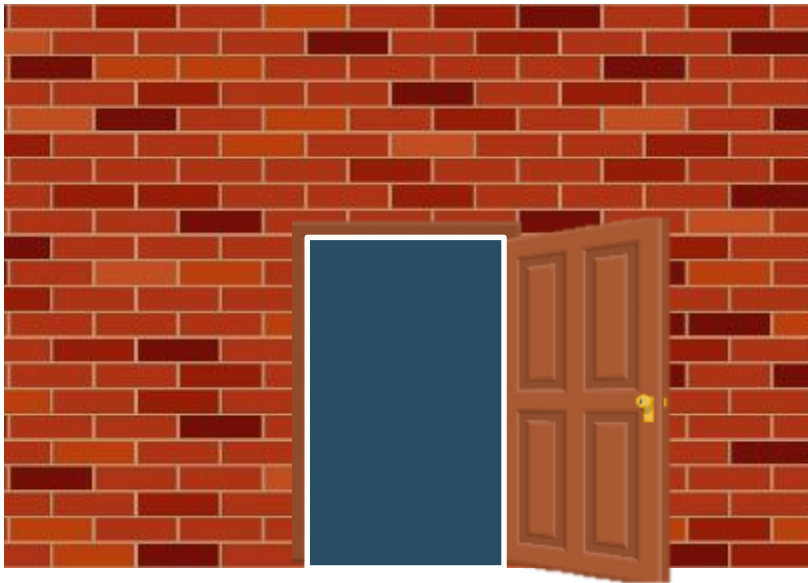
Sandbox:

- Temporary measures to allow innovations to be tested
- Learnings can inform amendment of regulatory framework as/if appropriate



Proportionality:

- Risk-based reduction of undue barriers
- Can enable entry point and graduation path for new, innovative firms



Implementing a sandbox: Tools available

- Regardless of exact form or what it is called, broadly, two categories of implementation tools exist:
 - Explicitly reduce regulatory barriers for innovators with **temporary bespoke regulatory treatment**
 - Implicitly reduce regulatory barriers with **communication and support tools**

Unpacking the sandbox implementation tools: Temporary bespoke regulatory treatment

Temporary bespoke regulatory tools:

- Restricted authorisation/reduced licensing requirements
- Waivers or exemptions
- No enforcement action letter/letter of no objection
- Active engagement with providers, other regulatory authorities, flexibility
- Appropriate safeguards

Examples:

- BNM Malaysia, CMA Kenya, IPEC Zimbabwe, UCC Uganda, FCA UK, NIC Ghana, TIRA Tanzania

Unpacking the sandbox implementation tools: Communication/ Support

Communication/ Support tools:

- Advice unit
- Innovation hub
- Innovation accelerator, industry/data sandbox
- Incubators
- Innovation workshops

Examples:

- Australia, France, Hong Kong, Japan, Korea and UK

When is a sandbox appropriate and what are the critical design considerations?

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graph TD; Q1[1. Regulator has the mandate to support innovation?] --> Q2[2. Is there a mindset/willingness to embrace and encourage innovation?]; Q2 --> Q3[3. Can this innovation be dealt with in the existing framework?]; Q3 --> Q4[4. If not accommodated, is there room for discretion?]; Q4 --> Q5[If yes, can consider tools for regulating/supporting innovation]; Q5 --> Q3; Q5 -.-> Q1; Q5 -.-> Q2; Q5 -.-> Q4; Q5 -.-> Q5; Q5 -.-> Q6[Combination of Temporary bespoke reg. treatment and Communication/support]; Q6 --> Q5;
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1. Regulator has the mandate to support innovation?

2. Is there a mindset/willingness to embrace and encourage innovation?

3. Can this innovation be dealt with in the existing framework?

4. If not accommodated, is there room for discretion?

If yes, can consider tools for regulating/supporting innovation

Combination of Temporary bespoke reg. treatment and Communication/support

Critical considerations in applying innovation support tools

Coordination



- Innovations often cut across authorities
- Options to address
 - MOUs
 - Inter-governmental committees
 - Be limited to products that fall within single regulator's mandate

Capacity



- Required for monitoring, advice, understanding risks
- Determines which tools can be implemented and how extensively
- To address:
 - Recruit and train for skills appropriate to the changing nature of the sector.

Regulatory barriers faced by providers in the market



- The tools implemented need to address the actual challenges faced by innovators in the market.
- To address:
 - Consultation with market players to understand primary challenges faced

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- The principle of creating a safe space to test, and most importantly, learn from new innovation is appropriate for developing country financial regulators to consider.
 - However, the nature and design of this approach will differ according to context and market realities.



- Whether to implement a sandbox or what is and is not a sandbox



- Going through the decision path in a deliberate way, being clear about the objectives, considerations and reality checks
- View approach to innovation in light of overall approach to market development

For FSDs

- Consider the decision path and whether regulators are in a position to consider implementing any type of sandbox
- When advising regulators, give clear consideration to the local context and what type of sandbox tools may be feasible and appropriate within a local context.
- Capacity building of regulators and assisting coordination
- Some of the non-regulatory sandbox tools may be supported or offered directly by entities other than the regulator
- Understanding the primary barriers faced by innovators in the market is critical to designing an effective approach

Annex: Case studies



UK: Financial Conduct Authority (FCA) sandbox

- Supports FCA's mandate – improve competition
- Cohorts open to all firms (authorised/unauthorised)
- Tools applied only If required/FCA allowed discretion
- Tests: limited duration/# of customers
- Monitoring via regular reporting

Eligibility criteria:

- ✓ Intended for UK market
- ✓ Genuine innovation
- ✓ Consumer benefit
- ✓ Need for a sandbox
- ✓ Ready for testing

Available tools:

- ✓ Restricted authorisation
- ✓ Individual guidance
- ✓ Waivers
- ✓ No enforcement action letters

Malaysia: Bank Negara (BNM) sandbox

- Set up to encourage financial sector development, fintechs
- Ongoing applications (not structured in cohorts yet)
- Tests: size/# of transactions and # of customers limited; mandatory disclosure to customers
- Can only waive/exempt regs administered by BNM

Eligibility criteria:

- ✓ Genuinely innovative, potential to improve:
 - ✓ Fin service provision
 - ✓ Risk management of fin institutions
 - ✓ Financing/investments in Malaysian economy
- ✓ Usefulness/functionality assessed/tested
- ✓ Resources to support sandbox testing
- ✓ Business plan for widening commercial scale
- ✓ “Incompatible” legal/reg requirements, required regulatory flexibilities identified

Available tools:

- ✓ Sandbox firms exempt from licence requirements
- ✓ Cannot waive/exempt regulations not administered by BNM

Kenya: Capital Markets Authority (CMA) planned sandbox

- For firms testing capital markets-based fintech innovations
- Limited tests/limits on value/clients
- Options for sandbox:
 - Create new sandbox regime – new authorisation requirements/rules
 - Amend sections of Capital Markets Act – CMA to issue limited waivers
 - Both require Policy Guidance Note (PGN) to facilitate sandbox's introduction

Proposed criteria:

- ✓ In scope – regulated by CMA
- ✓ Genuine innovation
- ✓ Consumer benefit
- ✓ Need for a sandbox

Kenya: IRA Test & learn

- Test & learn approach: allow piloting within certain thresholds
 - E.g. for index insurance, m-insurance
 - Accommodated via the product approval process
- Coordination with other relevant authorities via technical committee, initial discussions before pilot launch
- Pilots are required to submit data quarterly
- No limit on length of pilots, but monitoring required for 3 years regardless
- Pilots to date with existing players, considering sandbox to encourage startups
- Pending MI regulations encompass pilot learning

Ghana: National Insurance Commission (NIC) Test & Learn

- *“The inclusive insurance challenge is inherently an innovation challenge”*
 - Kofi Andoh
- Mandate: implicit, has allowed most innovations encountered to be accommodated
- Discretion: principles-based legislation provides sufficient scope for discretion
- Open door policy, rather than proactively seeking out innovators
- “Accommodation” approach: sitting down with players, thinking what can go wrong, devising monitoring structure
 - Allowed for development of m-insurance
- Tools:
 - Discretion to tailor product approval/review process
 - Letters of no objection, used e.g. for intermediaries not fitting in existing categories