

Is it time for a sandbox for start-ups in Estonia?

Anne Veerpalu and Nikolay Demchuk explain why Estonia needs a sandbox and what sandbox regimes are in place at the moment



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Estonia is well-known in Europe as a highly developed country in the ICT sector.

Almost everyone has encountered the headlines about Estonia as a “*startup paradise*” (the Reddit), “*the most digitalized country*” (MarketWatch), “*digital utopia*” or “*internet titan*” (the Guardian), “*leader in technology*” (the Economist) etc. There are approximately 30.6 startups per 100,000 inhabitants and digital innovations like Skype, TransferWise, e-Government and e-Residency have earned Estonia such praise. Estonia is rivaling Israel, South Korea and Singapore for the digital hub position worldwide.¹

There are many reasons why people choose Estonia as a country of incorporation of their startup. First of all, because of the favourable tax system where profit of the company is only taxed upon distribution, and then because of the availability of public e-services and the tech-savvy residents. Estonia is like a tiny incubator where you can prototype your products and services in.

What is a sandbox within the world of the financial technology sector?

Generally speaking, a sandbox is a special gate for businesses to enter the market and test ideas “in a live environment” without immediately incurring normal regulatory consequences. In other words, a sandbox could be a solution which helps new innovative FinTech startups to test their products and services in a real market, with real consumers,



without obtaining appropriate licenses or complying fully with existing laws.

It is well known that national legislation together with EU laws – regulations, directives, case law and soft law – become burdensome for startups and it costs them both time and money to realize under which laws their innovative business will be regulated. Usually the founders of startups are not skilled lawyers and they do not usually have financing to consult professionals on compliance. But investors want to know exactly about the functionality and the compliance before making large investments: here we have a typical catch 22.

A sandbox regime, however,

gives an alternative to test the product or service without obtaining a license or other compliance and without waiting for an official approval by an authority. This is a unique opportunity for businesses to try out their product or service. You only need to match certain conditions set by the sandbox authority to test the business in a live environment.

Certainly, there are also some requirements in order to be eligible to submit an application to the sandbox itself, but these are minuscule in comparison. The financial supervisory authority will also benefit from the activities of the sandbox as they will be able to ensure that new startups are not

going to affect the safety and robustness of the financial services ecosystem.

The world's first FinTech sandboxes are forming already

It comes as no surprise that the United Kingdom was the first country that included a sandbox regime into their financial regulatory system. So far readiness for sandbox regulations has also been announced by Australia, Singapore and Malaysia.

The first criterion that differs between the UK, Australia and Singapore is the eligibility for applying for a sandbox. In the UK and Singapore, both new and existing businesses are able to apply. Australia allows only new businesses to apply.

Once the business is eligible to be entered in a sandbox it has to match some further requirements. In the UK, the product or service has to be very innovative, or provide a consumer benefit. Additionally, it should be intended for the UK market and its activity should be within the scope of the UK's Financial Conduct Authority's (FCA) regulatory regime.

Opposite to the UK, Australia has no such requirement as innovativeness or consumer benefit, but the business is required to be funded by an organization recognized by the Australian Securities and Investment Commission (ASIC). The aim is to guarantee that the new business does not harm consumers. The eligibility requirements in Singapore are similar to the ones in the UK and in addition the applicants must show an intention to further deploy the FinTech solution in Singapore after a successful completion of testing in the sandbox.

Regarding the time period for testing, the UK agreed to three to six months duration for new businesses. Australia considers that one to six months is enough with no possibility to extend this period. Singapore suggests a more flexible procedure giving the

businesses the right to decide how much time they need and including the possibility of extension.

The most important part of the sandbox idea is the consumer protection issue. As there is no clarity how the new business will affect the consumers, procedures in these countries are different or still under consideration. For example, in the UK the businesses can test their innovative ideas only on consumers who have previously agreed to be involved in the test. The FCA also emphasizes that it will define the consumer rights/limits in every single case. In Australia, the businesses have to be members of an ASIC-approved external dispute resolution scheme and have to comply with the interests duty and conflicted remuneration provisions as if the businesses were acting under an AFS license. Singapore has not yet defined how it will deal with this issue.

The businesses testing their products or services in the UK must submit weekly and final written reports to the FCA about the results. After the FCA reviews the reports, the business can decide whether it will start offering the tested new product or service on the market. If yes, the business must apply for a proper license. There is no obligation of ongoing reporting in Australia. When a business finishes testing, ASIC gets the information about their experience. If the business wishes to operate further, a licence will be required. After the completion of testing in Singapore, the business can deploy their product or service only if the Monetary Authority of Singapore (MAS) is satisfied with the sandbox results and the startup is able to comply with the appropriate laws and regulations.

In the future, the sandbox test might even become a good tool for helping companies in insolvency-related matters. Innovative ideas in restructuring will also find their testing place in the sandbox. Only recently it was almost impossible to imagine that new services or products could be tested in such a complicated

matter without obtaining licences and without complying with complicated regulatory requirements. Today, however, this will become reality in the countries who have introduced the sandbox test. Therefore, it is time for lawyers in the countries where the sandbox is a subject of public discussion to come up with better regulation for the test, in order to ensure that during the testing period the new services will not harm consumers and the business itself.

How can Estonia benefit from the sandbox regime?

Estonia should either benefit from the experience of the countries which have already introduced sandbox regimes or benefit from the experience of the countries which have drafted a white paper for a broader discussion in order to encompass the interests of all stakeholders.

Already, the Estonian Financial Supervisory Authority (FSA) has taken the initiative to set up a FinTech Task Force which is to look into innovative solutions for the financial sector. A sandbox is really only just a few steps away. According to Kilvar Kessler, the head of FSA, (at a recent conference in Tartu), "Estonia as a country is almost like just a tiny sandbox", yet at the time being compliance with all regulations of the EU and the laws of Estonia is still a necessity for all Estonian FinTech start-ups. ■

Footnotes:

1. Baltic Start-ups in Numbers: Estonia Leading the Way, available at: <http://www.investinestonia.com/en/about-estonia/news/article/1050-baltic-startups-in-numbers-estonia-leading-the-way>

Further References:

1. ASIC consults on regulatory sandbox for Fintech startups: file:///C:/Users/User/Downloads/Financial%20Services%20Update%20-%20ASIC%20consults%20on%20regulatory%20sandbox%20for%20fintech%20startups.pdf
2. Regulatory sandbox (the UK): <https://www.fca.org.uk/firms/project-innovate-innovation-hub/regulatory-sandbox>
3. Singapore: <http://www.mas.gov.sg/~media/MAS/News%20and%20Publications/Consultation%20Papers/Consultation%20Paper%20on%20FinTech%20Regulatory%20Sandbox%20Guidelines.pdf>



A SANDBOX IS A SPECIAL GATE FOR BUSINESSES TO ENTER THE MARKET AND TEST IDEAS IN A LIVE ENVIRONMENT WITHOUT NORMAL REGULATORY CONSEQUENCES



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