

## MEMORANDUM

**DATE:** February 8, 2021  
**TO:** House Industry, Business and Labor Committee  
**FROM:** Lise Kruse, Commissioner  
**SUBJECT:** Testimony Regarding House Bill No. 1268

Chairman Lefor and members of the House Industry, Business and Labor Committee, thank you for the opportunity to testify regarding House Bill No. 1268.

Mr. Chairman and members of the Committee, our Department is for technology and innovation, and is very engaged on this topic on a national level. However, the Department opposes House Bill No. 1268 since it creates a new regulatory regime, which does not bring enough positive results to outweigh the costs. Since creating a Fintech Sandbox would have a significant impact on our Department's ability to meet our existing mission, I want to highlight issues that need additional consideration.

After this bill was introduced, I had the privilege of visiting with Rep. Toman, the main sponsor of this bill, and I appreciate Rep. Toman's intention of making sure that North Dakota does not fall behind or in any way inhibit innovation,

particularly when it comes to financial services and products. As I mentioned to Rep. Toman, our Department is always closely following the financial marketplace and are constantly looking for ways to make sure we are modernizing to allow for new innovation and technology without compromising consumer confidence in the financial products they use. Our Department charters 64 banks, 20 credit unions and has issued over 7000 consumer licenses to ensure North Dakota citizens have access to a wide array of financial products. As you know, North Dakota as a whole is business friendly, and our Department employees work personally with so many of our financial institutions and applicants to assist with any application processes or work through any concerns they may have.

Before addressing the bill itself, I would like to talk about fintechs and their role in the marketplace and how they relate to our Department. Fintech is short for “financial technology” and is used to describe new technologies used in the financial services industries. Although there are many different types, the most common we are likely all familiar with are payment apps and mobile wallets that we have on our phones. Services offered by PayPal, Venmo, Square, Apple Pay and Google Pay, for example, allow person-to-person money transfers or merchants to receive payments from customers. Fintechs will often partner with existing banks and many fintechs hold a money transmitter license with our department, including some of the companies I just mentioned.

Fintech sandboxes, or regulatory sandboxes, are designed to be alternative regulatory mechanisms to facilitate the development or testing of innovative

financial technology solutions. Existing regulatory requirements are adjusted to provide companies the opportunity to offer and test new products and services in a live environment, for a trial period, with an alternative approval process.

Nine states have created regulatory sandboxes: Arizona, Florida, Hawaii, Kentucky, Nevada, Utah, Vermont, West Virginia, and Wyoming. Two of these are for insurance products only, and the one in Hawaii is limited to digital currency money transmission. Arizona and Hawaii are the only states which appear to have had any participants in their sandbox. Since the inception of Arizona's sandbox in 2018, they have had 10 companies participate. Companies in the sandbox often want to test their products with consumers to gauge effectiveness and viability. Arizona's website lists three companies currently in their sandbox, two that are lending-related and one money transmission service. The Hawaii sandbox, or Digital Currency Innovation Lab, is tailored to crypto companies which are issued a "no action message" exempting the company from the state's money transmitter licensing requirements. Their website lists 11 companies – some of these are foreign or domestic-based crypto exchanges or digital custodian and wallet services. I am aware of six other states where sandbox legislation has been introduced but has not passed.

HB 1268 as presented would allow companies into the sandbox after a "waiver of existing rule/licensing requirement." From discussion with Rep. Toman, it appears his goal is to provide opportunities for companies dealing with crypto/virtual currency and blockchain technology. Under North Dakota law, these

types of activities are already exempt, specifically the 2017 legislature decided that virtual currency should not be included in the definition of money transmission. There are no regulations in place restricting virtual currency, so there would not be a waiver of existing rule or licensing requirement. Therefore, a sandbox would not impact nor help these companies. It should be noted that our Department does license many companies engaged in virtual currency, since these companies often offer additional services involving US dollar denominated currency as well, which are subject to licensing. Given the volume of customers these licensed companies have, it is unlikely that these companies would use the sandbox.

Any company approved to operate in the sandbox would only be available to offer services to North Dakota citizens since we cannot waive any licensing requirements of other states. Each state has separate licensing requirements for companies doing business with their citizens. Even if North Dakota waived traditional money transmission requirements, for example, money transmission activity to anyone other than a North Dakota citizen would require licensure in other states. This limits the practical business use of the sandbox and is also why companies seem to gravitate to sandbox states with larger populations.

None of our money transmitters or fintechs are headquartered in North Dakota, rather every company we license operates in multiple states. For that reason, we are coordinating and cooperating with other states in our licensing and oversight of these companies. Our Department is actively engaged in what we on a national basis call “networked supervision” to provide efficiencies by leveraging

our collective intelligence across the states and with federal regulators. Part of this effort is work on a model law for money transmitters, which we anticipate we will introduce in a bill for your consideration in 2023. This is a coordinated effort between all 50 states with input from the industries we regulate; a 33-member industry panel has provided feedback. By listening to the industry itself, I believe we can foster innovation and provide a good balance between regulation, consumer protection, and availability of services and products. The model law will replace our current money transmitter statute and has three primary objectives: 1) Consumer protection regulation; 2) Preserve public confidence; and 3) Prevention of unlawful individuals from entering the money services industry. The law contains licensure standards and financial responsibility requirements for money service businesses and includes the licensure of virtual currency. The law will provide clarity around when and how to regulate virtual currency businesses. For those conducting virtual currency activity, it includes: “Transferring virtual currency”; “Storing virtual currency”; and “Exchanging virtual currency”. We do not expect the proposed law to regulate or otherwise inhibit the underlying blockchain technology, be burdensome for startup companies, or otherwise create the need for a regulatory sandbox.

Attached to this bill is a fiscal note and I would like to address how we came up with that estimate. Since this bill establishes a new program where financial products are offered to citizens, appropriate measures must be in place to execute the program. We estimate an addition of 3 FTEs necessary: An attorney, IT

expert, and examiner. Since these are innovative companies which can range across a wide spectrum of products, applications may be complicated and legal review is necessary, which necessitates an attorney on staff who would also be responsible for drafting the rules as required in the bill. This approach will require a statutory change since we are currently under the Attorney General's office and are not an exempt agency as outlined in N.D.C.C. § 54-12-08. The need for specialization in financial regulation will be beyond what our current needs dictate. This attorney would effectively be tailoring new rules of operation specific to each applicant to support the special legal carve out from other existing laws and rules. When we coordinate with other states through the current application process, we are able to take advantage of other states' resources if they have certain expertise, such as in-house legal counsel. Since any sandbox product application will be solely in North Dakota, we must make sure that we have proper expertise in house. The bill specifically refers to blockchain, and with the potential applications from digital asset/crypto companies – if they deem a license ordinarily would be necessary for their activities, IT expertise and understanding of these specialized areas are necessary. Also, based on other states' experience, lending products may be part of this space, which makes a general examiner with expertise in examination of financial products and institutions a necessary addition. These companies would most likely be new and may need much assistance and close oversight, therefore, the Department is unable to absorb this program within its current resources.

Costs in addition to the 3 FTEs include training, which will be specialized, travel to out-of-state training, and examination expenses. Although the Department will be reimbursed by the applicants for the examinations, appropriations must be made for the expenses. Revenues are limited to application fees and the examination reimbursements. Estimates are based on other state experiences, although only Arizona has participants in what would be comparable to this sandbox bill to date. Even though most states do not have any participants in their sandbox, we must be ready to handle the applications and oversight since those must be acted upon within 90 days as stated in this bill. This short time requirement would require us to hire staff now to be ready to act on potential applications as required by the law. Resources will also be required beyond the examinations. The examination is a short time-period which is billable; but we will spend substantial time on off-site monitoring of the activity and researching what an examination program should even look like.

Where additional resources are an absolute necessity to take on any new programs, our request is also due to our current environment. We are in the midst of economic uncertainty due to the pandemic, and our Department's utmost priority is to keep our community banks and credit unions safe and sound. Our community financial institutions have stepped up in unprecedented ways to serve their customers throughout this pandemic and they are central to our economic recovery. Our Department must be on hand to assist in any way we can, to ensure the safety and viability of our local community financial institutions. Therefore, I

am unable to reallocate any resources or FTEs from our bank and credit union divisions.

Funding source to cover expenses to establish a sandbox is unknown since the Department is a special fund agency. Industries regulated by the Department fund their own costs, and one industry does not subsidize costs of other regulated industries. Costs would be incurred prior to any revenue being generated and proposed application revenue structures fall short of expected expenses. The State Banking Board which is the body responsible for setting bank assessment levels was briefed about this bill and was clear that they do not believe it is appropriate for banks to subsidize this program. This bill also creates a financial technology innovation account with the state treasurer, which would be new and the bill is not clear how that account would be funded and how resources would be replenished if there are not enough funds to administer the program.

One last item that must be address<sup>41</sup>ed in this bill is the fact that the Secretary of State is given authority to exempt financial industries or products from licensing, despite lack of authority to license these entities in the first place. This creates confusion and conflicts with other areas of the North Dakota Century Code since it creates a new and redundant financial regulator in North Dakota.

Finally, our Department's mission is to ensure the safety & soundness of our institutions to promote citizens' confidence in the financial services they receive. If the legislative body decides to establish a fintech sandbox, I ask that you make sure we can do it properly and approach this new regulatory regime with care and



consideration to ensure we can offer a level of customer protection. Any new financial product will need to be fully understood - and protecting our citizens' money is of utmost importance. Based on my research of sandboxes, as I said in the beginning, any benefit of a sandbox does not appear to outweigh the significant cost to establishing a fintech sandbox. I also believe that we can be, and have been, adaptive and on the forefront of financial innovation without such structure in place. Our Department in the next two years will prepare a bill for your consideration in 2023 to implement the new model law, which will ensure consistency across the nation, and our focus should continue to be coordination and participation with other states and federal regulators. This focus ensures a fair regulatory environment for companies as well as providing confidence and protection for North Dakota citizens. I believe North Dakota's current laws already establish a business-friendly environment, which makes a fintech sandbox unnecessary. Therefore, I request a do not pass on HB 1268.

Mr. Chairman, thank you for the opportunity to provide this testimony. I would be happy to answer any questions the Committee may have.