

The Season of the Sandbox

March 30, 2026 – Dorsey Law & Policy Notebook

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The concept of a regulatory sandbox is becoming a familiar one. When a recent White House executive order laid out a comprehensive legislative framework for artificial intelligence, it included a call for Congress to establish federal regulatory sandboxes, without any further

explanation. Just a few years ago, such a request might have been met with a confused stare. Now, the idea of a regulatory sandbox is a recognized policy making tool.

I serve on the advisory committee for Utah's General Regulatory Sandbox and am excited about the potential for sandboxes, both at the state and federal levels. Given recent developments and momentum, I decided to put together a quick post on the innovative policymaking approach, to be followed hopefully soon with a more fulsome guide for businesses.

What is a Regulatory Sandbox?

While you've heard the term and likely have a general sense for what is involved, here is a quick explanation. The term itself (sandbox) is borrowed from the world of software engineering, where new code is sometimes tested in an isolated environment for safety reasons before being released. Extending that concept to the policy world, a regulatory sandbox generally refers to a program run by a regulatory body where new products and solutions are allowed to be tested in the marketplace under temporary waivers or "no action letter" interpretations of regulatory restrictions. This is typically done over a limited period of time (1-2 years is typical) and in a controlled fashion, including regular check-ins with the regulator. If the test yields positive results, long-term regulatory changes might then be proposed and rolled out.

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How Long have Regulatory Sandboxes been a Thing?

The sandbox approach originated in the heavily regulated fintech space. The first one was an initiative in the U.K. in 2015 to support fintech startups. The approach has steadily gained traction since then, with sandboxes proliferating across the U.S., Europe and Asia. Arizona gets credit for adopting the first one in the U.S., a fintech sandbox launched in 2018, followed shortly by Utah. Utah took the concept a step further in 2021 by offering a comprehensive regulatory sandbox that is not limited to financial technologies. The state also offers legal and AI sandbox programs. At the federal level, the history is more start and stop. The Consumer Financial Protection Bureau launched a fintech sandbox in 2019, which had a short life when it was shuttered under the Biden Administration. A few months ago, the SEC and CFTC launched Project Crypto, which includes as a feature a sandbox-styled initiative where companies can trial tokenized products, particularly those with DeFi applications. As mentioned, there is momentum in DC around the concept of an integrated AI sandbox across agencies. Last year, Senator Cruz proposed a bill ([S.2750 - SANDBOX Act](#)) providing for just this approach.

What Sandbox Opportunities Exist Right Now?

While the AI sandbox vision contemplated by Senator Cruz's bill and the White House executive order remain policy proposals for now, regulatory sandbox opportunities already exist in various forms across the United States, both at the federal and state levels. States with sandboxes of one kind or another include *Arizona, Utah, Texas, Florida, Nevada, Kansas, North Carolina, Ohio, Kentucky, Vermont, South Dakota and West Virginia*. Most of these sandboxes target highly regulated sectors, such as fintech, AI or even insurtech. However, some, such as Utah's, are technology-and-sector-agnostic and are potentially open to any business. This list changes regularly.

What does it Take to Participate in a Sandbox?

Requirements vary, but the spirit of the sandbox concept is to promote both innovation and regulatory reform where it makes sense to do so. As such, typically a proposal needs to bring a new solution to the market. Simply saying you want to do the same thing you've always done but with less regulatory restriction generally is not a winning proposal. That said, such an approach is not necessarily out of the question if a good case can be made that a public benefit could be achieved (such as addressing housing affordability).

Is participating in a Sandbox a Good Idea for My Company?

Maybe!

It is certainly wise to look at a sandbox approach if you have a new business product or service that would be restricted by existing rules. Otherwise, to roll out your innovation you would need to challenge the law in some fashion or await formal policy change. However, given that sandbox options at the federal level are limited and state regulatory sandboxes only provide relief from state rules, the current sandbox opportunities are

likely to be helpful only if the restrictions you are focused on are state level ones. For example, state sandboxes are particularly useful for navigating licensing requirements and consumer protection statutes--but they won't help when it comes to federal permitting requirements. Another limitation of a state sandbox is that you would need to operate within the geographic limitations of the state(s) where you are granted the regulatory relief. Despite these limitations, a sandbox approach can be powerful in pioneering new products and showcasing their efficacy in the real world, providing compelling evidence both of the utility of the innovation and the appropriateness of a specific policy change.

Looking Ahead

Sandboxes have the potential to address significant policymaking challenges. As use of frontier technologies like artificial intelligence proliferates, we will need new regulatory frameworks that are fit for purpose to both empower customers and promote competition. Also, affordability and global competitiveness concerns have raised questions around the benefit of some legacy regulatory systems. Process-based approaches like sandboxes are appealing in both cases because they provide flexibility to move with the pace of technology, and they allow efficient ways to test existing rules. However, until we have more sandbox options at the federal level, their utility will be limited.

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