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TESTIMONY

A UNIVERSAL SANDBOX IN MISSOURI CAN PROMOTE INNOVATION AND REGULATORY REFORM

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Chair Hudson, Vice Chair Christ, Ranking Member Barnes, and members of the House Committee on Economic Development, thank you for the opportunity to submit this testimony in relation to House Bill 268.

My name is Agnes Gambill West, and I am a visiting senior research fellow at the Mercatus Center at George Mason University. My expertise is in blockchain, regulatory sandboxes, and innovation policy. I have shared my expertise to help other states in the process of enacting regulatory sandbox legislation, including North Carolina and Ohio. I have attached a policy article that highlights the factors that make state regulatory sandboxes successful.

Today I would like to offer the following takeaways about regulatory sandboxes:

1. Universal sandboxes offer potential benefits, including increased innovation and efficiencies in regulatory relief for multiple and hybrid industries.
2. Residency and reciprocity are important considerations in regulatory sandbox design.
3. States should partner with nonprofits, such as innovation hubs, that support sandbox participants beyond the sandbox.

BENEFITS OF A UNIVERSAL SANDBOX

A regulatory sandbox offers temporary relief from regulations to businesses in a specific industry to test a product or service before making it available more broadly.[1] A universal sandbox expands this definition by offering time-limited regulatory relief to businesses in any industry.[2]

1. Brian R. Knight and Trace E. Mitchell, "The Sandbox Paradox: Balancing the Need to Facilitate Innovation with the Risk of Regulatory Privilege," *South Carolina Law Review* 72, no. 2 (2021): 445–75.
2. Caden Rosenbaum, "Utah's Universal Sandbox Is Open for Business," Libertas Institute, February 4, 2022, https://libertas.org/free-market/utahs-universal-sandbox-is-open-for-business/.

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One benefit of the universal sandbox model is that it increases efficiency in the provision of regulatory relief for businesses that are regulated by more than one state agency. Hybrid industries with innovative business models, such as agricultural technology (AgTech) or medical technology (MedTech), may experience higher regulatory burdens than traditional single-industry firms and may welcome this type of multi-agency regulatory relief. An AgTech business, for example, could be subject to regulatory oversight for products or services that incorporate elements of fintech or other emerging technologies in addition to being subject to regulatory oversight for existing agricultural and environmental regulations.[3] Cutting red tape for hybrid industries and innovative businesses will encourage experimentation, discovery, and innovation.

Another benefit of a universal sandbox might include cost savings for legislating. If a state initially adopts an industry-specific sandbox, such as a fintech sandbox, and subsequently decides to expand the scope of the sandbox to insurance or real estate, lawmakers and the public will incur certain costs. It takes research specialists, legislative counsel, clerks, representatives, senators, and other participants to draft and debate new bills, resolutions, or amendments. There are also other costs at play: the time expended on the lengthy process of legislating, fees for bill drafting and enactment, and opportunity costs.[4] By adopting a universal sandbox at the outset, a state does not need to relegislate when new industries and innovative businesses seek entrance into a sandbox in search of regulatory relief.[5]

SANDBOX DESIGN: RESIDENCY AND RECIPROCITY ARE KEY

At least 11 states have regulatory sandboxes; however, rates of participation in each state sandbox vary widely.[6] One determinant of the variance is the degree of flexibility in the residency requirements of state sandboxes.

Sandbox legislation should have flexible residency requirements. It might seem that a requirement that sandbox applicants establish a physical presence in a state would lead to job growth and economic activity and be worth including in the program, but strict residency requirements may actually be a disincentive for out-of-state participants who do not want to relocate for the temporary duration of the sandbox.

For example, Wyoming's legislation stipulates that applicants must have a physical presence in the state.[7] By contrast, Arizona and Hawaii allow out-of-state applicants to participate in the sandbox.

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3. Research from Purdue University has shown that US Department of Agriculture regulations led to a 24.7 percent decrease in productivity growth, and EPA regulations led to a 36.8 percent decrease between 1997 and 2012. Matthew Nicaud, "Agricultural Innovation Exposes Regulations Ripe for Reform," Mississippi Center for Public Policy, December 17, 2021, https://mspolicy.org/agricultural-innovation-exposes-regulations-ripe-for-reform/; Levi A. Russell, John M. Crespi, and Michael R. Langemeier, "Agricultural Productivity Growth and Regulation" (unpublished manuscript, August 31, 2015), https://ag.purdue.edu/commercialag/home/wp-content/uploads/2015/08/201508_RussellCrespiLangemeier_AgriculturalProductivityGrowthandRegulation.pdf
4. In 2011, the average cost of a bill in the Wyoming legislature was estimated to range between $453 and $39,785. Michelle Dynes, "The Cost of a Bill," *Wyoming Tribune Eagle*, January 9, 2011.
5. Francesco Parisi and Nita Ghei, "Legislate Today or Wait until Tomorrow? An Investment Approach to Lawmaking," *Journal of Public Finance and Public Choice* 23, no. 1-2 (2005): 19–42.
6. "Regulatory Sandboxes in Your State," Libertas Institute, accessed November 14, 2022, https://libertas.org/outreach/sandbox/state/.
7. Wyoming Division of Banking, *Chapter 1: Financial Technology Sandbox*, December 15, 2019, 1–2, https://drive.google.com/file/d/1Gc4ZVXWXJDqIOxWRvhNxoMP_mzGypxMv/view (see section 4, Verification of In-State Presence Requirement).

Arizona and Hawaii have accepted in-state and out-of-state participants into their sandboxes since the inception of those programs, whereas Wyoming's sandbox has had no participants at all.

The present bill contains provisions that allow flexible residency. For example, the bill requires an applicant to establish either a physical residence or virtual location in the state. At the same time, the bill provides that the applicant is still subject to the jurisdiction of Missouri by consenting to the state's jurisdiction in the sandbox program's application form.

Provisions that support reciprocity with other state sandboxes could also attract sandbox participants. Statutory reciprocity allows states to form reciprocity agreements with other states, which would allow sandbox participants to access those states' sandboxes and markets. In doing so, reciprocity multiplies the benefits of a sandbox by allowing participants to engage in experimental sandbox activity across multiple states, rather than in just one.

Currently, 8 out of 12 states that have regulatory sandboxes allow for reciprocity, including Arizona, Florida, Ohio, Nevada, North Carolina, Utah, West Virginia, and Wyoming.[8] Reciprocity gives startups cost-effective access to a larger market at an early stage and exposure to a variety of valuable business insights. Such reciprocal arrangements might be particularly beneficial to entrepreneurs who live in less populated or rural states and who desire access to a different geographical market and other regions with diverse economic activity.

The present bill contains a reciprocity provision, which allows the regulatory relief office to enter into agreements with other states that have similar sandbox programs. This reciprocity provision gives in-state and out-of-state participants the opportunity to test innovative products and services in a flexible regulatory environment across a broader region. However, according to the present bill, reciprocity agreements must be supported by a two-thirds majority vote of the advisory committee and can only proceed with an order from the governor of Missouri. These additional layers of approval may present barriers for other states intending to enter into reciprocity agreements with Missouri and may hinder regional economic growth.

NONPROFIT PARTNERSHIPS CAN SUPPORT AN ENTREPRENEURIAL ECOSYSTEM BEYOND THE SANDBOX

The duration of a regulatory sandbox is limited by design, can last on average from 12 to 24 months, and can be extended another 12 months upon request. This limited program duration is important because although sandboxes give entrepreneurs an opportunity to test innovative products and services in a modified regulatory environment, not all sandbox participants succeed by the time their regulatory waivers expire.

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8. Agnes Gambill West, "States Can Attract More Entrepreneurs by Sharing Sandboxes," *RealClearPolicy*, September 22, 2022; "Frequently Asked Questions," Arizona Attorney General Mark Brnovich, accessed November 14, 2022, https://www.azag.gov/sandbox/faq; H.B. 624, 2021 Sess. (N.C. 2021); H.B. 1391, 2020 Leg., Reg. Sess. (Fla. 2020); "Nevada Sandbox FAQs," State of Nevada Department of Business and Industry, accessed November 14, 2022, https://business.nv.gov/Programs/Nevada_Sandbox_FAQs/; H.B. 243, 64th Leg., 2022 Gen. Sess. (Utah 2022); H.B. 4621, 85th Leg., 2020 Reg. Sess. (W.Va. 2020); "Financial Technology Sandbox," Wyoming Division of Banking, accessed November 14, 2022, https://wyomingbankingdivision.wyo.gov/banks-and-trust-companies/financial-technology-sandbox.

Upon completion of their participation in a sandbox, entrepreneurs need to plan for an exit strategy, and states can help with that transition. By partnering with nonprofits, such as innovation hubs, that support sandbox participants and innovation in general, states can build more effective entrepreneurial ecosystems.

Although regulatory resources may be constrained, nonprofits—especially innovation hubs—can fill an important gap by helping promote innovation and support sandbox participants before, during, and after participation in the sandbox. Specifically, nonprofits can shepherd applicants through the application process, give guidance on regulatory issues, provide contacts at regulatory agencies, and furnish technical and fundraising assistance.

For example, in creating a regional drone sandbox, Arkansas and Oklahoma have partnered with Tulsa Innovation Labs to establish a "launch pad" at the Helmerich Research Center at Oklahoma State University-Tulsa to fuel research and commercialization in the region.[9] The collaboration also taps educational institutions, including community colleges, to support workforce development opportunities. In North Carolina's regulatory sandbox bill, designated nonprofits can help sandbox participants with the design and implementation of products and services and with the sandbox application process.

The present bill does not specifically acknowledge the importance of public-private partnerships that might support sandbox applicants and the successful implementation of the regulatory sandbox. Working with universities, incubators, and economic development organizations, such as Missouri Partnership,[10] will support sandbox-led entrepreneurial activity in the state and region and will amplify the growth and sustainability of innovation in Missouri. However, the present bill does allow sandbox participants to apply for a series of extensions that amount to a cumulative maximum of seven years inclusive of the original 24-month sandbox demonstration period. This generous extension scheme coupled with the support of public-private partnerships may give sandbox participants a greater chance of success.

CONCLUSION

Regulatory sandboxes can promote innovation and regulatory reform, but the design and execution of a sandbox matters. The universal sandbox model may provide efficient regulatory relief to hybrid industries and innovative businesses that are regulated by multiple agencies. The universal sandbox model also avoids the costs of relegislating the expansion of scope for industry-specific sandboxes. To attract applicants to its universal sandbox, Missouri should recognize the importance of flexible residency requirements and reciprocity provisions. Nonprofit partnerships can also create value by supporting applicants beyond the universal sandbox and creating a sustainable entrepreneurial ecosystem in Missouri.

ATTACHMENT

Agnes Gambill West, "States Can Attract More Entrepreneurs by Sharing Sandboxes," *RealClearPolicy*, September 22, 2022.

9. Center for the Advancement of Science and Technology, "Governors Stitt, Hutchinson Partner to Create Super Region for Advanced Mobility in the Heartland," news release, August 18, 2022, https://oklahoma.gov/ocast/about-ocast/news/governors-stitt--hutchinson-partner-to-create-super-region-for-a.html.
10. "About," Missouri Partnership, accessed January 23, 2023, https://www.missouripartnership.com/about/.

RealClear Policy

States Can Attract More Entrepreneurs by Sharing Sandboxes

By Agnes Gambill West
September 22, 2022

As more states experiment with “regulatory sandboxes” to give innovators whose products don’t fit within old policy models a proving ground, one critique has been surfacing: Participation varies widely. Wyoming has struggled to recruit a single applicant despite its prolific success in creating a crypto-friendly jurisdiction. In comparison, Hawaii’s Digital Currency Innovation Lab has admitted at least 12 participants in its first cohort and 15 in the second, Prominent digital currency companies such as SoFi, BlockFi Trading, Gemini Trust Company, and Robinhood Crypto are among the participants. For a more drastic comparison, look across the Atlantic, where the U.K.’s sandbox has received over 550 applications since its 2016 launch.

Why are some states more successful in recruiting sandbox applicants than others? How might they attract more entrepreneurship?

Since 2018, regulatory sandboxes have created safe harbors for entrepreneurs to temporarily test new business models and novel products and services without incurring significant regulatory compliance costs or bearing the risk of noncompliance. Since 2018, 11 states have established them using one of two different models. The “industry-specific” model focuses on regulatory relief for businesses in distinct industries, typically cutting-edge fields like fintech or medical digital innovation. The “universal” model is all-encompassing and offers potential regulatory relief for any type of business in any industry.

Seven of the 11 states allow for reciprocity, arguably the most important provision in regulatory sandbox legislation: Arizona, Florida, North Carolina, Nevada, Utah, West Virginia, and Wyoming. However, Kentucky, South Dakota, Vermont, and Hawaii do not. Reciprocity allows for sandbox-based businesses to transact in other participating states through temporary regulatory waivers.

With statutory reciprocity, the benefits of a sandbox can be multiplied. Participants can engage in experimental business activity across multiple states, opening the door to a more diverse and larger market

for startups seeking to test their unconventional ideas. Startups can access geographically diverse markets that they otherwise might not consider or be able to reach at an early stage. They can learn how consumer preferences vary across regions and gain access to valuable data and business insights.

Digital asset businesses, which quite often face regulatory uncertainty, may find this multijurisdictional sandbox relief attractive and cost-effective. Other hybrid tech industries, such as AgTech and MedTech, also stand to benefit.

Reciprocity offers several other specific advantages. It could mean relief from cumbersome state licensing requirements, such as money transmission laws, which regulate the sending and receiving of money. The universe of money transmissions law is notoriously difficult and expensive to comply with because each state has its own set of rules — one reason why there have been numerous calls for uniform state money transmission laws or even a federal alternative.

It also alleviates the cost of researching and understanding the different laws and regulatory requirements of various states, which can be significant. Startups can focus on innovation rather than regulatory uncertainty, which might otherwise come at the expense of their bottom lines.

Because cryptocurrency payment platforms and trading exchanges, for example, often need money transmission licenses to legally operate, multistate regulatory waivers could result in significant cost savings for startups. Hawaii's program has already demonstrated the demand for this type of regulatory relief. While beautiful beaches and warm weather certainly don't hurt, the popularity of its sandbox is likely because of the simplicity of its sandbox model, the absence of residency requirements, and the speed and ease of getting a waiver. Other states should emulate this simplified model, and with the benefits of reciprocity they can become even more attractive options for startups.

Reciprocity also encourages regulators to place less emphasis on overly burdensome residency requirements. Wyoming's participation drought is reportedly due to strict requirements that a startup's physical presence be more than just a registered office or agent. Requiring residency in multiple states may inadvertently favor large companies over startups, but negotiating a residency waiver as a condition of reciprocity could level the playing field. Such an agreement could also be a competitive alternative to other regulatory relief initiatives, such as the Catawba Nation's Digital Economic Zone, which allows digitally native web3 or blockchain startups to legally register entities that are entirely virtual.

Some states could benefit from sandbox reciprocity more than others. Startups are incentivized to target large consumer bases in densely populated markets, like California and New York. It is no coincidence, then, that these wealthy states do not have sandbox initiatives while more rural ones, like South Dakota, Wyoming, Kentucky, and West Virginia, do. With reciprocity, rural, less populated states could form a "super sandbox" or "regional sandbox" as a competitive force to challenge the economic dominance of larger states who may be resting on their legacy reputations.

Despite these advantages, reciprocity is not a panacea for sandbox success and states should work to understand what additional changes could foster business dynamism, which has been on a downward trend in recent decades. Furthermore, the use of reciprocity in this space is not well understood. States seem to recognize the benefits, but could do more to create bridges for interstate and even federal participation. Nevada, for example, is already working with the federal Consumer Financial Protection Bureau's Office of Innovation, which manages a No Action Letter and Compliance Assistance Sandbox program. However, to date, no state has formally announced any cooperative agreement with another.

The availability and advantages of existing reciprocity agreements are also not well communicated to the public. These details are rarely listed on state sandbox websites and are often buried in dense legislative text. This important information needs better outreach and marketing, two underutilized strategies for attracting applicants and economic activity to a given state.

Whether or not regulatory sandboxes ultimately diversify state economies and create more high-paying jobs, reciprocity can signal that states are in the business of cooperation and business creation.

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