Chapter 5
Regulating FinTech Through Sandboxes:
Entering the UK and Malaysian Regulatory Sandbox

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ABSTRACT

Fintech emergence post-Global Financial Crisis puts a threat to the banking industry. One of the strategies for the banks to stay afloat and relevant in the current digital era is through regulatory sandbox. A regulatory sandbox is one of the tools opted by financial regulators in certain jurisdictions to regulate the rapid growth of fintech products within their financial sphere. The pioneer of which was the UK's market and conduct regulator, the Financial Conduct Authority (FCA). Bank Negara Malaysia (BNM) was also one of the first jurisdictions that followed suit. One of the basic structures in a sandbox is the eligibility criteria that the regulators draw for the financial service provider to participate in the sandbox. This chapter shall address the entry requirements in both jurisdictions as the structure of the regulatory sandboxes differs from one jurisdiction to another. This topic is crucial to the banks as they need to understand further how regulatory sandbox may help them offer innovative financial products to level the competition with the fintech players in the market.

INTRODUCTION

Financial regulation rests on the basis that financial regulators are mandated to regulate to ensure financial stability and provide adequate customer protection. The landscape of financial regulation has changed its course since the Global Financial Crisis (GFC) happened in 2007. Numerous reasons were cited (Arner, 2009), however, the main reason was due to a proliferation of financial innovations that

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were unsupervised and coupled with de-regulation incentives. Thus, post-GFC, the financial regulators around the world are more cautious in dealing with financial innovations. The latest financial innovation that caught the regulators' eye is the emergence of fintech in the financial industry. Fintech is a combination of the words between finance and technology whereby the financial services provider leverage on technology to provide products that are cost-effective to the financial consumers. Although the relationship between finance and technology have been established since the 19th century during the introduction of pantelegraph and telegraph, (Arner, Barberis, & Buckley, 2016), it is only recently the financial industry has accepted the usage of the term fintech.

The emergence of fintech brings a challenge to the financial industry, especially in the banking sector. The financial markets have evolved to accommodate the growing demands of fintech products. At a glance, the fintech products have more advantage than the traditional banking industry on several points. Fintech products leverage technology; hence the products are more efficient and convenient especially in providing banking services to unbanked or underbanked financial consumers (Ajlouni & Al-Hakim, 2018). This is further supported by the survey conducted in 2019 stating that there was significant growth in the adoption of fintech by the consumers in the financial market especially in the payments and remittance sector (Young, 2019). Hence, fintech players are a definite contender for the traditional banking system (Ajlouni & Al-Hakim, 2018) post GFC. In responding to the threat that fintech has against the banking sector, the banks need to explore opportunities offered in the fintech scene. One of the strategies that the banking sector has already applied in widening its horizon in this current digital era is, by partnering with fintech players in offering innovative products to the financial consumers. Thus, such collaboration between the banks and fintech players (Juengerkes, 2016) offering innovative financial products may fall under the category of fintech as well.

Not only fintech disrupts the banking industry but it has also added a new regulatory burden towards regulators around the world. The regulators are now expected to regulate without hampering innovation. (Board, 2017) In effect, this means the regulators will not only need to ensure financial stability and provide adequate customer protection but nowadays the regulators are burdened with another mandate of promoting innovation. As fintech exponentially increases in meeting the demands in the market, there is a need to regulate them to ensure financial stability. Therefore, for the regulators to discharge its' duties in regulating this new type of financial innovation, the regulators turned to regulatory sandboxes. Similar to children's sandbox, regulatory sandbox creates a perimeter between the regulators, financial service providers and financial consumers to test. It is a pilot program where the regulators may supervise the financial service providers in a more relaxed environment of reduced regulations to serve the best innovative financial products to the consumers before the fintech products are released to the markets.

Regulatory sandboxes had been the talk of the town between international financial regulators since its inception in the United Kingdom's ('UK') financial sphere back in 2016. The primary purpose of a regulatory sandbox is for the regulators to supervise in an informative manner (Financial Conduct Authority, 2015) to ensure that it balances its' burden to regulate while promoting innovation. Others may argue that the original structure of regulatory sandbox originated from the United States' ('US') Consumer Financial Protection Bureau ('CFPB') under its Project Catalyst, where CFPB provided a friendly environment for the financial players to have a communicative relationship with the regulators (Bureau, 2016). Nevertheless, the structure of the regulatory sandbox initiated by the UK's market conduct regulator, Financial Conduct Authority ('FCA') is the one that the financial regulators from other jurisdictions are considering transplanting to their regulatory frameworks. At the time of writing, about 50 jurisdictions are adopting regulatory sandbox into their financial regulation and these numbers