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The FCA announces the second cohort for its regulatory sandbox

The UK's Financial Conduct Authority ('FCA') has now announced the participants in the second cohort of its regulatory sandbox, with the companies involved offering a range of ideas-based payment services and artificial intelligence software. Tim Wright, Partner at Pillsbury LLP, provides an overview of the second cohort and their characteristics.

Following the success last year of the first wave of participants in the FCA's regulatory sandbox, the FCA recently announced details of a second cohort of firms whose applications to test their products and services in the FCA's regulatory sandbox have been successful¹. Part of the FCA's Project Innovate, the sandbox creates a 'safe space' for businesses to test innovative products, services and business models in a live environment.

A sandbox is attractive because it allows a firm to pilot test new and innovative products and services, and business models, without subjecting them to full regulatory oversight or punishment whilst ensuring that consumers are appropriately protected.

The FCA received a total of 77 applications, up from 69 for the first cohort. 31 applications met the 'sandbox eligibility criteria' and were accepted to develop towards testing, with 24 of those firms ready to begin testing shortly. The other seven firms who made it through were not yet ready to start testing, according to the FCA, and may be part of cohort three.

The wave two firms

Once again, applications came from diverse sectors and geographies, covering a raft of technologies, with submissions this time around covering a range of ideas-based payment services and artificial intelligence software. Products and services using distributed ledger technology (or blockchain) were again prominent with nine blockchain firms (BlockEx, Disberse, Nivaura,

Nuggets, OKLink, Oraclize, Paylinko, Sabstone, and ZipZap) making it through.

The complete cohort is described below. With the exception of Experian, the successful firms are not that well known, whereas cohort one included high street banks HSBC and Lloyds Bank, as well as Citizens Advice and Govcoin Limited in partnership with the Department for Work and Pensions. Interestingly, blockchain specialist Nivaura also participated in cohort one in order to test its automated private placement platform.

AssetVault: AssetVault enables consumers to catalogue all of their assets in a secure online register and better understand their total value. AssetVault then works with insurance providers to protect the consumer and their assets with appropriate insurance products.

Assure Hedge: Assure Hedge is a Dublin-based firm developing a web-based platform offering forex ('FX') options to assist SMEs and individuals to protect against losses incurred because of currency fluctuations.

Beekin: Leverages artificial intelligence and data sharing to build transparency and liquidity in alternative assets (real estate, angel investments), and offers risk management and analytics services to small investors.

BlockEx: BlockEx wishes to test a bond origination, private placement and lifecycle management platform based on distributed ledger technology.

Canlon: An insurance policy that saves a

portion of the net premium to reimburse policyholders if a claim is not made.

Disberse: A blockchain-based service provider that distributes and tracks development and humanitarian finance.

Evalue: An ongoing, fully automated online streamlined advice process for employees in the workplace designed to help them set and achieve realistic retirement goals.

Experian: A mortgage eligibility tool that can be used to help consumers who are in the research phase of buying a home by increasing awareness of their eligibility, based on the lender's affordability criteria.

FloodFlash: FloodFlash provides event-based flood insurance, even in high risk areas. Customers receive a pre-agreed settlement as soon as the company's sensor detects that flood waters have exceeded a certain depth.

Insure A Thing: An alternative insurance business model where the consumer makes payments at the end of the month, based on the exact cost of claims settled during that period.

Money Dashboard: A tool that offers an instant view of consumer affordability by aggregating and organising financial transactions from online accounts and mapping them to mortgage lenders' criteria, supporting a digital mortgage journey.

Moneyhub Enterprise: Moneyhub combines artificial intelligence, data analytics and psychology to

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nudge consumers to encourage affirmative financial actions.

Nimbla: Nimbla provides flexible trade credit insurance and credit and invoice management tools to UK SMEs, via an online platform.

Nivaura: Nivaura's focus is on automating the primary issuance and administration of financial assets through a centralised system or a blockchain infrastructure.

Nuggets: A consumer blockchain application that gives users a single biometric tool for login, payment and identity verification, without sharing or storing private data.

nViso: An online platform providing advisors and clients with behavioural assessment profiles generated by artificial intelligence and facial recognition.

OKLink: A money remittance service combining domestic e-money transfers on OKLink's cross-border blockchain settlement system.

Oraclize: A distributed ledger technology based e-money platform which turns digital identity cards into secure digital wallets through the use of smart contracts and fiat-backed tokens.

Paylinko: A DLT-based payments solution enabling users to send and receive payments using a link.

Sabstone: A blockchain based platform that aims to help companies receive early payments from their clients against their invoices.

Saffe: A face recognition payments and authentication service provider.

Systemsync: An employee benefits comparison platform for SMEs, powered by payroll's automated Workplace Pension submissions.

YouToggle: An app that uses mobile

phone telematics to monitor a user's driving and create an individual score that can then be shared with a car insurer to obtain a discount. Driving information captured by the app could also be used as evidence in the event of a motor accident.

ZipZap: ZipZap is a cross-border money remittance platform that chooses the most efficient means for a payment to reach its destination, including via digital currencies.

Cohort one - update

The first cohort of firms has now finished testing and the FCA expects most of the 18 firms that tested to take forward their propositions to market. A number of the cohort one firms have transitioned out of the sandbox already - the first was Billon, a company providing distributed ledger technology for micropayments, which has had the restrictions on its registered status as a small e-money firm lifted by the FCA following its sandbox trial. The FCA is working with those who have not yet transitioned out to ensure that they have the regulatory permissions they need when operating outside of the sandbox.

Applications for cohort three

With the success of cohort one seemingly assured, continued interest in the FCA's sandbox is expected. Applications to join the third cohort of firms can be made until 31 July 2017. The FCA expects all successful firms to be ready to begin testing from November 2017. The eligibility criteria is as follows:

- Is the firm in scope? The firm must be looking to deliver innovation which is either regulated business or supports regulated business in the UK financial services market.
- Is it genuine innovation? The innovation must be ground breaking or constitute a significantly different offering in the marketplace.
- Is there a consumer benefit? The innovation should offer a good prospect of identifiable benefit

to consumers (either directly or via heightened competition).

- Is there a need for a sandbox? The business should have a genuine need to test the innovation on real customers and in the FCA sandbox.
- Is the firm ready for testing? Is the proposition ready to test in a live environment?

Copycats and imitators

The FCA is rightly proud of its innovative approach and its sandbox is the envy of other regulators around the world. Sandboxes, which are designed to reduce the time, and cost, to enable firms to bring innovative new products and services to market, mark a shift towards a new collaboration-focused regulation of FinTech firms. Tests are run on a short-term and small-scale basis.

Copypat sandboxes are springing up globally, with a range of imitators in a host of jurisdictions including Australia, Canada, Hong Kong, Indonesia, Malaysia, Singapore, Thailand, the US and most recently Bahrain. Bahrain is following in the footsteps of other regional initiatives in Abu Dhabi and Dubai, building a dedicated infrastructure to capitalise on an expected boom in FinTech innovation in the Middle East over the coming years, driven by a large unbanked population, availability of venture capital and the rapid emergence of a host of new startups and disruptive technologies. The European Commission is also developing plans for national regulators inside the EU to create their own sandboxes.

The number of industry sandboxes, such as Boston based not-for-profit FinTech Sandbox, aimed at providing FinTech startups with free access to data and infrastructure to help accelerate product and solution development, also looks set to grow rapidly - in the UK, Innovate Finance recently led an industry consultation to explore the feasibility of an industry-led sandbox for testing off-market financial innovation.