



# BRIEF ON ARIZONA REGULATORY SANDBOX PROGRAM

HB 2434 CODIFIED AS A.R.S. §41-5601 TO 41-5612 — amended in 2019 per HB 2177

**Arizona is the first state** to create a regulatory “*sandbox*” for financial services companies to test “*innovations*” in financial products and services without complying with the licensing and supervision otherwise required by law<sup>1</sup>.

The **Regulatory Sandbox Program** (RSP) is in the **Office of the Attorney General** (OAG) and launched August 3, 2018<sup>2</sup>. The application fee of \$500 is the only fee charged by the OAG.

Initially, the companies eligible to apply to enter the RSP were those otherwise licensed and regulated under **A.R.S. Title 6 or Title 44, Chapters 2.1 or 13**. These include consumer lenders, money transmitters, some cryptocurrency products and services, car title lenders, and investment management. The law was amended in 2019 to permit financial firms not required to be licensed to apply to enter the RSP, if the business “*provides a substantial component of a financial product or service*” such as regulatory technology products. As a result, companies not subject to licensing in Arizona can nonetheless apply to enter the Regulatory Sandbox Program.

As initially enacted<sup>3</sup>, the Arizona sandbox law permitted the testing of “*innovative financial products or services*” defined as “*the use or incorporation of new or emerging technology or the reimagination of uses for existing technology to address a problem, provide a benefit or otherwise offer a product, service, business model or delivery mechanism that is not known by the attorney general to have a comparable widespread offering in this state.*” The next year, the law was amended<sup>4</sup> to permit testing of an “*innovation*” more broadly “*with respect to providing a financial product or service or a substantial component of a financial product or service*” that met those criteria. As a result, the tested product or service itself does not have to be innovative, just some aspect, feature, or method of it.

RSP 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. Testers must be Arizona residents except for money transmitter transactions.

RSP innovations are not required to benefit consumers. While applicants are required by law to state how the innovation benefits consumers, there is no threshold requirement that the innovation do so. The Arizona Office of Attorney General signed a Memorandum of Understanding with Taiwan<sup>5</sup> for reciprocal sandbox cooperation which more broadly states that the “*innovations*” should “*benefit the consumer, investor and/or industry.*” Without a clear requirement, there is no guarantee that “*innovations*” tested on Arizona consumers by unlicensed companies in the sandbox will be beneficial to consumers.

## LIMITATIONS<sup>6</sup>

**Duration in the RSP is two-years** after which the company must cease operations or obtain the license required for that type of business. The only basis for an extension of the RSP testing period or an increase in the consumer cap is for the purpose of pursuing a license or other authorization required by law.

**Up to 10,000 consumers** may transact or contract to use the innovation for each RSP participant. If a company “demonstrates adequate financial capitalization, risk management process and management oversight,” **up to 17,500 consumers** can use the innovation. The law was amended in 2019 to remove the cap on the number of consumers who can test the product during the period between when a license is applied for, if required, and when a license is obtained.

Sandbox companies making **Consumer Lender** loans may make loans up to **\$15,000** per loan or an aggregate total **\$50,000**. There is no limit on the size of loans or aggregate total for **car title loans**.

Sandbox companies testing **money transmitter** products and services, including cryptocurrency, are limited to transactions up to **\$2,500** and aggregate transactions per consumer of **\$25,000**. If the company is deemed financially sound, individual transactions can be up to **\$15,000** with an aggregate **\$50,000**. Out-of-state residents can test money transmitter products in the sandbox, following 2019 amendments.

### Product-specific requirements and protections

**Consumer Lender loans:** 6-114; 6-632; 6-635, subsections A, B, and C; 6-637.

**Sales Finance (car title) loans:** 44-286; 44-287 except not section 44-287 subsection B, paragraph 8; 44-288; 44-289; 44-290; 44-291; 44-293; and 47-9601.

**Investment management** (Title 44, chapter 13 supervised by the Corporation Commission): Section 44-3241; and ACC rules pursuant to Title 44, Chapter 13 regarding dishonest and unethical practices. 2019 amendments removed the requirement to comply with Corporation Commission rules on information required to be furnished to clients, custody of client funds or securities, and disclosure of financial and disciplinary information by clients.

**Money transmitters/cryptocurrency products and services:** None.

Unless specifically included in the law, **sandbox participants are not subject to state laws** that regulate a financial product or service. The Attorney General may determine that certain laws that regulate a product or service apply to the sandbox participant and must notify the participant when the application is approved.

## Protections and disclosures

- **Applicant** must disclose how it will use cybersecurity measures to avoid data breaches and protect consumer and transaction data.
- **Participants** are subject to the Arizona Consumer Fraud Act, A.R.S. Title 44, Chapter 10, Article 7.
- **Consumers** may file complaints with the Office of Attorney General.
- The **OAG** must issue a registration number for the RSP participant.
- Disclosures required before a RSP participant provides the “innovation” to consumers:
  - Name, contact information and registration number for RSP company.
  - That the “innovation” is authorized pursuant to the sandbox, that the participant does not have a license if applicable, that Arizona does not endorse or recommend the innovation, that the innovation is a temporary test that may be discontinued at the end of the test period, and the expected end date for the test.
  - That complaints can be filed with the Office of Attorney General with contact information.
  - That the Attorney General alone enforces state regulatory laws that apply to sandbox participants.

The Attorney General can require RSP participants to make additional disclosures.

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<sup>1</sup> A collection of links to related resources is maintained on the **Arizonans for Responsible Lending** coalition’s website at <https://www.nomoreloansharksaz.org/Sandbox/>

<sup>2</sup> **Welcome To Arizona's FinTech Sandbox** at <https://www.azag.gov/fintech>

<sup>3</sup> **HB2434 - financial products; regulatory exemption program**. Chaptered version of the bill approved by the Governor on March 22, 2018, at <https://www.azleg.gov/legtext/53leg/2R/laws/0044.pdf>

<sup>4</sup> **HB2177 - regulatory sandbox program; amendments**. Chaptered version of the amendment approved by the Governor on April 1, 2019, at <https://www.azleg.gov/legtext/54leg/1R/laws/0045.pdf>

<sup>5</sup> **Cooperation Agreement Relating to Innovation Functions between The Financial Supervisory Commission, Taiwan and The Office of the Arizona Attorney General** at <https://www.nomoreloansharksaz.org/gallery/2018-09-26%20az%20ag%20omou%20with%20taiwan%20ofsc%5B10594%5D.pdf>

<sup>6</sup> Current law is **A.R.S. Title 41, Chapter 55, Regulatory Sandbox Program §§ 41-5601 to 41-5611** starting at <https://www.azleg.gov/viewdocument/?docName=https%3A%2F%2Fwww.azleg.gov%2Fars%2F41%2Fo5601.htm>