

# REGULATORY SANDBOXES IN WEST VIRGINIA

Removing Barriers to Innovation in  
West Virginia

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# INTRODUCTION

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The COVID-19 pandemic severely damaged the U.S. economy due to government-mandated shutdowns. The 14 months where the country was forced to pause led to increases in unemployment, closures of business, and delays in supply chains. The regulatory machine has only worsened the effects of a struggling economy and a declining workforce for innovators and industry.

Government agencies set rules in every activity we participate in, whether we drive our cars, cut our hair, or what house we buy. In their conception, regulations are intended to protect civil liberties and worker safety. Instead, they have become one of the most significant harms to individuals and their businesses.

Regulation and innovation are natural competitors. The laws dictated by federal and state agencies create significant barriers to startups. These regulatory barriers include how money is spent for equipment, wages and benefits, staff requirements, safety, accounting, transportation, and financial services. [1] Other regulations may require a sure way to report or audit a business.

The principles of basic economics explain why regulation is detrimental to the foundation of new businesses: regulations have costs. If regulation creates mandates about how companies can or cannot operate, it creates models for expensive production, and costs must be offset to stay in operation. Many times this means transferring the liability to the consumer, which increases the price of a product. The Mercatus Center at George Mason University released a study in 2016 concluding that, on average, for each 10% increase in regulations, there is a 7% increase in consumer price. [2] New trials of various industries, known as "sandboxes," have been created to combat the regulatory impediments to innovation.

# WHAT IS A SANDBOX?

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Regulatory Sandboxes are gaining momentum across the nation as spaces for businesses to experiment with new ideas independent of regulatory burdens. Sandboxes are set up for a defined time in a defined location to allow businesses the opportunity to experiment in their industry free from existing regulations. This lowers the costs of improvisation and innovation, creates a more accessible setup, and promotes a timelier release of new products.

Sandboxes provide a safe space to experiment with new ideas and lower the "barriers to entry" for new companies looking to enter the market. These spaces are temporary and often require companies to enter contracts that limit their time in the sandbox, increase communication with regulatory offices, and provide firms with a way to test a new product without the government deeming it unacceptable before results are seen. [3]

Regulatory sandboxes can kick-start new business growth and fill a needed gap in an industry. As these innovation systems grow across the U.S., we can thank distant neighbors for the idea.

# ORIGINS OF THE SANDBOX

## Across the Pond

In 2014, the U.K.'s Financial Conduct Authority (FCA) created "Project Innovate" to promote competition for financial technology (fintech). [4] Its creation was to advance the ability to serve customers by making payment services easier to use and understand. [5] To do so, the FCA allowed a pilot testing process for data decision-making. [6] The FCA's sandbox required the following application steps: [7]

1. The interested business must apply, present a new idea, disclose concerns with the promise of regulatory compliance, and detail the expected result upon reduced regulations.
2. The FCA reviews the application to determine if it meets sandboxing eligibility criteria.
3. Upon FCA approval, the applicant and FCA determine how to conduct the pilot, create a key performance indicator (KPI), and select the length of time the pilot shall be conducted for.
4. The FCA requires the business to a list of quantitative target for each KPI. [8]
5. Once the business's sandboxing pilot begins, the KPI is measured and evaluated intermittently by the FCA.
6. Upon completion, the FCA determines whether the service or product provided the determining success.
7. If so, the FCA begins deregulation, and if the pilot yields no result, the sandboxing contract is terminated.

The establishment of the first fintech sandboxes created favorable results. After hosting 700 participants, outcomes indicated that those who participated entered the market 40% faster, 80% graduated successfully from the program, and attracted 135 million in equity funding. [9] The program also incentivized existing companies not in the sandbox program to become more inventive and to partner with firms to share current strategies. [10]

Subsequently, the U.K.'s model has served as a framework for regulatory sandboxes across the globe.

## Sandboxes Go Global

Since the creation of the first sandbox in 2014, many countries have followed suit in designing their sandbox initiatives, hoping to spark innovation in their own homes. Australia, Singapore, and Hong Kong introduced their fintech sandboxes in 2016, Malaysia followed soon after in 2017. [11]

In 2018, with help from the FCA, a global sandbox was created. The Global Financial Innovation Network (GFIN) also focuses on fintech, which provides companies with regulatory information and an environment to test global solutions to regulation. [12]

## Arizona

After sandboxes grew in popularity in the U.K, Arizona became the first state in the United States to offer regulatory sandboxes designed for financial technology services in 2018. The state's sandbox program application process is overseen by the Office of the Attorney General, who approves the entry of applicants into the program. [13] However, it is administered by the Civil Division. [14]

The Sandbox provides limited access to Arizona's fintech market to test products or services without obtaining state licensures first. [15] Arizona's sandbox also includes reciprocity, which allows the state's Attorney General to enter agreements with participants to operate in other jurisdictions. [16] Since the launch of the program, ten companies have participated. [17]

## The Consumer Financial Protection Bureau

Shortly after Arizona's first sandbox program, the Consumer Financial Protection Bureau (CFPB) followed suit, establishing the "Compliance Assistance Sandbox." According to the CFPB, the purpose of the sandbox policy is to "provide a mechanism through which the Bureau may more effectively carry out its statutory purpose and objectives by better enabling compliance in the face of regulatory uncertainty." [18]

The model created by the CFPB is centered around the idea of "safe harbors," [19] allowing regulators to determine if innovations may operate alongside existing regulations. This will also enable regulators to decide whether to adapt current rules to create a more preemptive atmosphere for startups, even simply clarifying existing laws. [20]

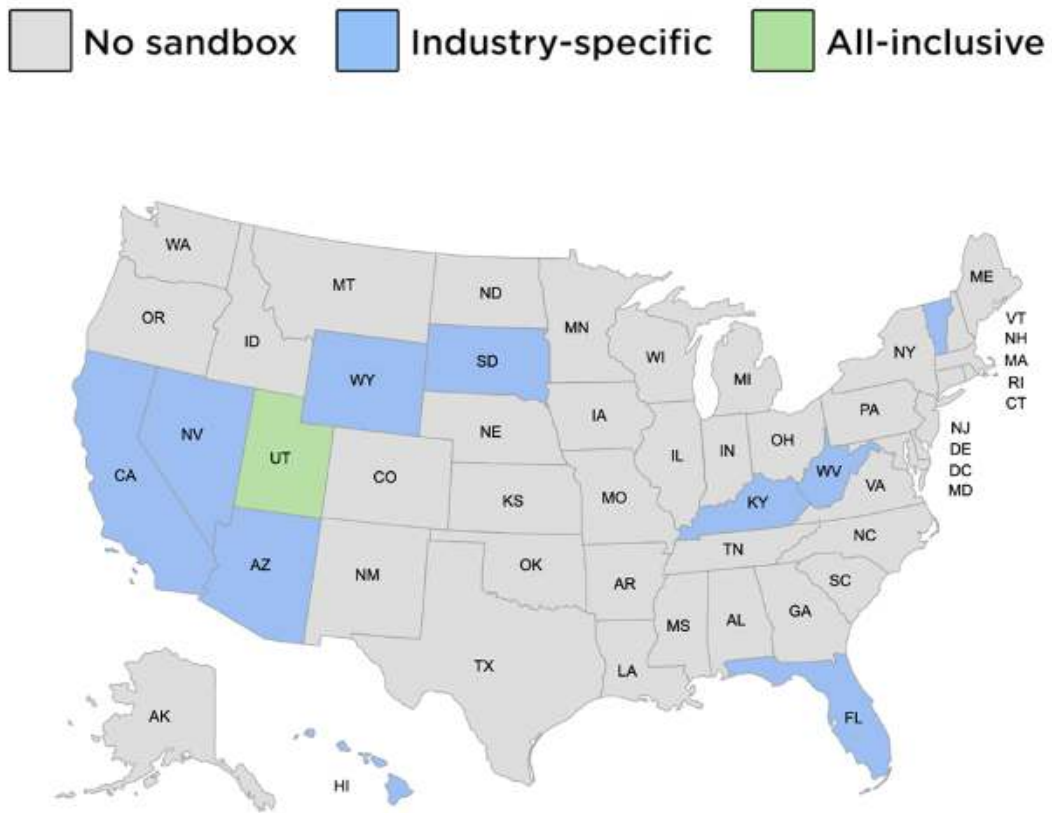


Figure 1 [21]

# EVOLUTION OF SANDBOXES

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Since the first emergence of a regulatory sandbox, innovations in industry covering legal services, insurance, and property tech have begun to gain steam, further enabling the ability to create. Regulatory systems have focused on solidifying rules, but sandboxes provide a new chance to offer adaptable services at an affordable rate. As a result, Sandboxing could be the next frontier of modernization, allowing our contemporary inventors to thrive.

## Legal Services

Utah established the first-in-the-nation sandbox for legal services in September 2020, hoping to provide more legal assistance to low-income residents. [22] The sandbox program allows non-attorneys to provide supervision over legal matters that do not require a law degree (such as paperwork) at a more affordable rate than traditional attorneys. [23] Unique to the Utah legal sandbox, the firms are not required to be owned by lawyers, with one company expected to be over 50% owned by non-lawyers. [24] Legal sandboxes provide an opportunity to safely conduct business and test a service without the risk of lawsuits for unauthorized practice of law.

Shortly after Utah established the legal sandbox, the state received over 30 applications with 12 businesses currently operating within the program. [25]

## Property Tech

In 2019, Arizona created the first property tech sandbox in the United States, [26] affording space to innovate in real estate. [27] The sandbox program went into effect on August 27, 2019. [28] Under the confines of the sandbox legislation, companies in the "proptech" industry may test new technologies for consumers before applying for licenses to promote industry-specific services. [29]

Participants are given strict access to test transfer and management of the property. [30] The Arizona Commerce Authority defines eligible products and services "related to property or real estate" while products and services related to new construction are not permitted for sandbox admission. [31]

## Digital Medical Technology

Wyoming implemented the nation's first and only digital medical technology sandbox in 2019. Digital health includes telehealth, telemedicine, health information technology, and mobile health. [32] These technologies have helped revolutionize healthcare, giving providers the ability to diagnose disease and enhance healthcare delivery for treatments accurately. [33]

Wyoming's legislation allows for the experimentation of medical products through trials that allow exemptions for sandbox companies. [34]

## Insurance

The insurance industry faces many barriers to entry, and states have taken notice. South Dakota and West Virginia have become the newest states to create regulatory sandboxes for the insurance industry.

South Dakota's insurance sandbox allows companies to offer their services for two years, requires the companies to share with consumers what services they explore, and creates a transitional pipeline to enter and exit the sandbox. [35]

Comparably, West Virginia provides controls for the entrance and exit of the sandbox and requires transparency. However, it allows companies to offer services for up to three years. [36]

# WEST VIRGINIA'S CHANCE TO REVOLUTIONIZE BUSINESS

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Relief from regulatory barriers can spur innovative growth in West Virginia. When individuals and businesses are provided the agency to create with low barriers to entry, prosperity is abundant. Regulatory sandboxes are a workroom for creation and should be available for all industries.

The COVID-19 pandemic has highlighted the reality that things can change overnight, and regulations cannot predict the future. Therefore, sandboxes are essential. Businesses should be free of restrictions that hinder adaptation in an ever-changing market. But, instead of adding sandboxes for each industry, a general (all-inclusive) regulatory sandbox should be established to enable agencies to determine if a sandbox is best for them, rather than the other way around.

Elon Musk said it best, "rules and regulations are immortal and if we keep making more... [without] removing them, then eventually we'll be able to do nothing." [37] West Virginia's establishment of a general sandbox will continue to set us apart from other states, encouraging business and innovation in Almost Heaven.

# ENDNOTES

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