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PUBLIC INTEREST COMMENT

COMMENT REGARDING THE CONSUMER FINANCIAL PROTECTION BUREAU'S PROPOSED NO-ACTION LETTER AND PRODUCT SANDBOX POLICIES

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Policy on No-Action Letters and the BCFP Product Sandbox
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I appreciate the opportunity to submit a comment to the Consumer Financial Protection Bureau (Bureau) in response to its proposed rulemaking regarding its No-Action Letter and Regulatory Sandbox proposal.[1] The Mercatus Center at George Mason University is dedicated to bridging the gap between academic ideas and real-world problems and to advancing knowledge about the effects of regulation on society. This comment, therefore, does not represent the views of any particular affected party or special interest group. Rather, it is designed to help the Bureau as it considers how to implement these policies. Specifically, the comment seeks to help the Bureau design and implement a system that allows innovative companies to achieve regulatory clarity and obtain appropriate regulatory relief while ensuring that consumers are protected. More generally, it seeks to help the Bureau pursue its goal of protecting consumers by allowing for competition and innovation in the market for financial services.

The Bureau's proposed No-Action Letter (NAL) and Regulatory Sandbox (Sandbox) policies are important proposals that represent a potentially significant improvement in the regulatory environment for consumer financial products. However, while the NAL and Sandbox policies, if executed well, could provide considerable benefit, they could also pose a significant risk to consumers, innovation, and competition if executed poorly. Therefore, it is critical that the Bureau establish appropriate rules and expectations for the policies at their inception, and implement those rules judiciously.

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[1] Policy on No-Action Letters and the BCFP Product Sandbox, Proposed Policy Guidance and Procedural Rule; Proposed Information Collection, 83 FED. REG. 64036 (proposed Dec. 13, 2018) [hereinafter *Policy on No-Action Letters and the BCFP Product Sandbox*] (proposed policy guidance and procedural rule; proposed information collection; request for comment).

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In the following comments I first discuss the current proposal and some likely implications. Then I recommend additions or changes to the proposal that I believe would make it more effective at its goal of encouraging innovation and competition while providing appropriate consumer protection. These recommendations can be summarized as follows:

1. The Bureau should increase transparency in the application process, requirements for entry, and the findings and limits of a Sandbox trial.
2. The Bureau should periodically reassess whether firms' plans to compensate consumers remain credible and whether firms and the Bureau should coordinate with new regulators, as well as the impact of the Sandbox on consumers and the market.
3. The Bureau should consider whether providing access to similarly situated competitors contemporaneously or near contemporaneously would help protect markets.
4. The Bureau should refrain from substituting its judgement regarding potential consumer benefit for the judgment of the market and work to ensure that nonparticipation in the Sandbox does not become a de facto regulatory disadvantage.
5. The Bureau should consider whether it should use its exemption authority under Dodd-Frank in addition to the enumerated consumer protection statutes.

THE CURRENT PROPOSAL

The Bureau's NAL/Sandbox proposal represents a significant enhancement over the Bureau's existing NAL policy. The proposal improves on the status quo in numerous ways, including the following:

- *Creating a Regulatory Sandbox*. The Bureau's acknowledgement that a well-constructed and operated regulatory Sandbox can provide benefits to consumers, market participants, and the Bureau itself that a traditional NAL policy cannot. While, as discussed later, there are some areas for potential improvement, the Bureau's current proposal is thoughtful and reflects the Bureau's commitment to innovation.
- *Removing the data-sharing requirement from the NAL policy*. The NAL policy serves to provide clarity to the entity seeking the NAL (and to the broader market) as to the requirements of the law. Unlike the Sandbox, the NAL policy does not involve asking the Bureau to exercise its statutory discretion to grant an exemption or approval that would change the entity's legal obligations or grant a safe harbor from potential liability. Therefore, there is no justification for requiring an entity to disclose information beyond what is otherwise required by law simply to obtain clarity as to its regulatory obligations.
- *Contemplating providing NAL/Sandbox relief for unfair, deceptive, or abusive acts or practices (UDAAP)*. UDAAP represents a significant part of the Bureau's jurisdiction and a considerable source of regulatory uncertainty. Working with entities to obtain clarity ex ante as to whether their proposed conduct may constitute UDAAP can help these entities avoid committing a proscribed act or practice and limit risk to both covered persons and consumers. Importantly, as the Bureau notes,[2] this relief does not waive the laws governing

[2] *Policy on No-Action Letters and the BCFP Product Sandbox*, *supra* note 1, at 64039, 64040, and 64044.

UDAAP or exempt an entity from UDAAP. Instead it reflects a determination by the Bureau that the proposed conduct does not constitute UDAAP. The Bureau is not allowing the entity requesting relief to act lawlessly; instead, it is providing clarity as to what the law requires.

- *Judicious use of the Bureau's approval and exemption authority*. The proposal wisely creates a framework by which the Bureau can prudently use the authority provided by enumerated consumer protection statutes to approve or exempt certain activities. Such use is consistent with the underlying laws and the authority granted to the Bureau by Congress to provide safe harbor for certain activities in instances where imposing all of the requirements of the underlying law are unnecessary for consumer protection. Importantly, this would not mean the underlying consumer protection law does not apply. Rather, it would reflect the Bureau using the discretion granted to it under those statutes to reduce regulatory burden.
- *Facilitating coordination and cooperation among regulatory agencies.* The Bureau's proposal should be commended for taking seriously the regulatory challenges posed by the fragmented nature of financial regulation. By building in mechanisms for entities to seek coordination with multiple regulators at the state, federal, and international level, the Bureau helps respect other agencies' jurisdiction and expertise and protect entities seeking regulatory relief. This openness and willingness to facilitate coordination helps to make the Bureau's NAL/Sandbox policy, and the comparable policies of other regulators with overlapping jurisdiction, more effective.
- *Requiring applicants to clearly articulate the uncertainty they are trying to resolve.* The Bureau should also be commended for seeking to require entities desiring relief to clearly articulate why relief is necessary. Given limited regulatory resources and the risk that participation in a Bureau-sponsored program may grant some unintentional competitive advantage or be interpreted by consumers as an endorsement, it is important for the Bureau to limit relief to those cases where there is a legitimate regulatory ambiguity that needs to be addressed.
- *Requiring applicants to clearly articulate the risks they anticipate, and how they stand ready to redress consumer harm.* Given the Bureau's important mission to protect consumers, it is vital that firms seeking relief, especially in the form of approval or exemption, be able to address any harms caused to consumers for which they would be entitled to redress under law. The Bureau should be commended for taking this concern seriously and should make certain, as it begins to operate the Sandbox, that firms obtaining relief are complying with this requirement.
- *Allowing for participants to respond to a Bureau decision to revoke an NAL or terminate Sandbox participation, and provide an orderly wind-down period.* Due process is an important component of any government action, and the focus of the Bureau's proposal on allowing a participant an opportunity to respond and to cure defects before their NAL expires or participation in the Sandbox is terminated is appropriate and commendable. Further, allowing an orderly wind-down period not only benefits the participant but can also benefit the participant's customers, since they will be able to cease using the product in an orderly manner.

RECOMMENDED IMPROVEMENTS TO THE PROPOSAL

While the Bureau's proposal is a strong start, there are some areas where improvements can enhance the Bureau's ability to protect consumers and facilitate competition, as well as areas where more clarity can be provided to regulated entities and the market.

Protecting Consumers

The Bureau's essential mission is to protect consumers. However, this protection should not take the form of the Bureau substituting its preferences for those of consumers. Instead, the Bureau should seek to ensure that firms using the NAL and Sandbox policies are able and willing to make customers whole in the event the firm violates the law in a way that harms consumers. The Bureau should also ensure that consumers enjoy transparency so that they can make informed decisions. To further this goal, the Bureau should consider the following suggestions:

- *Improve transparency regarding what participating in the Sandbox means.* The Bureau should require firms participating in the Sandbox to clearly and conspicuously state that their product is experimental and that the firm is participating in the Bureau's Sandbox program, and to include a link to the Bureau's Office of Innovation website or provide equivalent information about the terms and limitations that accompany the Sandbox (e.g., safe harbor from a private suit under an enumerated consumer protection statute). The Bureau should also require firms participating in the Sandbox to clearly and conspicuously state that participation in the Sandbox does not mean that the Bureau or any other regulator endorses the firm's product or service. This will help mitigate the risk that consumers may misunderstand the nature of the Sandbox and will allow them to make informed choices as to whether they wish to use an experimental service.
- *Periodically reassess whether firms' plans to make consumers whole in the event of a harm for which the consumer is entitled to compensation remain credible.* Conditioning access to the Sandbox on a firm's credible plan to compensate consumers for harms that result from a violation of consumer protection law is an essential part of the Sandbox proposal. Given the extended duration in which a firm may be in the Sandbox and the developing understanding of the product and its potential risks that may develop as the firm conducts its experiment,[3] it is appropriate for the Bureau to require the firm to periodically update its plan. It also is proper for the Bureau to make an independent assessment of whether the plan remains credible, in light of the firm's current and expected assets and exposures.
- *Periodically reassess whether coordination with additional regulators is called for*. The Bureau's proposal wisely anticipates coordination with other regulators and includes a mechanism for applicants to identify regulators during the application process. Given the duration in which a firm may be in the Sandbox and the possibility that the understanding of the nature of the product or service may evolve over time, it may be necessary to bring

[3] The Bureau estimates that two years will be an appropriate duration but acknowledges that some firms may participate longer. *Policy on No-Action Letters and the BCFP Product Sandbox*, *supra* note 1, at 64043 (footnote 83 and accompanying text).

new regulators in to consult on a product or service after the firm's application has been approved and the firm has begun to utilize the Sandbox.

Therefore, the Bureau should allow firms to request coordination with additional regulators on an ongoing experiment. The Bureau should also build into its Memoranda of Understanding a provision that would, to the greatest extent possible, encourage other regulators to refrain from bringing enforcement actions against firms operating in good faith and in accordance with the Sandbox's requirements, if the firm's failure to seek coordination with that regulator at the time of application was reasonable, given the firm's knowledge then.

- *Do not allow the Bureau to substitute its judgement for the market's with regard to potential consumer benefits.* The Bureau intends to solicit information from applicants for both NALs and the Sandbox regarding the expected consumer benefits the product or service will provide, and has stated that the Bureau will place "particular emphasis" on those criteria along with a few others.[4] While obtaining an understanding of potential benefit is important and appropriate, the Bureau should take steps to ensure that it does not become a means for the Bureau to stand in place of the market.

  The best way to assess whether a product or service is beneficial is to allow people, through an open market, to decide for themselves the product or service's value. Just because the Bureau does not see the value in a proposed product or service does not mean that potential customers, who may have different needs or preferences than the relevant Bureau employees, will not find a product valuable. So long as the firm is able to adequately compensate users for legally cognizable potential harm (which is a separate evaluation criterion), the Bureau should not deny access to a NAL or the Sandbox simply because Bureau employees do not find the applicant's value proposition compelling.

Protecting Markets and Competition

The NAL and Sandbox present the Bureau with something of a paradox: the NAL and Sandbox should help firms that seek appropriate regulatory relief without being so much of a benefit that those firms enjoy an undue competitive advantage. This is a particular risk to the extent that resource limitations prevent the Bureau from providing all similarly situated competitors the opportunity to obtain simultaneous relief.[5] While a decision on whether relief is appropriate inherently depends on specific facts and circumstances, and relief therefore cannot and should not be handed out without particularized analysis, there are changes the Bureau can make to its proposal that would help mitigate the risk that a firm obtaining relief through the NAL, and particularly the Sandbox gains a significant competitive edge. In particular, the Bureau should do the following:

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[4] *Policy on No-Action Letters and the BCFP Product Sandbox*, *supra* note 1, at 64037, 64039, and 64042. The other criteria are potential harm posed and regulatory or legal provisions from which relief is sought and the identification of uncertainty or ambiguity.
[5] The ability for trade groups to seek relief may help address this concern to a degree, but trade groups rarely cover the entire universe of market participants. Further, as the Bureau notes, it may be hard for a trade group to provide sufficient detail on the acts of specific members to allow the Bureau to evaluate whether relief is appropriate.

- *Consider whether it should also use its power under 12 U.S.C. § 5512(b)(3)*. This power allows the Bureau to exempt certain Sandbox participants from the provisions of Title X of Dodd-Frank in cases where the Bureau determines that such exemption is necessary or appropriate to carry out the underlying purpose of protecting consumers. As the Congress noted, there may be circumstances in which waivers for Title X compliance can help further the purposes of the title. The Bureau's Sandbox has the potential to foster innovation and increase competition in the marketplace for consumer financial products and services. Innovation and competition can increase consumer protection as they improve both the number and quantity of goods and services available, providing consumers with more robust markets. A more competitive and robust market, together with the requirement that Sandbox participants provide appropriate recompense in the event their products or services cause harm to consumers, could increase overall consumer protection and could, consistent with Congress's intent, warrant granting an exemption to Sandbox participants under 12 U.S.C. § 5512(b)(3) under certain circumstances.

  In granting the power to exempt entities from Title X, Congress instructed the Bureau to consider certain factors, including the total assets of the class of covered persons, the volume of transactions or services the covered person is engaged in, and the existing provisions of law that are applicable and whether they provide consumers with adequate protection.[6] An analysis of these three factors in light of the realities and limitations of participation in the Sandbox may argue in favor of exemption. First, firms participating in the Sandbox will frequently be smaller firms with limited assets.[7] Second, the limited nature of the Sandbox trial will limit the volume of transactions or services provided. Third, and most importantly, the Sandbox's requirement that participants be able to compensate consumers for legally cognizable harm, combined with the requirement for good-faith participation and cooperation with the Bureau, indicate that consumers are adequately protected by existing law and the limits and requirements placed on firms as a condition of Sandbox entry. Such an exemption would help forward the Bureau's Sandbox effort by providing more regulatory certainty to participants and should be considered.
- *Consider whether similarly situated competitors have received relief when assessing an application.* The Bureau should consider whether an applicant's similarly situated competitors have received relief from the Bureau previously or are in the process of receiving relief as a factor in favor of granting an applicant access.[8] Allowing similarly situated competitors to obtain relief may not only help the Bureau obtain more information on particular products and services and conserve resources, it will also help mitigate the potential that the NAL and Sandbox become a source of undue regulatory advantage.

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[6] 12 U.S.C. § 5512(b)(3)(B)(i–iii) (2010).

[7] For example, startups and small- and medium-sized enterprises made up the significant majority of the firms using the United Kingdom's Financial Conduct Authority's Sandbox in its first year. *See* FINANCIAL CONDUCT AUTHORITY, REGULATORY SANDBOX LESSONS LEARNED REPORT 9 (2017).

[8] To determine whether a competitor is "similarly situated" the Bureau should consider, *inter alia*, whether the competitor is offering a comparable product that poses comparable risks, whether the applicant is at a similar state of development to the competitor when the competitor received relief, whether the applicant has provided a similarly robust analysis of the regulatory issues on its application as its competitor did, and whether the regulatory issues are in fact comparable (though not necessarily identical) between the applicant and competitor.

- *Provide meaningful transparency and information regarding participants' applications and experiences*. The Bureau should provide as much information as possible about the regulatory and legal issues exposed by participants without disclosing confidential information or placing participants at a competitive disadvantage. This could include the types of companies participating, the types of legal and regulatory issues that clarity is sought for, any legal or regulatory analysis that the Bureau or another participating regulator performs, and the results of tests run by participants after their completion.

  Given its resource limitations, the Bureau will likely not be able to accept every qualifying firm into the Sandbox program and there is a risk that participation will become a source of competitive advantage. Providing the public and other market participants with information about legal and regulatory analysis in an NAL and the learnings acquired in the Sandbox will help the public assess the value of the Bureau's efforts and help other competitors avoid undue disadvantage. In cases where the Bureau wishes to release information that the participant believes is confidential or will place it at a competitive disadvantage, the Bureau should consider whether a summary drafted by the participant would be adequate, provided it conveys the necessary information.
- *Make clear that participation in the NAL and Sandbox is not mandatory*. Just as there is a risk that participating in a Sandbox could give a firm a competitive advantage, there is a risk that nonparticipation could result in firms facing a regulatory disadvantage. While participation in the NAL and Sandbox programs should be considered strong evidence of good faith (assuming compliance), this does not mean that firms electing not to pursue an NAL or admission to the Sandbox are operating in bad faith.

  While participation in the NAL and Sandbox can and should limit regulatory exposure, a firm operating in good faith outside of the NAL and Sandbox context that makes an honest mistake as to the law and is able and willing to restore customers should not face additional punishment simply because it did not seek an NAL or Sandbox admission. While the Bureau is unlikely to institute an overt policy that punishes non-NAL/Sandbox participants more than equivalent participants, it should also be on guard that it does not pursue such a de facto policy.
- *Clarify that Sandbox participants are responsible for compensating consumers for harms for which they are entitled redress as a matter of law*. The Bureau's proposal requires applicants to describe how they will provide restitution to consumers for "material, quantifiable, economic harm to consumers caused by the applicant's . . . offering or providing the product or service."[9] While it is entirely appropriate that Sandbox participants be obligated to compensate consumers for harms for which they, under law, are entitled compensation, participation in the Sandbox should not increase the potential regulatory exposure of a participant. Given the potential diversity and scope of products and services in the Sandbox, it is possible that there may be some harms suffered for which compensation generally is not entitled. In those cases, the participating firm should not face greater liability than nonparticipating competitors.

[9] *Policy on No-Action Letters and the BCFP Product Sandbox*, *supra* note 1, at 64042.

- *Periodically assess and report on the effectiveness and impact of the Sandbox*. The Bureau should regularly assess the impact the Sandbox program is having on the market for consumer financial services and report its findings to the public. Among the issues the Bureau should examine are whether the Sandbox is increasing or decreasing access to services, whether the Sandbox is distorting markets by unduly advantaging or disadvantaging certain firms, and whether consumers are being appropriately protected. In evaluating the impact of the Sandbox on the market the Bureau may wish to establish standard indicators so that the impact of the Sandbox can be compared from year to year.

CONCLUSION

The Bureau's NAL and Sandbox proposal represents an exciting opportunity for pro-innovation, pro-competition, and pro-consumer regulatory reform. The Bureau should be commended for taking this step. The NAL and Sandbox policy can help the Bureau achieve its critical mission of protecting consumers. It is my hope that these suggestions are helpful as the Bureau completes its implementation. If I can be of any further help, please do not hesitate to ask.

Respectfully,

Brian Knight