



## Can Sandboxes Protect Your Pocketbook?

Kelly Funderburk

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If you have a late fee on your credit card bill, what do you do? Do you look to the government to protect your pocketbook? Or do you call your credit card company to get them—hopefully—to waive the fee?

Paul Watkins, Director of the Office of Innovation at the Consumer Financial Protection Bureau (CFPB), says that many consumers have leverage against their credit card companies to get them to waive fees without needing back-up from the government because those companies know their clientele can take their business elsewhere. “We have options,” Watkins stresses. But he also notes that not every consumer has this privilege.

In a keynote address delivered in January at the Cato Institute, Watkins argued that robust competition often can achieve more than government enforcement can in increasing options and access to financial protection for consumers. And competition, Watkins declared, is driven by innovation.

Watkins then presented three regulatory policies that the CFPB has proposed to promote innovation in the financial services sector: no-action letters, product sandboxes, and disclosure sandboxes.

All three regulatory tools, Watkins explained, aim to advance the CFPB’s objectives as established by the Dodd-Frank Act: to facilitate innovation; to ensure competitive markets; and to ensure consumer access to financial information, products, and services.

The proposed “no-action letter” tool builds on a previous CFPB policy from 2016, which allowed companies developing financial innovations with uncertain regulatory implications to apply for limited protection from enforcement by the Bureau. Watkins explained that if a no-action letter is granted to a company, the Bureau is making a statement that it will not bring an enforcement action for failure to comply with the relevant regulations. Watkins noted that the CFPB had only issued one no-action letter under the old policy. The Bureau also received criticism for taking too long to process applications and for requiring too much disclosure from companies in the process.

Under the new no-action letter policy, letters would be more efficiently processed and more attractive to the industry, Watkins argued. For one, the Bureau would commit to issuing a grant or denial of a request for a letter within 60 days. In addition, the Bureau would allow third parties to apply for provisional letters. Trade associations, for example, could advocate for regulatory buffers around certain strains of innovation without disclosing specific business information up front. And companies would no longer be subject to the tight time constraints for product testing set by the 2016 policy.

The no-action letter, however, still would not prevent lawsuits against its grantees filed by private actors or other agencies, Watkins explained. On the other hand, the sandbox provisions, though intended for more narrow application than the letters, would offer more complete protection for companies.

A “sandbox” is, in short, a framework established by a regulator to allow private companies to test new innovations with limited oversight over a restricted time period.

The product sandbox would grant a two-year protection for companies developing new financial products in exchange for sharing data and information with the Bureau, according to Watkins. He expressed optimism that the sandboxes would help reduce substantial uncertainty for innovating companies and simultaneously increase incentives for the Bureau to understand the new products early on, with the aim of tailoring regulation down the line.

The disclosure sandbox would grant similar protection to companies that seek to test new ways to inform consumers about the terms of their products and services.

In a follow-up discussion to Watkins’s keynote, a panel of experts commented that although the financial services industry will likely welcome the CFPB’s new proposals, some industry critics will be concerned that the protections are not extensive enough. Several panelists encouraged the CFPB to address this concern in part by more thoroughly disclosing the rationale for granting or denying regulatory relief. Providing more information, the experts argued, would help reduce uncertainty for firms trying to assess regulations around their trial products and services.

Panelists also noted that the CFPB’s coordination with other regulatory bodies would be key to the success of the agency’s new sandbox policy. After all, protections from federal government action do not guarantee protection from action by state attorneys general. States could decide to challenge any of the CFPB’s proposals that would preempt their authority over financial firms.

In fact, the New York State Attorney General’s Office already has submitted public comment on the CFPB’s proposals on behalf of 22 state attorneys general, asserting that they “reject the notion—embodied in the Proposed Policies—that innovation can only be fostered by permitting companies to evade the law.” The state attorneys general asked the CFPB to “reconsider and rescind the Proposed Policies.”

In addition to state challenges, panelists also warned that the CFPB’s sandbox proposals have raised significant opposition from consumer advocate groups. These groups have expressed concern that the CFPB is simply allowing the financial services industry to work around the law, with potentially damaging consequences to consumers. One author sums up this concern in the American Banker: “Innovation can simply be a code word for putting ordinary people and the financial system at risk, with no upside except for short-term profits for the few.”

Watkins maintained that the proposed tools for easing regulatory constraints on innovating companies will not expose consumers to unwanted risk or fraud. He argued, in fact, the reverse: More information from companies seeking regulatory relief will help the CFPB stay ahead of dangers to consumers, rather than loosen the Bureau’s control.

Still, the practical effects of the CFPB’s regulations on consumers’ pocketbooks are yet to be seen.