



February 26, 2019

Paul Watkins, Director
Office of Innovation
Bureau of Consumer Financial Protection
officeofinnovation@cfpb.gov

Re: Response to the Policy on No-Action Letters and the CFPB Product Sandbox; Docket No. CFPB-2018-0042

Dear Mr. Watkins:

The Milken Institute would like to thank the Consumer Financial Protection Bureau (the Bureau) for the opportunity to respond to the revised No-Action Letter (NAL) and Product Sandbox proposals.

The Milken Institute¹ is a nonprofit, nonpartisan think tank determined to increase global prosperity by advancing collaborative solutions that widen access to capital, create jobs, and improve health. The Milken Institute's Center for Financial Markets (CFM)² promotes financial market understanding and works to expand access to capital, strengthen and deepen financial markets, and develop innovative financial solutions to the most pressing global challenges.

Since the launch of the Milken Institute's financial technology (FinTech) program in October 2014, CFM has been a leading voice in the debate over how policymakers should respond to the growth of FinTech. CFM actively promotes flexible financial regulatory policy to foster greater FinTech innovations that enhance access to capital, financial inclusion, and transparency and compliance.

The Institute is encouraged to see the Bureau proactively engaged at the domestic and international level³ with industry participants and regulators interested in offering or understanding and responding to innovative, consumer-friendly products and services. Importantly, we are hopeful that the work transitioned from Project Catalyst to the Office of Innovation also includes a continuation of open office hours, which has provided a bridge between the Bureau and innovators located in select cities across the United States.⁴ Continued engagement among the Bureau, industry participants, and other

¹ <http://www.milkeninstitute.org/>

² <http://www.milkeninstitute.org/centers/markets>

³ The Consumer Financial Protection Bureau is one of 11 initial members of the Global Financial Innovation Network (GFIN). The Institute's response to the latest GFIN consultation can be viewed here: <https://www.milkeninstitute.org/publications/view/943>

⁴ The last office hours took place under Project Catalyst in March 2018 in San Francisco, CA – roughly four months before the creation of the Office of Innovation.

regulators remains critical given the pace of technological advancement in the provision of financial products and services to consumers. A well-informed financial regulator has the potential to produce more tailored regulatory guidance, while providing industry participants with an understanding of the regulatory frameworks under which their product or service will operate.

In this letter, we provide initial reactions and thoughts with regards to both the proposed policy on No-Action Letters and the Product Sandbox proposal, and propose several recommendations to further strengthen the proposal.

No-Action Letter Proposal

In our 2014 comment letter in response to the Bureau's original NAL proposal,⁵ which became final policy in 2016, we highlighted upfront how the original list of the Bureau's 15 requirements for applicants was very broad and, in certain circumstances, lacked clarity. We also stated that because the Bureau did not intend for an NAL to be issued for "well-established" products, early-stage firms would be the ones to file a significant portion of the requests. However, the lack of legal expertise and/or financial resources necessary to address the 15 requirements gave us the concern that few, if any, early-stage firms would submit an application for an NAL.

Two years on from the final policy guidance, our concerns have been realized; only one firm has been approved for an NAL.⁶ As such, it is encouraging to see the Bureau revisit the original NAL policy given the dearth of applicants, despite its good, overall intentions.

Beyond streamlining the application process, the Bureau has also provided greater clarity and incentives to potential applicants, including:

- **A 60-day notification period after submission of application.** The inclusion of an expected timeline for when the Bureau would respond to an NAL request gives potential applicants the assurance that the Bureau will respond in quick fashion without being subjected to a long, drawn-out process that could lessen interest in the policy.
- **Upgrading the authority by which NALs are approved.** By shifting the authority from staff recommendation to a decision that is fully backed by the Bureau, the NAL provides potential applicants with a clearer indication into how the Bureau recognizes the request.
- **Inclusion of UDAAP-focused NALs.** Given that the Bureau has yet to define "abusive" other than to build precedent through prior enforcement actions, the Bureau's willingness to issue UDAAP-focused NALs could provide applicants with a

⁵ <https://www.milkeninstitute.org/publications/view/678>

⁶ <https://www.consumerfinance.gov/about-us/newsroom/cfpb-announces-first-no-action-letter-upstart-network/>

greater degree of security from enforcement actions given the confusion and uncertainty stemming from the ill-defined term.⁷

- **Reduced complexity surrounding the identification of statutory and/or regulatory provisions.** In our 2014 comment letter, we noted that the Bureau should allow firms the opportunity to provide a general explanation of how they see their product fitting within the regulatory landscape, rather than having to list each and every legal authority. Recognizing resource limitations, the Bureau has provided firms the opportunity to provide “the maximum specification practicable,” while being able to explain the limitations on further specification. In doing so, firms can provide the Bureau with enough specification as to what statutes/provisions the NAL should cover, while minimizing disruption to the business.
- **Greater clarity on how the Bureau intends to publish No-Action Letters, including confidential treatment of the information provided by the applicant.** In our 2014 comment letter, we discussed how the lack of clarity as it relates to the disclosure of information publicly could discourage participation. Under the current proposed policy, however, the Bureau provides applicants with a more concise process by which information contained in the application, particularly proprietary information, can remain confidential under the Bureau’s Disclosure Rule.

We would note that while the Bureau’s interest in aligning NAL policy with other federal regulators provides some additional clarity and certainty in how the Bureau seeks to issue and oversee NALs, differences will remain. Even so, we believe that the changes proposed in this policy, including the removal of data sharing requirements and allowing trade associations, service providers, and other third parties into the mix, will lead to increased demand for no-action letters from firms seeking relief from certain regulations to be able to provide financial products and services to consumers.

Product Sandbox Proposal

The Product Sandbox, as proposed by the Bureau, is the first sandbox proposal to be offered by a U.S. federal financial regulator.⁸ While it is encouraging to see federal regulators continue to think about how to respond to innovation in the financial services industry, we reiterate that sandboxes are not a panacea in developing an innovation-friendly ecosystem and agile regulatory frameworks.

In our August 2017 white paper,⁹ as seen in Appendix I, we identified some of the pros and cons of regulatory sandboxes based on what we had seen, at that time, from

⁷ In October 2018, former Acting Director Mick Mulvaney stated that the Bureau intends to define “abusive” in an upcoming rulemaking. At this time, it is unknown when the proposal will be published. More from American Banker’s Kate Berry, *CFPB walks tightrope in effort to define ‘abusive’ practices* <https://www.americanbanker.com/news/cfpb-walks-tightrope-in-effort-to-define-abusive-practices>

⁸ It is important to note that Rep. Patrick McHenry (R-NC) has been at the forefront of congressional efforts to introduce legislation to drive sandbox adoption by certain U.S. financial regulators. In the 114th Congress, Rep. McHenry introduced the Financial Services Innovation Act. In a prior white paper covering bipartisan U.S. FinTech policy, we discuss the formation of innovation offices. The paper can be accessed here: <http://www.milkeninstitute.org/publications/view/906>

⁹ Jackson Mueller. FinTech: Considerations on How to Enable a 21st Century Financial Services Ecosystem. Milken Institute Center for Financial Markets, August 2017. Available at: <https://www.milkeninstitute.org/publications/view/872>

various regulatory agencies around the world. These observations still stand nearly two years on.

While the Bureau provided legal justification in the proposal as reason for launching the Product Sandbox, we believe the Bureau should address the following questions before opening up the Sandbox to participants:

- ***Does the Bureau need a sandbox?*** More generally, why does any U.S. regulator or agency (state or federal) need a sandbox? It is not as if financial innovation, or financial technology, is new to the United States. Over the last two decades, in particular, we have seen significant investment, hundreds of billions of dollars, flow to tech-driven platforms operating in the financial services ecosystem. With deep, liquid capital markets, active investment from venture capital and angel networks, technology and finance hubs that dot select cities across the U.S., and an education system that is increasingly interested in and focused on advancements in technology, one can see why the U.S. continues to be a haven for FinTech formation and investment. A sandbox, or sandboxes, did not play any role in the emergence of well-known FinTech companies such as PayPal, Intuit, Stripe, Kabbage, Betterment, etc., nor have they been the catalyst for the growth of consumer-oriented, tech-driven platforms. Rather, it was an innovative ecosystem that continues to spur FinTech development and growth, despite the regulatory morass at the federal and state levels. So why the need for a sandbox now given the growth and maturation of FinTech in the U.S. already? As with any regulatory action, the Bureau should provide a statement of need, beyond just citing statutory authority to do so.
- ***What does success look like?*** The Bureau does not define “success” in any part of this initiative. The Bureau is not alone here. Despite the roughly 30 regulatory sandboxes that have been launched or are in the works around the world, determining what success is and how it is measured remains a challenge.¹⁰ While the experimentation a product sandbox would offer given the exemptions and two-year testing timeframe certainly acts as an incentive to partake in the sandbox, if, at the end of the testing period, a firm is still expected to comply with any and all regulations that pertain to that product or service, even if it is discovered during the testing phase that the regulations do not make sense in this time and age, can the Bureau honestly say that this process is a “success”? At what point do we finally see the learnings from firms participating in sandboxes translate to regulators revisiting legacy regulatory frameworks to make them more agile and responsive?
- ***Is the Bureau an initiator or a facilitator?*** Given the interest in and proliferation of state-level sandboxes, it is worth asking what is the role of the Bureau in all of this? The Bureau mentions its interest in coordinating with states on NALs and its Product Sandbox, including offering an “alternative means of admission” for firms engaged in a state sandbox to join the Bureau’s Product Sandbox. We would question whether

¹⁰ In October 2018, the Milken Institute Center for Financial Markets submitted comments to the Bureau on the Global Financial Innovation Network. In the appendix to the comment letter, we provided a list of countries that have implemented or are contemplating regulatory sandboxes or alternative licensing regimes to support FinTech development and proliferation. The comment letter is available here: <https://www.milkeninstitute.org/publications/view/943>

the need to join multiple sandboxes is really of interest to innovative firms. Rather than operating its own Product Sandbox, thereby effectively competing against state sandbox efforts – going through a federal sandbox would seem to have more appeal than a certain state sandbox – we would suggest the Bureau adopt a facilitator approach in that the No-Action Letters and exemptions provided under the Product Sandbox could also be offered to participants in state sandboxes without the need for an additional, federal sandbox (and process). If states truly are the “laboratories of innovation,”¹¹ shouldn’t the Bureau support rather than directly compete against state sandbox efforts?

Recommendations

As it relates to the No-Action Letter and Product Sandbox proposal, we believe the proposed policy, overall, can be further strengthened in the following ways:

- **Require applicants interested in a No-Action Letter to identify ways in which they will compensate customers in the event of harm.** The No-Action Letter application must include a requirement that the applicant identify how the firm intends to make the customer whole in the event of wrongdoing and revocation of the NAL. Unlike the Bureau’s product sandbox proposal, which includes a commitment on the part of the applicant to compensate consumers for any harm resulting from the product, the proposed No-Action Letter policy, in its current form, does not require an applicant to indicate how it will compensate consumers for any losses incurred in the event of wrongdoing.
- **Revise language in the proposed policy to ensure the Bureau can and will retroactively use its enforcement authority if the NAL recipient’s products cause consumer harm.** In both the NAL and Product Sandbox proposals, the Bureau states that if an applicant is revoked for a reason other than the failure of the recipient to substantially comply in good faith with the terms and conditions that the Bureau will not pursue an action to impose retroactive liability in such circumstances. While the Bureau anticipates revocation to be quite rare, we are deeply concerned that the language contained in the proposed policy would protect bad actors from enforcement action by the Bureau. As such, we recommend the Bureau revise this language to make clear that in the event of wrongdoing and customer harm, the Bureau can still issue enforcement actions against NAL recipients.
- **Require applicants to the Bureau’s Product Sandbox to explain how the consumer will be informed that the applicant is taking part in the Bureau’s Product Sandbox.** It is unclear from the proposal whether the Bureau will require applicants to demonstrate in the application process how they will notify customers that the platform has been accepted into the Product Sandbox and what that means for the customer. The Bureau should make clear, whether in disclosures provided by the accepted firm, or otherwise, the customer’s rights in this process and options to

¹¹ NYDFS Superintendent Maria Vullo when asked by Bloomberg’s David Westin on the topic of federalism and financial regulation: “The states have always been the innovators. They’ve been the laboratories for innovation. The federal government has never been that.” The interview can be accessed here: <https://www.bloomberg.com/news/videos/2019-01-18/ny-s-vullo-on-bank-regulation-obamacare-protections-and-cryptocurrencies-video>

remove themselves from being included in the testing phase. We would encourage the Bureau to take a look at the UK Financial Conduct Authority and the Monetary Authority of Singapore's sandbox process for information pertaining to disclosures to the customer.

- **Require the Bureau to produce an annual report to Congress on the learnings from the No-Action Letter and Product Sandbox proposals.** The Bureau should model this report after the FCA's "lesson's learned" report that covered the first year of the UK FCA sandbox.¹² The report should include information on the types of firms that have been awarded NALs or that are part of the Product Sandbox, the types of data collected and early findings resulting from the aggregate data received by the Bureau, identification and suggested changes to current regulations based on the information received and knowledge acquired by Bureau staff during the testing phase, and forward-looking views or next steps by the Bureau as it relates to providing a conducive environment for innovative consumer financial products and services to flourish.
- **Address whether NALs or Product Sandboxes are an effective answer to outdated or burdensome regulation.** As the Bureau notes in the proposal, part of its objectives include ensuring that outdated, unnecessary, or unduly burdensome regulations are regularly identified *and* addressed. If so, it is unclear how an NAL or Product Sandbox would allow the Bureau to fulfill this objective.

The Milken Institute Center for Financial Markets would again like to thank the Bureau for providing the opportunity to comment on the proposed policy, and we welcome the opportunity to discuss our recommendations further with the Bureau.

Sincerely,

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¹² Regulatory Sandbox Lessons Learned Report. UK Financial Conduct Authority. October 2017. Available at: <https://www.fca.org.uk/publications/research/regulatory-sandbox-lessons-learned-report>

Appendix I: Potential Positives and Negatives of Regulatory Sandboxes

Regulatory Sandboxes			
Focus	Potential Positives	Potential Negatives & Concerns*	Categorization*
Jurisdiction	Engagement early on between regulators and industry (start-up and incumbent); collective engagement and harmonized guidance	Regulatory complexity in certain jurisdictions may limit how successful engagement is—does collective engagement lead to collective output? Uncertainty as to whether multiple regulators came away with the same viewpoint.	Institutional, Organizational
Communication	Transparency between regulator and regulated	Uncertainty regarding what constitutes a “successful” sandbox, or a “successful” outcome/program/cohort. Will guidance posted on success/declines be enough to inform similar, like-minded firms as to how regulators view their models?	Organizational, Operational
Purpose	A “safe space” whereby platforms can test their innovative product or service under the guise of a regulator or multiple regulatory bodies	Sandboxes become susceptible to concerns that this is a part of a regulatory race to the bottom. Accusations that firms involved will not be subject to the same oversight and standards imposed on similar firms situated outside the sandbox. What does the safe space do, and who is it for?	Institutional, Operational
Proof of Concept	Live testing environment	Concerns that those affected during the tests will not be compensated. Uncertainty as to who is ultimately responsible. Who bares the risk and costs? The company, the regulator(s)? The consumer?	Operational, Financial
Evidence-based	Obtain data-driven, empirical information	Unclear whether the use of this data will sway leadership of regulatory agencies to act (and in what ways they will act). Who is the audience we’re trying to inform—regulators, policymakers, the public?	Operational
Transparent Access	Public promotion (media exposure)	Accusations of regulatory bodies favoring one company over similar, like-minded platforms. Sandbox process viewed as a way to attract higher amounts of capital from VCs and angels, institutions, rather than view the process based on original intent/mission	Operational

** Not all potential positives and negatives related to the formation and operation of a sandbox have been listed in this chart. The list merely reflects the views of participants during a private roundtable session in April 2017.*

*** In this column, we have assessed where the identified positives and negatives fit within the sandbox structure. Institutional: How this effort works within the government/other agencies, as well as stakeholder coordination; Organizational: The resources and human capacity to follow through to fruition; Operational: The step-by-step processes or set of protocols to ensure the sandbox is executed successfully; Financial: The costs resulting from the establishment and processes of a sandbox.*