

July 24, 2018

Mr. Mark Brnovich  
Office of Attorney General  
2005 N. Central Avenue  
Phoenix, Arizona 85004

Re: Arizona “Regulatory Sandbox Program” Implementation

Dear Attorney General Brnovich:

We represent consumer and community groups and nonprofit organizations that work for strong consumer protections in the financial services market in Arizona. We are writing to offer suggestions on the implementation of the new Arizona Regulatory Sandbox Program (RSP) created by passage of HB 2434 this year. The RSP authorizes financial services companies subject to licensing and supervision to “test” innovative products, services, and business methods for two years without a license or regulatory supervision or coverage by all consumer protection laws in a program overseen by the Office of Attorney General.

The sandbox law, in our view, weakens current consumer protections and creates an extra layer of bureaucracy on top of the Arizona Department of Financial Institutions’ and the Arizona Corporation Commission’s supervision of financial companies. There is no evidence that current licensing and supervision hampers innovation in the Arizona market or that exemption from all legal requirements for money transmitters sets a safe market for consumer-facing cryptocurrency products and services.

Now that the “sandbox” law is in effect, we would like to work with your staff and with the Arizona Department of Financial Institutions to ensure that consumers are protected, that the program is fair and transparent, and that Arizonans are not harmed going forward. Our recommendations address consumer protections; operations and transparency; and a start on future work to protect Arizona in the consumer-facing cryptocurrency money transmitter market.

**Actions Needed to Protect Consumers:**

Prohibit usury in the sandbox: We strongly objected to the addition of a predatory loan product to the sandbox by the legislature. HB 2434 applied the inadequate product protections in Title 44, Chapter 2.1 which authorizes title lenders to charge triple-digit rates up to 204 percent APR, make asset-based loans with no consideration of the borrower’s ability to repay, and structure loans as balloon-payment debt. The car title loan law should be repealed, not admitted to the Regulatory Sandbox Program.

We urge the Office of Attorney General to only permit loans to be made in the sandbox under the terms of the Consumer Lender law. The law gives the Attorney General authority to impose other protections and requirements of the licensing law that would otherwise apply to sandbox participants. The decisions on admitting applicants to the sandbox are yours alone and cannot be appealed. We urge you to use that authority to prevent predatory, debt-trap title loans from operating without a license or supervision in the sandbox.

Require Money Transmitters (MT) to meet the safety requirements of the MT law: None of the Money Transmitter law's safety and soundness requirements were applied to sandbox money transmitter and cryptocurrency companies. Given the high risk of fraud, lack of security for cryptocurrency, and complete absence of consumer protections that consumers take for granted with other forms of money, it is dangerous for these companies to be permitted to sidestep the requirements of the Money Transmitter law and licensing and supervision by AZDFI.

We strongly urge you to require all money transmitters and cryptocurrency companies offering consumer-facing products and services to adhere to the modest requirements of the Money Transmitter law. Specifically, money transmitters and those offering cryptocurrency products and services to consumers should be subject to A.R.S. § 6-1205, 6-1205.01, 6-1212, 6-1214, 6-1241, and 6-1242. These are the basic safety and soundness requirements that protect consumers in the money transmitter market, including holding a surety bond, meeting net worth requirements, making only permissible investments, specifying the liability of licensees, and reporting to the Office of Attorney General to prevent money laundering. You have the authority to require all money transmitter sandbox participants to comply with these code sections and should do so to protect the public and to provide fair competition with licensed money transmitters.

**Transparency needed to ensure consumer confidence and knowledge:**

HB 2434 requires the Office of Attorney General to give each sandbox participant a unique identifier but does not require that the Office maintain an online roster of all sandbox participants. Consumers can currently check the website for the Arizona Department of Financial Institutions to find if a company is licensed as well as full contact information. We urge you to set up the same type of online roster of sandbox participants listing unique identification numbers, contact information, which type of license they would otherwise be required to hold and the products and/or services each participant is offering. Since the requirements to comply with unspecified laws will be different for each company, we urge the Office of Attorney General to list which legal requirements are mandated for each participant. It is not enough to just have sandbox participants disclose generally that they are not licensed. The public needs to know each company that is granted the right to do business in Arizona without a license, what product/s and/or services are being offered to consumers, and which legal requirements apply to each participant.

Actively oversee the sandbox. As noted by the analysis of the introduced bill done by the National Consumer Law Center, the law does not require the Office of Attorney General to do much in supervising and monitoring sandbox participants. Sound operation considerations are necessary to

prevent regulatory arbitrage by companies shopping for the most permissive regulator in Arizona, making unsupported claims that their product/service/business method is “innovative” to avoid licensing requirements, and creating unfair competition for licensed companies in the same market. Since sandbox products and services are intended to be “innovative” and are likely to be offered to vulnerable consumers, we urge the Office of Attorney General to proactively set up a program of examinations, market monitoring, blind shopping, and other actions to make sure that participants are complying with all the conditions set for admission to the program and compliance with the law. In order to enforce the Arizona Consumer Fraud Act, staff must closely monitor program participants. Consumers have the right to file complaints with your office, but the law does not require that anything be done with those complaints. We urge your office to investigate all complaints and take action.

Warn consumers if they have no protection in the money transmitter market. If the Office of Attorney General declines to require all money transmitter/cryptocurrency sandbox participants to post a bond, meet financial standards, hold the public’s money in permitted investments, and meet the other safety and soundness requirements for licensed money transmitters, we urge that each sandbox money transmitter be required to prominently post a warning that there are no financial protections for anyone using their products or services. It is an unfair trade practice to permit sandbox money transmitters to operate without warning potential customers there are no protections in the same market as licensed money transmitters that must meet basic financial soundness requirements.

**Preparation for the Future:**

After sandbox participants spend two years or so in the Regulatory Sandbox Program, companies that wish to continue offering the “innovative” product or service are required to obtain the appropriate license from the Arizona Department of Financial Institutions. In the case of money transmitters in the cryptocurrency market, Arizona does not have a modern money transmitter licensing law to transition to.

Other states, such as New York, have updated their money transmitter laws to better fit innovation and three of the first six New York BitLicense holders are also licensed as money transmitters in Arizona. The Conference of State Bank Supervisors developed a model state law for money transmitters that offer consumer-facing cryptocurrency products and services. We urge you to promptly start discussions on legislation based on the CSBS model to offer in 2018 so that Arizona will have a modern money transmitter law in place when cryptocurrency sandbox participants are ready to be licensed.

We are very interested in monitoring the Regulatory Sandbox Program to see if real innovation beneficial to consumers is fostered and if consumers are protected from usury and unsafe products and services. We look forward to working with your staff as this program is implemented.

Please let us know if we can provide further information or answer any questions.

Sincerely,

Arizona Community Action Association, Cynthia Zwick CEO  
Arizona Council for Human Services, Emily Jenkins, CEO  
Arizona Grandparent Ambassadors Ann Nichols, Chair  
Arizona Housing Coalition, Joan Serviss President & CEO  
Center for Economic Integrity Kelly Griffith, Executive Director  
Protecting Arizona's Family Coalition Shannon Schell, Executive Director  
St Vincent's de Paul Society Stephany Brown, President  
UFCW Local 99 Jim McLaughlin, President  
William E. Morris Institute for Justice, Ellen Katz

Resources:

NCLC Analysis of HB 2434 for the Center for Economic Integrity at  
<https://www.nclc.org/images/pdf/legislation/arizona-sandbox-lttr-nclc.pdf>

CEI/CFA, "Wrong Way: Wrecked by Debt/Auto Title Lending in Arizona," Jan. 2016 at  
<https://consumerfed.org/reports/wrong-way-wrecked-by-debtauto-title-lending-in-arizona/>

Conference of State Bank Supervisors, "State Regulatory Requirements for Virtual Currency  
Activities/CSBS Model Regulatory Framework," Sept. 15, 2015 at  
<https://www.csbs.org/sites/default/files/2017-11/CSBS-Model-Regulatory-Framework%28September%2015%202015%29.pdf>

Consumers Union, "Crypto Concerns: Consumer Issues & Policy Response to Virtual Currencies,"  
Christina Tetreault, June 2018