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CENTRAL BANK OF SRI LANKA



# FINANCIAL TECHNOLOGY REGULATORY SANDBOX OF THE CENTRAL BANK OF SRI LANKA

FRAMEWORK

FINTECH

Version 1.0  
February 2020

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## GLOSSARY

|                                |   |
|--------------------------------|---|
| <b>Accounts</b>                | This refers to financial relationships/arrangements between customers and their financial institutions.   |
| <b>Applicant</b>               | An entity that makes a formal application to enter the FinTech Regulatory Sandbox of the Central Bank of Sri Lanka.   |
| <b>Cohort Basis</b>            | Applicants are admitted to the Sandbox in a batch and they navigate the stages of the Sandbox together  |
| <b>Financial Institution</b>   | This includes Commercial or Specialised Banks and Finance Companies licensed by the Central Bank.   |
| <b>FinTech</b>                 | The technology and innovation that aims to support or enable banking and financial services.  |
| <b>Graduate</b>                | A Participant that has successfully completed the Testing Stage of the FinTech Regulatory Sandbox of the Central Bank of Sri Lanka and which has been awarded a Certificate of Graduation.  |
| <b>Independent Third Party</b> | An individual or entity, registered in Sri Lanka, independent of the Applicant or partnering Financial Institution, having experience in providing systems auditing or validation services for products or services in the Financial Technology sector and being acceptable to the Central Bank of Sri Lanka.   |
| <b>Innovative</b>              | The product or service may address the gaps in or open up new opportunities for financing or investing in the Sri Lankan economy, improve accessibility, efficiency, security and quality in the financial services, enhance the efficiency and effectiveness of financial institutions and management of risks etc. This may also include the use of new methodologies/processes/technology to implement existing solutions or the use of existing methodologies/processes/technology to implement new concepts. |
| <b>Participant</b>             | An Applicant that has been admitted to the FinTech Regulatory Sandbox of the Central Bank of Sri Lanka.   |
| <b>Regulatory Sandbox</b>      | A framework set up by the Central Bank of Sri Lanka to allow small scale, live testing of innovations by select entities, in a controlled environment (operating under a special exemption, allowance, or other limited, time-bound exception) under its supervision.   |
| <b>Roll-over Basis</b>         | A Sandbox model where Applicants will be admitted to the Sandbox on a continuous basis.   |



**ACRONYMS**

|             |  |
|-------------|--|
| <b>AML</b>  | Anti-Money Laundering  |
| <b>CBSL</b> | Central Bank of Sri Lanka                                    |
| <b>CDD</b>  | Customer Due Diligence                                       |
| <b>CFT</b>  | Combating the Financing of Terrorism                         |
| <b>FIU</b>  | Financial Intelligence Unit of the Central Bank of Sri Lanka |
| <b>KPI</b>  | Key Performance Indicator                                    |

## 1. INTRODUCTION

- 1.1. The plethora of innovations in the field of financial technology have had significant economic impact on a global scale whilst driving changes in consumer behavioural patterns. In line with these developments, there have been a multitude of new payment instruments/mechanisms and ways of minimising uncertainty being introduced to the payments ecosystem, which have revolutionised the financial sector and facilitated a marked increase in customer centred products and services.
- 1.2. Technological innovations in the field of finance have been continuously on the rise globally, and have permeated the local payments sphere. Therefore, establishing regulatory framework detailing compliance requirements for Financial Technology (FinTech) products, in line with the existing regulatory framework of the Central Bank of Sri Lanka (CBSL) has become necessary.
- 1.3. Innovative FinTech products may require a secure space in which to be tested, where strict financial regulations do not hinder their development. Further, technology based financial services may also need to operate in a live environment with real customers for a limited time before scaling to the mass market level. Therefore, it is opportune to establish a FinTech Regulatory Sandbox (hereinafter referred to as the Sandbox) to enable development of the innovative FinTech products which could later be introduced to the market, in a way that they comply with regulatory requirements and ensure customer protection methods.
- 1.4 A Regulatory Sandbox will provide temporary relaxations of regulatory requirements for selected FinTech products enabling developers to conduct the necessary testing of their products in a live environment. For Participants in the Sandbox, CBSL shall consider the temporary relaxing of directions, regulations, circulars, guidelines and rules issued by CBSL. Acts of Parliament, however, will not be relaxed in this Sandbox.



- 1.5 The establishment of such Sandbox will facilitate the growth of FinTechs, supporting innovations in the way financial services are delivered.
- 1.6 CBSL continually strives to improve the local financial sector and in turn, to enhance the wellbeing of the country's citizens. Accordingly, CBSL, empowered by the Payment and Settlement Systems Act, No.28 of 2005, aims to establish a FinTech Regulatory Sandbox with the intent to encourage and enable FinTech initiatives that promote efficiency, safety and increase access to and usage of financial products and services.

## 2 OBJECTIVES OF THE SANDBOX

- 2.1 To facilitate robust and sustainable innovations that can enable more efficient financial intermediation, greater financial inclusion, and create a less-cash society through digitalisation.
- 2.2 To provide a safe, bounded space within a controlled environment for selected innovators to test their products and services, without the risk of infringing on regulatory requirements.
- 2.3 To provide innovators with an opportunity to better equip themselves to seek regulatory approval.

## 3 BENEFITS OF THE SANDBOX

- 3.1 FRS will improve accessibility, efficiency, security and quality of financial services offered by Financial Institutions.
- 3.2 The Sandbox will help in reducing the regulatory uncertainty faced by FinTech companies, thereby enabling them to focus on innovations.



3.3 The Sandbox will also aid in the reduction of costs and time for successful FinTech Applicants to reach the market, thus providing greater feasibility for their initiatives.

3.4 The Sandbox will provide regulators with the necessary insight on the new and emerging technological developments which may require regulatory facilitation and intervention.

## 4 PRINCIPLES OF THE SANDBOX

4.1 To encourage adoption of innovative and safe technologies in Sri Lanka's financial sector, the Sandbox is envisioned as an enabling environment provided by CBSL along with its requisite regulatory support to FinTechs, to experiment with their applications within a pre-agreed time frame, in a limited and controlled environment, initially on a roll-over basis. The mode of operation of the Sandbox may change to a cohort basis depending on future requirements, in which case the Sandbox timelines specified within are liable to change. However, the Sandbox should not be used as a means to circumvent the legal and regulatory system.

4.2 Applicants may utilize the Sandbox only in the absence of existing applications that provide similar services locally (i.e. in Sri Lanka) or applications that use similar technologies locally. Further, similar products or services will not be considered for entry into the Sandbox at the same time, and will be considered on first come first served basis.

4.3 The proposed products/services should improve efficiency of any existing process, help manage associated risks more effectively, create new opportunities, and help improve financial services and financial inclusion.

4.4 Applicants should also specify the reason for their application to the Sandbox. i.e. the Applicant shall state the regulations that are wholly or partly incompatible with the process of implementing their innovation.



- 4.5 Applicants must prove that their proposition will not negatively affect the economy or financial system stability and shall report to CBSL according to agreed formats and timeline.
- 4.6 Applicants should have an Exit Plan which covers both successful and unsuccessful exits from the Sandbox.
- 4.7 The Applicant should have a practical dispute resolution / consumer redress framework(s) which can be improved in collaboration with CBSL, if needed.
- 4.8 The Sandbox operates in a production environment. Therefore, it is mandatory to have a well-defined and restricted set of parameters (for example sample size, transaction limits, transaction volume, transaction frequency, geographical areas, demographics, number of customers among others) for evaluating, categorizing, and prioritizing risks, within which the consequences of risk can be contained. These parameters will be set by CBSL following the evaluation of Sandbox applications, on a case by case basis.
- 4.9 Participants of the Sandbox shall be responsible for sourcing their own hardware, software, communication networks and other necessary service providers. Participants should have the necessary resources and expertise to support testing in the Sandbox whilst mitigating and controlling potential risks and losses arising from the offering of the product or service.
- 4.10 Participant should commit adequate and competent resources to undertake the testing and implement risk mitigating solutions that have been proven to be effective in containing the consequences of any failure.
- 4.11 Once in the Sandbox, the Participant must accept testing conditions that ensure no violation of or infringement upon customer rights, as well as rights pertaining to funds and data privacy. Participant should also ensure avoidance of any financial losses to customers.

- 4.12 Participants must disclose information about the test outcomes and provide any other information requested by CBSL. Manipulating test outcomes, providing false data or failing to comply with pre-agreed test scenarios will lead to immediate removal from the Sandbox.
- 4.13 Participant's customers must be informed of the Participant's involvement in the Sandbox prior to entering the Testing Stage of the Sandbox. Customers must give their consent to participate in the testing.
- 4.14 Information Technology Systems of the Applicant should have necessary safeguards built-in to prevent unauthorized access, modification and disclosure of data. In addition, appropriate mobile/web application standards, payment card standards, etc. relating to data security should be complied with.

## 5 ELIGIBILITY CRITERIA

5.1 The eligibility criteria for Sandbox participation shall include the following:

- a) **Innovative:** The offered solution is required to be either truly innovative or significantly different from existing products in the market. Solutions offering an existing service via innovative means/technology will also be eligible.
- b) **Tested:** The offered solution must be thoroughly tested in a lab environment prior to being submitted to the Sandbox. A verification of the test results, conducted by a reputed independent third-party auditor should be submitted along with the Sandbox application form, ascertaining that the implementation of the solution has been completed.
- c) **Beneficial:** The offered solution must provide clearly identifiable benefits to its customers such as but not limited to better customer experience, increased efficiency, increased safety, improved quality of product/service, lower prices, or support financial inclusion. The product or service may address the gaps in or open new opportunities for financing or investing in the Sri Lankan economy, improve accessibility, efficiency, security and quality of financial services, enhance the



efficiency and effectiveness of financial institutions and help better management of risks.

5.2 The eligibility demonstrated by the Applicants must be clearly backed by required evidence to the satisfaction of CBSL.

5.3 The Sandbox is open to both local and foreign Applicants.

5.4 All Sandbox Applicants other than a CBSL licensed financial institution must partner with a CBSL licensed financial institution in order to be considered for entry into the Sandbox.

## 6 STAGES OF THE SANDBOX

6.1 The stages of the Sandbox shall consist of the following:

**a) Application**

- i. The application form can be downloaded at <https://www.cbsl.gov.lk/en/public-notice> (Annexure 01) and should be filled and emailed to [sandbox@cbsl.lk](mailto:sandbox@cbsl.lk).

**b) Assessment**

- i. During this stage, the submitted application is assessed against the eligibility criteria given under section 5.1.
- ii. The Applicant may be contacted during this stage for any clarification or further information.
- iii. The regulatory barriers applicable to the submitted proposal will be identified at this stage.
- iv. If the proposed solution requires any CDD or related regulation relaxations, then an addendum to the application will be provided to the Applicant for completion, to be assessed by the FIU.
- v. An initial assessment of the risks involved in the proposal will be conducted.
- vi. The Applicant will be informed whether the application has met eligibility criteria within 15 working days of application submission.



- vii. If the application has met the eligibility criteria, it will be forwarded to the Financial Technology Advancement Committee (FTAC) for approval. FTAC is the decision-making body of the Sandbox, established under the Chairmanship of the Deputy Governor of the CBSL.

**c) Approval**

- i. Proposals will be submitted to the FTAC for their consideration and approval.
- ii. If required, FTAC will call on Applicants to present their solution and/or provide further clarification.
- iii. The decision of the FTAC on whether to accept or reject the application will be communicated to the Applicant within 30 working days from the end of the Assessment Stage, at which point the approved Applicants will become Sandbox Participants.
- iv. If an addendum has been submitted, the decision of the FTAC on whether to accept or reject the application will be communicated to the Applicant within 30 working days of addendum submission.
- v. Should the FTAC reject the proposal, there will be a cooling off period of 6 months before the Applicant may submit their revised proposal.

**d) Processing**

- i. If approved by the FTAC, the responsible Case Officers from the FinTech Division (FTD) of PSD, CBSL, will meet with the Participant to discuss any concerns and risks that have been identified or raised regarding the application.
- ii. The Key Outcomes, Success/Failure Indicators along with the Key Performance Indicators (KPIs) will be jointly developed and agreed upon by the Case Officers and the Participant.
- iii. If the FIU approves any exemption or relaxation related to any CDD rule, a letter of forbearance will be issued to the financial institution partnering with the Applicant under the signature of the Director of FIU. This letter will include the duration and specific scope and terms of forbearance and may include monitoring and reporting requirements by and for the FIU in addition to what is required by the FTAC.



- iv. The reporting requirements (Interim/Final) for the proposal will be discussed and agreed upon as well.
- v. Participants will be informed of the tentative dates of on-site examinations (if required) by CBSL.
- vi. The duration of this stage will be 30 working days from the granting of approval.
- vii. A letter listing the terms and conditions governing the Participant's operations while in the Sandbox will be issued to the Participant, prior to commencing the Testing Stage.

#### **e) Testing**

- i. The Participant will conduct testing of the product or service in accordance with the terms agreed upon in the Processing Stage.
- ii. The Participant is required to submit the agreed upon reports according to the defined timelines.
- iii. On-site examinations will be conducted by CBSL officers during the agreed upon dates as well as on an ad-hoc basis, if needed.
- iv. At the end of the specified testing period, which shall be a maximum of 9 months, the success/failure of the solution will be determined based on KPIs, reports and on-site examinations.
- v. The Participant has an option of requesting an extension during this stage. The request for the extension should be submitted 30 working days prior to the end of the testing period.
- vi. CBSL reserves the right to extend the period in the Sandbox for a certain Participant, if deemed necessary.
- vii. A meeting will be held with the Participant to inform the decision of CBSL on the success of the product or service and the extension (if any).

#### **f) Exit**

- i. A Participant shall exit the Sandbox based on the following scenarios:
  - Regular exit (Graduate or Fail)
  - Premature exit (disconnect) - following the decision of CBSL
  - Voluntarily by the Participant

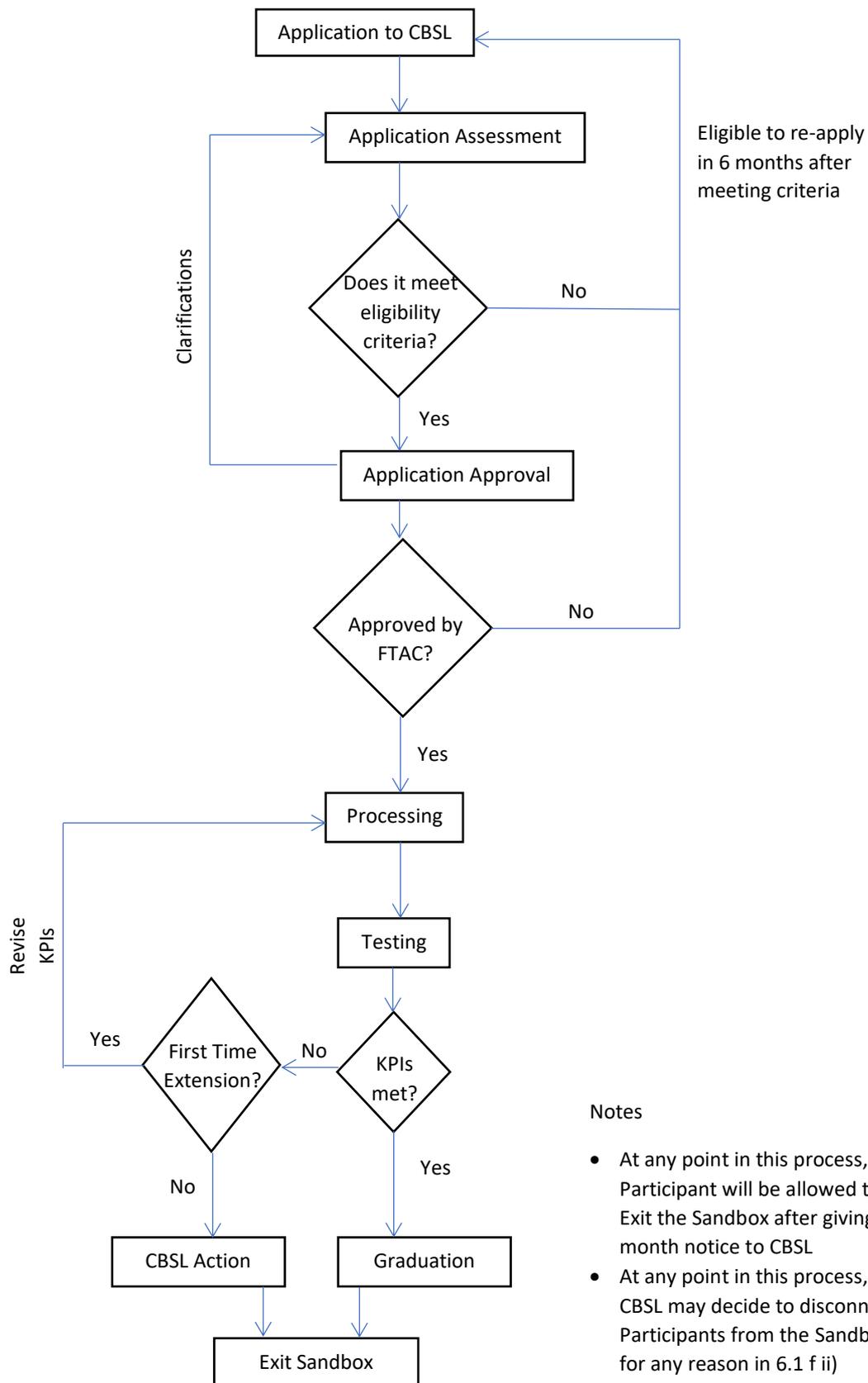


- ii. Participants will be disconnected from the Sandbox by CBSL in case of:
  - a. failure to comply with pre-agreed testing scenarios and parameters
  - b. failure to commence testing and/or commercial deployment within an agreed and prescribed period given by CBSL
  - c. repeated failures to disclose test results and required documents within the pre-agreed time frame
  - d. manipulation of test results
  - e. information coming into the public domain about the organisation that could potentially damage the reputation of CBSL through association
  - f. the operation of the product or service is harmful to customers
  - g. any other reasons as deemed applicable by CBSL
- iii. In the case of a letter of forbearance having been issued, the said letter may be withdrawn with immediate effect at any time by the FIU when solely in its own judgement the terms of the letter of forbearance have been violated, or when AML/CFT assessed risks have become too high or for any other reason deemed applicable by the FIU. Further, when forbearance ends (whether through withdrawal, non-renewal or lapse) financial institutions must fully apply all CDD rules and must close accounts and cease services when CDD rules cannot be applied.
- iv. Once the Testing Stage is completed, the Participant will submit a Final Report to CBSL.
- v. The Final Report must cover the following details:
  - a. Process flows
  - b. Key outcomes
  - c. Status of meeting key objectives
  - d. Operational metrics, for example quality and regularity of service
  - e. Business metrics
  - f. Technical metrics
  - g. Customer satisfaction statistics
  - h. Final results of the test cases and future plans



- vi. FTAC will review the Final Report along with on-site and off-site supervisions and decide whether to declare the product/service as fit to be deployed in the Sri Lankan financial system.
- vii. In the event of success and upon CBSL approval, the Participant will be ready to graduate from the Sandbox and deploy its product or service in the Sri Lankan financial system. However, in certain instances, existing regulations may need to be amended before the application is deployed. In these instances, CBSL may grant the Sandbox Participant a conditional approval to continue their operations until such time the regulations are amended or introduced.
- viii. CBSL may prohibit deployment of the product or service due to the following reasons found during the testing stage:
  - a. in the event of an unsuccessful testing based on agreed test measures
  - b. the product or service has unintended negative consequences for the public and/or financial system stability of the country

### 6.2 Flowchart: Sandbox Stages



## 7 RISKS AND SAFEGUARDS

- 7.1 The Applicants are required to identify and divulge any potential risks to financial institutions, customers and the financial systems stability of the country, from the proposed product or service including financial, legal, process, market, and operational risks. Further, the Applicants are required to state the dispute resolution mechanisms and customer protection safeguards and countermeasures in place for the avoidance/mitigation of identified risks.
- 7.2 These safeguards may include a proper process for selecting customers who understand the associated risks and voluntarily join the test period, enhanced complaint handling procedures, a mechanism for timely and fair compensation of customers' financial losses caused by any failures during the test period and appropriate arrangements for customers to exit from the relevant testing agreements.
- 7.3 CBSL risk evaluation of the submitted proposals will include but not be limited to the following areas:
- a) Financial System Stability Risk
  - b) Market Risk
  - c) Exchange Rate Risk
  - d) Inflation Risk
  - e) Technology Risk
  - f) Cybersecurity Risk
  - g) AML/CFT Risk
  - h) Legal Risk
  - i) Reputation Risk
  - j) Consumer Rights Violation Risk
- 7.4 CBSL considers the safety of the customers and of national financial systems to be of the utmost importance and due regard will be given to these aspects when evaluating the submitted proposals.

7.5 When evaluating the above risks, CBSL will give due consideration to:

- a) Ensuring the security, reliability and efficacy of national payment systems and instruments
- b) Ensuring customer data protection
- c) Ensuring fair business practices and ethical treatment of consumers
- d) Endorsing anti-money laundering and counter terrorism financing measures
- e) Enabling comprehensive financial and business practices to enable price and financial system stability

7.6 Participants of the Sandbox shall be solely responsible for any financial losses due to the product/service incurred by their customers, service providers, and any other entity/entities, during their stay in the Sandbox and upon their exit.

## 8 REPORTS

8.1 The reporting requirements/formats for each Participant in the Sandbox will vary according to the product or service being tested. It is the responsibility of the Participants to ensure the maintenance of proper records to facilitate such reporting requirements/formats.

### INTERIM REPORTS

8.2 Interim reporting requirements may include monthly or quarterly reports which include but not limited to the following:

- a) Key milestones, KPIs, and statistical data
- b) Key issues observed during the Testing Stage including customer complaints
- c) Actions taken to rectify observed issues

8.3 The exact frequency and content of the reports will be agreed upon between the Participants and CBSL during the Processing Stage.



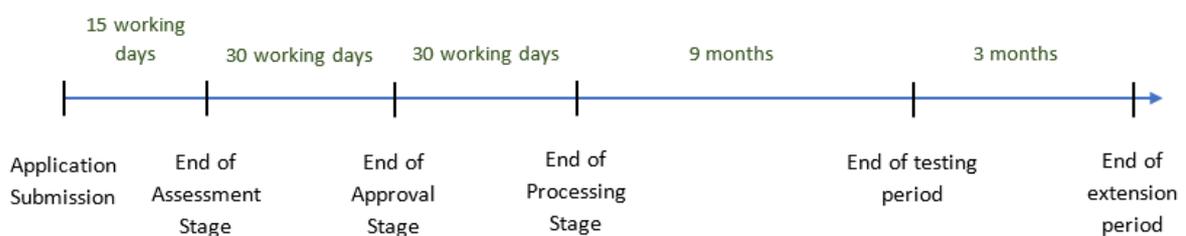
## FINAL REPORT

8.4 Sandbox Participants are required to submit a Final Report with the following information within 30 working days upon completion of the Testing Stage:

- a) Success or failure indicators for the test cases of the product or service as well as whether previously agreed upon key outcomes and KPIs have been met.
- b) Complete compilation of incident reports throughout the Testing Stage, rectification measures taken, and the success of the same.
- c) Lessons learnt during the testing period.

8.5 All reports must be confirmed and duly endorsed by the CEO or competent authority of the Participant and verified by the CEO or competent authority of the partnering financial institution, where applicable.

## 9 REGULATORY SANDBOX TIMELINE



## 10 EXIT STRATEGY

10.1 Once the initial testing period of 9 months has been completed, any and all regulatory relaxations granted to the Participants will expire unless a written notice of extension has been granted by CBSL for the product or service to continue in the Sandbox.

10.2 This extension must be requested in writing by the Participant, 30 working days prior to the end of the testing period, detailing the reason/s for the extension request and the required extension period. Such requests will only be granted up to a maximum of 3 months.



- 10.3 CBSL reserves the right to allow the product or service to be introduced to the market at a national level, once the testing is complete.
- 10.4 CBSL also reserves the right to prohibit or delay the deployment of the product or service in commercially in the event of unsuccessful testing or if the product or service has unforeseen negative implications for the financial system stability or the public at large.
- 10.5 Upon graduation from the Sandbox, a Participant shall receive a graduation certificate which states that a particular product or service that is offered by the Participant has graduated from the FinTech Regulatory Sandbox of the Central Bank of Sri Lanka and that the Participants are eligible to continue operations of this product or service in the commercial environment. This certificate permits the holder to launch the product or service in its full scale.
- 10.6 CBSL reserves the right to cancel the graduation certificate granted at any given time if CBSL considers that a Participant who graduated from the Sandbox is not fit and proper to retain the graduation certificate.
- 10.7 The general public shall be notified of any and all graduations from the Sandbox via CBSL website, or via any other media.
- 10.8 If the Participant wishes to change or expand the graduated product or service in a manner not affected by existing regulations, they must first seek the approval of CBSL. If the change or expansion to the product or service is contrary to existing regulations, the Participant must return to the Sandbox and follow the requisite procedure.
- 10.9 CBSL reserves the right to set Conditions of Commercial Deployment for all Graduates of the Sandbox in order for them to maintain their status and privileges as a Sandbox Graduate.

## 11 CANCELLATION OF APPROVAL

11.1 CBSL reserves the right to cancel the approval given to Sandbox Participants at any stage of the Sandbox process for the following reasons:

- a) Participant has provided incorrect, misleading or imprecise information or has knowingly withheld pertinent information in the application or at any other stage.
- b) Participant breaches any other laws of the country other than the specific laws which have been relaxed in order for the product or service to gain entrance to the Sandbox.
- c) Participant fails to carry out the safeguards referred herein or any other, as deemed by FTAC.
- d) Participant fails to effectively address any technical defects, flaws or vulnerabilities in the product, service or solution which gives rise to recurring service disruptions or fraud incidents.
- e) Misuses the privileges granted through the Sandbox to gain monetary or competitive advantage for any personal gain.
- f) Utilizes Sandbox privileges to engage in unethical business practices or illegal/criminal activities.
- g) Participant is facing bankruptcy or has gone into liquidation.
- h) Breaches customer data security and confidentiality.

11.2 Prior to the cancellation of approval, CBSL will give Participants 15 working days' notice and allow the Participant to respond accordingly.

11.3 If any delay in the cancellation of approval may result in grave consequences to the general public or financial system stability of the country, CBSL reserves the right to cancel the approval immediately. In this circumstance, the Participant will also be given the opportunity to respond. However, the Participant's grievances will only be considered after the date of cancellation, due to the urgent nature of such instance, which necessitated immediate cancellation.



11.4. If the approval is cancelled, the following steps must be adhered to by the Participant:

- a) Notify customers, service providers, etc. of the termination of the product or service, provide customer support where required, dispense of any obligations to the customers including the return of customer funds and compensate any customers who had suffered financial losses arising from the Testing Stage.
- b) Exit the Sandbox immediately and cease operations of the product or service.
- c) Safely dispose of all confidential information gathered during the time spent in the Sandbox, according to existing regulations.
- d) Submit a report to CBSL on actions taken for 11.4 (a) – (c) within 30 working days of cancellation.

