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Innovation Inside and Outside of the Regulatory Sandbox

By Naeha Prakash

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A regulatory sandbox should only be a starting place, and regulators will need to move outside of the sandbox to enable and foster innovation in a concrete way. The tension regarding a regulatory sandbox lies in whether it offers participants the ability to innovate further or whether, instead, it functions as a narrow window by which participants must operate in order to innovate. A regulatory sandbox, although intended to support innovation, raises considerations regarding its practical ability to increase financial inclusion for consumers, while also fostering responsible innovation by financial institutions.

Given that financial services firms—banks or non-banks—in the U.S. operate in a multi-agency system, with both federal banking agencies and state regulators, any approach to regulatory sandboxes inherently requires regulatory consistency and coordination in order to further foster innovation.[1] Of course, one of the benefits of a regulatory sandbox is that it has the potential to provide clear rules of the road for market participants, particularly where new technologies or new products and services pose challenging questions with respect to regulatory requirements and ensuring consumer protection.

However, it is also important to consider why there is a need for a regulatory sandbox in the first place. As various regulatory agencies consider implementing their own sandbox-like structures, including the CFPB, OCC and FDIC (among others),[2] the question that follows is why innovation must be fostered through a regulatory sandbox, rather than through the regulatory framework? In particular, if the ultimate goal for regulators is to provide regulatory clarity for innovative products and services through a sandbox structure that imposes various guidelines, limitations and considerations on only the market participant that seeks that clarity, there should be a corresponding mechanism to ensure that this regulatory clarity can be used by the market as a whole.

While a regulatory sandbox gives both the market participant and the regulators the ability to pressure test a product or service and learn from that process, it potentially leaves other firms that want to innovate without the same clear direction, especially if they want to use a similar new and innovative feature. It also adds an additional layer to the development process for firms that want to use this process. Some regulators have tried to address this by allowing for an accelerated or truncated process, which can alleviate this issue.[3] However, the most meaningful way to address this issue is to provide for more

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1 The need for regulatory coordination was highlighted in the Treasury Report, which noted a unified solution among federal and state regulators is needed to support innovation in the banking space. U.S. Department of Treasury, A Financial System that Creates Economic Opportunities: Nonbank Financials, Fintech and Innovation (July 2018).

2 CFPB, *CFPB Issues Policies to Facilitate Compliance and Promote Innovation* (Sept. 10, 2019); OCC, *OCC Solicits Public Comment on Proposed Innovation Pilot Program* (Apr. 30, 2019); FDIC, *Comment Request Re: Information Collection for Innovation Pilot Programs*, 84 Fed. Reg. 59808 (Nov. 6, 2019).

3 *See e.g.,* CFPB, *Policy on No-Action Letters*, 84 Fed. Reg. 48,229 (Sept. 13, 2019).

modernized, flexible regulatory approaches— such as through supervision or regulations—that more broadly allow for innovation. After all, the only constant is that technology is ever-evolving and ever-changing.[4] Moreover, these regulatory approaches should be built in a manner that ensures a level-playing field across various types of institutions and allows for a coordinated effort on the part of the various regulators.[5]

Another question that arises regarding the challenges of a regulatory sandbox, and likely the most important question: do regulatory sandboxes increase access to credit and further financial inclusion for consumers, while appropriately balancing consumer protection? Banks and others currently engage in innovating and developing consumer products and services that foster financial inclusion and make the process of getting a loan or opening a deposit account more transparent and meaningful by using innovative technologies, disclosures and platforms. Incorporating new technologies into consumer financial products and services can further financial inclusion by enabling additional metrics to assess an underserved borrower's ability to repay, allow a customer to check how much they have in their savings account on their mobile phone, or instantaneously allow a consumer access to a credit card product.[6]

Therefore, to some degree, the question regarding a sandbox's benefits to consumers raises similar considerations regarding the need for regulatory consistency; in order for consumers to benefit, they need a clear understanding of how they fit in the process. Without longevity and meaningful updates more broadly with respect to the regulations that apply across the marketplace, consumers may be left without consistent protections in the process and fewer consumers may reap the benefits of innovative options.

Each of these questions relay some of the challenges for regulators as they review each sandbox application, speak to every bank or fintech company that wants to innovate, or consider more broadly how to modernize their regulatory approaches to innovative consumer financial products or services. But these questions also demonstrate the challenges for banks and others as they consider what innovation means to them. Regulatory sandboxes offer both regulators and financial institutions the ability to think thoughtfully about innovation, but the key is to ensure that these thoughts become actions. That is, whatever is achieved in that regulatory sandbox should go beyond its four corners to foster innovation for financial firms and financial inclusion for consumers in a systematic way.

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4 The United Kingdom Financial Conduct Authority has noted that for the purposes of their regulatory sandbox, "[t]he majority of technology use-cases we have seen so far have been the new application of technologies to traditional products or services, as opposed to using technologies to create entirely new products," which demonstrates that some of the regulatory uncertainty relates to how to apply existing regulations for consumer financial products and services with the advent of new technologies. *See* FCA, Regulatory Sandboxes Lessons Learned Report 9 (Oct. 2017).

5 *Cf*. Nathan Cortez, *Regulating Disruptive Innovation* 29 Berkeley Tech. L.J. 175, 202 (2014) (noting the potential way in which a clear regulatory signal may be needed to demonstrate that innovation is permitted); Hilary J. Allen, *Regulatory Sandboxes*, 87 Geo. Wash. L. Rev. 579, 603 (2019) (noting that a principles-based regulatory framework can allow for more flexibility with new innovations).

6 *See e.g.*, CFPB, *An Update on Credit Access and the Bureau's First No-Action Letter* (Aug. 6, 2019); FDIC, *Opportunities for Mobile Financial Services to Engage Underserved Communities* (May 25, 2016); American Express Credit Passport by Nova Credit (last visited Nov. 1, 2019).