

# Regulatory Sandboxes and Innovation Hubs for FinTech

## Impact on innovation, financial stability and supervisory convergence

The [original full study](#)<sup>1</sup> analyses the design and operation of regulatory sandboxes and innovation hubs (collectively referred to as 'innovation facilitators') as part of jurisdictions' regulatory response to financial innovation, focusing on the models adopted in the EU and the EFTA countries. The goal is to identify key elements of their design and operational parameters, which impact on the potential benefits and risks linked to their operation. Looking ahead, the study discusses certain proposals for strengthened coordination at EU level to mitigate the risk of diverging supervisory practices and market fragmentation and to contribute to the formulation of an EU-wide policy response to FinTech.

### Background

FinTech brings a promise of increased competition, new, more efficient or more beneficial products and services. The increasing use of technology in finance also adds complexities and poses challenges for regulators and supervisors across the globe.



Jurisdictions across the EU and beyond have adopted various initiatives to keep abreast of the rapid technological developments and to encourage the development of their FinTech ecosystems.

A regulatory response to innovation in the financial sector requires a balancing approach, which weighs-up the potential benefits of innovation against the risks for consumers, investors and the stability of the financial system as a whole. Assessing those risks requires a deep understanding of the technologies used to deliver the innovative services or products. In the face of the rapidly changing environment and given the limitations of traditional law making, jurisdictions

have resorted to innovative regulatory approaches to respond to the innovative disruptions, such as piloting schemes, setting up of innovation offices/hubs, regulatory sandboxes and innovation accelerators, and more recently RegTech and SupTech. This study focuses on innovation hubs and regulatory sandboxes, referred together as 'innovation facilitators', as an important part of the regulatory response to innovation, which aim to increase supervisor's understanding of the new FinTech activities.

### Key findings

**Innovation hubs** provide a specific scheme, via which firms can engage with the supervisor to raise questions and seek clarifications or non-binding guidance about FinTech related issues. **Regulatory sandboxes** enable a direct

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testing environment for innovative products, services or business models, pursuant to a specific testing plan, which usually includes some degree of regulatory lenience combined with certain safeguards.

Their increasing level of adoption and the proliferation of different models in recent years have prompted a number of concerns, such as the **risks** of regulatory arbitrage and 'race-to the bottom' style competition among jurisdictions, distortion of the level playing field, and more broadly, consumer protection and financial stability. Within the Single Market, the operation of innovation facilitators at a national level, could lead to the development of divergent regulatory and supervisory approaches to the innovative use of technology in finance and, in turn to market fragmentation. The main **expected benefits** from the operation of innovation facilitators include enhanced supervisory understanding of emerging technologies, which can inform an adequate policy and supervisory response to FinTech. For innovators, they can help reduce regulatory uncertainties and provide clarification on regulatory and supervisory expectations. In a broader context, it is expected that the operation of innovation facilitators can spur competition and beneficial innovation in the financial sector.

The study examines the **most relevant elements of the design and operational parameters** of innovation facilitators in the context of their potential risks and benefits: objectives, scope, access conditions, nature of regulatory relief and testing parameters (if applicable), as well as the means for knowledge sharing. Certain choices made in relation to the design and operational parameters of innovation facilitators may emphasise certain risks and would require that corresponding safeguards be included as part of the design.

To date, no large-scale evaluation has been carried out to assess the outcome and impact of the operation of innovation facilitators in the Single Market. Granular and comparable aggregated data about key elements that are necessary for such an analysis is currently not available, mainly due to the short life span of the innovation facilitators and the divergent modalities for publications of statistics (if any). As innovation facilitators become more established, it would be opportune to carry out a proper **assessment of the outcomes and impact of the operation** of innovation facilitators in the EU. In the meantime, arrangements need to be made to ensure that granular and comparable information is available about certain key indicators that are necessary for such an assessment, for example by means of common standards on the statistics and key indicators that are to be published and shared.

The study identifies the **gained enhanced knowledge** (in a broad sense) as a key benefit from operating innovation facilitators: both, for the FinTech entities and for the supervisors. It, therefore, emphasises the need of effective mechanisms to optimise the use and sharing of such knowledge. The study argues that, within the Single Market, some common principles and standards for adequate knowledge sharing of the learnings from innovation facilitators beyond the entities engaged with the facilitator and between relevant authorities could be valuable.

The recently established **European Forum for Innovation Facilitators (EFIF)** brings further potential to the efforts towards enhancing supervisory cooperation and convergence. Its role as a platform for knowledge sharing could further be strengthened, in particular in order to contribute to the formulation of an EU wide policy approach on FinTech. Moreover, the possibility of sandbox testing, which enables market access across the EU, would increase the attractiveness of the EU as a destination for FinTech innovation. Therefore, the study argues that the EFIF should leverage the opportunity to coordinate cross-border testing between nationally operated regulatory sandboxes. Moreover, the feasibility of EU-wide experimental projects on specific targeted issues should be considered, for example, where the need for cross-border consistency is most relevant.

On a **global scale**, enhanced **cross-jurisdictional regulatory cooperation** on FinTech matters can be beneficial to create an international FinTech enabling environment and to mitigate risks of regulatory arbitrage. Engagement with, and up-close monitoring of, the work carried out via global supervisory initiatives, is vital due to the inherently borderless nature of FinTech.

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<sup>1</sup> [https://www.europarl.europa.eu/ReqData/etudes/STUD/2020/652752/IPOL\\_STU\(2020\)652752\\_EN.pdf](https://www.europarl.europa.eu/ReqData/etudes/STUD/2020/652752/IPOL_STU(2020)652752_EN.pdf)