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**SENATE COMMITTEE ON  
BANKING AND FINANCIAL INSTITUTIONS**  
**Senator Monique Limón, Chair**  
**2023 - 2024 Regular**

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**Bill No:** AB 39 **Hearing Date:** June 21, 2023  
**Author:** Grayson  
**Version:** June 12, 2023 Amended  
**Urgency:** No **Fiscal:** Yes  
**Consultant:** Michael Burdick

**Subject:** Digital financial asset businesses: regulatory oversight

**SUMMARY**

This bill establishes a licensing and regulatory framework, administered by the Department of Financial Protection and Innovation, for digital financial asset business activity. The bill intends to provide regulatory clarity to businesses and legal protections for consumers and retail investors in this emerging industry.

**EXISTING LAW**

- 1) Establishes the Department of Financial Protection and Innovation (DFPI) as the state agency responsible for licensing, regulating, and supervising a range of financial services companies that provide products or services to California consumers, including but not limited to, securities issuers, broker-dealers, investment advisers, and investment advisers representatives; persons offering or selling off-exchange commodities; persons holding securities as custodians on behalf of securities owners; money transmitters; and persons offering or providing consumer financial products or services. (Financial Code Section 300)
- 2) Provides the Corporate Securities Law of 1968, administered by DFPI, which governs the issuance and sale of securities in California. (Corporations Code Sections 25000 et seq.)
- 3) Provides that it is unlawful for any person to offer or sell any security in this state, unless such sale has been qualified by DFPI, as specified, or the sale is covered by an express exemption from qualification. (Corporations Code Section 25110)
- 4) Provides the Money Transmission Act, administered by DFPI, which requires licensure of persons engaged in the business of money transmission, unless the person is exempt. (Financial Code Section 2000 et seq.)
- 5) Defines money transmission as selling or issuing payment instruments, selling or issuing stored value, or receiving money for transmission. (Financial Code Section 2003(q))

**THIS BILL**

- 1) Establishes the Digital Financial Assets Law to be administered by DFPI.
- 2) Defines the following terms, among others:

- a) “Digital financial asset” means a digital representation of value that is used as a medium of exchange, unit of account, or store of value, and that is not legal tender. Specifies that “digital financial asset” does not include:
    - i) Value issued by a merchant as part of an affinity or awards program that cannot be exchanged for legal tender, bank credit, or a digital financial asset.
    - ii) A digital representation of value issued by a publisher and used solely within an online game, as specified.
    - iii) A security registered with the Securities and Exchange Commission, qualified with DFPI, or exempt from such registration or qualification.
  - b) “Legal tender” means a medium of exchange or unit of value, including the coin or paper money of the United States, issued by the United States or by another government.
  - c) “Digital financial asset business activity” means exchanging, transferring, or storing a digital financial asset; issuing a digital financial asset with the authority to redeem the currency for legal tender, bank credit, or another digital financial asset; or other specified activities related to electronic precious metals and digital representations of value used in online games.
  - d) When used in reference to a transaction or relationship involving a digital financial asset, “control” means the power to execute unilaterally or prevent indefinitely a digital financial asset transaction.
  - e) “Exchange” when used as a verb, means to assume control of a digital financial asset from, or on behalf of, a resident, at least momentarily, to sell, trade, or convert either of the following:
    - i) A digital financial asset for legal tender, bank credit, or one or more forms of digital financial assets.
    - ii) Legal tender or bank credit for one or more forms of digital financial assets.
  - f) “Store” except in the phrase “store of value,” means to maintain control of a digital financial asset on behalf of a resident by a person other than the resident.
  - g) “Transfer” means to assume control of a digital financial asset from, or on behalf of, a resident and to subsequently do any of the following:
    - i) Credit the digital financial asset to the account of another person.
    - ii) Move the digital financial asset from one account of a resident to another account of the same resident.
    - iii) Relinquish control of a digital financial asset to another person.
- 3) Exempts from the new division banks, as specified; persons providing only specified computing, network, or data storage or security services; persons using a digital financial asset solely on the person’s own behalf; and persons registered as a securities broker-dealer to the extent of its operation as such, among other specified exemptions.

- 4) On or after January 1, 2025, prohibits a person from engaging in digital financial asset business activity without a license from DFPI, as specified.
- 5) Establishes requirements of an application for licensure, authorizes DFPI to charge a fee to cover the reasonable costs of regulation, and requires DFPI to investigate specified characteristics of the applicant before making a decision on the application.
- 6) Authorizes DFPI to issue a conditional license to an applicant who holds or maintains a license to conduct virtual currency business activity in New York, as specified.
- 7) Requires a licensee to maintain a surety bond or trust account in a form and amount as determined by DFPI for the protection of residents with whom a licensee engages in digital financial asset business activity, as specified.
- 8) Requires a licensee to maintain capital and liquidity in an amount and form as DFPI determines is sufficient to ensure the financial integrity of the licensee and its ongoing operations based on an assessment of specific risks applicable to the licensee, as specified.
- 9) Establishes a process for a licensee to renew its license on an annual basis.
- 10) Authorizes DFPI to adopt rules necessary to implement the division and issue guidance as appropriate.
- 11) Authorizes DFPI to conduct an examination of a licensee for compliance with the division and requires a licensee to maintain business records, as specified.
- 12) Requires a licensee to file with DFPI a report related to a material change in information provided in the application for licensure, a material change in the licensee's digital financial asset business activity, or a change of an executive officer, responsible individual, or person in control of the licensee.
- 13) Provides specified applicable rules in determining whether a person has control over a licensee; requires that, before a proposed change in control of a licensee, the proposed person to be in control submit an application with information required by this division for an application for licensure, as applicable; and prohibits DFPI from approving the application unless the department determines specified suitability conditions have been met.
- 14) Provides a process similar to an application related to a proposed change in control for an application of a proposed merger or consolidation of a licensee with another person.
- 15) Defines "enforcement measure" as an action to do any of the following:
  - a) Suspend or revoke a license.
  - b) Order a person to cease and desist from doing digital financial asset business activity.
  - c) Request the court to appoint a receiver for the assets of a person doing digital financial asset business activity.
  - d) Request the court to issue temporary, preliminary, or permanent injunctive relief against a person doing digital financial asset business activity.

- e) Assess a penalty of up to \$100,000 for each day that a person engages in digital financial asset business activity without a license.
  - f) If a person required to obtain a license materially violates a provision of the division, assess a penalty of up to \$20,000 for each day of violation or for each act or omission in violation.
  - g) Recover on the security described in #7 of this section and initiate a plan to distribute the proceeds for the benefit of a resident injured by a violation of the law.
  - h) Impose necessary or appropriate conditions on the conduct of digital financial asset business activity.
  - i) Seek restitution on behalf of a resident if the department shows economic injury due to a violation of this division.
- 16) Authorizes DFPI to take an enforcement measure against a person in any of the following instances:
- a) The person materially violates a state law applicable to digital financial asset business activity.
  - b) The person does not cooperate with an examination or investigation, fails to pay a fee, or fails to submit a report or documentation.
  - c) The person, in the conduct of its digital financial asset business activity, engages in an unsafe or unsound act or practice; an unfair or deceptive act or practice; fraud, intentional misrepresentation, or other dishonest act; or misappropriation of legal tender, a digital financial asset, or other value held by a fiduciary.
  - d) A federal agency or another state takes an action against the person, which would constitute an enforcement measure if the department had taken the action.
  - e) The person is convicted of a crime related to its digital financial asset business activity or involving fraud or felonious activity, as specified.
  - f) The person becomes insolvent or takes specified actions indicating financial weaknesses.
  - g) The person makes a material misrepresentation to the department.
- 17) Specifies processes related to enforcement actions, including a person's rights to notice and opportunity for a hearing as appropriate, when a revocation of a license is effective, and when a suspension of a license is effective.
- 18) Authorizes DFPI to enter into a consent order with a person regarding an enforcement measure and permits the order to provide that it does not constitute an admission of fact.
- 19) States that the chapter of the bill related to enforcement does not provide a private right of action, but does not preclude an action by a person to enforce rights related to property interests described in #22 of this section.

- 20) Defines “covered person” as a person required to obtain a license related to digital financial asset business activity. This term is intended to be more expansive than the term “licensee” which applies only to those persons who already have a license. The author intends any provision that refers to the obligations of a “covered person” to be effective starting on January 1, 2024, while the licensure requirement is not effective until January 1, 2025.
- 21) Requires a covered person to provide disclosures, as specified, to its customers. Information required to be disclosed includes, but is not limited to, the following, as specified:
- a) A schedule of fees and charges.
  - b) Whether the product or service provided is covered by insurance or other guarantee from loss.
  - c) A description of specified terms related to their customers’ rights and responsibilities and processes associated with transfers or exchanges.
  - d) That no digital financial asset is currently recognized as legal tender by California or the United States.
  - e) A list of instances over the past 12 months when the person’s service was unavailable to 10,000 or more customers due to a service outage, as specified.
- 22) Requires a covered person to provide a transaction confirmation record, as specified.
- 23) Requires a covered that has control of a digital financial asset for one or more persons to maintain in its control an amount of each type of digital financial asset sufficient to satisfy the aggregate entitlements of the persons to the type of digital financial asset.
- a) Provides that, in the event of a violation of this requirement, the property interest of the persons in the digital financial asset are pro rata property interests in the type of digital financial asset to which the persons are entitled without regard to the time the persons became entitled to the digital financial asset or the covered person obtained control of the digital financial asset.
  - b) Requires that digital financial assets maintained for compliance with the provision to meet all of the following criteria: be held for the persons entitled to the digital financial asset, shall not be property of the covered person, and shall not be subject to the claims of creditors of the covered person.
- 24) Defines a “covered exchange” as a covered person that exchanges or holds itself out as being able to exchange a digital financial asset for a resident.
- 25) Requires a covered exchange, prior to listing or offering a digital financial asset that the covered exchange can exchange on behalf of a resident, to certify that the covered exchanged has conducted specified due diligence related to the digital financial asset, including the likelihood the asset would be deemed a security by federal or state regulators, provided a full disclosure relating to conflicts of interests, and conducted a comprehensive risk assessment of the asset, among other things. Exempts a covered exchange from these obligations for any digital financial assets that were approved by New York regulators on or before January 1, 2023.

- 26) Requires a covered exchange to make every effort to execute a resident's request to exchange a digital financial asset in a manner so that the outcome to the resident is as favorable as possible under prevailing market conditions, as specified.
- 27) Requires a licensee to prominently display on its internet website a toll-free telephone number through which a customer can contact the seller for customer service issues and receive live customer assistance, 10 hours per day, Monday through Friday, excluding federal holidays.
- 28) Prohibits a covered person from exchanging, transferring, or storing a stablecoin unless the issuer of the stablecoin is a licensee, a person that applies for a license, or a bank and the issuer of the stablecoin at all times owns eligible securities that fully back the stablecoin, as specified.
- 29) Requires a prospective licensee, prior to seeking approval from DFPI, to create and, during licensure, maintain policies and procedures related to information security, operational security, business continuity, disaster recovery, antifraud, money laundering prevention, terrorist financing prevention, and compliance with applicable laws, as specified.
- 30) Provides that the new division applies to digital financial asset business activity conducted on and after January 1, 2025.

## **COMMENTS**

### 1) PURPOSE

According to the author:

AB 39 will promote a healthy and sustainable crypto asset market by licensing and regulating businesses that help Californians buy and sell these new digital financial products. While crypto assets have the potential to empower consumers and disrupt the financial sector in unexpected ways, their high volatility and the prevalence of fraud, illicit behavior, and technical and security vulnerabilities expose California consumers to significant financial harm. AB 39 strikes a balance between protecting consumers from harm and fostering a responsible innovation environment by establishing clear rules of the road.

### 2) BACKGROUND

This bill is similar to AB 2269 (Grayson, 2022), which proposed a licensing law for digital financial asset businesses that would be administered by the Department of Financial Protection and Innovation (DFPI). This committee passed AB 2269 on a 6-0 vote, and the bill was approved by the Senate on a 31-6 vote and by the Assembly on a 71-0 vote. Governor Newsom, however, vetoed the bill. As discussed in a subsequent comment, the author has made targeted changes to his proposal from last year to address various industry concerns and to ease the implementation burden on DFPI. The structure and major provisions of this bill adhere closely to those found in AB 2269, and the focus of the bill remains on providing a clear regulatory framework that prioritizes consumer protections within the digital financial asset industry.

This bill uses the term “digital financial assets” to describe a range of money-like, digital representations of value that are not considered legal tender and are not issued by a central bank of a sovereign nation. Similar terms used to describe this concept are *cryptocurrencies*, *digital currencies*, *virtual currencies*, *crypto assets*, and *digital assets*, among others. Prominent examples of digital financial assets include bitcoin, ether, dogecoin, tether, and USD Coin. This committee’s analysis of AB 2269 from last year provides detailed background of the digital financial assets industry, the legal context within which it operates, and why additional regulation is necessary to better protect consumers. That analysis is incorporated herein by reference.<sup>1</sup>

### 3) GOVERNOR’S VETO OF AB 2269

As mentioned in the previous comment, Governor Newsom vetoed AB 2269 last session, a substantively similar bill to AB 39 and by the same author. The governor’s veto message to the legislature reads:

AB 2269 would establish a licensing and regulatory framework, administered by the Department of Financial Protection and Innovation, for digital financial asset activity. Digital assets are becoming increasingly popular in our financial ecosystem, with more consumers buying and selling cryptocurrencies each year. I share the author's intent to protect Californians from potential financial harm while providing clear rules for crypto-businesses operating in this state.

On May 4, 2022, I issued Executive Order N-9-22 to position California as the first state to establish a transparent regulatory environment that both fosters responsible innovation, and protects consumers who use digital asset financial services and products - all within the context of a rapidly evolving federal regulatory picture. Over the last several months, my Administration has conducted extensive research and outreach to gather input on approaches that balance the benefits and risk to consumers, harmonize with federal rules, and incorporate California values such as equity, inclusivity, and environmental protection.

It is premature to lock a licensing structure in statute without considering both this work and forthcoming federal actions. A more flexible approach is needed to ensure regulatory oversight can keep up with rapidly evolving technology and use cases, and is tailored with the proper tools to address trends and mitigate consumer harm. Additionally, standing up a new regulatory program is a costly undertaking, and this bill would require a loan from the general fund in the tens of millions of dollars for the first several years. Such a significant commitment of general fund resources should be considered and accounted for in the annual budget process.

I am committed to working collaboratively with the Legislature to achieve the appropriate regulatory clarity once federal regulations come into sharper focus for digital financial assets, while ensuring California remains a competitive place for companies to invest and innovate.

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<sup>1</sup> See Senate Banking and Financial Institutions analysis dated 6/20/2022 at the following link: [https://leginfo.legislature.ca.gov/faces/billAnalysisClient.xhtml?bill\\_id=202120220AB2269#](https://leginfo.legislature.ca.gov/faces/billAnalysisClient.xhtml?bill_id=202120220AB2269#)

Since the Governor's veto, the digital financial asset industry has continued to struggle as major companies have filed for bankruptcy and federal and state agencies have initiated dozens of enforcement actions and lawsuits alleging illegal activities. Additionally, the current Congress appears to be gridlocked on any crypto-related legislation, with no apparent resolution between the policy positions of pro-industry House Republicans and crypto-skeptic Democrats in the US Senate. From the executive branch, the Biden Administration has generally taken a more skeptical view on the industry than it communicated in 2021, with US Treasury and the Council of Economic Advisers emphasizing the risks and problems of crypto and downplaying industry claims of purported benefits of crypto.

Within California, there has been little progress under the Governor's executive order towards achieving a transparent regulatory environment that protects consumers with no proposals for new regulations or legislation or requests for additional budget resources. DFPI has brought numerous enforcement actions against crypto companies and individual fraudsters for violating state securities laws, but there remains a lack of state supervision over the activities of crypto businesses. Compared to businesses in the traditional financial system – such as, banks, securities brokers and dealers, and payments providers – crypto businesses continue to operate with far less oversight and outside of existing regulatory frameworks. This lack of oversight likely contributes to a higher rate and intensity of harm to consumers than would exist if the industry were properly regulated.

#### 4) INDUSTRY STRUGGLES OVER THE PAST YEAR

The past year in the crypto industry was tumultuous.<sup>2</sup> When this committee heard AB 2269 a year ago, crypto markets had recently experienced a sharp downturn, sparked by the collapse in May 2022 of the so-called stablecoin, TerraUSD, which was a token designed and marketed to keep a value of \$1.00. Along with its sister token, Luna, the collapse of TerraUSD wiped out \$40 billion of market value and catalyzed the eventual failures of several large crypto companies, including Three Arrows Capital, Celsius, Voyager, BlockFi, and Genesis. These failures affect not only the owners and employees of these companies, but also have imposed financial losses on those companies' customers, who range from sophisticated institutional investors to working people who unwittingly invested their savings or retirement assets in companies that were far riskier than they realized.

After several months of relative quiet, turmoil returned in early November 2022 with reports revealing that FTX, a large crypto exchange, and its associated trading firm, Alameda Research, engaged in related-party transactions with significant conflicts of interests, calling into question the financial viability of the two companies. The reports initiated a run on FTX with account holders liquidating their balances or pulling their assets off of the platform. Subsequent reporting revealed that FTX lent billions of dollars of customer assets to Alameda Research, who subsequently gambled the assets away, and by November 11, 2022, FTX filed for chapter 11 bankruptcy protection. The following month, Sam Bankman-Fried, founder and CEO of FTX, was arrested in the Bahamas after federal prosecutors in New York filed criminal charges related to fraud, money laundering, and other crimes.

The revelation of Sam Bankman-Fried's alleged criminal activities likely contributed to a change in tone at the federal level related to regulating crypto businesses. In 2021 and 2022,

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<sup>2</sup> The following events were chronicled in many media outlets. The facts summarized in this comment were sourced from the following article published by The Wall St. Journal: <https://www.wsj.com/articles/crypto-crisis-a-timeline-of-key-events-11675519887?mod=ftx-ribbon>, accessed on June 21, 2023.



FTX had spent millions of dollars on advertising campaigns, using celebrities and star athletes to build the company's brand identity and attract customers to its platform. Meanwhile, Bankman-Fried was among the most prominent advocates lobbying federal regulators and Congress to support new laws that would arguably give FTX and other crypto businesses preferential treatment compared to traditional financial institutions. The combination of high public visibility and active lobbying and associated campaign contributions had bolstered the perceived credibility of FTX and Bankman-Fried in the eyes of regulators and Congress, which made the criminal allegations particularly shocking and has likely led to a more skeptical view in Washington, D.C. of the entire industry, especially among Democrats.

The response from federal regulators in 2023 has been pronounced. Federal banking regulators issued in January 2023 a joint statement to banks about crypto activities, which stated that issuing or holding crypto is "highly likely to be inconsistent with safe and sound banking practices."<sup>3</sup> The Federal Reserve followed on January 27th with a rejection of an application from a crypto-focused bank to gain access to the central bank's payment system. In February the Securities and Exchange Commission (SEC) proposed a rule that may make it more difficult for many asset managers to invest their clients' funds in crypto assets.

On the law enforcement front, the SEC, Commodities Futures Trading Commission, the U.S. Department of Justice, and state regulators have brought actions against nearly all of the major players in the industry for alleged violations of laws. Settled or outstanding cases include multiple actions against Binance and Coinbase, the two most prominent exchanges, as well actions against Kraken, Gemini, Genesis, Do Kwon (the founder of Terra), Justin Sun (the founder of BitTorrent and Tron), Nexo, Bittrex, and Paxos. In various lawsuits and enforcement actions, the SEC has declared at least 55 crypto assets as unregistered securities, including nearly half of the top 20 tokens in purported market cap: BNB token (issued by Binance), XRP (issued by Ripple), Cardano, Solana, Tron, Polygon, Toncoin, Avalanche, and Binance USD.<sup>4</sup> As alleged by law enforcement entities, a large portion of the crypto markets have been operating – and continue to operate – out of compliance with existing law.

In recent weeks, Prime Trust, a Nevada-chartered trust company that serves as a custodian for crypto firms, was revealed to be insolvent, and the Nevada financial regulator is pushing the company into receivership.<sup>5</sup> Prime Trust has apparently been insolvent since 2021 when the company discovered that it was unable to access digital wallets that stored assets on behalf of the company's customers. Prime Trust had relationships with other crypto companies who interacted directly with consumers, while Prime Trust was intended to be a safe place for consumers' assets to be stored. The failure of Prime Trust is another reminder of the technological and operational risk inherent within the crypto ecosystem and the downsides presented by blockchains that make transactions difficult, and sometimes practically impossible, to reverse.

## 5) COMPARING THIS BILL TO AB 2269 OF 2022

The table below provided by the author's office compares several key differences between this bill and AB 2269 of 2022 that was vetoed by the Governor. In general, this bill enhances consumer protections in several areas, while providing additional flexibility to industry

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<sup>3</sup> <https://www.occ.gov/news-issuances/news-releases/2023/nr-ia-2023-1a.pdf>

<sup>4</sup> <https://cointelegraph.com/news/sec-labels-61-cryptocurrencies-securities-after-binance-suit>

<sup>5</sup> <https://www.coindesk.com/policy/2023/06/27/nevada-places-crypto-custodian-prime-trust-into-receivership/>

participants and DFPI to address a number of implementation concerns. In addition to the items in the table below, the amendments recommended in Comment #8 below include changes that are intended to address additional concerns raised by industry, provide specificity to provisions that would require DFPI to conduct rulemaking if left vague, and better align terminology in this bill with laws that DFPI already administers. In summary, the changes proposed by this bill, compared to last year’s bill, are intended to reduce the burden and cost for DFPI to administer the law, to avoid potential problems in standing-up the licensing program which could disrupt business activity in the market, and to relax aspects of the licensing program to avoid compliance challenges for industry, all while maintaining strong consumer protections throughout the law.

<b>AB 39 (2023)</b>	<b>AB 2269 (2022)</b>
<p><b>Consumer protections go into effect on January 1, 2024.</b></p> <p>AB 39 requires all crypto companies to comply with the bill’s key consumer protections starting on January 1, 2024. Companies that do not comply with these protections will be unable to get a permanent license.</p>	<p><b>Consumer protections would have taken effect on January 1, 2025.</b></p> <p>AB 2269’s consumer protections would not have taken effect until the required licensure date of January 1, 2025. As a result, consumers would have remained vulnerable in that window of program implementation.</p>
<p><b>Conditional licensing for those licensed or chartered in New York</b></p> <p>AB 39 allows for an ongoing conditional license to any company that is licensed or chartered to do business in New York State. These companies must still comply with AB 39’s other provisions.</p>	<p><b>No conditional licensing provision.</b></p> <p>AB 2269 would <u>not</u> have allowed for a conditional license for companies holding a New York license or charter.</p>
<p><b>Exchanges must self-certify that crypto assets meet certain standards.</b></p> <p>AB 39 requires any crypto exchange, prior to listing a token or crypto asset for sale, transfer, or exchange, to self-certify that the exchange has conducted a comprehensive risk assessment, and provided full and fair disclosure of all materials related to conflicts of interest, among other topics.</p>	<p><b>Proposed a “best interest” standard for crypto exchanges.</b></p> <p>AB 2269 would have required a crypto exchange to serve the best interests of their customers by disclosing and mitigating conflicts of interest, forming a reasonable basis for any recommendations made to customers, and exercising reasonable diligence to evaluate specified criteria before listing any specific digital financial asset as available for exchange.</p>

<p><b>Requires licensees to have live customer service 10 hours a day, 5 days a week.</b></p> <p>AB 39 aligns customer service requirements to those that apply to licensed money transmitters.</p>	<p><b>Requires licensees to have live customer service 24 hours a day, 7 days a week.</b></p> <p>AB 2269 would have required licensees to have live customer service around the clock.</p>
<p><b>Permanently requires stablecoins to be fully backed by reserves.</b></p> <p>AB 39 prohibits crypto companies from making a so-called “stablecoin” available for exchange, transfer, or storage unless the stablecoin’s value is backed by reserve assets.</p>	<p><b>Temporarily required stablecoins to be fully backed by reserves.</b></p> <p>AB 2269 would have also prohibited crypto companies from making a so-called “stablecoin” available for exchange, transfer, or storage unless the stablecoin’s value is backed by reserve assets, but only until January 1, 2028.</p>

6) ARGUMENTS IN SUPPORT

The Consumer Federation of California writes in support, as sponsor:

AB 39 will license digital financial assets companies under the California Department of Financial Protection and Innovation (DFPI), giving industry necessary regulatory clarity on how to operate safely while protecting consumers. Licensing in this area will provide basic consumer protections and is an appropriate and necessary next step to ensure that foundational “rules of the road” are met and followed to do business in the state of California. In 2022 alone, \$3.7 billion was lost to crypto scams, and FTX’s bankruptcy was just one of five within the crypto market. AB 39 seeks to boost transparency, adopt a regulatory framework, and, above all, protect consumers.

7) ARGUMENTS IN OPPOSITION

Crypto Council for Innovation (CCI), an association whose members include Andreessen Horowitz, Block, Coinbase, Electric Capital, Fidelity Digital Assets, Gemini, OpenSea, Paradigm, and Ribbit Capital, writes in an “oppose unless amended” position:

CCI is grateful for the progress the Committee has made in addressing industry concerns following Governor Newsom’s veto of AB 2269, including the expedited licensing pathway for businesses operating in compliance with New York’s virtual currency business activity regulations and the exemption for smaller digital asset businesses...

CCI continues with requests for various amendments, some of which have been incorporated by the author in the current version of the bill and some of which are reflected in proposed amendments in the subsequent comment. Outstanding items of concern for CCI include, but are not limited to, the requirement that stablecoins are fully backed by high-quality assets, a desire for an entities-based exemption for entities registered with the Commodities Futures

Trading Commission, an increase in the exemption threshold for small companies to \$2 million of business activity, and a desire for more concrete application and review timelines.

## 8) AMENDMENTS

Committee staff recommends and the author has agreed to the following amendments.

- a) Align definition of “control” with existing law in Financial Code Section 1250.

Amend paragraph (2) of subdivision (c) of Section 3102 to read:

(2) When used in reference to a person, the direct or indirect power: ~~to direct the management, operations, or policies of the person through legal or beneficial ownership of voting power in the person or under a contract, arrangement, or understanding.~~

**(A) To vote 25 percent or more of any class of the voting securities issued by a person; or**

**(B) To direct or cause the direction of the management and policies of a person, whether through the ownership of voting securities, by contract (other than a commercial contract for goods or nonmanagement services), or otherwise; provided, however, that no individual shall be deemed to control a person solely on account of being a director, officer, or employee of such person.**

- b) Ensure definition of “executive officer” is not overly prescriptive by including those persons who make or implement policies.

Amend subdivision (l) of Section 3102 to read:

“Executive officer” **includes, but is not limited to,** ~~means~~ an individual who is a director, officer, manager, managing member, partner, or trustee of a person that is not an individual, **or any other person who performs similar policy-making or policy-implementation functions.**

- c) Exempt a licensee from the definition of “resident” so that California-based licensees are not limited to only engaging in digital financial asset business activity with other companies that are licensees.

Amend subdivision (r) of Section 3102 to read:

**(1)** “Resident” means any of the following:

**(A)** A person who is domiciled in this state.

**(B)** A person who is physically located in this state for more than 183 days of the previous 365 days.

**(C)** A person who has a place of business in this state.

**(D)** A legal representative of a person that is domiciled in this state.

**(2) “Resident” does not include a licensee or an affiliate, as defined in subdivision (a) of Section 90005, of a licensee.**

- d) Remove exemption for digital asset control services vendor. The failure of Prime Trust highlights the need for state oversight of non-customer-facing custodians and other service providers who exert control over the digital financial assets of California residents.

Delete paragraph (13) from subdivision (b) of Section 3103.

- e) Provide DFPI with ability to exempt, in whole or in part, persons or transactions from the licensing law, as appropriate. Business activity related to digital financial assets is evolving quickly. If provisions of this licensing law are ill-fit for new or emerging business models or practices, DFPI may be better equipped to ensure consumer protections by granting businesses flexibility with case-by-case exemptions, rather than codifying broad and rigid statutory carve-outs.

Add the following subdivision (d) to Section 3103.

**(d) The commissioner may, by regulation or order, either unconditionally or upon specified terms and conditions or for specified periods, exempt from all or part of this division any person or transaction or class of persons or transactions, if the commissioner finds such action to be in the public interest and that the regulation of such persons or transactions is not necessary for the purposes of this division. The commissioner shall post on the commissioner’s Internet Web site a list of all persons, transactions, or classes of person or transactions exempt pursuant to this section, and the part or parts of this division from which they are exempt. The commissioner may, by regulation or order, amend or rescind any exemption made pursuant to this subdivision.**

- f) Specify the documentation that an applicant would provide to demonstrate compliance with capital and liquidity requirements. This language was borrowed from existing regulations that apply to money transmitters.<sup>6</sup>

Amend subparagraph (J) of paragraph (2) of subdivision (a) of Section 3203 to read:

(J) Documentation demonstrating that the applicant has the capital and liquidity required by Section 3207. **Documentation includes, but is not limited to:**

**(i) A copy of the applicant’s audited financial statements for the most recent fiscal year and, if available, for the two-year period next preceding the submission of the application.**

**(ii) A copy of the applicant’s unconsolidated financial statements for the current fiscal year, whether audited or not, and, if available, for the two-year period next preceding the submission of the application.**

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<sup>6</sup> 10 CCR § 80.4111

**(iii) If the applicant is publicly traded, a copy of the most recent report filed with the United States Securities and Exchange Commission under Section 13 of the federal Securities Exchange Act of 1934 (15 U.S.C. Sec. 78m).**

- g) Increase the time for a licensee to comply with a requirement from DFPI to increase the amount of security deposited or capital or liquidity required pursuant to Section 3207.

Change from 15 to 30 the number of days provided by Section 3207(a)(4) and (e).

- h) Clarify inconsistencies and vagueness in the provision related to liquidity requirements. As currently drafted, subdivisions (c) and (d) of Section 3207 are inconsistent and unclear. Subdivision (c) provides that DFPI determines the proportion of specified assets that may be used to meet the liquidity requirement, while subdivision (d) suggests that the licensee has a role in calculating its capital and liquidity. Subdivision (c) also includes terms that lack specificity and precision.

Amend subdivision (c) and delete subdivision (d) of Section 3207, as follows:

(c) A licensee shall hold ~~liquidity~~ **liquid assets** required to be maintained in accordance with this section in the form of cash, digital financial assets **other than digital financial assets over which the licensee has control for a resident entitled to the protections of Section 3503,** or high-quality, **liquid assets as defined in subdivision (a) of 12 C.F.R. 249.20** ~~highly liquid, investment grade assets,~~ in proportions determined by the department.

~~(d) (1) A licensee may include in its calculation of capital and liquidity the value of digital financial assets other than the digital financial assets over which it has control for a resident entitled to the protections of Section 3503.~~

~~(2) For purposes of this subdivision, the value of digital financial assets shall be the average value of the digital financial assets in United States dollar equivalent during the prior six months.~~

- i) Clarify and narrow the type of investigations and data security breach events that require disclosure by the licensee to DFPI to those where the licensee is the subject of the investigation or breach.

Amend subparagraphs (C) and (D) of paragraph (3) of subdivision (b) of Section 3211 by replacing the two instances of “involving” with “of.”

- j) Specify the scope of changes in a licensee’s business that require reporting to DFPI, by aligning with requirements of New York’s BitLicense program.

Amend paragraph (2) of subdivision (a) of Section 3307 to read:

(2) A ~~material~~ change in the licensee’s business for the conduct of its digital financial asset business activity with, or on behalf of, a resident **that meets one of the following criteria:**

**(A) The change may raise a legal or regulatory issue about the permissibility of the licensee’s digital financial business activity.**

**(B) The proposed change may raise safety and soundness or operational concerns.**

**(C) A change is proposed to digital financial business activity that may cause such activity to be materially different from that previously listed on the application for licensing by the commissioner.**

- k) Modify the parameters for determining whether a person has control over a licensee to more closely reflect existing law that applies to other licensing programs administered by DFPI, such as those found in Financial Code Section 1250.

Amend subdivision (b) of Section 3309 to read:

(b) The following rules apply in determining whether a person has control over a licensee:

**(1) There is a rebuttable presumption of control if a person directly or indirectly, owns, controls, holds with the power to vote, or holds proxies representing, 10 percent or more of the then outstanding voting securities issued by the licensee.**

~~(2)~~ A person has control over a licensee if the person's voting power in the licensee constitutes or will constitute at least 25 percent of the total voting power of the licensee.

~~(3)~~ A person has control over a licensee if the person's voting power in another person constitutes or will constitute at least 10 percent of the total voting power of the other person and the other person's voting power in the licensee constitutes at least ~~25~~ **10** percent of the total voting power of the licensee.

~~(34)~~ A person does not have control over a licensee solely because that person is an executive officer of the licensee.

- l) Align DFPI enforcement authority related to the timing of alleged unlawful acts with existing law under the California Consumer Protection Law.

Amend subdivision (a) of Section 3403 and subdivision (a) of Section 3407, as follows:

3403. (a) The department may take an enforcement measure against a licensee or person that is not a licensee but **has engaged**, is engaging, **or proposes to engage** in digital financial asset business activity with, or on behalf of, a resident in any of the following instances:

(1) The licensee or person materially violates this division, a rule adopted or order issued under this division, or a law of this state other than this division that applies to digital financial asset business activity of the violator with, or on behalf of, a resident.

(2) The licensee or person does not cooperate substantially with an examination or investigation by the department, fails to pay a fee, or fails to submit a report or documentation.

(3) The licensee or person, in the conduct of its digital financial asset business activity with, or on behalf of, a resident, **has engaged**, engages, **or proposes to engage** in any of the following:...

3407. (a) If a person other than a licensee **has engaged**, engages, **or proposes to engage** in digital financial asset business activity with, or on behalf of, a resident in violation of this division, the department may assess a civil penalty against the person in an amount not to exceed one hundred thousand dollars (\$100,000) for each day the person is in violation of this division.

- m) Clarify that the “no private right of action” language does not intend to block any existing common law rights and remedies.

Amend Section 3413 to read:

(a) This chapter ~~does not~~ **shall not be construed to** provide a private right of action to a resident.

**(b) The duties and obligations imposed by this chapter are cumulative with any other duties or obligations imposed under other law, and shall not be construed to relieve any party from any duties or obligations imposed under other law.**

~~(c)~~ This section does not preclude an action by a resident to enforce rights under Section 3503.

- n) Add provisions intended to protect customers’ assets in the event a licensee falls into financial trouble or files for bankruptcy, modelled after protections found in the Money Transmission Act.

Add the following subdivisions (d) and (e) to Section 3503:

**(d) Even if commingled with other assets of the covered person, digital financial assets maintained for purposes of compliance with this section are deemed to be held in trust for the benefit of the customers of the covered persons’ digital financial asset business activity, in the event of bankruptcy or receivership of the covered person, or in the event of an action by a creditor against the covered person who is not a beneficiary of this statutory trust. No digital financial assets maintained for purposes of compliance with this section or eligible securities impressed with a trust pursuant to this subdivision shall be subject to attachment, levy of execution, or sequestration by order of any court, except for a beneficiary of this statutory trust.**

**(e) A covered person shall at all times own eligible securities, as described in subdivision (b) of Section 2082, having an aggregate market value computed in accordance with United States generally accepted accounting principles of not less than the aggregate amount of all of its outstanding United States dollar-denominated liabilities owed to its customers.**

- o) Clarify the definition of “stablecoin” to better reflect the intent of the provision to prevent the marketing of so-called stablecoins that are not backed by high-quality assets. The current language in the bill may have a loophole for tokens that do not have an express



redemption feature. This important provision is motivated by the meltdown of TerraUSD, mentioned in a previous comment, in which the so-called stablecoin de-pegged and is now valued at essentially nothing. Users of Terra USD collectively lost billions of dollars on a crypto asset that was marketed as a substitute for fiat currency or bank money – these users were not speculating on the price of the token going up, rather they were assuming that the token would simply keep its \$1.00 value.

Amend paragraph (3) of subdivision (b) of Section 3601 as follows:

(3) “Stablecoin” means a digital financial asset that is denominated in United States dollars or pegged to the United States dollar or denominated in or pegged to another national or state currency ~~and is issued with a fixed nominal redemption value~~ **and is marketed with the intent of establishing in a manner that intends to** establish a reasonable expectation or belief among the general public that the instrument will retain a nominal ~~redemption~~ value that is so stable as to render the nominal ~~redemption~~ **value** effectively fixed.

- p) Fix a drafting error that contains duplicative language and that unintentionally delays the operative date for certain aspects of the bill. With this change, the licensing requirement has a delayed implementation date of January 1, 2025, while consumer protection requirements related to disclosures, fully-backed stablecoins, and business policies and procedures (i.e., Chapters 5-7 of the bill) will be effective on January 1, 2024.

Delete Section 3801.

## 9) DOUBLE REFERRAL

This bill is double-referred to the Judiciary Committee.

## **LIST OF REGISTERED SUPPORT/OPPOSITION**

### Support

California Bankers Association  
 California Credit Union League  
 California Low-income Consumer Coalition  
 Cameo - California Association for Micro Enterprise Opportunity  
 Consumer Federation of California  
 Consumer Reports  
 Consumers for Auto Reliability & Safety  
 Digital Currency Traders Alliance  
 Los Angeles County Democratic Party  
 Oakland Privacy

### Opposition

Crypto Council for Innovation