

REPORT ON THE FEASIBILITY OF CREATING A REGULATORY SANDBOX IN THE DISTRICT OF COLUMBIA

**DISTRICT OF COLUMBIA
FINANCIAL SERVICES
REGULATORY SANDBOX AND
INNOVATION COUNCIL**

SEPTEMBER 2020



GOVERNMENT OF THE
DISTRICT OF COLUMBIA
MURIEL BOWSER, MAYOR



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INTRODUCTION

On January 23, 2019, Mayor Muriel Bowser signed Mayor's Order 2019-003, which created the District of Columbia Financial Services Regulatory Sandbox and Innovation Council (Council). The Commissioner of the Department of Insurance, Securities and Banking, or his or her designee, is the Chairperson of the Council. The District of Columbia's Chief Technology Officer and seventeen (17) public members, who have backgrounds in insurance, securities, banking, technology, and consumer advocacy comprise the membership of the Council.

Pursuant to Mayor's Order 2019-003, the Commissioner is transmitting this report to the Mayor for her consideration.



The purposes and functions of the Council include:

1. Investigate the feasibility of developing a regulatory sandbox (Sandbox) for financial services, insurance, and other regulatory technology that will enable existing and new services licensees to test innovative products, services, business models, and delivery methods without immediately incurring all the normal regulatory consequences of engaging in the proposed activity.
2. Investigate the benefits of establishing a Sandbox in the District and study how innovative technology services can improve service to consumers and financial services, insurance and other regulatory technology markets.
3. Review barriers Financial Technology (FinTech), Insurance Technology (InsurTech), Regulatory Technology (RegTech), and other technology businesses face in bringing innovative services and products to the District's financial services, insurance and other regulatory technology markets, and how they can be mitigated or eliminated to encourage innovation.
4. Review the amendment or elimination of unnecessary or unduly burdensome regulatory provisions that impede financial services, insurance and other regulatory technology markets' innovation.
5. Study the dangers to consumers and the market from regulatory relief of a Sandbox and the necessary safeguards to protect consumers and the financial services, insurance and other regulatory technology markets.
6. Review the legal challenges that must be overcome and any necessary legislative changes in the establishment of a Sandbox.
7. Study how blockchain (distributed ledger technology) and smart contract technology can be used to improve the cost and delivery of financial services, insurance and other regulatory technology markets, and how the District can assist these providers in the development and use of blockchain in the District, including how the District can utilize blockchain to reduce the regulatory burden on such providers.
8. Study how other innovations such as artificial intelligence and the use of big data can be deployed to improve financial services, insurance and other regulatory technology markets.
9. Identify how a Sandbox can facilitate the implementation of autonomous vehicles in the District.
10. Review and address consumer protection issues that may arise with financial services, insurance and other regulatory technology innovation.
11. Investigate options for the development, implementation, and administration of a Sandbox for financial, insurance and other regulatory technology services, and establishment of a blockchain and innovation regulatory framework, to improve the District's markets and attract and retain service and technology businesses to the District by developing the District into a smart financial services, insurance services, and other regulatory technology services center.
12. Provide a feasibility report to the Mayor as further described below.
13. Meet every six (6) months, or more frequently as determined by the Council, to review and examine operations of the Sandbox and to review the effectiveness of the Blockchain and Innovation Regulatory Framework.



SANDBOX OBJECTIVES

The Mayor's Order requires the Council's Report to include the following recommendations:

1. Establishment and implementation of a Blockchain and Innovation Regulatory Framework ("Framework") for the regulation of blockchain and other financial services, insurance services and regulatory technology innovations.
2. Development, implementation, and administration of a Sandbox in the District for FinTech, InsurTech, RegTech, and other technology businesses impacting the financial services, insurance services and regulatory technology markets in the District, which shall include:
 - a. Recommended scope of the Sandbox;
 - b. Criteria and eligibility for use of the Sandbox;
 - c. Level of, and criteria for, regulatory relief to be provided by the Sandbox;
 - d. Consumer safeguards;
 - e. Safety and soundness and other market safeguards; and
 - f. Monitoring and compliance standards and activities.

Finally, if necessary, the Report shall include draft legislation, regulations, policies, and procedures or other specific steps recommended for implementing the recommendations of the Council.

The Council held its first meeting on December 18, 2019 and met monthly through September 24, 2020. Minutes of the Council meetings can be accessed by visiting the Department's website: disb.dc.gov.

The Sandbox shall fulfill the following objectives:

- Embrace new technology and foster innovation in financial services, insurance services and regulatory technology to attract tech innovators to the District.
- Increase access to affordable high-quality financial services and products that benefit residents and businesses in the District.
- Enhance financial inclusion for District residents who have been excluded or underserved by current market participants.
- Create a regulatory environment and market for financial services and products that fosters innovation while ensuring consumer protection.
- Create, maintain and monitor a secure environment for software testing, quality assurance (QA) and production rollout of tech innovations developed by participants of the Sandbox.
- Ensure that participants do not engage in any activity in the Sandbox that will harm consumers in the District.



COMMITTEES

The Council created the following committees to examine issues relating to feasibility:

- Market Committee – Responsible for determining what part of the District’s FinTech market (or other District markets) would benefit most from the innovation opportunities provided by the Sandbox.
- Sandbox Structure Committee – Responsible for proposing/developing the actual logical structure of the District’s Sandbox, including entities that would be allowed to participate, application procedures, timeframes for project/product completion, etc.
- Legislative/Regulatory Committee – Responsible for researching/determining any necessary changes to District law and regulations in order to facilitate the creation of the Sandbox, recognizing the need to balance changes that will promote speed to market with appropriate consumer protections.

FINDINGS AND RECOMMENDATIONS

Market Considerations

The Council found that the District’s market for the delivery of innovative products and services in the financial services sector is robust. Through meetings and interactions with a variety of business enterprises, the Council determined that there is an appetite for the opportunities that a Sandbox can provide. The Council determined that interests in regulatory sandboxes established in other jurisdictions have come primarily from FinTech companies that provide innovative ways of providing money transmission and payment systems. These services could be especially helpful in resolving the persistent problem of banking deserts in certain parts of the District.

In addition to businesses currently operating in the District, the objective of a Sandbox is to build a regulatory environment where businesses can test the feasibility of offering innovative goods and services. An attractive Sandbox framework has the potential to entice businesses headquartered in other states to come to the District to test innovative products and services that can serve our residents and bolster the District’s economy. Promoting this kind of economic diversity and resilience through private sector development is consistent with Mayor Bowser’s economic vision and strategy for the District.

COVID-19 has caused severe economic challenges for certain business sectors and residents in the District. The Sandbox has the potential to address these challenges by increasing the availability of new products and services, and making existing products and services more affordable and accessible for the District’s underserved communities.

Arizona, Kentucky, Utah, Vermont and Wyoming have recently enacted regulatory sandbox legislation. Arizona has approved the most applications—a total of eight (8) to date. All of the participants in Arizona are focused on consumer lending and the provision of money transmission services. If the Sandbox is approved, the District can expect to receive similar proposals since the banking/payment sector has taken the lead in innovation.

The Council recommends the District establish a Sandbox to be administered by the Commissioner of the Department of Insurance, Securities and Banking (Department).





IN ADDITION TO BUSINESSES CURRENTLY OPERATING IN THE DISTRICT, the objective of a Sandbox is to build a regulatory environment WHERE BUSINESSES CAN TEST THE FEASIBILITY OF OFFERING INNOVATIVE GOODS AND SERVICES.

Legislative and Regulatory Considerations

The creation of a Sandbox will require new legislation. The Council and the Department evaluated legislation from jurisdictions across the United States that authorized the creation of regulatory sandboxes. Department staff also conducted research on the creation of sandboxes internationally, including in the United Kingdom which is home to the first FinTech Sandbox.

The Council determined that the legislation enacted by Arizona was an acceptable model for the District to use in drafting its enabling legislation. The Council recommended certain additional language be added to the District's legislation to enhance adequate consumer protection, which the Department staff incorporated into the draft legislation.

The following are the key points of the draft legislation with respect to the creation and operation of the Sandbox:

- Applicants will be subject to the jurisdiction and regulatory oversight of the Department.
- Companies that are currently licensed to offer financial services and products, and innovators that provide services to these businesses will be eligible to apply to participate and test innovative products and services.

- 24 months will be provided for innovative product testing. The Commissioner may grant an extension for good cause shown.
- Testing will generally be limited to no more than 8,750 District consumers per innovative product.
- A strong consumer protection infrastructure, including complaint procedures, participant reporting requirements and enforcement authority will be provided.
- The Commissioner will have the authority to temporarily waive or modify existing regulatory requirements to accommodate participants without compromising consumer protection.

Upon final enactment of the Sandbox legislation, the Commissioner shall promulgate rules and an application that will provide additional structure to the Sandbox program and guidance for entities that want to participate.

Potential Sandbox Structure

Participant Eligibility

The Sandbox will be administered by the Department. Any business that provides products and services in the financial services industry is eligible to apply to participate and test innovative products in the Sandbox, subject to satisfying all applicable requirements set forth in applicable District law and regulations. All financial services, insurance and other regulatory technology businesses are encouraged to apply to participate in the Sandbox including, but not limited to: insurance companies and lenders that leverage technology such as blockchain, mobile payment applications, and cryptocurrency technology; and robo advising and stock trading applications that improve access to and affordability of high quality financial services and products. In addition, both start-ups and existing businesses would be eligible to apply. Businesses that offer products or services targeted at underserved communities are particularly encouraged to apply for admission to the Sandbox.

Each Sandbox applicant shall be required to demonstrate to the Commissioner its readiness to build and test the innovation approved for use in the Sandbox. Testing shall be completed within twenty-four (24) months from the date the application is approved for the Sandbox. The Commissioner would have the authority to grant one or more extensions, none of which could exceed twenty-four (24) months, of the initial testing time period for good cause shown.

Businesses that offer innovative product and services that do not require a waiver of any current District law or regulations to test such products or services are encouraged to apply to the Sandbox. Interested businesses should contact the Department directly to obtain further information on licensing requirements.

Sandbox Application Process

Interested Sandbox participants will be invited to meet with Department staff to discuss their plans for participating in the Sandbox. An interested business shall provide the staff with an overview of its business plan including, but not limited to: financial information, marketing plan, technology platform, data security, and consumer protection. If the Department and the business conclude that participation in the Sandbox is feasible, the business will be encouraged to submit a formal application. The applicant shall be required to pay a non-refundable application fee with the application. Once an application is received, the applicant will receive a decision on whether it is approved to participate within thirty (30) days. In addition to an application fee, the applicant will have to pay all applicable license renewal and examination fees while in the Sandbox. Further details related to the application, license, renewal and examination fees shall be set forth in rules issued by the Commissioner.

The following are examples of the key requirements to be included in the application:

- Product description and stage of development;
- Consumer benefit of product or service, including consumers in underserved communities;
- Any licensing, key technology or intellectual property information;
- Explanation of how product or service is eligible for the Sandbox;
- Anticipated consumer experience;
- Description of product or service money flows;
- Project plan with clear milestones;
- Testing plans;
- Consumer protection plans; and
- Addressable market size for the product.



The establishment of the Sandbox will not have an initial fiscal impact on the Department's budget, as the implementation costs will be absorbed into its authorized budget. The Commissioner, however, may request additional funding in future budget submissions to pay for the cost of additional staff, marketing or consulting services s/he deems necessary to properly administer the Sandbox, based on the number and complexity of the Sandbox participants.

- **Cost Estimates:** Minimum, general cost estimates on elements that should be provisioned for the Sandbox environment.
- **Expense Benefit Statement:** Include general advice for additional services, and deployment and maintenance options that could potentially increase or decrease implementation and operation costs as they increase or decrease functionality, ease of deployment, etc.

Technology Requirements

The Council considered technology requirements from two perspectives: First, the Council considered the issues related to the development, ownership and maintenance of software and hardware for those Sandbox participants who proposed to provide technology solutions for District agencies, such as the Department of Transportation, the Department of Energy and Environment, and others.

The Council also proposed and considered certain technology requirements, optionality, and cost estimates for the District's Sandbox. Highlights of those proposals include the following:

- **Components and Configuration:** Include a brief description of the technology baseline for implementing the Sandbox.
- **Architecture:** Indicate appropriate options for the Sandbox architecture based on industry best practices and basic calculation of need.
- **Requirements/Benefit Statement:** Include a brief description of the technological goal of the Sandbox construct and the benefits that should be achieved by the FSRS with the proposed technology approach.
- **Optionality:** Include basic diagrams depicting possible formats for data storage, redundancy and code development.

OCTO has recommended that the Department engage with a third-party vendor to manage the technological aspects of the Sandbox environment via a cloud service provider infrastructure. If approved to go forward, the Department would continue to work in consultation with OCTO to ensure that any vendor selected can provide the technological elements proposed by the Council while maintaining all OCTO standards necessary to protect the District's network from potential security vulnerabilities.

While the Council encourages third-party vendors with innovative solutions to seek opportunities with the District government, it decided not to attempt to address specific IT requirements in this Report. Instead, businesses interested in doing business with the government will have to satisfy the IT requirements of the contracting agency during the procurement process.

Second, the Council considered IT issues related to Sandbox participants that intend to engage in transactions with District consumers directly that do not involve any contractual arrangements with the District government. Sandbox applicants will be required to provide the Commissioner with a description of its software as part of the application process. Such description shall not include any proprietary or trade secret information. Applicants approved to participate in the Sandbox will own and maintain their IT.

Participant Expectations While in the Sandbox

Sandbox participants should expect their participation in the Sandbox to be subject to certain reasonable “rules of engagement.” Some of the expected rules may include, but are not limited to, the following:

- Participants must retain records, documents and data produced in the ordinary course of business regarding an innovation tested in the Sandbox.
- Participants must respond within ten (10) business days to requests for information from the Commissioner or the Commissioner’s designee to monitor Sandbox project development.
- Participants must agree to comply with any order to submit to an examination of their Sandbox activities.
- Participants must submit monthly progress reports to the Commissioner detailing:
 - Updates on meeting project milestones;
 - Project accomplishments;
 - Planned or in-process tasks and goals;
 - Identified points to research;
 - Comments or feedback; and
 - Testing progress and results.
- Redefinition of regulatory and compliance requirements to balance safe use of the innovation with opportunity for market entry to the innovator, where possible.
- That other incentives for successful participants may be offered to them to continue to operate and innovate in the District outside of the Sandbox environment.
- A participant that does not successfully complete its participation in the Sandbox, withdraws from the Sandbox or decides for any reason to discontinue its operations in the District, shall satisfy all of its obligations to its customers in the District.
- A participant may elect or may be required by the Commissioner to exit the Sandbox at any time if it is determined by the participant or the Commissioner that the innovation is not viable.
- The Commissioner may order the participant to leave the Sandbox and terminate all business activity if the Commissioner determines the participant has substantially harmed consumers in the District.

Potential Outcomes Upon Completion of Sandbox Participation

- After the successful completion of a developmental period in the Sandbox, a participant may expect one or more of the following outcomes: An opportunity to sell, lease, license, or distribute an innovation to the public that has been approved as safe and useful to the District according to guidelines set by the Commissioner.
- An opportunity to become a vendor, contractor, consultant, or advisor to the Commissioner, the Executive Office of the Mayor or predefined stakeholders in the District, consistent with applicable District laws, regulations and contracting procedures.
- An opportunity to receive applicable licensing to continue to provide services to the District using their developed innovation.
- To receive official feedback on the viability, feasibility or desirability of their innovation to the District.



CONCLUSION

The Council recommends that the District establish a Sandbox for financial services companies and business entities that would fall under the jurisdiction of the Department of Insurance, Securities and Banking.

The District is uniquely positioned to benefit from the establishment of a Sandbox. The District is home to (1) a vibrant technology sector, (2) several highly ranked universities, (3) a diverse population, (4) communities with a higher than average educational attainment and household income, and (5) a significant number of unbanked and underbanked residents. Moreover, the District is among a handful of jurisdictions in the U.S. that regulate insurance, securities, banks and money services businesses under a single regulator.

The establishment of a Sandbox will send a clear signal to all emergent technology innovators, whether they are established firms or start-ups, that the District is open to, and welcoming of, innovation. The Sandbox will provide an environment where live experiments can be conducted in a controlled manner and with safeguards in place to contain any potential harm to consumers.

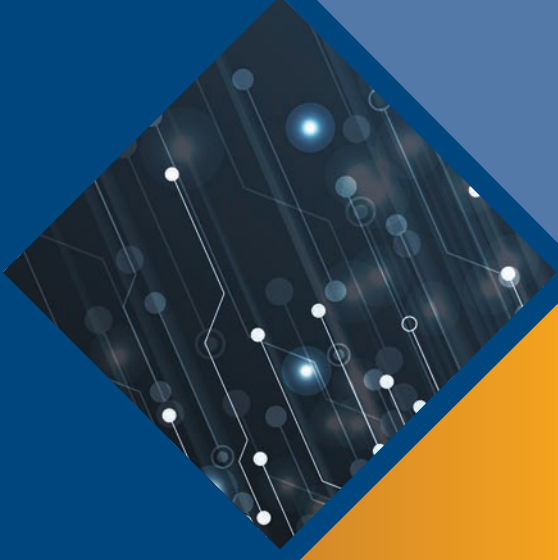
The creation of a Sandbox is not without risks. The regulator must strike the proper balance between an openness to innovation with the need to protect consumers of financial services, insurance and other technological products. The District is committed to fostering appropriate consumer protection, social responsibility and an ethical approach to the development of innovations for participants in the Sandbox. Having an appropriate balance between innovation, regulation and consumer protection is necessary to create a successful Sandbox.

In a similar vein, the Sandbox must be able to identify and admit true innovators that, if given the opportunity, will use the Sandbox as a place to test their products or services to satisfy the objectives of the Sandbox, rather than businesses that are more interested in finding a regulatory environment where they can operate under a different set rules and requirements to gain a competitive advantage over other businesses operating in the same space.

Each potential Sandbox applicant's business proposition must be adequately evaluated to ensure that it will be successful and contribute to the District's economy in the long run. Therefore, it is important that the Department have the capacity to assess the technology underlying the innovation as well as the firm's probability of success.

Lastly, the District must be able to deliver on its commitment to provide both a safe space to innovate during the testing phase, and a place where graduates of the Sandbox may continue to operate successfully. The District's efforts to attract innovators to create economic opportunities will be short-lived if commitments to Sandbox participants are not kept. Sandbox participants will need to know, when applying to participate in the regulatory sandbox, what to expect if they are successful. The government must decide and clearly articulate what the regulatory environment will look like post-Sandbox if the District is to be successful in attracting and retaining innovators. Though it is imperative that the Sandbox objectives are achieved, there must be balance so that Sandbox participants are not discouraged from applying for entry into the Sandbox or find it necessary to leave the District upon graduation because regulatory requirements or other mandates such as residency or hiring requirements are too burdensome to operate efficiently and effectively.

As noted above, the Department has prepared draft legislation to create a Sandbox that would make the District extremely attractive to FinTech, InsurTech, RegTech, and other technology innovators to test their ideas. The draft legislation is attached to this report.



The Department of Insurance, Securities and Banking (DISB) would like to thank the members of the District of Columbia Financial Services Regulatory Sandbox and Innovation Council for their invaluable contributions and service to the District's business community, residents and the Government of the District of Columbia.

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