State Accelerate Activity to Establish Fintech Sandboxes

**Overview:** As state legislative sessions for 2019 get underway, there appears to be significant momentum related to the creation of fintech “sandboxes” at the state level, complementing ongoing sandbox-related activities at the federal and international levels.

A fintech sandbox is intended to encourage and facilitate innovation by relaxing certain regulatory requirements for companies to develop and test new financial products and services. For instance, a company may be exempt from licensing requirements while it tests an innovation, or a regulator might agree not to bring an enforcement action against a company for testing a new product or service. In exchange, the company may have to identify and mitigate potential risks on the front end or share certain information with the regulator about how tests are progressing.

Following the enactment into law of legislation establishing a fintech sandbox in Arizona last year, new legislation has been introduced in New York and Wyoming this year that would, in some respects follow Arizona’s lead. The following provides a brief background on the sandbox legislation proposed in each of these states.

I. Arizona

Arizona became the first state to create a regulatory fintech sandbox when House Bill 2434 was signed into law on March 22, 2018. Arizona’s Regulatory Sandbox Program provides exemptions from state licensing requirements for companies testing innovative financial products and services. The law defines innovation to include not only new and emerging technologies, but also “the reimagining of uses for existing technology” to address problems or provide benefits in new ways. For purposes of complying with federal financial services laws, sandbox participants will be deemed to possess the appropriate Arizona licenses or authorizations.

Some of the key provisions in Arizona’s law provide for the following:

- Interested companies must file with the Arizona Attorney General an application form that may require, among other things: a description of how the innovation would benefit consumers; a discussion of how the innovation differs from other products or services available in Arizona; and a description of potential consumer risks.

- Applicants must show they have sufficient plans for testing, monitoring, and assessing their innovations, while also ensuring consumers are protected from a test’s potential failure.

- Participants will have two years to test their innovations on no more than 10,000 consumers (or 17,500 consumers in some instances), who must be residents of Arizona.
Participants testing consumer lender loans must cap loan amounts at $15,000 per loan and $50,000 per consumer, and loans over $10,000 are subject to additional restrictions.

Participants must disclose certain information to consumers, including that: Arizona does not endorse the innovation; the participant does not have a license (if applicable); and consumers may contact the Attorney General with complaints.

Participants must retain business records and data for innovations and must notify the Attorney General of any failures, along with a report on what actions were taken to protect consumers.

Participants remain subject to state consumer protection laws.

So far, three companies have been accepted into the Arizona sandbox. These participants will test a direct ACH payment system, an application offering personalized financial services, and a block-chain enabled financing product.

Currently pending in the Arizona legislature is House Bill 2177, which would amend the sandbox program law by, for instance: requiring applicants to explain how they will use cybersecurity measures to protect data; allowing participants to request an increase in the 10,000 consumer testing cap; and clarifying certain other existing provisions.

II. Wyoming

Wyoming’s House Bill 0057 creates a financial technology sandbox for companies to test innovative consumer financial products or services. The bill specifically touches on blockchain technology by including it in the definition of “innovative” and providing that use of the technology will be considered in deciding to authorize or deny an application. Wyoming’s bill differs from the Arizona sandbox law in certain key respects, including the following:

- It lists the specific statutes and rules that may be waived for participants for the “sandbox period,” which may be up to two years.
- It requires participants to post a consumer protection bond of at least $10,000 as security for potential losses consumers suffer as a result of the innovation.
- It allows the state banking commissioner or secretary of state to exercise discretion in capping the number of consumer testers for an innovation on a case-by-case basis.


III. New York

In New York, Assembly Bill 2213 establishes a regulatory sandbox program that, like the one in Arizona, would allow participants to test financial technology products or services for two years without obtaining a license or other potentially required authorization. The New York State Assembly emphasizes the blockchain-related features of the bill, including its potential to “work toward long-term solutions to safeguard and monitor cryptocurrency exchanges” and to “provide a safe space for blockchain and Financial Technology startups.”

Interestingly, Maria Vullo, the recently departed Superintendent of New York’s Department of Financial Services, voiced strong opposition to the use of regulatory sandboxes for fintech companies. According to a statement published on the DFS website, Vullo’s stance is that “[t]oddlers play in sandboxes. Adults play by the rules.” Whether the Department will continue to oppose the sandbox legislation under new leadership remains to be seen.

Currently, the New York bill is pending in the State Assembly’s standing committee on banks.
Outlook: As of now, the Arizona sandbox remains the only active fintech sandbox operating in the United States. However, the recent momentum for the creation of fintech sandboxes at both the federal and state levels appears poised to continue. At the federal level, the Consumer Financial Protection Bureau is likely to finalize two different sandbox proposals unveiled in the second half of 2018—one focused on financial disclosures, the other on products and services. Both proposals originated within the Bureau’s Office of Innovation, a new Bureau division headed by Assistant Director Paul Watkins that focuses on “encouraging consumer-friendly innovation.” Perhaps not surprisingly, Mr. Watkins came to the Bureau after leading the effort to implement the Arizona sandbox last year. It is also likely that several other states will consider legislation to authorize fintech sandboxes during the current legislative session. We will continue to monitor this activity and will report on new developments in future editions of this briefing.

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