

REGULATORY
SANDBOXES:

Where Innovation Happens



Eric Peterson

Director, Center for Technology and Innovation



How Sandboxes Work

Across the world, legislators and regulators are looking to reduce regulatory burden and encourage innovation in specific sectors of the economy. Many have turned to regulatory sandboxes to achieve these goals.

Regulatory sandboxes are a novel way to govern innovative companies, allowing them to test their product under an alternative regulatory structure. A company enters the sandbox, and the regulator maintains ongoing oversight to protect consumers. After an agreed-upon period of time, a company must either meet the standard regulatory requirements or regulations are updated to meet the needs of these new business models.

The United Kingdom created the world's first regulatory sandbox in 2014.¹ Since then, sandboxes have spread like wildfire, with over 70 different sandbox programs in 57 jurisdictions and countries.²

Not all sandboxes work in the same way.

Most only apply to a specific industry, such as financial technology (fintech), insurance, or legal services. Additionally, the structure of sandboxes can differ greatly. Many international sandboxes run through a central bank, while state authorities usually run American sandboxes. Despite their differences, all sandboxes provide some sort of regulatory relief to innovative businesses or products.

For an in-depth examination of the ins and outs of specific state sandboxes, as well as companies that have participated, the appendix offers more details. Specifically, the appendix highlights the Arizona financial technology sandbox, the Hawaii digital currency sandbox, the Utah legal sandbox, and the Consumer Financial Protection Bureau (CFPB) sandbox.

As sandboxes continue to proliferate across the United States, it's worth examining why, and what makes them successful, and the challenges they face.

Why Policymakers Look to Sandboxes



“A review of the first regulatory sandbox in the United Kingdom found that since its inception in 2014, over 700 participants have joined the program.⁴ **Approximately 80 percent of those companies are still in existence—a much higher rate than similar non-sandboxed firms.**

Regulators and lawmakers often struggle to keep up with innovation. This is especially true in fintech, where innovations like cryptocurrency were virtually unknown a decade ago to a current market cap in excess of a trillion dollars.³ Even when attempting to write sensible regulations for dynamic environments, the rules of the road lawmakers and regulators create can often be counterproductive.

Sandboxes offer a test-and-learn model. Once companies enter the sandbox, they work with regulators throughout their testing process. The company can obtain regulatory certainty from the administrator of the sandbox and the regulator can see which rules are necessary to protect consumers and which are unnecessarily burdensome. It's a win-win situation.

There are demonstrable benefits to companies with products that gain acceptance to a sandbox program. A review of the first regulatory sandbox in the United Kingdom found that since its inception in 2014, over 700 participants have joined the program.⁴ Approximately 80 percent of those companies are still in existence—a much higher rate than similar non-sandboxed firms. The study also shows that sandboxed firms are more likely to draw investors, that firms actually raised more capital than their non-sandboxed peers, and firms made it to market quicker, compared to non-sandboxed firms.

Sandboxes have benefits that go beyond businesses. Allowing more products to enter the market safely and quickly is an obvious benefit to consumers. Many of the products brought to market through sandboxes specifically target low-income consumers, providing important legal and financial services to those who might not be able to otherwise afford them. Sandboxes encourage these kinds of innovations by both lowering the costs for businesses to start up and allowing for innovative service models which were previously in a legal gray area. Examples include Build Commonwealth, a nonprofit which helps employees increase their savings; and Rasa, a company which helps Utahns expunge their prior criminal records. More information is available about these companies in the appendix.

Sandboxes provide a novel form of governance for innovative products and services. They give regulators more flexibility to tailor regulations to fit the product and protect consumers rather than trying to fit a round peg into a square hole. Businesses benefit from regulatory certainty and the market rewards sandbox participation with more venture capital. Finally, consumers benefit from having additional products available to them and many of these benefits go to those struggling with financial limitations.

A Survey of Sandboxes

Sandboxes have spread across the globe since the creation of the first sandbox in the United Kingdom. America was relatively slow to adopt sandboxes. While CFPB started one in 2016, it had only one participant until it was retooled a few years later (see the appendix for details).⁵ The state of Arizona started the first successful American sandbox in 2018, and several states have followed suit since.⁶ The graphic at the right shows a timeline of American sandbox creation.

AMERICAN REGULATORY SANDBOX TIMELINE



2016

2-1-2016

CFPB FINANCIAL TECHNOLOGY

2017



2018

8-3-2018

Arizona FINANCIAL TECHNOLOGY

2019

2-19-2019

Wyoming FINANCIAL TECHNOLOGY

3-15-2019

Wyoming MEDICAL DIGITAL INNOVATION

3-21-2019

Arizona PROPERTY TECHNOLOGY

3-25-2019

Utah FINANCIAL TECHNOLOGY

6-27-2019

Kentucky INSURANCE

9-10-2019

CFPB (reworked) FINANCIAL TECHNOLOGY

2020

1-17-2020

Nevada FINANCIAL TECHNOLOGY

1-30-2020

Vermont INSURANCE

3-17-2020

Hawaii FINANCIAL TECHNOLOGY

5-12-2020

Utah INSURANCE

8-14-2020

Utah LEGAL SERVICES

2021

1-1-2021

Florida FINANCIAL TECHNOLOGY

7-1-2021

South Dakota INSURANCE

7-1-2021

West Virginia FINANCIAL TECHNOLOGY

7-9-2021

West Virginia INSURANCE

10-1-2021

Utah ALL INCLUSIVE

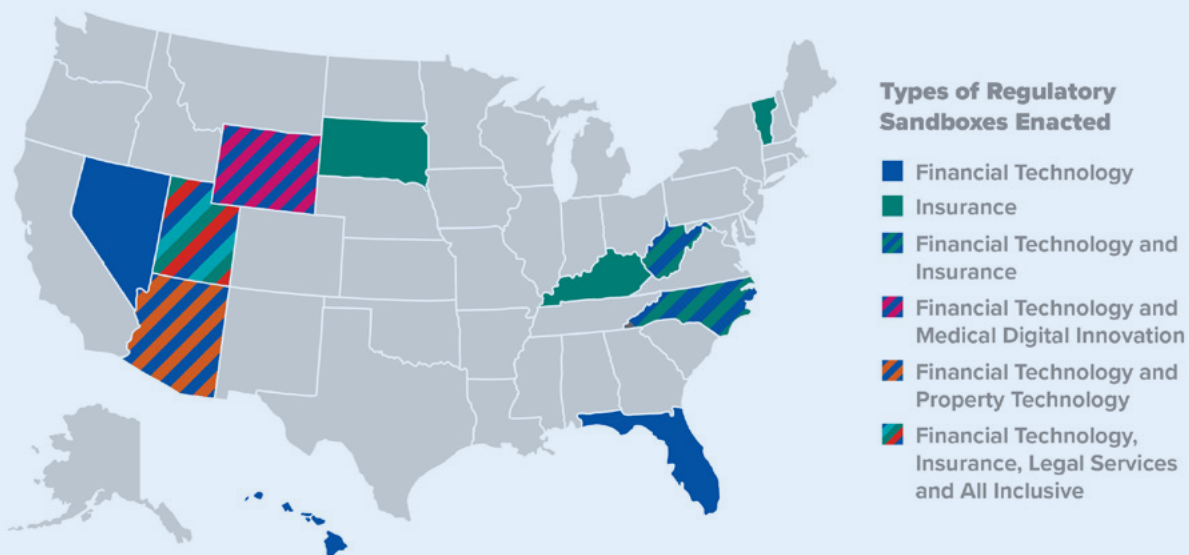
10-15-2021

North Carolina FINANCIAL TECHNOLOGY

2022

America's sandboxes are unique in that the vast majority of them are run at the state level rather than the federal level or through a central agency, as is the case in other countries. The lone exception is the sandbox in the CFPB. America also has a greater variety than other countries, with sandboxes in financial technology, insurance, legal services, property technology, and medical digital innovation. A map of state sandboxes, as well as the total of each type of sandbox, can be found below.

STATES THAT HAVE ENACTED REGULATORY SANDBOXES



REGULATORY SANDBOXES IN THE UNITED STATES BY TYPE



This number is expected to grow in the coming months, as of now 17 bills relating to sandboxes have been introduced in the 2022 legislative session.

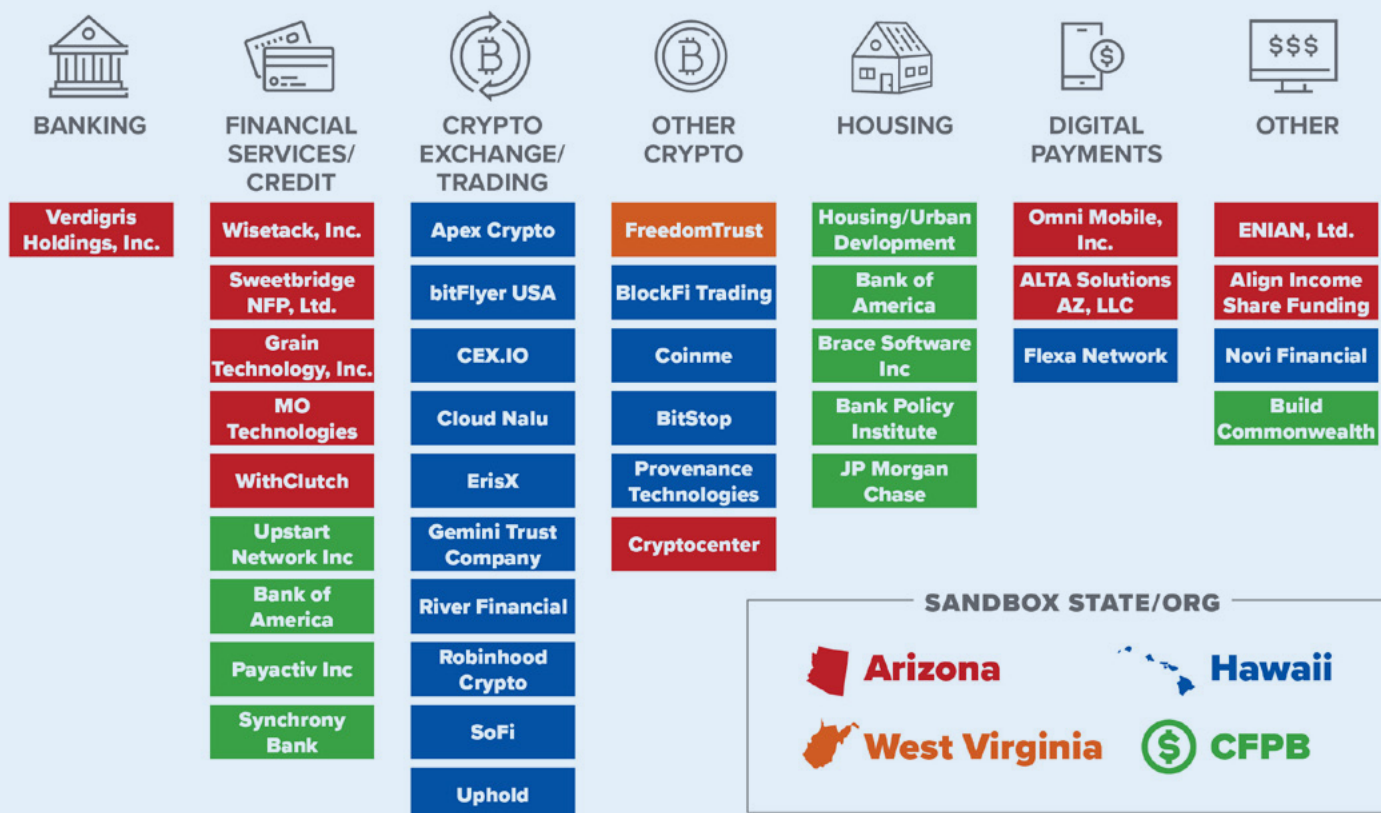
Sandboxes are nothing without companies taking advantage of them. Though the distribution of sandboxes across the country is diverse, sandboxes with participants are concentrated. Of the 18 American sandboxes, only five have had participants. Four of these are fintech sandboxes (Arizona, Hawaii, West Virginia, and the CFPB). The remaining one is the Utah legal services sandbox, which has proven enormously successful.

In total, 67 companies have participated in a sandbox program—38 in a fintech sandbox and 29 in the legal sandbox. Sandboxes have proven

invaluable for companies like River Financial, which wanted to serve the people of Hawaii but could not due to creating burdensome cash reserve requirements for cryptocurrency companies. For River Financial, the sandbox offered the only real option for the company to operate in Hawaii.

Fintech sandboxes can be structured and administered in different ways, so different types of companies gravitate to sandboxes that suit their needs. For example, the Hawaiian sandbox is geared toward cryptocurrency technologies, while the Arizona sandbox is broader in scope. The chart below lists the financial companies by product category and shows the jurisdiction of their sandbox.

FINANCIAL TECHNOLOGY COMPANIES BY BUSINESS



Unlike the fintech sandboxes, there is only one legal sandbox in the United States, which resides in Utah. With the number of companies which have participated in the sandbox, explaining each company would be impractical. As such we have displayed information about the companies in two charts: one is the type of innovation from the previous regulatory structure and the other is the types of legal services they offer. Note that companies may innovate and practice law in multiple areas.

LEGAL COMPANIES | INNOVATION

23

NON-LAWYER OWNED

- » Jordanelle Block
- » Law Geex
- » Legal Claims Benefits (Trajector Legal)
- » FOCL Law
- » Hello Divorce
- » Mountain West Legal Protective
- » Davis annd Sanchez
- » Xira Connect
- » Pearson Butler
- » DSD Solutions
- » Off the Record Inc.
- » Law on Call
- » Firmly, LLC
- » Estate Guru
- » Lawpal
- » R and R Legal Services
- » AGS Law
- » Nuttall, Brown, and Coutts
- » Blue Bee Bankruptcy Law
- » Rocket Lawyer
- » LawHQ
- » 1Law
- » Legal Atoms

17

MANAGEMENT BY NON-LAWYERS

- » Jordanelle Block
- » Law Geex
- » Legal Claims Benefits (Trajector Legal)
- » FOCL Law
- » Hello Divorce
- » Davis annd Sanchez
- » Pearson Butler
- » DSD Solutions
- » Law on Call
- » Firmly, LLC
- » Estate Guru
- » Lawpal
- » R and R Legal Services
- » Nuttall, Brown, and Coutts
- » Blue Bee Bankruptcy Law
- » LawHQ
- » 1Law

9

ALT BUSINESS STRUCTURES

- » Jordanelle Block
- » Mountain West Legal Protective
- » Xira Connect
- » Pearson Butler
- » Estate Guru
- » Nuttall, Brown, and Coutts
- » Rocket Lawyer
- » Legal Atoms
- » Utah Legal Advocates

14

SOFTWARE

- » AAA Fair Credit Foundation with Peoples Legal Aid
- » Jordanelle Block
- » Law Geex
- » FOCL Law
- » Xira Connect
- » DSD Solutions
- » Off the Record Inc.
- » Sudbury Consulting and Code for America
- » Estate Guru
- » Lawpal
- » Nuttall, Brown, and Coutts
- » LawHQ
- » 1Law
- » Legal Atoms

12

NON-LAWYER PROVIDER

- » Holy Cross Ministries
- » Jordanelle Block
- » FOCL Law
- » Pearson Butler
- » Timp Legal Certified Advocate Program
- » DSD Solutions
- » Law on Call
- » Estate Guru
- » Lawpal
- » Nuttall, Brown, and Coutts
- » 1Law
- » Utah Legal Advocates



LEGAL COMPANIES | SERVICE

ACCIDENT/INJURY = 4

- » Legal Claims Benefits (Trajector Legal)
- » Davis and Sanchez
- » Nuttall, Brown, and Coutts
- » LawHQ

BUSINESS = 6

- » Law Geex
- » Firmly, LLC
- » Estate Guru
- » AGS Law
- » Rocket Lawyer
- » LawHQ

HOUSING/PROPERTY = 5

- » Jordanelle Block
- » Mountain West Legal Protective
- » Estate Guru
- » AGS Law
- » Legal Atoms

FULL SERVICE = 3

- » Pearson Butler
- » DSD Solutions
- » R and R Legal Services

FINANCE ISSUES = 5

- » AAA Fair Credit Foundation with Peoples Legal Aid
- » Holy Cross Ministries
- » Estate Guru
- » Blue Bee Bankruptcy Law
- » Rocket Lawyer



INTERMEDIARY = 3

- » Xira Connect
- » Law on Call
- » 1Law

MARRIAGE/FAMILY = 5

- » FOCL Law
- » Hello Divorce
- » Timp Legal Certified Advocate Program
- » Legal Atoms
- » Utah Legal Advocates

CIVIL/CRIMINAL JUSTICE = 3

- » Off the Record Inc.
- » Sudbury Consulting and Code for America
- » Rocket Lawyer

OTHER = 9

- » AAA Fair Credit Foundation with Peoples Legal Aid
- » Holy Cross Ministries
- » Law Geex
- » Legal Claims Benefits (Trajector Legal)
- » Lawpal
- » AGS Law
- » LawHQ
- » Legal Atoms
- » Utah Legal Advocates

How Sandbox Structure Influences Participation

Some sandboxes have been incredibly successful at attracting participants and allowing for the creation of new services in a relatively short time frame. Others have had no participants at all. By examining what the successful sandboxes have in common (and where they differ from their unsuccessful competitors), we can draw some conclusions for the design of a successful sandbox.

Before getting into these factors, it's worth noting that sandboxes are still a relatively new concept in the United States. The first state regulatory sandbox was created in 2018. Many of the subsequent sandboxes were started just prior to or during the COVID-19 pandemic. It's possible that businesses were more concerned with keeping their doors open than looking for novel regulatory structures. This theory will be tested as the economy continues to recover from the worst of the pandemic.

SANDBOX SCOPE: WIDE VS NARROW



A narrow sandbox

structure requires a potential participant to identify exactly what kind of regulatory relief it is seeking. In other words, it must ask the regulator for an exception to a specific regulation on the books.



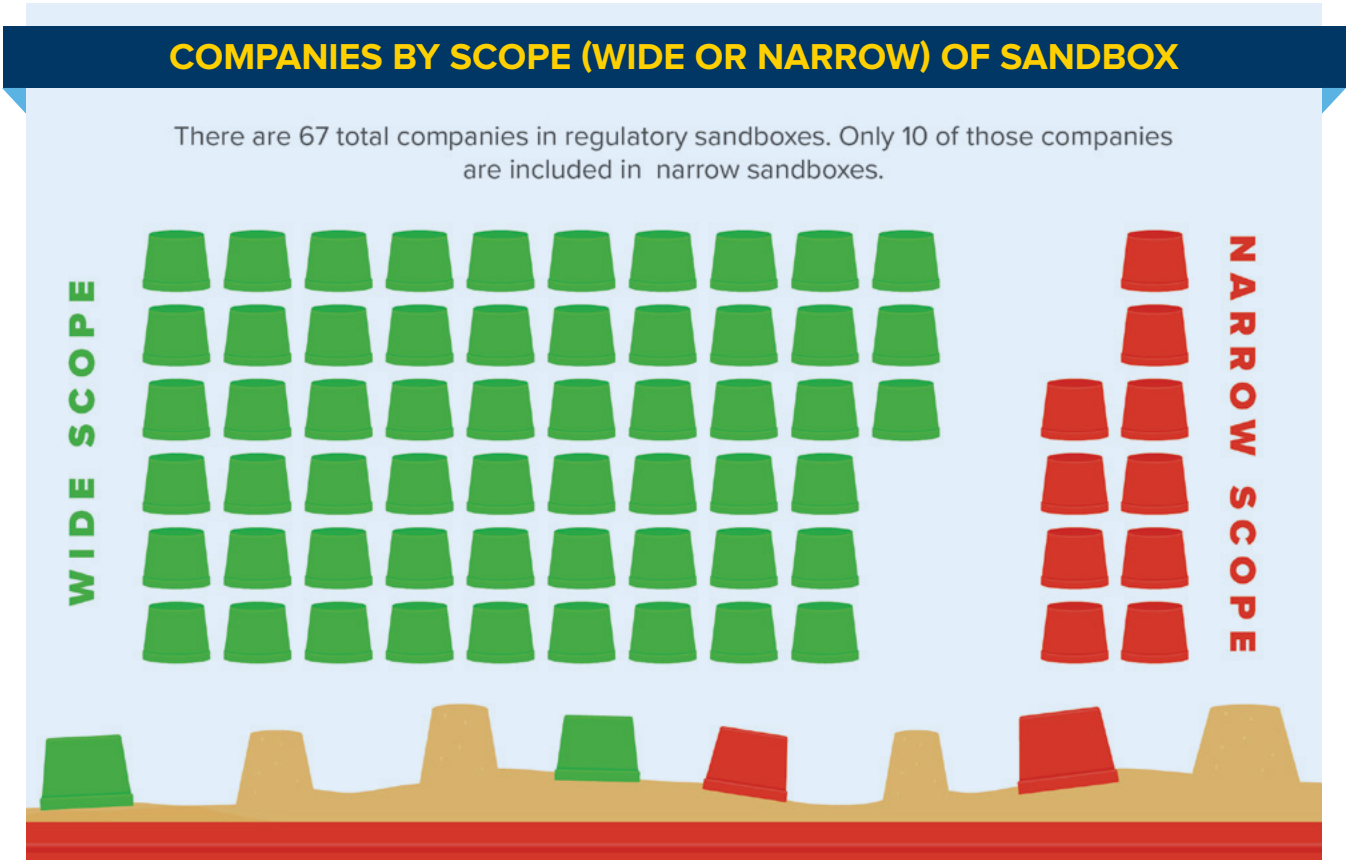
A wide sandbox

structure puts the burden on regulators to define which regulations should apply to each company. They may also provide for broad swaths of regulatory exemptions, such as Utah's legal sandbox, which allows for non-lawyer ownership of legal firms among other exemptions.

Wide and narrow are imprecise terms which do not cover the full scope of all the differences in sandbox structures. For example, Nevada is categorized as wide, but limits the number of customers a sandbox business can serve. Nevertheless, these categories provide a useful rule of thumb for lawmakers looking to understand the structure of sandboxes across the United States.

The vast majority of companies have entered wide sandboxes. The only narrow sandbox which has significant participation is overseen by the CFPB. Most companies which have been accepted are large banks that can more easily meet the higher up-front costs of application.⁷ Furthermore, the CFPB allows applicants to ask for the same relief that was granted to another company, meaning that subsequent applications are often less costly to file.

By contrast, wide sandboxes do not require an intimate working knowledge of regulation. This means that companies can submit their application without incurring the expense of identifying these regulations. Furthermore, they may need relief from more than one regulation to complete their business model. A narrow scope makes creating a business like that incredibly difficult.





Sandbox Type

Another key factor to attracting companies is the type of sandbox. There are a few reasons why four of the five successful sandboxes deal with fintech.

Sandboxes started with fintech in the United Kingdom. This model was copied around the world with the majority of sandboxes abroad being fintech and run by a central bank. This gives fintech sandboxes not only proof of concept, but companies some familiarity with them. It is no coincidence the first state sandbox was also in fintech. Sandboxes like the Property Technology Sandbox in Arizona and the Medical Digital Innovation Sandbox in Wyoming are one of a kind. This might make potential companies more hesitant to try them or even unaware that such arrangements exist. More time or better marketing might overcome these obstacles.

But simply building a fintech sandbox is not enough to bring in applications. There appears to be a strong first mover advantage. Arizona started the first state fintech sandbox program and saw immediate results. Hawaii's first cryptocurrency-specific sandbox saw similar results. Perhaps the advantage from regulatory arbitrage for fintech can only be generated for a few states.

While determining what has made fintech sandboxes generally successful, it is worth

considering insurance sandboxes' lack of success. Internationally, most companies in insurance sandboxes have made it easier to compare and shop for insurance rather than offering alternative insurance models. However, it is difficult to determine if this is due to a lack of desire to innovate on the model or simply that these were the products that would fit in the sandboxes.

Some companies, such as Otmo.com in Utah, have attempted alternative insurance models. This company provided insurance for when vehicle warranties expired, similar to health care sharing ministries where participants pay a monthly subscription fee. This business model was successful for over a year before the Utah insurance commission required the company either change its business model or shut down. Unable to change its model to comply, Otmo.com shut its doors.⁸ Utah has since created

an insurance sandbox, but neither Otmo.com nor any other business has yet joined the sandbox. This is likely due to a lack of information about the sandbox or a clear application process.

Another potential reason insurance sandboxes lack applicants is that all the insurance sandboxes within the United States have a narrow scope. It is possible that smaller



“Arizona started the first state fintech sandbox program and saw immediate results. Hawaii's first cryptocurrency-specific sandbox saw similar results.”

insurance companies that may be interested in developing alternative products cannot meet the regulatory requirements to apply.

One additional explanation is that insurance products often rely on relatively large customer pools to be fiscally viable. States like Vermont with small customer pools, especially for novel products, may not be worth the upfront investment by a company. If states worked to grant reciprocity for such participants, however, companies could view these smaller markets as a testing ground for a product before expanding.

Insurance sandboxes are still new, and groups like the National Council of Insurance

Legislators, which have a model sandbox bill, remain bullish on their prospects.⁹ Still, it is likely that existing sandboxes will need revisions to be successful and new attempts at insurance sandboxes will have to differ from previous models.



“It is likely that existing sandboxes will need revisions to be successful and new attempts at insurance sandboxes will have to differ from previous models.”

Although some sandboxes struggle to attract participants, there are many potential solutions for these challenges. The following section offers some options for policymakers to reform existing sandboxes and structure new sandboxes in a more effective manner. Many of these recommendations come from first-hand interviews with companies which have been accepted into a sandbox.



Policy Recommendations

1



PUT THE BURDEN ON GOVERNMENT, NOT THE COMPANY

A common sandbox structure requires a company to identify which regulation or regulations it wants waived during the application process. Meeting this requirement is easier for large firms (like those in the CFPB sandbox) or when the potential exemptions are well understood (like the Utah legal sandbox). In general, however, this requirement seems to hinder applications. When creating new products, entrepreneurs are often unaware of the rules of which they may run afoul. Understanding regulations with certainty requires both time and money. As many sandbox firms are small, this requirement might prevent a firm from applying. A preferable structure allows companies to submit a general application for their products and put the burden on the government to determine where they may be subject to current regulations, and what regulatory relief needs to be granted. Alternatively, granting broad relief (as in Hawaii) also seems effective.

The CFPB application model provides another way to reduce the burden on companies. It allows businesses to build off previous applications by asking for the same waiver granted to a previous applicant. No doubt, JPMorgan Chase building off of Bank of America's successful application reduced the cost for theirs.¹⁰ Some sandboxes work in the opposite direction by requiring a company to explain to the regulator how its product is unique. If it cannot, its application is denied. This is an unnecessary requirement and could act as a barrier to entry for companies. Consumers are better off when multiple companies compete for their dollars, and these policies grant a pseudo-monopoly to the first applicant to propose a new product.

2



EASE OF APPLICATION AND INFORMATION

Firms often have questions and concerns before applying to a sandbox. Successful sandboxes set up easy-to-access websites explaining to a potential applicant how they might apply and provide contact information for any further questions. Additionally, successful sandboxes often have regulators who market the sandbox and work with companies throughout their application process. Conversely, sandbox programs which were not well marketed or lacked easily accessible information found little to no success.

3

WORKING WITH REGULATORS

One of the largest benefits that sandbox participants mentioned in interviews we conducted with them was the ability to work with, rather than against regulators. As companies worked through the regulatory process, having open lines of communication provided immense benefits in testing products and ultimately graduating from the sandbox. It must be noted, however, that the regulators must have already bought in to the concept of the sandbox—otherwise they will likely be detrimental to a program’s success. Legislators should be mindful of who runs the sandbox.

4

RECIPROCITY

When interviewing sandbox participants, the most-mentioned potential improvement was reciprocity between sandboxes. Participants believed reciprocity would provide three main benefits.

Foremost, it would drastically reduce the time and cost to do business in another state. Rather than figure out how to navigate another application process, they wanted to reuse much of their previous application.

Reciprocity would also greatly expand a company’s consumer base. Indeed, a lack of consumer base may be the reason some sandboxes have not attracted participants. Vermont, for example, has less than 700,000 residents, so the cost of a company testing out a product in the state is likely to be too high for the potential benefits, especially in a heavily regulated market like insurance. By allowing reciprocity, the economic calculation can allow sandboxes, even in small states, to be attractive destinations.

Finally, reciprocity in sandboxes can serve as a bulwark against states with overly aggressive regulation. New York’s Bitlicense is widely seen as a burdensome barrier to doing business, but the size of the market still makes it worth it for some firms to obtain and turns New York into the de facto cryptocurrency industry regulator.¹¹ If states create reciprocity agreements, they can match or even surpass the size of such markets, allowing for a generally permissive regulatory environment rather than letting some large states raise regulatory barriers for everyone.

5

SUPPORTING THE INSTITUTION

All the activities outlined above require substantial time, talent, and resources to complete. Asking a government agency to decide what regulations need to apply to each specific company requires time and experience. Tracking data and creating publicly accessible reports also requires work. Finally, promoting the sandbox seems to be a key factor in its success. It is imperative that rather than just giving a mandate to create a sandbox, those in charge of running it must have the proper support and funding.



Summary

Less than a decade old, sandboxes are proving to be an effective tool at encouraging innovation in specific sectors. The United States has taken a distinctly federalist approach to their implementation. This has shown some states derive large benefits from their sandboxes, while others have seen little to no benefit. As the process of refining sandboxes continues, state legislators should borrow the best ideas from successful sandboxes and avoid the issues of those that have been unsuccessful.

States like Louisiana can benefit from sandboxes by attracting entrepreneurs from other states who are stifled by inflexible regulations while empowering innovators here at home. Benefiting from sandboxes requires more than just creation; it entails crafting the right approach that can both induce applicants and help regulators understand the best way to protect consumers and promote innovation.

Appendix of Case Studies

While an overview of sandboxes across the United States provides valuable data, the concentration of companies within certain sandboxes merits further investigation. The following section provides a more in-depth description of how those specific sandboxes work, as well as case studies about a company that has entered the sandbox.



ARIZONA FINANCIAL TECHNOLOGY SANDBOX

The Arizona Financial Technology Sandbox started on August 3, 2018 and is run under the Arizona's Attorney General's office.¹² The sandbox grants broad regulatory relief by allowing accepted companies to test their products without having to comply with state licensing laws related to licensing. Specifically, sandbox participants are "not subject to state laws that establish requirements pursuant to a license or authorization issued by an applicable agency that otherwise would or may regulate an innovative financial product or service" except as otherwise provided in the statute. A.R.S. §41-5605(F)¹³ This is a different method than requiring companies to explain what regulations need waived or granting broad no-action letters.

This does not mean that Arizona is the wild west of deregulation. Rather, the law authorizes the Arizona Attorney General's Office to determine which regulations should be required for each participant in addition to customized monitoring, reporting, disclosure, and other requirements. This way, each business gets a custom regulatory regime that fits their business type and risks.

Arizona's regulatory regime attracted the most diverse businesses of any sandbox in the United States. Examples of firms entering and graduating from the sandbox include income-based loan repayments (Align Income Share Funding), refinancing car loans (With Clutch LLC), and token-based payment systems for the cannabis industry (Alta).¹⁴ It seems that the structure of Arizona's sandbox successfully attracted diverse types of companies and helped those companies graduate from the sandbox.

If there is a blemish on the sandbox's record, it is that only one new company has entered it since 2019.¹⁵ It is difficult to disentangle if this was due to COVID-19 or some other factor. For example, the Arizona sandbox has a cap on the number of customers, loan amounts, and money transmission. These restrictions may limit new applicants. As the sandbox with the most data on companies entering and exiting, Arizona should look for ways to streamline and update its program to ensure it continues to bring in new businesses.

ARIZONA COMPANY CASE STUDY: BRIGHT FI

Bright Fi is a financial technology company with over 30 employees that provides products and services to help banks quickly launch digital banking services at low cost. Bright Fi's goal is to expand financial services to traditionally underserved communities by making it profitable for financial institutions to serve these customers. Bright Fi started in Ohio and quickly realized that while it was growing it would need additional resources and integration across government and business. It then started exploring other options for its headquarters. When researching where to move its business, Arizona jumped to the top of the list because of its fintech sandbox. The sandbox gave Bright Fi a defined space to operate and a close working relationship with its regulator.

Before applying for the sandbox, it had questions about what the regulatory process might look like. For example, how would it apply and get through the sandbox? Who would be their point of contact while in the sandbox? While Bright Fi was initially unfamiliar with the concept, the benefits looked promising and they wanted to make sure the structure afforded them the opportunity to deploy its technology in a flexible environment to allow for testing, learning, and feedback from all involved.

After graduating in June 2020, Bright Fi considers their time in the sandbox to be a success. The sandbox lowered the regulatory costs for the company during its startup phase, where capital is most important. The sandbox also offered the opportunity to test and retest Bright Fi's products and make contacts within the financial technology ecosystem in Arizona. Bright Fi believes the biggest additional advantage the Arizona and other sandbox efforts could pursue is reciprocity amongst states to further expand the ability for regional testing and product development.



HAWAII'S DIGITAL CURRENCY INNOVATION LAB

The Hawaiian financial sandbox is distinct from other models in a variety of ways. Foremost, the sandbox was not created due to a desire to lead in the cryptocurrency industry, but rather as a remedy to burdensome regulations around the industry.

Before it had over a dozen cryptocurrency companies doing business in the state, Hawaii all but kept them out. In 2017, the Hawaii Division of Financial Institutions (DFI) provided guidance that companies dealing with digital currency were subject to Hawaii's money transmitter laws.¹⁶ That meant that any company working with digital currency would have to hold an equivalent amount of fiat currency in reserve. For example, if a company's customers held 1 million dollars' worth of Bitcoin, the company would have to have 1 million dollars in cash reserves. Given not only digital currency volatility, but the massive growth in value over the past few years, this requirement made it all but impossible for any cryptocurrency company to do business in Hawaii. Although legislation was introduced to address these requirements, it failed to become law.

To remedy the situation, the DFI and the Hawaii Technology Development Corporation (HTDC) launched a Digital Currency Innovation Lab (DCIL), which functions like a traditional regulatory sandbox.

The partnership launched in March 2020 and is set to run until a wind down period ending in December 2022.¹⁷ Rather than exempt companies from a broad swath of regulation like Arizona, or have the companies identify specific regulations they wanted relief from, the DCIL provided no-action letters from the Commissioner of Financial Institutions. These no-action letters allow companies to operate without

fear of government lawsuits or shutting down of the companies as long as they continue to operate as outlined in their sandbox application.

The first group of 11 companies began operation in August 2020. This initial success led to a second group of applications with four companies joining in June 2021.¹⁸

These 15 companies include some well-known names in fintech, including Gemini, Sofi, and Apex Crypto. But even with the companies centered around digital currency, there are a variety of different business models and services offered. For example, Coinme creates Bitcoin kiosks, which allow customers to purchase Bitcoins from physical machines throughout the state of Hawaii. Eris X allows for spot trading of digital currencies. BlockFi, which has been shut down by attorney generals in other states, offers interest-bearing cryptocurrency accounts.¹⁹

For a two-year pilot program, Hawaii's sandbox has been extraordinarily successful. Only Utah's legal services sandbox has had more participants. A few key factors have contributed to its success.

No-action letters serve as a permission slip for businesses by offering a large degree of freedom without a large investment. However, these letters do not give permission for companies to run wild. In many ways these companies are under more scrutiny since regulators have an incentive to keep an eye on them for political reasons and to ensure they abide by the terms of the sandbox.

A cryptocurrency innovation sandbox was well timed as the COVID-19 pandemic saw an explosion of interest in cryptocurrency. Hawaii has also done an exceptional job marketing the program. Information explaining the program, its benefits, and how to apply is easily accessible online. Government officials touted it by sending out press releases and contacting companies directly. They were rewarded with more than a dozen applications. This stands in stark contrast to many sandboxes which do not have comparable marketing or easily accessible information for potential participants.

The lasting success of the program remains in question. It has yet to be extended beyond 2022. Additionally, the legislature has yet to solve the problem that required the sandbox in the first place. If Hawaii wants to continue to be a destination for digital currency innovation, it should identify the regulations that need to be fixed as companies exit the sandbox program and if possible, provide a long-term or permanent extension of the sandbox to attract new businesses.

HAWAII COMPANY CASE STUDY: RIVER FINANCIAL

River Financial is a financial services company with more than 35 employees that makes it easy and secure for investors to purchase Bitcoin. Although customers can hold their Bitcoin directly, River also offers services similar to a traditional investment account, like a person might have with Fidelity. River operates in and is regulated by a large number of states, most commonly as a designated Money Transfer Licensee.

River was interested in offering its services in Hawaii, but the state's cash requirements for digital currency companies rendered this unfeasible. While looking for solutions to this issue, River came into contact with Iris Ikeda and the Hawaii Commission of Financial Institutions, who let them know about Hawaii's creation of their sandbox. Sensing that the sandbox would be an important step toward the creation of a positive regulatory environment, River applied and was accepted into the first cohort of sandbox participants. Today, the company says they are proponents of sandboxes, believing they can spur market-friendly innovation. Like Bright Fi, River supports the creation of reciprocity agreements between different jurisdictions on the basis that reciprocity will achieve better results for regulators, services providers, and consumers.



UTAH LEGAL SANDBOX

In August 2018, the Utah Supreme Court established a working group on regulatory reform for the purpose of expanding access to legal services. A year later, the group released a report entitled “Narrowing the Access-to-Justice Gap by Reimagining Regulation.”²⁰ The report recommended that the Supreme Court create a legal regulatory sandbox which would allow new models for legal services to flourish in Utah and expand access to the legal system. In August 2020, the Utah Supreme court followed these recommendations and issued Standing Order 15 which created the legal sandbox and the Innovation Office.²¹

The regulatory relief it granted is vastly different from the other successful models of Arizona and Hawaii. Instead of broad relief, the Utah legal sandbox is specific in the regulations that can be waived, such as allowing for ownership by non-lawyers, fee sharing agreements, and the use of non-lawyers for document completion.

Even with this narrow relief, the sandbox has proven extremely successful. This is likely because the legal sector is heavily regulated, with strict rules on who is and is not allowed to partake in any part of the legal process. Even a mild loosening of these regulations has opened up a flurry of new business models.

According to the November 2021 report, the Innovation Office has received 52 applications, of which 32 were recommended to the Supreme Court for authorization leading to 31 authorized entities.²² Only two applications have been denied so far.

These entities have provided over 8,400 legal services for more than 7,000 unique clients. Of these services, 93% were completed by a lawyer or a lawyer working with software. The remaining 7% were completed by a non-lawyer with some sort of lawyer involvement. The most common services offered were military and veteran benefits at 30.4%, accident and injury at 18%, and business law at 15.5%.²³

Risk management remains a top priority for the Innovation Office. It puts out frequent publicly available reports which track the number of consumer complaints, among other statistics. So far there have only been four complaints, less than one per 2,000 services rendered.²⁴

Although the Utah legal sandbox is still new, its success should not be understated. The number of firms eager to join the sandbox prove the concept and the number of services already rendered shows that consumers are eager to do business with these companies. It should be noted that while California and Florida are likely to follow a similar path to Utah and create a sandbox-like program to increase availability for legal services, it is not the only path forward.

Arizona also created a task force to study how to expand legal services.

In August 2020, the Supreme Court took up some of the recommendations of the task force but did not create the same sandbox structure.²⁵ Some of the accepted reforms include allowing legal paraprofessionals to provide limited legal services to clients, allowing fee sharing and allowing non-lawyers to have economic interest in law firms. These reforms were implemented on January 1, 2021.²⁶

It is too early to tell whether elimination of these rules like in Arizona or the sandbox model in Utah will be more effective at expanding legal services to the citizens of each state. Different models might be more viable in different states, depending on the existing rules for legal practice. Furthermore, these models might also be more or less effective depending on how the Supreme Court is determined in each state, such as election or appointment. But there is a clear demand to reimagine the legal services industry and sandboxes are one avenue to achieve it.

UTAH COMPANY CASE STUDY: RASA

One of the purposes of the Utah Regulatory Sandbox is to expand access to legal services for those who might not be able to afford lawyers. One area of the law where this is particularly needed is in the area of criminal record expungement.

1 in 3 Americans have some type of record, but expunging a record is costly, time-consuming, and complicated, particularly for self-represented people. Noella Sudbury had worked on expanding access to expungement legal services for many years. She organized and participated in many clinics around Utah to help people get their records expunged. People would often drive hours for this legal help. As the Utah Supreme Court began the process of studying whether or not they wanted a legal sandbox, they asked for the input of lawyers like Noella.

After the sandbox was implemented, she wanted to see if she could take her passion for giving people a fresh start and find a cheaper and simpler way to help them expunge their records. Noella liked the idea of the sandbox but had a lot of questions about what it would be like to participate. The application was long, and there were a lot of reporting requirements. Ultimately, she decided to apply because she felt she couldn't pass up the opportunity to close the gap for those who needed expungement services. Noella's application was approved, and her new company, Rasa, is developing software and training non-lawyers to make clearing a record simple and affordable for anyone who needs it. Without the sandbox, her project would not be possible.



CONSUMER FINANCIAL PROTECTION BUREAU SANDBOX

The sole federal sandbox is at the Consumer Financial Protection Bureau (CFPB). The CFPB was created in 2010 as a part of the Dodd-Frank legislation to regulate financial markets after the crash of 2007-2008. Traditionally, the CFPB has put more regulations on financial entities rather than removing them or granting specific waivers. However, Dodd-Frank allows for the CFPB to permit providers of consumer financial services and products “to conduct a trial program that is limited in time and scope, subject to specified standards and procedures, for the purpose of providing trial disclosures to consumers.”²⁷

The CFPB sandbox program went live in 2016 but had few participants. Only one company, Upstart, was granted entrance in 2017.²⁸

In 2019 the CFPB overhauled the program and issued three new policies to spur innovation: the No-Action Letter Policy, the Trial Disclosure Program, and the Compliance Assistance Sandbox Policy.²⁹ The No-Action Letter Policy is similar to the Hawaiian sandbox where a company can operate with regulatory certainty after receiving one of these letters from the CFPB. The Trial Disclosure Program allows for alternative disclosures of financial information to consumers while the Compliance Assistance Sandbox Policy allows for companies to operate in areas with legal uncertainty, like sandboxes previously discussed.

Since the implementation of these policies, the number of participants has increased significantly as one company joined in 2019 and eight joined in 2020. This can be explained by a number of reasons. Unlike many of the state sandboxes, the companies joining here are larger in scope. Companies like Bank of America, JPMorgan Chase, and Synchrony Bank are large, established players in financial services and are already used to dealing with the CFPB. It could also be explained by the fact that the CFPB requires these firms to identify the regulations they are uncertain about or want no-action letters in regard to.

That said, not only does a no-action letter from the CFPB allow for market access across the country but allows other companies to submit similar proposals. For example, JPMorgan Chase essentially requested the CFPB grant the same waiver that Bank of America received.³⁰

CFPB COMPANY CASE STUDY: BUILD COMMONWEALTH

While the CFPB regulates some of the largest financial institutions in the world, a relatively small nonprofit organization was able to successfully navigate their sandbox process. Commonwealth, a national nonprofit, aims to build financial security and opportunity for financially vulnerable people through innovation and partnerships. As such, they have worked with the CFPB for years on a number of novel approaches to addressing financial insecurity.

Upon the CFPB's release of the three new regulatory policies in 2019, Commonwealth identified that the Compliance Assistance Sandbox policies could provide clarity around an important regulatory issue related to their work and reached out to the CFPB to better understand the process and next steps. Commonwealth eventually submitted a template letter that would allow for the creation of an "Autosave Account" program.

This program functions similar to a 401(k), where a portion of an employee's earnings is automatically deducted from their paycheck and put into a savings account. While the employee would be able to opt out at any time, this automatic deduction would be the default. Commonwealth is not looking to develop this program and offer it to employers for a fee, but rather work with employers to develop this program for their employees.

Like many small organizations, Commonwealth had some initial concerns that they would be able to navigate the legal process of applying. Through working with the CFPB, they were convinced that even an organization of their size could complete the process.

Commonwealth's application was approved in July of 2020 and the company reported they have seen benefits. Not only do they have regulatory certainty about what they need to help businesses create such a program, but the approval has raised the company's profile and they have connected with employers interested in their program. They expect other employers to use their approved application as a template to propose specific Autosave programs through the CFPB sandbox in the future.



About the Author



Eric Peterson is the Director of the Pelican Center for Technology and Innovation Policy. The Center's mission is to make Louisiana the most innovation friendly state in the nation. Eric has worked at the Center since 2019 and since that time authored many research papers and articles including on closing the digital divide, telehealth, and antitrust.

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504-500-0506

info@pelicaninstitute.org

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