

Analysis Framework for Sandbox Proposals

In 2018, regulators at the Consumer Financial Protection Bureau and legislators in Arizona and Illinois proposed fintech “sandboxes,” which would allow companies to test “innovative” financial products for a period of time without standard consumer protections, licensing, and oversight. These sandbox proposals are a significant threat to families’ financial security, creating consumer protections deserts where consumers bear all of the risk.

Sandboxes are new -- Arizona is the only state with an active sandbox. However, we are likely to see more of these proposals pop up in other states and federal agencies. This framework provides a tool to analyze sandbox proposals and questions to ask sandbox proponents.

Overarching Question: What is the goal of the sandbox?

The first question you should ask of any sandbox proposal and its proponents is: what is the goal of the sandbox?

- Regulators’ Possible Answer: Regulators will often answer this question by saying that they are encountering new financial technology (fintech) products that don’t currently fit into existing regulations, and the sandbox is a way of bringing them into the regulatory fold.

Suggested Response: Ask for specific examples of the kinds of products that don’t fit within existing regulations. Usually, when you examine the underlying financial transaction, the product is not new, and actually *does* fit within current regulations.

In Illinois, when we asked for examples of these kinds of products, nearly all of them fit into current regulation when you look at the underlying financial transaction. For instance, one of the examples given was an app that allows a customer to directly tip their server, without the tip going through their employer. When you look at the financial transaction, it is simply a money transfer, which is regulated under money transmission laws.

In the case that there seems to be a truly new financial product, which is extremely rare, we recommend that consumer protections are developed for that product.

- Sandbox Advocates Possible Answer: There are two arguments we’ve heard from sandbox advocates about the goal of sandbox proposals. One is that fintech products are new and need to be tested before going full-scale. The other is that many of the fintech companies are small start-ups that don’t have the resources to navigate the regulatory landscape and apply for the appropriate licenses.

Suggested Response: A sandbox will not address the fact that small start-ups don’t have the resources to navigate the regulations and apply for licenses. If that is truly an issue, we should provide additional resources to regulators to support new and small companies navigate

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regulations, and support additional capital and resources for small businesses, so that they have the capacity to launch products that are in full compliance with the law and fair for consumers.

- Sandbox Advocates Possible Answer: We need to create a pro-innovation environment.

Suggested Response: There are ways to support innovation that do not harm consumers. We need to ensure that families' financial lives are not devastated in the name of innovation.

Access to the Sandbox

- Sandbox Eligibility: Who is allowed to apply to be part of the sandbox? Is it just companies, or also individuals? Is any product allowed to be tested in the sandbox, or just certain kinds of products? Are there any limits on the terms of the financial products? For instance, on how much a company can lend someone in a sandbox? Is there an explicit provision that a product can only be tested by a company once?
- Application and Screening Requirements: What is the application and screening process to be part of the sandbox? How much information does the company need to provide about itself and the product? What criteria are regulators using to determine who should be part of the sandbox? Under what circumstances would a company be denied entrance into the sandbox?

During the Sandbox Period

- Sandbox Structure: Is there a limit on the length of time that a product can be tested, and on how many people can test the product?
- Regulator Support: Is there a regulator assigned to work with the companies? Does the regulator have the capacity to oversee the products in the sandbox and provide support to companies?
- Initial Disclosure: Is there a clear and conspicuous disclosure in the company's first interaction with a consumer? Does the disclosure include the following?
 - That the product is being tested temporarily
 - How long the product will be available, and a disclosure that the product may be ended after the sandbox period is over
 - What will happen when the product is no longer available
 - How to submit complaints
 - What methods of recourse are available to the consumer
- Denial Explanation for a Financial Product: If a person is denied for a financial product in the sandbox, is the company required to provide an explanation as to why the person is not eligible for the product?
- Lending Protections: Is there an interest rate cap and strong underwriting for any lending products? Does the company have direct access to a consumer's finances through automatic withdrawals or other mechanisms? If so, what protections are in place for this? Are there notifications for the

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withdrawals? If there is a failed withdrawal attempt, does the company have to cease withdrawal attempts?

- Fraud: Is there an explicit provision prohibiting fraud and deception?
- Data Privacy and Security: What data privacy requirements are in place? Are the companies allowed to collect personal information, including fingerprints, geolocation, or other private information? Are they allowed to sell that information to third parties? Do the companies have to get explicit permission from the consumer to collect this information? How are companies protecting that data?
- Enforcement: Does the Attorney General's Office and other relevant regulators have oversight and enforcement authority?
- Reporting and Examination: What are the reporting requirements? Are companies required to report to the regulators regularly on the product they are testing? Are regulators required to examine the companies and product on a regular basis?

Wind Down and Post-Sandbox Period

- Sandbox Extensions: Are companies allowed to apply for an extension of the sandbox? If so, what are the application requirements and criteria for an extension? Is there an explicit provision that companies are allowed only one extension per product that is being tested?
- Exit Plan: Is there a requirement that the company develop an exit plan to ensure that harm to consumers is limited as much as possible?
- Exit Notifications: Are there requirements for clear and conspicuous notifications to consumers that the test period is ending, and that the companies communicate next steps to consumers (ie, that the product will no longer be available, or that there may be changes to the product, etc.)?
- Restitution: What happens if a consumer is harmed by the product? Are companies required to make consumers whole? Is there a requirement for companies to post bond, or have insurance or enough assets to make consumers whole?
- Arbitration: Is arbitration mandatory in the event of a dispute?
- Public Reporting: Is there any regular public report available online and to legislators?