

RESEARCH SUMMARY

Fintech Regulatory Sandboxes: How to Benefit Customers without Hurting Competitors

Regulatory burdens and uncertainty in the financial sector can cost companies money and make them risk averse. In such circumstances, fintech (financial technology) “sandboxes” provide an experimental environment for companies to test new products or services in a laxer regulatory environment—and to pass the benefits on to the consumer. But as Brian Knight and Trace Mitchell argue in [“The Sandbox Paradox: Balancing the Need to Facilitate Innovation with the Risk of Regulatory Privilege,”](#) there is a risk that these sandboxes may have an unfair impact on competitors.

Requirements for regulatory sandboxes can vary, but they generally share these features:

- They are temporary
- They are for a limited number of consumers
- They contain provisions for consumer protection and compensation
- Sandbox participants are required to share information with regulators regarding their operations

REGULATORY SANDBOXES RISK TAMPERING WITH THE MARKETPLACE

While sandboxes can provide a valuable service, they also come with three primary potential drawbacks:

- 1) The government may be empowering certain companies at the expense of others
- 2) Sandboxes could potentially muddy the market, making it unclear for consumers and investors which products are reliable—and which are unduly propped up by government
- 3) Sandboxes could open the door to favoritism in the regulatory process, potentially creating a quid pro quo relationship between companies and regulators

REGULATORS CAN TAKE STEPS TO MAKE SANDBOXES AS FAIR AND PRODUCTIVE AS POSSIBLE

Despite these concerns, regulatory sandboxes can still make a valuable contribution to the financial sector. To enhance their productivity, here are several ways regulators can minimize the negative effects of fintech sandboxes:

- Establish liberal procedural qualifications for entry. This would allow as many qualified firms as possible to participate.
- Permit third parties (such as industry groups) to manage sandbox entry for their members. This would help many firms to benefit from the sandbox and minimize government favoritism.

- Institute well-defined sandbox terms and guidelines at the outset so that firms are all regulated by the same standards. This would help eliminate regulator bias.
- Ensure the duration of the sandbox is no longer than necessary to achieve its goals.
- Publish detailed reports of all sandbox findings. This would both help the public learn more about sandboxes and add an extra layer of transparency.
- Clarify that nonparticipation in a sandbox is not cause for suspicion or for different treatment on the part of regulators.