



Developing regulatory sandboxes for legal services innovation

28 July 2020

Introduction

In 2016, the Financial Conduct Authority (FCA) pioneered the use of regulatory sandboxes to support innovation in financial services. Since then, many other sectors have adopted sandboxes as a key part of their own Research and Development functions. Sandboxes help firms to understand the risks relating to their innovation and enables them to test within regulatory boundaries.

For consumers and investors this brings increased credibility, as such programmes provide reassurance that the innovation has been tested within the relevant regulatory frameworks prior to launch. It also means that in certain heavily regulated markets, new entrants who may have otherwise struggled with complex rules are incentivised to enter the market and develop new products and services which could benefit consumers.

The Covid-19 pandemic has exemplified the need for innovation in historically traditional sectors, with changes in consumer behaviour and the take-up of technology accelerating at a pace never before seen. Consumers are becoming increasingly reliant on technology to access support for medical advice, banking services and even legal advice from their homes. As a result, regulators will be challenged to assess whether existing regulatory rules are a hindrance or barrier to innovation; not just in terms of technological development or service delivery, but with regards to providing flexibility in the ways in which advice or services can be delivered.

The Legal Services Board (LSB), in their Business Plan of 2019/20, committed to undertake a project to promote the wider use of sandboxes by the sector's regulators.¹ In response, the Panel committed to write a short paper to explore how legal services regulators could maximise the benefits of such sandboxes, whilst also protecting consumers.

What is a regulatory sandbox?

Several papers² define sandboxes as 'a safe playground' for providers to experiment and test their innovations (services, products or business models) with consumers. Ideally the testing is done in a live market environment, whilst ensuring that appropriate safeguards are in place. The testing is typically done under the regulators' supervision supported by clear guidance.

The need for regulatory sandboxes

One of the drivers for sandboxes in many sectors is the external perception that regulation is a barrier to innovation. Regulators have responded in different ways to this; from simplifying their rule books and increasing their flexibility to pioneering the concept of

Case study – innovation without using technology

In November 2019, the Solicitors Regulation Authority (SRA) introduced flexible employment arrangements which enable solicitors to offer services outside of the traditional legal models. Solicitors can now:

1. Work in unregulated firms to deliver unreserved legal services.
2. Work as individual self-employed solicitors ("freelance solicitors") to provide reserved legal services.

It is important to note that these changes led to a reduction in the scope of consumer protection, the impact of which are yet to be evaluated.

¹ <https://www.legalservicesboard.org.uk/our-work/current-work/technology-and-regulation>

² FCA, Regulatory sandbox lessons learned report, October 2017; BEIS, [Regulator approaches to facilitate, support and enable innovation](#), January 2020; Ofgem, Innovation Sandbox Service – Overview, February 2020.

sandboxes.³ For example, Ofgem launched its sandbox in 2017 to support innovators who had historically struggled to comply with existing regulation within energy markets⁴ (see *more in the Youtility case study below*).

Quote

“The FCA sandbox levels the playing field between incumbents and startups, by allowing smaller firms to get up to speed with financial regulation and think about their business models as much as their innovation.”

Nuggets (FCA Sandbox participant, September 2018)

Furthermore, research shows that firms see merit in participating in sandboxes. In their feedback to the FCA, firms mentioned various reasons for joining the sandbox,⁵ including wanting to increase their understanding of regulatory requirements, accelerate the development of existing products or test their product or service with real consumers. Regardless of their primary driver, most firms acknowledged that they also wanted the “badge of honour” of being invited to participate in the sandbox programme. In turn, firms

hoped that such partnerships would provide them with increased credibility with both consumers and investors. This was also confirmed by Ofgem who stated that start-ups want to signal low regulatory risks to investors.⁶

However, it has been noted that sandboxes can lead to the unintended consequence of an uneven playing field between firms which are accepted and those which are not. On the other hand, this can also level the playing field between more established firms and start-ups once accepted to the sandbox, by allowing smaller firms the opportunity to adapt to the regulatory environment at an accelerated pace, all the while refining their respective innovations, as well as the business models that support them.

The benefits of sandboxes

A review of the impact of the FCA regulatory sandbox and similar work on legal services sandboxes, we came across the following consumer benefits:⁷

- A marked reduction in the time and cost of getting innovative ideas to the market.
- Enabling products and services to be refined within a regulated context prior to launch.
- Ensuring that appropriate consumer protection is built into new products and services from day one.
- Reduction of regulatory barriers for new firms wishing to enter the sector.
- Identification of regulations that may be inhibiting innovation.
- Consumers benefit from greater access to justice and consumer confidence in products or services that have been tested within a sandbox.⁸

Developing sandboxes in legal services

There are four main stages of developing sandboxes identified in other sectors:⁹

³ Deloitte, A journey through the FCA regulatory sandbox, 2018.

⁴ Ofgem, Innovation Sandbox Service – Overview, February 2020.

⁵ Deloitte, A journey through the FCA regulatory sandbox, 2018.

⁶ Ofgem, Innovation Sandbox Service – Overview, February 2020.

⁷ FCA, Regulatory sandbox lessons learned report, October 2017; M. Hagan and J. Gabriel Jimenez of the Legal Design Lab at Stanford Law School, Regulatory Sandboxes for legal services innovation, November 2019.

⁸ Although the BEIS research did not find any evidence for increased consumer trust in the products and services that went through a sandbox, it is worth mentioning that consumers were not involved in the research. See [BEIS, Regulator approaches to facilitate, support and enable innovation, January 2020](#).

⁹ For more information on these stages please see [BEIS, Regulator approaches to facilitate, support and enable innovation, January 2020](#), page 27.

Application stage – regulators either select firms to join a sandbox over a defined period or through an ongoing application process. The latter method allows firms to approach the regulator at any time when they are ready and is favoured by some regulators due to its agile nature. Applications are then assessed by regulators against a pre-defined set of criteria.

Design of the testing environment stage – regulators work closely with the selected firms to design the testing space and secure any necessary licences. This is usually done on a case-by-case basis, which can be resource-intensive.

Testing stage – during this stage, firms are expected to pro-actively communicate and share data with the regulator and raise any issues as soon as they arise. Firms are expected to adjust “in real time” to emerging requirements. The time spent at this phase varies considerably depending on the nature the innovation.

Exit and evaluation stage – once the testing stage has been completed, a final report is produced either solely by the firm or jointly with the regulator. A joint plan for eliminating any limitations identified can then be put in place.

Considering the four stages outlined above we recommend that legal services regulators consider the following:

- The eligibility criteria for such programmes should be straightforward and not overly prescriptive, and where necessary prioritise services for vulnerable consumers.
- The admission criteria should be clear and transparent, to ensure consistency and earn the trust of potential applicants. For example, Innovate UK are publishing videos and running briefing events for potential applicants to their programmes, these cover FAQs and allows potential applicants to learn more about the admission process. Regulators could make available similar resources.
- Some applicants will be developing disruptive business models that may differ from traditional ways of doing things, meaning that effective assessment of such applications could be difficult. We would, therefore, encourage regulators to be pragmatic in this regard and, where appropriate, to enter into further discussions with such applicants to better understand their offering.
- If a proposition is deemed ineligible for the sandbox, the regulator should provide detailed feedback that could aid future applications.¹⁰
- The FCA has offered access to its sandbox to both regulated and unregulated firms.¹¹ The Panel would welcome this approach in the legal services sector because it allows the latter to test their innovation, adhere to regulated standards and prevent potential consumer harm before launch.
- Timing, technology readiness and the ability to adapt to regulation are critical in achieving beneficial alignment of the needs of regulators and innovators.
- Regulators should ensure that safeguards are put in place by firms both before and during the consumer testing phase.

Quote

“The application process was quite complex, and it would be great to make it more accessible for organisations, especially those from non-financial and non-legal backgrounds.”

Northrow (FCA Sandbox participant, September 2018)

¹⁰ Ofgem, Innovation Sandbox Service – Overview, February 2020.

¹¹ FCA, Regulatory sandbox lessons learned report, October 2017 and [SRA Innovate](#).

- Consumers should be made aware of the risks involved before the testing phase and provided with clear and accessible information which would enable them to make an informed decision.
- In other sandboxes, firms reported confusion around end dates for some programmes. Thus, we would encourage regulators to have a clear exit strategy marked by a “graduation day”.¹²
- The “exit and evaluation” stage is crucial due to the way regulators formulate the final guidance, and indirectly impacts consumers. At this stage, the regulators should draw lessons from the testing phase to amend their regulatory framework to be more agile and robust in supporting innovation and protecting consumers.
- Several firms suggested to the FCA that it should share the lessons learned in the sandbox with the wider industry, in an anonymised form.¹³ Sharing the guidance publicly would also mitigate against the risk flagged earlier, that sandboxes unintentionally provide a certain competitive advantage to the firms that are admitted to participate in it.
- Given that the legal services sector has multiple regulators, we would encourage the LSB and the regulatory bodies to consider the challenges of having multiple sandboxes running simultaneously. The regulators should consider working together where there is common interest, e.g. looking at property law, wills or probate. For regulators, this would avoid the duplication of resources and ensure consistency.

Case Study – Legal Access Challenge

The SRA won a total of £950,000 from the Government’s ‘Regulators Pioneer Fund’, aimed at helping regulators to develop innovative products and services to unlock the long-term opportunities identified in the recent Industrial Strategy.

The SRA partnered with NESTA to run the Legal Access Challenge that focused on advancing the development of technological solutions to increase consumers’ access to justice, especially for vulnerable consumers and SMEs.

In April 2020, the two winners were announced:

1. CourtNav and FLOWS by RCJ Advice and Rights of Women – is designed to support domestic abuse survivors through innovative platforms that effectively integrate technology with human advice and support.

2. The Chatbot, developed by Mencap and Access Social Care – a chatbot that offers legal information for those with social care needs.

The SRA have since been working closely with the winners to bring their ideas to market.

The limitations of sandboxes

Having considered the lessons learned from the financial sector and beyond,¹⁴ the Panel has identified the following limitations:

- Consideration should be given to how ‘hands-on’ the nature of this support should be. A hands-on approach is more resource intensive (time and cost), whereas a more hands-off approach limits engagement and learning.

¹² Deloitte, A journey through the FCA regulatory sandbox, 2018.

¹³ Ibid.

¹⁴ FCA, Regulatory sandbox lessons learned report, October 2017; Margaret Hagan and Jorge Gabriel Jimenez of the Legal Design Lab at Stanford Law School, Regulatory Sandboxes for legal services innovation, November 2019; BEIS, Regulator approaches to facilitate, support and enable innovation, January 2020.

- Accepting applicants on a cohort basis is less resource intensive than admission on an ongoing basis but limits the responsiveness of such programmes.
- Regulators should consider the impact of testing their innovations on vulnerable consumers and ensure appropriate safeguards are in place to protect them.
- Firms should be mindful of the limitations of undertaking testing with such a small number of consumers over a relatively short timeframe. Special consideration should therefore be given to the ‘scale-up’ viability of businesses within the sandbox.
- There is no guarantee an innovation will be successful beyond the sandbox, especially for entirely new products or services. That is the nature of innovation and firms’ expectations should be managed accordingly.
- Firms should mitigate risks by building additional safeguards before testing products and services in the sandbox.
- Participation in a sandbox may inadvertently signal to consumers that regulators endorse a certain service or product, while the firm has only been given temporary exemption to test the quality and regulatory compliance. To avoid such confusion, firms should undertake the appropriate disclosures to consumers to clarify that the regulator bears no legal responsibility for the service provided.
- Some consumers might have no or very limited digital literacy - roughly 9 million people in the UK (16%) are unable to use the Internet and their device by themselves.¹⁵ We would encourage regulators to be mindful of this and to consider alternative ways for vulnerable consumers to benefit from similar innovations and access to legal services.

Case Study - Youtility

Youtility is an app that saves consumers time and money by allowing them to make more informed financial decisions within a single user experience. It connects different bank accounts, tracks spending and compares energy providers using an in-built switching tool.

Youtility were new to the energy sector and found it challenging to navigate the complex regulatory framework, including data protection and access to smart meter data. Over 12 months, Innovation Link (Ofgem’s sandbox) offered bespoke documents to Youtility, as they developed their idea.

Youtility has now launched their app and also received FCA’s approval in August 2018. They are currently working in partnership with Citizens Advice.

Youtility said: *“It was invaluable being able to speak to different teams within Ofgem and we based a number of our key decisions on the back of Ofgem’s responses”*.

Conclusion

There is no doubt that sandboxes have proven to be a useful tool for regulators in other sectors, allowing them to both foster innovation within their respective sectors, as well as improving access to services for their consumers.

The challenge for the legal services regulatory bodies considering adopting sandboxes lies in ensuring consistency and avoiding the duplication of effort. As a result, we would recommend that regulators explore the viability of pooling their resources where there is common interest, both to maximise the effectiveness of such initiatives and to avoid confusion on the side of applicants.

¹⁵ Lloyds Bank UK Consumer Digital Index 2020.

We would also recommend that the LSB provides clear guidance on how the regulated community could work together on these initiatives and ensure that adequate consumer protections are put in place by firms taking part in such programmes.

Finally, sandboxes offer regulators the unique opportunity to quickly draw lessons from the consumer testing stage and update their regulatory framework accordingly. This is an opportunity that should be grasped with both hands.

Legal Services Consumer Panel | 3rd floor, The Rookery, 2 Dyott Street, London, WC1A 1DE

0207 271 0076 | www.legalservicesconsumerpanel.org.uk

Twitter: [@LegalservicesCP](https://twitter.com/LegalservicesCP)

LinkedIn: www.linkedin.com/company/lscp