
THIRD READING

Bill No: AB 39
Author: Grayson (D), et al.
Amended: 9/8/23 in Senate
Vote: 21

SENATE BANKING & F.I. COMMITTEE: 6-0, 7/5/23
AYES: Limón, Bradford, Caballero, Min, Nguyen, Portantino
NO VOTE RECORDED: Niello

SENATE JUDICIARY COMMITTEE: 10-0, 7/11/23
AYES: Umberg, Wilk, Allen, Ashby, Caballero, Durazo, Laird, Min, Stern,
Wiener
NO VOTE RECORDED: Niello

SENATE APPROPRIATIONS COMMITTEE: 5-2, 9/1/23
AYES: Portantino, Ashby, Bradford, Wahab, Wiener
NOES: Jones, Seyarto

ASSEMBLY FLOOR: 70-1, 5/25/23 - See last page for vote

SUBJECT: Digital financial asset businesses: regulatory oversight

SOURCE: Author

DIGEST: 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.

Senate Floor Amendments of 9/8/23 clarify the bill's applicability to merchants, delay the operative date of the licensure requirement and other specified requirements, authorize the commissioner to approve stablecoins that do not comply with specified rules, and add contingent enactment language providing that

this bill will become operative only if SB 401 (Limón) of this legislative session is also enacted.

ANALYSIS:

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) Authorizes DFPI to exempt, in whole or in part, transactions or persons from the Digital Financial Assets law, as specified.
 - 5) Prohibits, on or after July 1, 2025, a person from engaging in digital financial asset business activity without a license from DFPI, as specified.
 - 6) 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.
 - 7) 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.
 - 8) 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.
 - 9) 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.
 - 10) Requires a licensee to report annually to DFPI and to pay the licensee's pro rata share of costs incurred by DFPI to administer the licensing program.
 - 11) Authorizes DFPI to adopt rules necessary to implement the division and issue guidance as appropriate.
 - 12) Authorizes DFPI to conduct an examination of a licensee for compliance with the division and requires a licensee to maintain business records, as specified.

- 13) 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.
- 14) 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.
- 15) 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.
- 16) 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.
- 17) 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, has engaged, is engaging, or is about to engage 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.
- 18) 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.
- 19) 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.
- 20) States that the chapter of the bill related to enforcement shall not be construed to provide a private right of action, but does not preclude an action by a person to enforce rights related to property interests described in #24 of this section.
- 21) 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.

- 22) 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.
- 23) Requires a covered person to provide a transaction confirmation record, as specified.
- 24) Requires a covered person 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.

- c) Provides that a covered person shall at all times own eligible securities, as specified, having an aggregate market value of not less than the aggregate amount of all of its outstanding United States dollar-denominated liabilities owed to its customers.
- 25) 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.
- 26) 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 exchange 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.
- 27) Requires a covered exchange to make every effort to execute a resident’s request to exchange a digital financial asset fully and promptly and to use reasonable diligence to ensure that the outcome to the resident is as favorable as possible under prevailing market conditions, as specified.
- 28) 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.
- 29) On or after July 1, 2025, prohibits a covered person from exchanging, transferring, or storing a stablecoin or engaging in digital financial asset administration unless the issuer of the stablecoin is a licensee, a person that applies for a license, a bank, or a California or federal trust, and the issuer of the stablecoin at all times owns eligible securities that fully back the stablecoin, as specified. Provides a process whereby a stablecoin that does not meet specified requirements may be issued and made available for exchange, transfer, or storing, subject to approval by the commissioner.
- 30) 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.

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) *Overview*

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. Under existing state law, business activity related to digital financial assets does not fall under any licensure requirements nor does state law provide rules, restrictions, or prohibitions specific to this emerging industry.¹

This bill is similar to AB 2269 (Grayson, 2022), which proposed a licensing law for digital financial asset businesses to be administered by the Department of Financial Protection and Innovation (DFPI). AB 2269 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, citing concerns that the measure was “premature,” due in part to potential regulatory actions at the federal level. The veto message also raised fiscal concerns related to a loan from the General Fund that would have been required to stand-up the licensing program.

¹ The Senate Banking and Financial Institutions Committee analysis of AB 2269 (Grayson, 2022) provides a more 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. 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#

Less than two months after the governor’s veto, one of the largest crypto exchanges, FTX, imploded in a high-profile scandal that led to dozens of criminal charges against the firm’s founder and chief executive, Sam Bankman-Fried. The FTX scandal and numerous other business failures within the crypto industry was followed by a crackdown by federal regulators and law enforcement agencies against a variety of businesses in the crypto industry. As of the writing of this analysis, there are no known bills or proposed regulations at the federal level that are expected to provide broad regulatory clarity or enforceable legal protections for users of digital financial assets.²

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. Furthermore, according to the Senate Appropriations Committee analysis dated September 1, 2024, “DFPI does not anticipate the need for additional General Fund support, and will likely be able to cover its administrative costs through the Financial Protection Fund until the program is able to collect adequate fee revenue to support this program’s operations,” thus addressing one of the concerns cited in the governor’s veto of AB 2269 last year.

3) *Recent Amendments*

This bill was amended on September 1, 2023, and September 8, 2023, with various technical and substantive changes. Substantive changes include, but are not limited to, the following:

- *Delayed implementation date.* The requirements in the bill will be operative on July 1, 2025, providing ample time for industry participants to prepare to comply with the law and for DFPI to implement and administer the proposed licensing program.
- *Cost recovery mechanism.* The bill specifies procedures for recovering costs from licensees related to the licensing program. Similar to other licensing laws administered by DFPI, program costs will be recovered through a combination of application fees, cost recoveries for examinations of specific

² For more extensive discussion of the industry struggles and federal regulatory response, see the Senate Banking and Financial Institutions Committee analysis of this bill, dated July 3, 2023, located here: https://leginfo.legislature.ca.gov/faces/billAnalysisClient.xhtml?bill_id=202320240AB39.

licensees, and a pro rata assessment to cover other outstanding program costs. The pro rata assessment is based on the number of a licensee's California customers, relative to the total number of California customers served by all licensees.

- *Contingent enactment language with SB 401 (Limón)*. The bill provides that it will go into effect only if SB 401 (Limón), related to digital financial asset transaction kiosks, of this legislative session is also enacted.

FISCAL EFFECT: Appropriation: No Fiscal Com.: Yes Local: No

According to the Senate Appropriations Committee, DFPI reports costs of approximately \$14.0 million in year one, \$17.0 million in year two, and \$21.2 million in year three and ongoing for a multi-year build-up of the program and for continued administration and enforcement workload (Financial Protection Fund). Costs to establish the program would include equipment, software, other IT operating expenses, and workload related to promulgating regulations and training for DFPI staff. Ongoing costs would include additional staffing resources to conduct licensing, examination, investigation, and enforcement activities.

Generally, when DFPI establishes a new regulatory program it will cover those start-up costs through the Financial Protection Fund. Once the program is fully operational, the DFPI will recoup those costs through that program's licensing fees, fines, penalties, settlements, or judgements. DFPI does not anticipate the need for additional General Fund support, and will likely be able to cover its administrative costs through the Financial Protection Fund until the program is able to collect adequate fee revenue to support this program's operations.

SUPPORT: (Verified 9/11/23)

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

OPPOSITION: (Verified 9/11/23)

Coinbase
Crypto Council for Innovation
Defendingconstitutionalrights.com

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.

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.

ASSEMBLY FLOOR: 70-1, 5/25/23

AYES: Addis, Alanis, Alvarez, Arambula, Bains, Bauer-Kahan, Bennett, Berman, Boerner, Bonta, Bryan, Calderon, Juan Carrillo, Wendy Carrillo, Cervantes, Chen, Connolly, Davies, Mike Fong, Friedman, Gabriel, Gallagher, Garcia, Gipson, Grayson, Haney, Hart, Holden, Irwin, Jackson, Jones-Sawyer, Kalra, Lackey, Lee, Low, Lowenthal, Maienschein, McCarty, McKinnor, Muratsuchi, Stephanie Nguyen, Ortega, Pacheco, Jim Patterson, Pellerin, Petrie-Norris, Quirk-Silva, Ramos, Reyes, Luz Rivas, Robert Rivas, Rodriguez, Blanca Rubio, Sanchez, Santiago, Schiavo, Soria, Ta, Ting, Valencia, Villapudua, Waldron, Wallis, Ward, Weber, Wicks, Wilson, Wood, Zbur, Rendon

NOES: Dixon

NO VOTE RECORDED: Aguiar-Curry, Megan Dahle, Essayli, Flora, Vince Fong, Hoover, Mathis, Papan, Joe Patterson

Prepared by: Michael Burdick / B. & F.I. /
9/11/23 18:44:33

**** END ****