

Date of Hearing: March 3, 2025

ASSEMBLY COMMITTEE ON BANKING AND FINANCE

Avelino Valencia, Chair

AB 236 (Chen) – As Introduced January 13, 2025

SUBJECT: Digital financial asset businesses: regulatory fees

SUMMARY: This bill establishes a \$5,000 cap on the Digital Financial Asset Law (DFAL) license application fee.

EXISTING LAW:

- 1) Provides for the DFAL (Financial Code Section 3101 et. seq.), administered by the Department of Financial Protection and Innovation (DFPI), which prescribes rules, including a requirement to become licensed beginning on July 1, 2026, applicable to a person engaging in digital financial business activity, as defined.
- 2) Requires an application for DFAL licensure to pay a nonrefundable fee in the amount determined by the department to cover the reasonable costs of application review.
- 3) Requires an applicant, in addition to the nonrefundable fee, to pay the reasonable costs of DFPI's investigation into specified criterion related to their ability to conduct digital financial business activity.

FISCAL EFFECT: Unknown. This bill is keyed Fiscal by Legislative Counsel.

COMMENTS:

1) Purpose.

According to the author:

AB 236 will promote the attractiveness of California as a place to operate in the digital financial market while encouraging financial innovation at the same time. Removing unnecessary barriers to entry, the bill takes necessary action to ensure small to medium-sized businesses can continue operating in the digital financial asset market.

Having pro-competitive effects on the market, AB 236 creates business opportunities in California's digital financial asset market, while at the same time never compromising the ability to regulate it as an emerging market.

2) Digital financial assets.

A digital financial asset (also referred to "cryptocurrency," "crypto asset," or "virtual currency," terms used interchangeably in this analysis) is a digital representation of value that is not issued or backed by a government or central bank. Unlike the dollar, cryptocurrency is not considered legal tender, but private parties may agree to it to facilitate an economic exchange. Bitcoin, the most well-known virtual currency, and many other virtual currencies

are created and tracked via a decentralized protocol, rather than the centralized issuance model that prevails in the world of fiat money.

Proponents of cryptocurrency believe that these products and systems offer viable alternatives to those found in the traditional financial system. They argue that cryptocurrency is beneficial because it is decentralized, allowing for peer-to-peer transactions, easy and fast transactions, portfolio diversification, acts as an inflation hedge, encourages cross-border payments, promotes financial inclusion, and provides transactional freedom.

However, these assets can pose risks to consumers due to the lack of regulatory clarity and established rules for companies operating in this space. In recent years, market turmoil has exposed a host of consumer and investor risks in the crypto market. These risks include fraud, hacks, scam products, extreme volatility, insider trading, information asymmetry, and a lack of clear federal and state legal protections. Such risks have exposed everyday investors and consumers to financial losses beyond their control.

3) Digital Financial Asset Law (DFAL) and implementation thus far.

In response to reports of consumer harm caused by an under-regulated crypto market, the Legislature passed AB 39, Chapter 792, Statutes of 2023. This legislation established the DFAL and a licensing program for digital asset companies serving California customers. Under the DFAL, crypto companies must apply for a license by July 1, 2026, and adhere to new rules related to policies and procedures, customer service standards, and financial stability.

DFAL is an expansive and ambitious law that will require DFPI to develop new expertise in digital assets. Because of this, it is expected to generate significant new workload for the department. In a 2024 Budget Change Proposal (BCP), department staff acknowledge this with the following:

The DFAL requires the Department to develop regulations and exam procedures that no other state or federal agency has yet to fully develop. The Department's exam activities will require sophisticated software and technological expertise. At this time, the only other state that issues licenses for virtual currency and examines at the level required by DFAL, is the New York Department of Financial Services (NYDFS). While NYDFS has recently developed some rules and issued guidance for licensees, its regulations and exam procedures are limited at this time.

The DFAL covers several distinct and complex crypto asset products, which are constantly evolving in the marketplace. The Department will therefore be required to assess a dynamic variety of financial companies and their safety and soundness status in a way that is unprecedented in financial regulation. Unlike banks or credit unions, there are no federal agencies that are regulating the same institutions and using their extensive resources to oversee these companies.

A key component of DFAL is the application process, which will require an upfront review of crypto companies wishing to do business with California customers. This process is expected to be rigorous and complex. In addition to reviewing the information provided by applicants regarding their proposed digital asset business plans, their financial records, and their recent litigation history, DFPI must also evaluate the applicant using a range of criterion, including whether the applicant has the sound financial condition, competence, and responsibility to engage in digital financial asset business activity.

To help pay for this work, DFAL grants DFPI the ability to establish fees meant to cover the reasonable costs of regulation or reviewing applications. While having industry pay for its own regulation is standard in financial services regulation, DFAL's flexibility is relatively unique since many of DFPI's other licensure programs have established fee amounts in the authorizing statute.

On October 2, 2024, DFPI requested public comment on proposed rules related to the DFAL license application and other topics. DFPI's proposed regulations include a \$20,000 application fee.¹

4) What this bill does.

AB 236 would modify DFAL to cap the application fee at \$5,000, which is significantly lower than the \$20,000 fee proposed by DFPI via regulation. This would align the DFAL application fee with a similar fee for money transmitters, even though the DFAL application process is likely to be more complex and time-consuming. Importantly, DFPI's proposed \$20,000 application fee is not final, and may be lowered after reviewing public input.

5) Considering the trade-offs.

DFPI's proposed \$20,000 application fee, if finalized, would be significantly higher than other licensure programs. However, before lowering that fee to \$5,000 through legislation, it is worth reviewing some of the previous discussions around DFAL and the competing pressures DFPI faces in rolling out the new licensure law.

When AB 39 went through the legislative process, industry representatives voiced concerns about a "bottleneck" of initial applications when the law went into effect. These concerns were based on experiences in New York, where the regulating department failed to process applications in a timely manner. Based on industry feedback, it appears the main challenge facing New York DFS was capacity: There simply were not enough people working on their program, and there was no cost recovery mechanism in their statute. As a result, applicants were caught in limbo as they waited months for a response, and DFS was limited in its ability to hire more staff to address the backlog of work.

To address these valid concerns, AB 39's author allowed for some flexibility in how DFPI could implement the DFAL, including allowing for conditional licensure for New York-licensed companies and authorizing DFPI to set appropriate fee levels. These provisions were

¹ <https://dfpi.ca.gov/regulated-industries/digital-financial-assets/>

intended to empower DFPI to “hit the ground running” on July 1, 2026 with trained staff and other relevant infrastructure in order avoid New York’s early mistakes.

AB 236’s fee cap may result in trade-offs that work against the crypto industry’s interests. By lowering the application fee from \$20,000 to \$5,000, DFPI will have fewer resources to hire staff and build out the DFAL licensure program, which could result in delays for application approval. If “time is money,” then such long application delays could be costly to a company hoping to enter the California market, and such costs would likely exceed \$20,000.

REGISTERED SUPPORT / OPPOSITION:**Support**

None received.

Opposition

None received.

Analysis Prepared by: Luke Reidenbach / B. & F. / (916) 319-3081