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# “Sandbox” - Act for the digital transformation of the financial system

Legal flash

November 17, 2020

The Spanish parliament has passed the [\*Act for the digital transformation of the financial system\*](#), which includes the regulation of a “sandbox” or controlled testing area, aimed at technology-based financial innovations. The test area has been devised as a regulatory and supervisory instrument, which will provide valuable insight into the developments and potential effects of digital transformation on the provision of financial services.



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## Key aspects

- > A **controlled testing area** (“sandbox”) is regulated that can give rise to new business models, applications, processes and products. Under this regulation, it is mandatory to have a **testing protocol** in place regulating the rules and conditions of the pilot project and a **system of liability and guarantees** in relation to the potential damage arising from the performance of tests.

A **one-stop** access system is also established for the presentation of projects by technology companies, financial institutions, research centers and any other interested promoters.

- > The creation of a **communication channel and a channel for written consultations** related to technological innovation aimed at facilitating communication with supervisory authorities.



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## Objectives of the Act

The Spanish government considers that, in the context of digital transformation of the economy and of the financial sector, legislation must be passed to ensure the protection of consumers of financial services, financial stability and market integrity.

Therefore, the Spanish parliament has passed the [Act 7/2020, of November 13, for the digital transformation of the financial system](#) (the “Act”), which is already in force.

As a significant new development, the Act regulates a controlled testing area (“sandbox”) enabling the implementation of technological projects for innovation in the financial system in compliance with the legal and supervisory framework.

Moreover, the necessary instruments are strengthened to ensure financial policy objectives in the context of digital transformation. More specifically, to monitor the controlled testing area, a coordinating commission is established, chaired by the Secretariat General of the Treasury and International Financing, and formed by the other authorities involved.

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## Sandbox

### Main aspects

- The Act regulates a controlled testing area secure for participants and for the financial system as a whole, for the purpose of protecting users and their personal data, and preventing money laundering and the financing of terrorism.
- Access to the controlled testing area will not require an authorization to be granted for an activity to be performed or for the ordinary provision of financial services on a professional basis. Projects and tests will be subject to the provisions of the Act.
- If entities already authorized to engage in an activity participate, measures will be included, when necessary, to define the tests that will be carried out on the ordinary financial activity.
- The Act also establishes a system of guarantees and protection for participants while the tests are being performed, with the following precautions:
  - a) informed consent and data protection
  - b) right of withdrawal
  - c) promoter’s liability
  - d) guarantees covering the promoter’s liability
  - e) confidentiality
  - f) monitoring throughout the performance of tests



- g) possibility of interrupting tests, e.g., in cases of malpractice or infringement of legislation or of the protocol

### Eligibility requirements

- Access to the controlled testing area may be obtained by **any individuals or legal entities** that, alone or together with others, **request the launch of a pilot project** of their own in accordance with the provisions of the legislation, including technology companies, financial institutions, representative associations, and public or private research centers.
- Only projects that **contribute technology-based innovation** applicable to the financial system and that are at a sufficiently advanced stage for testing will be eligible. To be considered sufficiently advanced, projects must present a prototype offering minimal functionality to verify their usefulness and future viability.
- Also, projects **must provide potential usefulness or added value** to existing uses relating to at least one of the aspects below, and are therefore required to:
  - a) facilitate regulatory compliance by improving or standardizing processes or other instruments;
  - b) potentially benefit financial service users in terms of cost reduction, enhancement of quality or of access conditions, and availability of the supply of financial services, or of increased protection for customers;
  - c) increase efficiency of entities or markets; or
  - d) provide mechanisms for improved regulation or better financial supervision.
- Access to the controlled testing area will not be available to projects whose promoters are legally related to or are the same as promoters of projects that have been interrupted within two years before the admission deadline, unless they prove the grounds for interruption have been amended and no longer exist.
- Tests may be interrupted at any time if the competent authority finds breaches of the legal rules applicable, manifest or repeated deficiencies, or possible risks to financial stability. They may also be interrupted on the promoters' initiative.

### Submission of applications

- Promoters must submit applications using the one-stop system set up on the website of the Secretariat General of the Treasury and International Finance, by means of a standard form. Applications must include a report explaining the project and demonstrating compliance with eligibility requirements.



- Every six months, the Secretariat General of the Treasury and International Finance will publish the deadline for admission of applications on its website.
- The Secretariat General of the Treasury and International Finance will forward applications to the competent supervisory authorities according to the subject matter of the project. These authorities will issue a report stating reasons for the favorable or unfavorable assessment of the project.
- The list of projects receiving a favorable prior assessment will be published on the website of the Secretariat General of the Treasury and International Finance. Projects with an unfavorable assessment will be rejected by reasoned resolution.

### Testing protocol

- Within three months from the publication of the favorable prior assessment, a testing protocol will be signed between the promoter and the relevant supervisory authority, i.e., the CNMV (Spanish Securities and Exchange Commission), the Spanish Central Bank or the Directorate General for Insurance and Pension Funds.
- The protocol will lay down the rules and conditions to which the pilot project will be subject. As well as any issues the promoter or competent authority considers relevant, the protocol will include:
  - a) the volume of users and transactions, amount of the transactions and time required to perform the tests;
  - b) how the tests will be monitored;
  - c) the stages of the project and objectives to be achieved at each stage;
  - d) the promoter's available resources;
  - e) the system of guarantees and indemnity;
  - f) where relevant, confidentiality clauses, industrial and intellectual property rights; and
  - g) the necessary precautions to ensure the protection of participants and markets under the legislation in force.
- Testing can begin when the protocol has been approved, consent has been obtained from participants, and the system of guarantees and indemnity has been activated.
- While the tests are being performed, the supervisory authority will monitor them and establish an ongoing dialog with the promoter



### Examination of results and access route to the activity

- Once the tests have ended, promoters will draw up a report assessing the results, which they will send to the supervisory authority within one month.
- Promoters may request authorization to begin the activity or, where relevant, extend it.
- The terms of the authorization procedure, where applicable, will be reduced by half if the competent authorities consider that the information and knowledge acquired during test performance allow for a simplified analysis of eligibility requirements.

### System of liability and guarantees

- All participants must accept in writing the conditions for participation by submitting an information document approved by the supervisory authority, which will include, among others, the nature, implications and liability that may arise from their participation and the rules on withdrawal.
- The promoter will be solely liable for any damages participants may suffer as a result of participating in the tests when they are caused by the promoter's breach of the protocol, they arise from risks that have not been properly reported, or they are caused through the promoter's fault or negligence. The promoter will also be liable for any damages arising from technical failure or human error in the course of the tests. Losses arising from market fluctuation as envisaged in the relevant protocol are not considered damage.
- At the time the tests begin, promoters must provide financial guarantees to cover liability for any losses and damages they may incur.



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## Specific communication channels

The Act provides other additional measures aimed at facilitating communication with supervisory authorities:

- Supervisory authorities will establish specific direct communication channels to deal with consultations relating to new applications, processes, products, business models and other issues related to technological innovation.
- Any interested party can submit questions in writing to the authority regarding the system, classification or application of sectoral financial regulations relating to a case in which technology is applied to the provision of financial services.

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For additional information, please contact Cuatrecasas.

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