

Regulatory Sandbox framework

1. Objective

This Board Memorandum proposes the regulatory framework to facilitate and operationalize the Regulatory Sandbox ('sandbox') framework. The sandbox is intended to serve as a testing ground for new business models and technologies that benefit investors, Indian markets and the economy at large. Under this framework, entities regulated by SEBI shall be granted certain facilities and flexibilities to experiment with FinTech solutions in a live environment and on real customers. These features will be fortified with necessary safeguards for investor protection and risk mitigation.

2. Background

2.1 Participants in the capital market in India have been early adopters of technology. It is felt that adoption and usage of emerging financial technology ('FinTech') would have a profound impact on the development of securities market. FinTech can act as an instrument to further develop and maintain an efficient, fair and transparent securities market ecosystem.

2.2 With a view to facilitating the development and adoption of innovative FinTech solutions, SEBI constituted the Committee on Financial and Regulatory Technologies ('CFRT') under the chairmanship of Shri T.V. Mohandas Pai. The other members of CFRT include experts from startup industry, Fintech community, academicians etc. Based on the recommendations of CFRT, SEBI vide circular SEBI/HO/MRD/2019/P/64 dated May 20, 2019, stipulated a framework for an industry-wide Innovation Sandbox. Under this framework, FinTech startups and entities not regulated by SEBI have access to market related data, particularly, trading and holding data in an anonymised form, which is otherwise not readily available to them, to enable them to test their innovations effectively before the

introduction of such innovations in a live environment subject to fulfillment of certain eligibility criteria.

2.3 CFRT also recommended that SEBI may set up a regulatory sandbox to provide a live testing environment where new solutions can be deployed on a limited set of eligible customers for a specified period of time with certain relaxations. Accordingly, a consultation paper on the framework for Regulatory Sandbox was issued by SEBI on May 28, 2019 in line with the recommendations of CFRT. The proposed Regulatory Sandbox framework, post incorporating the public comments received from 12 entities, and as agreed upon by CFRT is given below:

3. Regulatory Sandbox

3.1 Introduction

3.1.1 “Regulatory Sandbox” refers to a live testing environment where new products, processes, services and business models can be deployed, on a limited set of eligible customers, for a specified period of time, with certain relaxations in the extant SEBI regulations and guidelines.

3.1.2 Innovation through investor-centric experimentation has the potential to create better financial products, lower the cost of transaction for investors and promote financial inclusion especially for Indian investors with limited means. However, there have been instances when innovation without proper regulatory oversight has caused damage to investors and economies. It is, therefore, imperative that new technology intensive business models and innovations are deployed with proper regulatory oversight and risk mitigation safeguards.

3.1.3 By participating in the sandbox, while the companies would get an opportunity to test their solutions on real customers/ investors, it may help SEBI to frame

policies that may reduce the time and cost of deploying new investor-centric solutions in the capital market.

3.1.4 The framework covers eligibility criteria of the project such as genuineness of innovation, genuine need to test, limited prior testing, direct benefits to users, risks to the financial system, testing readiness of the solution, deployment post testing, fit and proper criteria etc. Further, the framework also covers circumstances under which testing is not permitted under the sandbox, identification of potential risks to any market participants arising from the testing of the solution, procedure for submitting the application and approval process, proper maintenance of records during the testing period, rights and obligations of the user, conditions for revocation of the approval, etc.

3.2 Eligibility

3.2.1 To begin with, all entities registered with SEBI under Section 12 of the SEBI Act 1992, shall be eligible for testing within the Regulatory Sandbox. An entity can participate on its own or use the services of a FinTech firm. The registered entity shall be treated as the principal applicant, even if it uses the services of a FinTech firm, and shall be solely responsible for testing of the solution in the sandbox.

3.2.2 In subsequent phases, depending on the response received, SEBI may consider permitting FinTech startups, FinTech firms and other entities that are not regulated by SEBI, to participate in the Regulatory Sandbox.

3.3 Regulatory Framework

3.3.1 Within the overarching principles of market integrity and investor protection, no exemptions would be granted from the extant investor protection framework, Know-Your-Customer (KYC) and Anti-Money Laundering (AML) rules.

3.3.2 With a view to ensuring that the sandbox environment has minimum regulatory burden, SEBI may consider exemptions / relaxations, if any, which could be in the form of either comprehensive exemption from certain regulatory requirements or selective exemptions on a case-by-case basis.

4. Issue under consideration

4.1 The registration granted by SEBI to all entities registered with SEBI under Section 12 of the SEBI Act, 1992 is activity based. An entity which is registered with SEBI for a particular activity is authorized to carry out activity in that domain. SEBI is considering the cross domain approach for Regulatory Sandbox, wherein a regulated entity shall be permitted to test solutions for activities for which it is not registered. This would entail the entity to seek limited certificate of registration in a domain different from the domain in which it is registered. This concept of limited registration shall facilitate the entities to operate in a Regulatory Sandbox without being subjected to the entire set of regulatory requirements to carry out that activity. Thus, it is proposed that a limited certificate of registration to test solution(s) in a domain different from the domain in which it is registered may be accorded under the Regulatory Sandbox.

4.2 Accordingly, regulatory relaxations from various SEBI regulations may be provided after analyzing specific sandbox testing applications. A reference list is given at para 4.3/4.4 below with examples of the regulatory requirements that will be mandatory and those for which SEBI may consider granting relaxation during the sandbox testing.

4.3 Requirements for which relaxation will not be considered

4.3.1 Confidentiality of customer information

4.3.2 Fit and proper criteria particularly on honesty and integrity

- 4.3.3 Handling of customer's moneys and assets by intermediaries
- 4.3.4 Prevention of money laundering and countering the financing of terrorism
- 4.3.5 Risk checks (like price check, order value check, etc.)
- 4.3.6 Principles of KYC

4.4 Requirements that may merit relaxation

- 4.4.1 Net worth
- 4.4.2 Track record
- 4.4.3 Registration fees
- 4.4.4 SEBI Guidelines, such as technology risk management guidelines and outsourcing guidelines
- 4.4.5 Financial soundness

4.5 Regulatory provision for providing relaxation(s)

- 4.5.1 In order to enable the cross domain testing of FinTech solutions, an existing registered entity would be required to first obtain a limited certificate of registration for the category of intermediary for which it seeks to test the Fintech solution(s). The relaxation(s) from the strict applicability of the provisions of that particular regulation may be amended as proposed below. With a view to enabling the respective regulatory department(s) of SEBI to grant such limited certificate of registration to the applicant(s) who want to test the solution(s) in the Regulatory Sandbox framework, it is proposed to insert a common chapter in respective regulations of SEBI which is given below (at 4.5.2 para) so as to enable the respective department(s) to grant relaxation(s)/exemption(s), as may be deemed fit, while granting such limited certificate of registration.

*Chapter ***

Exemption from enforcement of the regulations in special cases:-

- I. The Board may, exempt any person or class of persons from the operation of all or any of the provisions of these regulations for a period as may be specified but not exceeding twelve months, for furthering innovation in technological aspects relating to testing new products, processes, services, business models, etc. in live environment of regulatory sandbox or otherwise, in the securities markets.*

- II. Any exemption granted by the Board under sub-regulation (1) shall be subject to the applicant satisfying such conditions as may be specified by the Board including conditions to be complied with on a continuous basis.”*

4.5.2 As stated above, the aforesaid chapter is to be inserted in respective regulations towards fulfilling this objective. It may be noted that apart from amendments to regulations pertaining to the SEBI registered intermediaries, other regulation may also be amended in order to provide relaxation from the regulatory requirements specified therein. Accordingly, aforesaid Chapter may be inserted in the following regulations –

- a) SEBI (Stock Brokers) Regulations, 1992
- b) SEBI (Merchant Bankers) Regulations, 1992
- c) SEBI (Debenture Trustees) Regulations, 1993
- d) SEBI (Underwriters) Regulations, 1993
- e) SEBI (Registrars to an Issue and Share Transfer Agents) Regulations, 1993
- f) SEBI (Portfolio Managers) Regulations, 1993
- g) SEBI (Bankers to an Issue) Regulations, 1994
- h) SEBI (Mutual Funds) Regulations, 1996
- i) SEBI (Custodian Of Securities) Regulations, 1996
- j) SEBI (Buy Back Of Securities) Regulations, 1998

- k) SEBI (Credit Rating Agencies) Regulations, 1999
- l) SEBI (Collective Investment Schemes) Regulations, 1999
- m) SEBI (Foreign Venture Capital Investors) Regulations 2000
- n) SEBI (Issue of Sweat Equity) Regulations, 2002
- o) SEBI (Central Database Of Market Participants) Regulations, 2003
- p) SEBI (Issue and Listing of Securitised Debt Instruments and Security Receipts) Regulations, 2008
- q) SEBI (Issue and Listing of Debt Securities) Regulations, 2008
- r) SEBI (Intermediaries) Regulations, 2008
- s) SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009
- t) SEBI (Delisting of Equity Shares) Regulations, 2009
- u) SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011
- v) SEBI (KYC (Know Your Client) Registration Agency) Regulations, 2011
- w) SEBI (Alternative Investment Funds) Regulations, 2012
- x) SEBI (Issue and Listing of Non-Convertible Redeemable Preference Shares) Regulations, 2013
- y) SEBI (Investment Advisers) Regulations 2013
- z) SEBI (Share Based Employee Benefits) Regulations, 2014
- aa)SEBI (Research Analysts) Regulations, 2014
- bb)SEBI (Real Estate Investment Trusts) Regulations, 2014
- cc)SEBI (Infrastructure Investment Trusts) Regulations, 2014
- dd)SEBI (Issue and Listing of Municipal Debt Securities) Regulations, 2015
- ee)SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015
- ff) Securities Contracts (Regulation) (Stock Exchanges and Clearing Corporations) Regulations, 2018
- gg)SEBI (Issue of Capital And Disclosure Requirements) Regulations, 2018
- hh)Securities and Exchange Board of India (Depositories and Participants) Regulations, 2018
- ii) SEBI (Buy-back of Securities) Regulations 2018
- jj) SEBI (Foreign Portfolio Investors) Regulations, 2019

5. Proposal for consideration and approval of the Board:

5.1. The Board is requested to approve the proposal at Paras 4.1, 4.2, 4.3, 4.4 and 4.5 as mentioned above.

5.2. The Board is also requested to authorize the Chairman to take all consequential and incidental steps to give effect to the decision of the Board.