

State Legislation Governing Fintech Regulatory Sandboxes

‘Sandbox’ Regulations

Regulatory Sandboxes provide a temporary legal framework for FinTech companies to test innovative financial products in the form of credit extending services, mortgage lending, money transfers, as well as blockchain and cryptocurrency products. A Sandbox functions like an incubator, allowing FinTech players to build and evaluate new financial products outside of the full regulatory requirements that apply to traditional products. From the bank perspective, FinTech players would partner with banks as a method of empowering traditional banks to innovate, while introducing new entrants into the banking system. Startups and banks both possess a unique set of strengths that are complimentary to each other. Fintech companies have lighter regulatory oversight which allows them to introduce new products and test them quickly. Banks bring new products to the market through partnerships and trusting customer relationships facilitated by protections granted by consistent regulation and oversight.

ABA supports innovation both inside and outside of the banking system. However, the benefits of FinTech are only guaranteed when delivered responsibly and consumer protections are maintained. Thus, regulators should ensure that non-banks that offer banking services are being monitored appropriately, while remaining abreast of new technologies and sharing their findings. Coordination between regulating agencies is a crucial component of facilitating innovation in the banking industry.

To lessen burdensome licensing requirements for companies regulated by the states, the Conference of State Bank Supervisors (CSBS) has established a multi-state agreement between [twenty-three](#) states to standardize key elements of the licensing process for money service businesses (MSB). This initiative modernizes state regulation of non-banks, which includes FinTech firms, with aims to have state regulators throughout the nation adopt an integrated licensing and supervisory system.

A few questions that banks should consider when evaluating proposed regulatory sandbox legislation are provided below:

- Which state laws and regulations would the Sandbox exempt participants from and how can participants remain compliant with federal regulations in the meanwhile?
- What is the regulatory structure at the federal level and how does a state sandbox proposal differ in terms of lowering the regulatory burden while protecting consumers?
- Would the legislation provide a private right of action for violations?
- Who is responsible for administering the ‘sandbox’ program. If the program is administered by the Attorney General, how will they work with the banking regulator?

Existing State Laws

State	Statute	Description
AZ	§§ 41-5601 to 41-5612	Creates a regulatory “sandbox” for financial services companies to test “innovative” products and services without complying with the licensing and supervision otherwise required by law. Products and services that can apply to enter include consumer lenders, money transmitters, some cryptocurrency products and services, car title lenders, and investment management. Participants are not required to be Arizona-based but must have a physical or virtual location accessible to the Attorney General and be subject to the jurisdiction of the Arizona Attorney General. The duration of the program is two-years after which the company must cease operations or obtain the license required for that type of business. Each

		participant may transact or contract with up to 10,000 consumers. If a company “demonstrates adequate financial capitalization, risk management process and management oversight,” up to 17,500 consumers can use the innovation.
FL	§ 559.952	Creates a Financial Technology Sandbox Program within the Office of Financial Regulation to allow financial technology innovators to test new products and services in a supervised, flexible regulatory sandbox, using waivers of specified general law and rule requirements under defined conditions. A person whose Financial Technology Sandbox application is approved may make an innovative financial product or service available to consumers during the sandbox period. The commissioner may, on a case-by-case basis, specify the maximum number of consumers authorized to receive an innovative financial product or service, after consultation with the person who makes the financial product or service available to consumers.
NV	SB 161 (pending statutes)	Modeled after the Arizona Sandbox bill, provides for the establishment and administration of a sandbox program by the Director of the Department of Business and Industry. Persons offering or providing such a product or service in an innovative way may seek temporary exemption from some or all statutory and regulatory provisions that otherwise apply to the product or service. If the Director approves the application, section 15 of this bill provides that the product or service of the participant is generally exempt from any provision of chapter 645A, 645B, 645F or 645G of NRS, title 55 or 56 of NRS or any regulation adopted pursuant to any of those statutes, except as the Director may otherwise require. The period of participation in the Program is generally limited to 2 years, at which time a participant must cease to offer or provide a product or service under the Program. A participant may seek an extension of this period to apply for any license or other authorization otherwise required for the product or service. The effective date for the program was January 1, 2020.
UT	§§13-55-101 to 13-55-108	The statute establishes the Regulatory Sandbox Program and enables a company to obtain limited access to the market in the state to test innovative financial products without obtaining a license or other authorization that might otherwise be required. These products may include peer-to-peer lending, credit extending services, money transmission and certain blockchain or cryptocurrency products. Participants would have 24 months to test the innovative product and would not be required to be Utah residents, but would be subject to Utah’s jurisdiction and would be required to have an established physical location in Utah. Participants would also be subject to Utah’s licensing requirements and as determined on a case by case basis, some regulatory provisions may be suspended during the Regulatory Sandbox period. This would not exempt participants from federal laws and Utah criminal laws. In addition, generally applicable state laws, such as the Utah Consumer Sales Practices Act, would still apply to Regulatory Sandbox participants. There would be no set minimum bond or net worth requirement; however, each applicant must demonstrate that consumers will be protected for the duration of the test.

WV	§§31A-8G-1 to 31A-8G-8	The statute establishes a regulatory sandbox to enable entities that would normally require licensure in West Virginia to test an innovative financial product or service for a limited period of 24 months. After the end of the sandbox period, if the test of the product or service has been deemed successful, the entity would be able to continue operating in West Virginia subject to any licensure requirements at that time.
WY	§§40-28-103 to 40-28-109	The provisions requiring Wyoming’s Banking Commissioner and Secretary of State to adopt implementing regulations became effective on February 19, 2019. The remainder of the Sandbox Act is effective January 1, 2020. This measure creates a financial technology sandbox for the testing of financial products and services. The Wyoming statutes that may be waived pursuant to the Sandbox Act include the Uniform Consumer Credit Code, the Uniform Electronic Transactions Act, the Money Transmitters Act, and the Residential Mortgage Practices Act. These statutes allow the Banking Commissioner or Secretary of State, on a case by case basis, “to specify the maximum number of consumers permitted to receive an innovative product or service” after consulting with a person whose “financial technology sandbox application” has been approved. The statute provides a person who makes an innovative financial product or service available to consumers in the financial technology sandbox is not immune from civil damages for acts and omissions relating to this act and is subject to all criminal and consumer protection laws.

Proposed State Laws

State	Bill Number	Description
ND	HB 1268 (2021)	The measure awaits further consideration and may need to be amended in order to pass but has failed the House vote. Would require an applicant for a financial technology sandbox to submit to a background check. It would also require an individual filing a financial technology sandbox application and individuals who were substantially involved in its development to submit to a criminal history background check.
NY	AB 3336 (2021)	Would mandate the attorney general and state comptroller to establish a regulatory sandbox program in consultation with applicable agencies of the state. Would require the attorney general and state comptroller to study long term solutions to issues that arise from financial technology products or services and produce an annual report on the results of the studies. The bill establishes the application process and requirements for any person that may apply to enter the regulatory sandbox to test financial technology products or services. It also establishes the requirements for a sandbox participant that may request an extension of the regulatory testing period, for the purpose of pursuing a license or other authorization required by law. The measure has a repeal date of July 1, 2028.

RI	HB 5425 (2021)	Would establish a regulatory sandbox program for innovative financial products or services available to consumers. The sandbox period may be initially not longer than 24 months. In addition to creating a sandbox program, the measure would also regulate virtual and digital assets, set regulations for the sale of hemp, and establish a special purpose depository charter for cryptocurrency companies.
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Federal Law & Guidance

CFPB

The Consumer Financial Protection Bureau is proposing to revise its 2016 Policy and proposing the BCFP Product Sandbox through its proposed Policy on No-Action Letters and the BCFP Product Sandbox (Policy) in order to more effectively carry out its statutory purpose and objectives.

The proposed Policy has two parts. Part I is a revision of the 2016 Policy designed to increase the utilization of the Policy and bring certain elements more in line with similar no-action letter programs offered by other agencies. Part II is a description of the BCFP Product Sandbox. The proposed Policy has the following overarching goals: (1) Streamlining the application process; (2) streamlining the Bureau’s processing of applications; (3) expanding the types of statutory and/or regulatory relief available; (4) specifying procedures for an extension where the relief initially provided is of limited duration; and (5) providing for coordination with existing or future programs offered by other regulators designed to facilitate innovation.

The BCFP Product Sandbox would include no-action relief substantially the same as that available under Part I, as well as two forms of additional relief: (a) Approvals by order under three statutory safe harbor provisions (approval relief); and (b) exemptions by order (i) from statutory provisions (as well as provisions of regulations implementing the statute in question) under statutory exemption-by-order provisions (statutory exemptions); or (ii) from regulatory provisions that do not mirror statutory provisions under rulemaking authority or other general authority (regulatory exemptions).

In keeping with the “sandbox” concept, approval relief and exemption relief would be provided for a limited period of time. The Bureau expects that two years would be appropriate in most cases. Part II of the proposed Policy also includes a section regarding extensions for participation in the BCFP Product Sandbox, which would specify the procedures for applying for such an extension and clarify the Bureau’s intention to grant such applications where there is evidence of consumer benefit and an absence of consumer harm.

Similarly, in contrast to Part I, Part II would require applicants to commit to sharing data with the Bureau concerning the products or services offered or provided in the BCFP Product Sandbox.

SEC

The SEC Commissioner, Hester Pierce, stated in her speech in Los Angeles in May, that while talk about sandboxes are welcome, she is still wary of how regulators may challenge these new forms of innovation and says there is much to learn. She also mentions that the lack of familiarity could lead to pressures that produce bad regulation. “The SEC’s role is not to hand out permission slips for innovation. Innovation happens—organically through private decisions and irrepressible human creativity. We at the Commission have a role to play in protecting investors and market integrity by deterring and punishing fraud and setting clear rules. As we sit atop our lifeguard’s stand and survey the beach, however, let’s not lose sight of the benefits new

technology can provide in the area of capital formation, market efficiency, economic growth, and overall societal well-being.”

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