



# Reducing Regulatory Uncertainty: Sandboxes and Letters of Interpretation

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## The Issue

Regulations often constrain economic growth and prevent the realization of new ideas and initiatives. The cost and burden of research, applications, reporting, compliance, fees, and possible administrative and civil penalties for violations can overwhelm all but the most strident and fully capitalized innovators. And in many instances of new and innovative products or services, it is not always clear what regulations may apply or if there are alternatives to compliance. Innovative businesses need greater certainty regarding what regulations may prohibit or restrict their business and how to proceed with operations without penalty. Fortunately, there are such solutions: regulatory sandboxes and letters of interpretation with presumption of authorization.

*According to George Mason University, the state of Texas has the fifth highest number of regulations in the country, with approximately 263,000 regulatory restrictions in its Texas Administrative Code.*

## Reducing Regulatory Uncertainty

Large enterprises that operate within a clearly regulated industry are more likely to understand and comply with regulations. But smaller businesses seeking to offer new, innovative products or services that may not perfectly match existing regulations often do not have the same level of resources to research and comply with regulations. This results in regulatory compliance risk—in other words, risk of being found in violation of existing regulations and being forced to defend those allegations or to potentially pay enforcement penalties.

## Regulatory Sandboxes (With Oversight)

A regulatory sandbox is a controlled environment where startups and other innovative businesses can test products or services under regulatory supervision while being temporarily exempt from specific regulations that would otherwise restrict or prohibit the operations. The business submits an application to a designated government agency outlining its proposed product, service, or business model and lists the specific regulations it seeks to have waived. The application may be approved in whole or in part, and if approved, the business is granted initial clearance to begin operations and is not subject to enforcement penalties for violations of the applicable regulations.

## Letters of Interpretation with Presumptive Authorization (No Oversight)

Similar to traditional sandboxes, a business would submit an application seeking an interpretation of law—specifically whether or not certain regulations apply to the innovation. The governmental agency would issue a letter of interpretation stating whether and to what extent the innovation is prohibited or otherwise subject to regulations, and if so, cite the regulations.

If the agency determines that the regulations in question do not apply, this letter would be an official interpretation of statutory and regulatory law issued by the government, with protection from penalties for good faith violations. If the interpretation is that the regulations in question do apply and restrict or prohibit the innovation in question, the business may still apply for a sandbox.

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## TPPF RECOMMENDS A MODIFIED REGULATORY SANDBOX PROGRAM

We recommend implementing a regulatory sandbox program with modifications to include and begin with letters of interpretation with presumptions of authorization. Additionally, the letters should be made public and apply to all similarly situated businesses to prevent competitive advantages. When letters of interpretation determine a regulation in question prohibits or restricts an innovative business, regulatory sandboxes should be made available to provide a trial period for businesses and regulators to begin operations free of regulatory restriction. We further recommend that the program be administered and overseen by a centralized government agency, such as the governor's office, in consultation with the appropriate regulator, to ensure a consistent process and level playing field. Finally, the administering agency should be directed to review and submit a recommendation on whether the identified regulation should be retained, amended, or repealed.

### Conclusion

Properly created, regulatory sandboxes and letters of interpretation with presumptions of authorization can be valuable tools to reduce regulatory burdens and foster innovation. Already in place in many states, these tools should be modified and expanded to provide even greater certainty and to apply broadly across all spectrums of regulations and industries. Ultimately, with fewer regulations and greater certainty for those regulations that do exist, innovators can flourish, and consumers thrive. ★

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