



Briefing

FinTech



Building innovation in the sandbox

Back in November 2015, [the FCA announced its ambitious plan to launch a 'regulatory sandbox'](#). Now, after months of engaging with interested parties and seeking input from the market, the FCA has announced its launch date. On 9 May 2016, 6 months after the initial plan, the FCA opened the sandbox to applications from firms seeking to test their innovative ideas within the sandbox.

What is the sandbox?

The sandbox forms part of the FCA's 'Project Innovate' which was set up to encourage competition and growth in financial services. The FCA wants to directly address industry concern about increasing financial regulation and its effect on innovation in the market.

The sandbox is therefore part of a versatile approach to tackle this problem - it is designed to increase freedom within the industry to develop new solutions to financial services without compromising consumer protection.

Who can apply and when?

The sandbox is a new approach to regulation that will support unauthorised businesses, authorised businesses and technology businesses supporting financial services. Though firms looking for a banking licence will not be eligible for the Sandbox and will need to apply to the [FCA and PRA new bank start-up](#) unit instead.

The Sandbox will initially be run using a cohort approach. The FCA will start by running two cohorts a year to allow them to learn and perfect the sandbox programme, with the deadline for applications to the first cohort being 8 July 2016 and acceptance into the Sandbox expected by mid-August. The second cohort applications are expected to be accepted from November 2016 to mid-January 2017.

Firms looking to apply for the Sandbox must meet the FCA's eligibility criteria and satisfy the following key questions:

- Is the firm looking to deliver innovation which is either regulated business or supports regulated business in the UK financial services market?
- Is the innovation ground-breaking or constitutes a significantly different offering in the marketplace?
- Does the innovation offer a good prospect of identifiable benefit to consumers (either directly or via heightened competition)?
- Does the business have a genuine need to test the innovation on real customers and in the FCA sandbox?

- Is the business ready to test their innovation in a live environment?

Since there will only be a limited number of places in each cohort, the FCA anticipates there will be healthy competition to submit the best plans for testing. Further details on the eligibility criteria can be found on the [FCA website](#).

How does it work?

The sandbox will enable firms authorised by the FCA to test their ideas within the restrictions imposed by the sandbox. The intention is that this will reduce the time and cost involved in the initial business development.

Understandably authorisation for sandbox testing will come with restrictions, for example, on the duration of the authorisation and the number of customers the firm is permitted. Details on the default standards for sandbox testing can be found on the [FCA website](#).

Once the firm has completed its testing, it will be expected to provide a final report to the FCA within four weeks. The FCA will then provide written feedback on the firm's report, but it will not certify or "kitemark" business models – this is something that many firms have been interested in, but the FCA has repeatedly ruled this out in light of its statutory objective to facilitate competition. Subject to considerations on confidentiality, the FCA will also try to publish its findings and on testing in the Sandbox.

Following completion of testing and the FCA's feedback, if the firm wishes to launch the product into the market, the usual authorisations for carrying out the relevant activity will apply.

How will the FCA permit firms operate within the sandbox?

Since the sandbox is a novel concept, the FCA appreciates that there will be some initial uncertainty around applying the rules to innovative businesses and their testing. It has therefore identified the following three mechanisms, depending on firm type, in which it can help sandbox firms within the strict UK and EU framework around financial services.

Unauthorised firms that are accepted into the Sandbox will be granted restricted authorisation that only allows them to test their ideas.

Authorised firms accepted into the Sandbox, and already subject to UK and EU financial services legislation, will be assisted by the FCA issuing:

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- **Individual Guidance:** the FCA will issue individual guidance to a sandbox firm on how it will interpret the rules to their testing. Compliance with the FCA's guidance, will be treated as compliance with the rules.
- **Waivers:** where certain rules have become unduly burdensome, the FCA has the power to waive or modify them for that firm (excepting rules imposed by EU law or primary legislation).
- **No Enforcement Letter:** in rare cases where individual guidance or waivers do not help, the FCA can issue 'no enforcement letters' by which, provided the firm continues to meet certain conditions, no disciplinary action will be taken against them.

The FCA understands that support is required for technology businesses that support financial services and where these businesses are providing innovative technologies that may stray within the regulated perimeter. These firms can take part in the Sandbox if they require further clarity on applicable rules before testing.

What next?

The sandbox is at the start of a process by which it will continuously evolve to encourage the growth and development of UK financial services whilst continuing to protect the consumer.

We welcome the FCA's ambition and efforts to improve financial services and will continue to engage with the FCA on this and its other initiatives supporting the industry, such as its current RegTech initiative.

We will continue to monitor the sandbox as it develops, but if you have any questions regarding anything raised in this article, please do get in touch.

Contact:



Adrian Shedden
Senior Associate

+44 (0) 117 307 6813
adrian.shedden@burges-salmon.com



Alex Gillespie
Trainee Solicitor

+44 (0) 117 307 6846
alex.gillespie@burges-salmon.com

Burges Salmon LLP, One Glass Wharf, Bristol BS2 0ZX Tel: +44 (0) 117 939 2000 Fax: +44 (0) 117 902 4400
6 New Street Square, London EC4A 3BF Tel: +44 (0) 20 7685 1200 Fax: +44 (0) 20 7980 4966

www.burges-salmon.com

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