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TECHNOLOGY, MEDIA & TELECOMMUNICATIONS ALERT

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Bridging the gap between fintech innovation and regulation: Is a local regulatory sandbox the answer?

The Intergovernmental Fintech Working Group released its first Fintech Landscaping Report on 22 January 2020, which analysed the South African fintech market to support policymakers tasked with regulating this fast-changing local field.

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The Intergovernmental Fintech Working Group (IFWG) released its first Fintech Landscaping Report on 22 January 2020, which analysed the South African fintech market to support policymakers tasked with regulating this fast-changing local field.

The IFWG describes fintech as *"technology-enabled financial innovation which can lead to new business models, applications, processes and products, [and is] transforming the financial services sector globally"*. It adds that *"Fintech has the potential to reduce costs and frictions, increase efficiency and competition, narrow information asymmetry, as well as broaden access and be an enabler for financial inclusion"*.

Based on the research contained in the report, the IFWG, which comprises stakeholders such as National Treasury, the South African Reserve Bank, the Financial Intelligence Centre and the Financial Sector

Conduct Authority, announced its intention to launch an online portal consisting of a fintech innovation hub in 2020, which will *inter alia* include a regulatory sandbox.

A regulatory sandbox can be described as a semi-controlled testing environment similar to the clinical trials available in the healthcare and pharmaceutical industries. While the approach in South Africa is yet to be announced, it generally functions by allowing companies to test fintech products in a *"live"* environment whilst offering temporary regulatory relief by exempting a company from compliance for a limited time and subject to certain conditions and safeguards, while still operating under the supervision of regulators.

These conditions may include a limit on the number of customers and the funds the company may work with. Once this trial period ends, the company can typically apply for the relevant licences and consents to carry on business or may cease their operation, *inter alia* if they will not be able to meet the regulatory requirements. Fintech companies can therefore trial their products and services and also test whether their offerings will be compliant without running the risk of severe penalties.

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Fintech companies should also note that a regulatory sandbox is not intended to be a “free pass” to avoid regulatory compliance but rather a testing ground to assess compliance.

The existing legislative framework for financial services, both in South Africa and abroad, predates the ascent of fintech in many respects. Compliance with this legislative framework can be challenging for fintech companies with operating models which differ considerably from those envisioned in the existing legislation. The rapid pace at which fintech companies innovate and grow can also be stunted by the need to adhere to outdated legislation.

A regulatory sandbox may also benefit the regulators responsible for overseeing the fintech industry by allowing the regulators an opportunity to receive meaningful input from fintech companies. It facilitates the regulators’ job to ensure that the regulatory landscape is sufficiently robust and appropriate to, on the one hand, achieve the relevant regulatory purposes and adequately protect consumers in the industry, whilst on the other hand not stifling innovation.

The intention behind a regulatory sandbox is to bridge the gap between regulation and innovation and notably over 30 countries including the United Kingdom, Kenya, Mauritius, Russia, Australia, Malaysia, the United States and Mexico have introduced their own versions.

However, the concept is not without its risks and care must be taken to ensure that the pursuit of innovation does not compromise consumer and other rights. The model should be transparent and

ensure that consumers are well informed of *inter alia*: the product or service operating within a regulatory sandbox; which exemptions apply to the company and what the consequences for its non-compliance are, while at the same time ensuring that fintech companies are not exempted to the extent that consumer rights are adversely compromised.

Fintech companies should also note that a regulatory sandbox is not intended to be a “free pass” to avoid regulatory compliance but rather a testing ground to assess compliance. The tendency by certain fintech companies to use their participation in a regulatory sandbox as a marketing tool for potential investors has also been criticised by global stakeholders as a misguided use of the model.

A regulatory sandbox in South Africa could therefore provide a safe, controlled environment for fintech companies to develop and innovate their products and test regulatory compliance alongside each other and may even pave the regulatory way for other rapidly evolving industries such as the energy and healthcare sectors. The key lies in ensuring that the balance between promoting innovation and consumer rights is maintained, and that both fintech companies and consumers benefit equally from the model.

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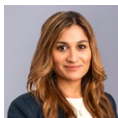
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