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A REGULATORY SANDBOX FOR THE INDUSTRY OF LAW

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A Regulatory Sandbox for the Industry of Law

How do you experiment to determine the best regulatory regimes to govern new technologies? In financial services, the concept of a “regulatory sandbox” has become a common structure around the world for companies and regulators to experiment with new types of services and technologies to determine the best mode to regulate them. It is a methodological approach to potential relaxation of regulatory requirements that build in more testing and feedback through a safe innovation zone.

In 2018, Arizona launched a regulatory sandbox for financial technology, specifically to promote entrepreneurship and investment around blockchain, cryptocurrencies, and other emerging technologies.¹ The United Kingdom’s Financial Conduct Authority had the first regulatory sandbox, starting in 2016. Since then, it has had four cohorts of regulatory sandboxes to promote financial services innovation.² The Monetary Authority of Singapore has run sandboxes to encourage experimentation with financial technology.³ Abu Dhabi’s Regulatory Lab set up a sandbox for Fintech, which involved the Abu Dhabi Registration Authority, the Financial Services Regulatory Authority, and the courts.⁴ Other financial technology sandboxes have been run in Australia, Mauritius, the Netherlands, Canada, Thailand, Denmark, and Switzerland.

Legal regulators can learn from these examples. In 2016, the Law Society⁵ in the U.K. called for a sandbox approach to regulatory reform that would allow changes to promote innovation and new business structures that improve access to justice to be tested safely.⁶ In response, the Solicitors Regulation Authority (SRA),⁷ the regulator of solicitors and lawyers in England and Wales, created SRA Innovate a mechanism that allows firms to innovate⁸ in order to offer clients affordable legal services. As legal regulators in California, Utah, and elsewhere look at the possibility of changes that would promote innovation, the sandbox approach is well worth considering.

What Exactly Is a Regulatory Sandbox?

A sandbox is a safe playground in which to experiment, collect experiences, and play without having to face the strict rules of the real world.⁹ The private sector can innovate without worrying about fines or liability, the regulatory agency can test regulations to see what works before going through the long process of creating new rules, and consumers have access to these services in a controlled environment. The goal is to relax or change existing regulation in a controlled and evaluated space to run real-world experiments. These experiences can be collected and inform evidence-based regulatory schemes. Sandboxes are used as an alternative to regulation that is based on speculation about what behaviors could result — and what risks and harms can emerge — from changing technologies or changing policies.

1 Stanley, A. (2018, March 24). Arizona Becomes First U.S. State To Launch Regulatory Sandbox For Fintech. Retrieved January 7, 2019, from <https://www.forbes.com/sites/astanley/2018/03/23/arizona-becomes-first-u-s-state-to-launch-regulatory-sandbox-for-fintech/#377e33691372>.

2 F. (2018, October 22). Regulatory sandbox. Retrieved January 7, 2019, from <https://www.fca.org.uk/firms/regulatory-sandbox>.

3 Room, R. (n.d.). FinTech Regulatory Sandbox. Retrieved from <http://www.mas.gov.sg/Singapore-Financial-Centre/Smart-Financial-Centre/FinTech-Regulatory-Sandbox.aspx>.

4 ADGM Launches Its FinTech RegLab. (n.d.). Retrieved January 8, 2019, from <https://fintech.adgm.com/adgm-launches-its-fintech-reglab>.

5 The Law Society is the professional association that represents and governs solicitors for the jurisdiction of England and Wales. More information: Law Society of England and Wales. (2019, January 27). Retrieved January 8, 19, from https://en.wikipedia.org/wiki/Law_Society_of_England_and_Wales.

6 Rose, N. (2016, August 21). Law Society calls for “innovation sandbox”. Retrieved January 9, 2019, from <https://www.legalfutures.co.uk/latest-news/law-society-calls-innovation-sandbox>.

7 How we work. (n.d.). Retrieved January 9, 2019, from <https://www.sra.org.uk/sra/how-we-work.page>.

8 SRA Innovate. (n.d.). Retrieved January 9, 2019, from <https://www.sra.org.uk/solicitors/innovate/sra-innovate.page>.

9 Ringe, W., & Ruof, C. (2018). A Regulatory Sandbox for Robo Advice. *European Banking Institute*, (26), 2018th ser. doi:10.2139/ssrn.3188828, pp. 34.

Some authorities such as the Financial Supervisory Commission in Taiwan have substituted a regulatory sandbox with a pilot program. There is an inherent connection between a regulatory sandbox and a testing and piloting program. A sandbox can be seen as an umbrella that contains a testing or pilot program.¹⁰ The defining characteristic of a regulatory sandbox is the establishment of a formal and structured mechanism to receive applications by firms to work with the regulatory agency to test innovative services, products, or business models.¹¹ Thus, the sandbox is the umbrella or regulation that enables a pilot or test program to operate.

Regulatory sandboxes are often case-by-case rather than one-size-fits-all. That means that individual firms propose exactly how the regulations might be changed for their particular innovation proposals. The burden is often on the firm to set what a new, better regulatory environment would look like for their vision of innovation. They are allowed to test this vision as long as they stay within the authority's principles and they agree to be evaluated regularly. They also are limited in how many customers they can interact with, how long they can run the experiment, and how they get consent from possible customers.

Why Do We Need a Regulatory Sandbox for the Industry of Law?

The legal market needs to overcome its most significant challenges: the access to justice crisis, and widespread dissatisfaction among legal buyers.¹² Regulation can play a crucial role to overcome these challenges. Proper regulation can promote competition, encourage innovation, and ensure appropriate safeguards for consumers.

The regulators should differentiate the "legal profession" from the "legal industry", however. The legal profession refers to lawyers (training, licensure, ethical responsibilities, among others). The legal industry describes the business of delivering legal services.¹³ More than 1,100 legal technology companies are changing the way legal work is done,¹⁴ however, most firms report regulatory and legislative hurdles as the most important barriers to innovation.¹⁵ And it's the consumer who loses when access to legal services is reduced.¹⁶

A regulatory sandbox for the legal industry would allow experimentation with new approaches involving new business models or legal technology. The sandbox enables a safe environment for business to test services or products without the risk of being sued for the unauthorized practice of law. In return, regulators could require participants to incorporate appropriate safeguards to protect the public interest and support competitive innovation in the legal market.

SRA Innovate is helping firms and new entrants, alternative business structures (ABS), and traditional law firms to run and grow their business in creative ways. This help includes:

- offering multi-disciplinary partnerships that give the public to access a "one-stop-shop" for legal and non-legal services;
- allowing specific rules to be waived;
- offering dedicated guidance to help firms deal with any regulatory barrier; and
- providing a sense-check to technology firms looking to develop new platforms for legal businesses.

This Innovation Space lets firms explore new business models and introducing original ideas that can be tested and likely benefit the public in a controlled way.¹⁷

10 Zetzsche, D. A., Buckley, R. P., Amer, D. W., & Barberis, J. N. (2017). Regulating a Revolution: From Regulatory Sandboxes to Smart Regulation. *Fordham Journal of Corporate and Financial Law*, 23(31), 103rd ser. doi:10.2139/ssrn.3018534, pp. 84.

11 *Regulatory Sandboxes* [PDF]. (2017, November 1). Toronto: Toronto Centre, from <https://res.torontocentre.org/guidedocs/Regulatory%20Sandboxes.pdf>.

12 Cohen, M. A. (2018, May 21). Innovation Is Law's New Game, But Wicked Problems Remain. Retrieved January 9, 2019, from <https://www.forbes.com/sites/markcohen/2018/05/21/innovation-is-laws-new-game-but-wicked-problems-remain/#4332b8383890>.

13 Cohen, M. A. (2018, March 29). Law Is a Profession and an Industry – It Should Be Regulated That Way. Retrieved January 10, 2019, from <https://www.forbes.com/sites/markcohen/2018/03/29/law-is-a-profession-and-an-industry-it-should-be-regulated-that-way/#4aacf1306598>.

14 CodeX Techindex. (n.d.). Retrieved January 10, 2019, from <https://techindex.law.stanford.edu/>.

15 SRA Innovate: Innovation and growth in legal services report. (n.d.). Retrieved January 10, 2019, from <https://www.sra.org.uk/solicitors/innovate/innovation-report.page>.

16 Juettten, M. (2018, May 23). Unauthorized Practice Of Law Claims Threaten Access To Justice. Retrieved January 11, 2019, from <https://www.forbes.com/sites/maryjuettten/2018/05/08/unauthorized-practice-of-law-claims-threaten-access-to-justice/#5af082fa67a5>.

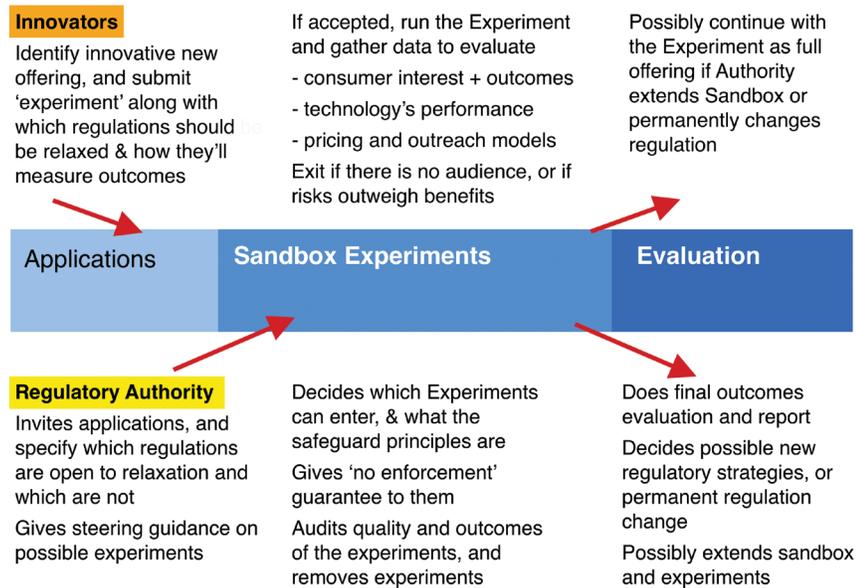
17 SRA Innovate. *Op. cit.*

The Proposed Structure of the Sandbox

The structure of the Sandbox is in phases, to promote experimentation, evaluation, and then possible extension, scaling of the sandbox, or abandonment of it. It is not meant to be a permanent thing, but rather a “prototype” of a new policy, which the firms’ experimentation can help refine. Or the prototype might show too much risk and danger, thus informing the authority that the regulation model in the sandbox should be considered a failure and abandoned.

It is helpful to think of the Sandbox in a timeline, as shown in the model below:

A Regulatory Sandbox Model



Details of How Authority is Exercised

Government authorities of financial services use several tools to ensure that the sandboxes are safeguarded. The SRA also has assured the applications protect their public interest purpose: to protect consumers and support the rule of law and administration of justice.

- **Key Principles** – Each sandbox is set up with guidelines to ensure that any unintended consequences are limited and managed. For example, before granting a waiver, the SRA must check the applicant is at least advancing some of the objectives of the Legal Services Act: protecting and promoting the public interest, obeying the rule of law, improving access to justice, protecting the interest of consumers, promoting competition, encouraging a diverse and effective legal profession, and increasing the understanding of citizens’ legal rights.¹⁸
- **Restrictions on Who Can Enter the Sandbox** – The regulator decides which firms can join the sandbox and enjoy the exploratory environment. For the SRA, a firm needs to show the proposal will result in a significantly different way of delivering legal services and identify the impact of the waiver concerning the regulatory objectives.¹⁹

¹⁸ *Enabling innovation – Consultation on a new approach to waivers and developing the SRA Innovation Space* [PDF]. (2016, December 1). Solicitors Regulation Authority, from <https://www.sra.org.uk/sra/consultations/enabling-innovation.page#download>.

¹⁹ SRA Innovate. *Op. cit.*

- **Regulatory Waivers/No Enforcement Action Letters** – A regulator can issue individual guidance or specific waivers to firms if there are burdensome rules that firms request relief from. The SRA generally publishes a summary of all waiver decisions, including an overview of the application.²⁰ These let a firm know that if they openly deal with the regulator and abide by the agreement to stay within the sandbox parameters and to treat customers fairly — then the regulator agrees not to take disciplinary action even for unexpected issues. It gives some guarantee to the firm that they can take controlled risks and that they will not face punishment like unauthorized practice of law claims. Still, the regulator maintains discretion to hold firms liable if the public is harmed.
- **Controlled Lists of Requirements that Can Be Relaxed or Maintained** – The authority can prescribe the list of what regulations may be altered, relaxed, or removed. They can also insist that some rules will be kept without a waiver.
- **Rolling Evaluation** – The authority can evaluate the outcomes throughout the sandbox behavior. The authority typically spells out broad metrics (around promoting innovation, promoting consumer benefit) in their initial guidelines, and then individual firm participants should define how their particular “innovation” will be evaluated. The SRA requires a formal report letter, including information on agreed-upon measures that demonstrate the success of the innovation, significant issues that have occurred, and any complaints or actions of dissatisfaction.²¹
- **Informed Consent** – The authority can require a firm to ensure that potential consumers understand they are participating in an experiment when the firm is trying to engage them with the “innovation”.

Lessons Learned So Far

In 2017, the UK’s Financial Conduct Authority issued a report on what they had learned from their series of regulatory sandboxes.²² The FCA found that the sandbox had led to high levels of innovation with new offerings for financial consumers, including new blockchain solutions, biometric services, and custom-automated financial advice. It also led to more significant investment in new technology and competitive pressure on incumbents. Regulators also found there was little misbehavior on behalf of the participating firms. The safeguards worked, and firms helped the regulators create more custom safeguards for particular experiments.

People need better access to affordable legal services. Firms report regulatory and legislative hurdles as the most common barrier to innovation. A regulatory sandbox for the legal industry, taking the experiences of the fintech sandboxes and the Innovation Space of the SRA, could be helpful in meeting the challenges of a changing market, assist new legal business to flourish, and advance access to justice.

²⁰ Annex 1 *Guidance on granting a waiver* [PDF]. (n.d.). Solicitors Regulation Authority, from <https://www.sra.org.uk/sra/consultations/enabling-innovation.page#download>.

²¹ SRA Innovate. *Op. cit.*

²² *Regulatory sandbox lessons learned report* [PDF]. (2017, October 1). Financial Conduct Authority, from <https://www.fca.org.uk/publication/research-and-data/regulatory-sandbox-lessons-learned-report.pdf>.



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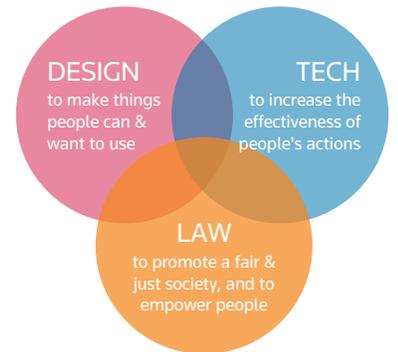
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