

March 9, 2022

House Economic Matters Committee

House Bill 1204: Financial Institutions – Decentralized Financial Regulatory Sandbox Program

Re: Letter of Information

HB 1204 seeks to establish a “Decentralized Financial Regulatory Sandbox Program” (Program) to facilitate access to Maryland’s financial market in order to permit the testing of certain “products or services” with Maryland resident consumers without licensure or other authorization. HB1204 directs the Maryland Office of the Commissioner of Financial Regulation (OCFR) to “implement and administer” the Program. HB1204 reflects the approach taken by other states and countries in which licensing burdens are loosened in an attempt to attract product developers and would be complementary to OCFR’s existing efforts to facilitate the entry of innovative businesses into Maryland. Consequently, in keeping with the OCFR’s mission of operating a modern financial regulatory system that encourages responsible business innovation, the OCFR is supportive of efforts to encourage the development of new and innovative financial products for Maryland consumers and businesses. However, the OCFR has reviewed HB1204 and identified several provisions of this proposed legislation that should be modified to increase their clarity and otherwise remove uncertainty as to the obligations of both the applicants and the OCFR.

The OCFR has a “Fintech Innovation Contact” on staff specifically to assist those seeking advice on accessing Maryland’s marketplace. Information about the contact can be found on the OCFR’s website at: <http://www.dllr.state.md.us/finance/industry/frfintech.shtml>. Establishment of the Program would complement that effort and would add Maryland to the listing of states and countries trying this approach. However, while a few states have created sandboxes, their success in attracting business or innovative products has been limited. For example, Arizona’s and Hawaii’s sandbox programs have attracted only ten (10) companies between them.

HB1204 appears to borrow provisions from Virginia Senate Bill 712. That Bill was introduced during their 2022 Session seeking to create a new “Department of Regulatory Innovation ” to oversee Virginia’s Regulatory Sandbox Program. Adaptation of that Bill to HB 1204 was not always followed or tailored for implementation in Maryland. The Virginia bill contains a higher level of detail regarding the implementation and administration of the sandbox program. Also, VA SB712 creates a new VA Department that “may [c]ooperate and consult with applicable [State] agencies in the administration of the Program.” HB1204 picks up that concept by stating that the OCFR “shall consult with and receive approval from each applicable unit... [emphasis added]” but since the OCFR is Maryland’s regulatory agency responsible for implementing the Program and regulating financial markets, the reference to consultation with other “units” is not appropriate as it may present conflicts. As of February 9, 2022, VA SB712 was “continued” to the 2023 Session.

HB1204 purports to apply to a “product or service” that is an “innovative decentralized financial product or service that generally requires a license, registration, or other authorization in the State, and uses or incorporates new or emerging technology, including blockchain technology, to address a problem, provide a benefit, or otherwise offer a product,

service, business model, or delivery mechanism that is not known by the [OCFR] to have a comparable widespread offering in the State.” The OCFR believes this definition needs to be clarified and better focused. For example, the definition of covered products and services refers to a product or service that is an “innovative decentralized” product, yet the standards following this general description do little to clarify the intended coverage of the bill. Innovative products and services may not clearly require licensure, registration or other authorization but could benefit from the protections the bill intends to offer. Yet, it is unclear if such products are intended to be included in the sandbox. Similarly, the definition refers to a “decentralized” financial product but does not define what is considered a “decentralized” product. This term has arisen in connection with blockchain technology but does not, to the OCFR’s knowledge, have a precise and universally accepted meaning within the financial services industry. Finally, the requirement that the products or services that can be developed in the sandbox are to be those that are not “known by the [OCFR] to have a comparable widespread offering in the State” is difficult to implement as the OCFR does not maintain any listing of all products that are offered in the State, much less the degree of penetration of any particular type of product.

While HB1204 provides that OCFR is to “implement and administer” the Program, that provision is unclear as to whether the intent is to confer additional powers on the OCFR and whether the OCFR has authority to limit the distribution of the proposed product to certain consumer types.

The OCFR is uncertain as to how “access to the financial market in the State” is appropriately limited for consumer protection purposes. Specifically, the bill allows OCFR to limit the number of products and services offered but does not permit OCFR to limit the number of consumers who may acquire these products and services from any given applicant. The bill also isn’t clear on whether the OCFR can require an applicant to conduct a suitability analysis before selling a product or service to a certain consumer. Further, HB1204 requires applicants to fully describe and justify the product or service they wish to “test”, yet it does not provide any explicit limitations or parameters for that testing. The bill also states that a participant testing a product or service is not subject to State laws, regulations, or licensing or authorization requirements; that is a broad exemption, which the OCFR believes may potentially lead to constitutional challenges, particularly if a consumer is harmed.

HB1204 also provides that participants in the Program may (emphasis added) “enter into agreements” with or follow best practices of (1) the Consumer Financial Protection Bureau, or (2) similar programs in other states. The OCFR believes this provision provides no effective consumer protections as it is permissive (as opposed to mandatory) and refers to vague concepts such as “best practices” which, in the context of innovative products and services, may not yet exist. The bill also states that participants are not immune from criminal prosecution. This section fails to recognize that existing statutes governing financial products and services may contain components elevating certain violations to a criminal offense. How participants may be exempt from the application of these laws but remain liable for criminal offenses is unexplained. A subsequent provision states that participants must disclose to consumers that they are not immune from civil liability, but there is no indication of the laws which may apply to create this civil liability nor is there any bonding requirement in place to protect consumers.

In sum, while this bill covers a specific and complex subject matter, the OCFR believes there are significant gaps in HB1204 as to the manner of its implementation, and, while it places considerable responsibility on the OCFR from a regulatory perspective, it lacks consumer protections.