

Date of Hearing: April 27, 2015

ASSEMBLY COMMITTEE ON BANKING AND FINANCE

Matthew Dababneh, Chair

AB 1326 (Dababneh) – As Amended April 20, 2015

SUBJECT: Virtual currency

SUMMARY: Requires the licensing of entities engaged in the business of virtual currency by the Department of Business Oversight (DBO). Specifically, **this bill:**

- 1) Defines “virtual currency” as any type of digital unit that is used as a medium of exchange or a form of digitally stored value or that is incorporated into payment system technology. Virtual currency shall be broadly construed to include digital units of exchange that (1) have a centralized repository or administrator, (2) are decentralized and have no centralized repository or administrator, or (3) may be created or obtained by computing or manufacturing effort. Virtual currency shall not be construed to include digital units that are used solely within online gaming platforms with no market or application outside of those gaming platforms, nor shall virtual currency be construed to include digital units that are used exclusively as part of a customer affinity or rewards program, and can be applied solely as payment redeemed for goods, services, or for purchases with the issuer or other designated merchants, but cannot be converted into, or redeemed for, fiat currency.
- 2) Defines “virtual currency business” as the conduct of either of the following types of activities involving a California resident:
 - a) Storing, holding, or maintaining custody or control of virtual currency on behalf of others; or
 - b) Providing conversion or exchange services of fiat currency into virtual currency or the conversion or exchange of virtual currency into fiat currency or other value, or the conversion or exchange of one form of virtual currency into another form of virtual currency.
- 3) Provides for the following exemptions:
 - a) The United States or a department, agency, or instrumentality thereof, including any federal reserve bank and any federal home loan bank;
 - b) Money transmission by the United States Postal Service or by a contractor on behalf of the United States Postal Service;
 - c) A state, city, county, city and county, or any other governmental agency or governmental subdivision of a state;
 - d) A commercial bank or industrial bank, the deposits of which are insured by the Federal Deposit Insurance Corporation (FDIC) or its successor, or any foreign (other nation) bank that is licensed under state law or that is authorized under federal law to maintain a federal agency or federal branch office in this state; a trust company licensed pursuant to

Section 1042 or a national association authorized under federal law to engage in a trust banking business; an association or federal association, as defined in Section 5102, the deposits of which are insured by the FDIC or its successor; and any federally or state chartered credit union, with an office in this state, the member accounts of which are insured or guaranteed as provided in Section 14858;

- e) An entity licensed as a money transmitter under the Money Transmission Act;
 - f) A merchant or consumer that utilizes virtual currency solely for the purchase or sale of goods or services; or
 - g) A transaction in which the recipient of virtual currency is an agent of the payee pursuant to a preexisting written contract and delivery of the virtual currency to the agent satisfies the payor's obligation to the payee. "Agent" has the same meaning as that term as defined in Section 2295 of the Civil Code. "Payee" means the provider of goods or services, who is owed payment of money or other monetary value from the payor for the goods or services. "Payor" means the recipient of goods or services, who owes payment of money or monetary value to the payee for the goods or services.
- 4) Requires an applicant for a license to pay the commissioner of DBO (commissioner) a nonrefundable application fee of five thousand dollars (\$5,000).
 - 5) Provides that an applicant for a license shall do so in a form and in a medium prescribed by the commissioner by order or regulation.
 - 6) Allows for the following licensing fees:
 - a) A nonrefundable application fee for filing an application for licensure and approval to acquire control of a licensee is three thousand five hundred dollars (\$3,500);
 - b) A license renewal fee of two thousand five hundred dollars (\$2,500); and
 - c) A licensee shall pay annually on or before July 1, one hundred twenty-five dollars (\$125) for each licensee branch office in this state.
 - 7) Requires that each licensee shall maintain at all times such capital as the commissioner determines is sufficient to ensure the safety and soundness of the licensee and maintain consumer protection and its ongoing operations.
 - 8) Specifies that a licensee shall not appoint or continue any person as agent, unless the licensee and the person have made a written contract that requires the agent to operate in full compliance with this division.
 - 9) Provides that an agent shall not provide any virtual currency business outside the scope of activity permissible under the written contract between the agent and the licensee.
 - 10) Requires each licensee to exercise reasonable supervision over its agents to ensure compliance with applicable laws, rules, and regulations with regard to the virtual currency

business.

- 11) Prohibits a licensee from appointing any person as an agent unless it has conducted a review of the proposed agent's fitness to act as an agent and has determined that the proposed agent and any persons who control the proposed agent are of good character and sound financial standing.
- 12) Requires a licensee to maintain records of this review for each agent while the agent is providing any virtual currency business on behalf of the licensee, and for three years after the relationship with the agent has terminated.
- 13) Prohibits a person, including an agent, from providing any virtual currency business on behalf of a person not licensed or not exempt from licensure under this division.
- 14) Specifies that a person that engages in that activity provides virtual currency business to the same extent as if the person was a licensee and shall be jointly and severally liable with the unlicensed or nonexempt person.
- 15) Allows the commissioner at any time and from time to time examine the business and any branch office, within or outside this state, of any licensee in order to ascertain whether that business is being conducted in a lawful manner and whether all virtual currency held or exchanged is properly accounted for.
- 16) Requires the directors, officers, and employees of any licensee being examined by the commissioner shall exhibit to the commissioner, on request, any or all of the licensee's accounts, books, correspondence, memoranda, papers, and other records and shall otherwise facilitate the examination so far as it may be in their power to do so.
- 17) Requires a licensee to file a report with the commissioner within five business days after the licensee has reason to know of any occurrence of the following events:
 - a) The filing of a petition by or against the licensee under the United States Bankruptcy Code (11 U.S.C. Secs. 101-110, incl.) for bankruptcy or reorganization;
 - b) The filing of a petition by or against the licensee for receivership, the commencement of any other judicial or administrative proceeding for its dissolution or reorganization, or the making of a general assignment for the benefit of its creditors;
 - c) The commencement of a proceeding to revoke or suspend its virtual currency business license in a state or country in which the licensee engages in such business or is licensed to engage in such business;
 - d) The cancellation or other impairment of the licensee's bond or trust account as required by subdivision (b) of Section 26008; or
 - e) A charge or conviction of the licensee or of an executive officer, manager, director, or person in control of the licensee for a felony.

- 18) Requires a licensee to maintain any records as required by the commissioner for determining its compliance with this division for at least three years.
- 19) Allows a licensee to surrender its license by filing with the commissioner the license and a report with any information as the commissioner requires. The voluntary surrender of the license shall become effective at the time and upon the conditions as the commissioner specifies by order.
- 20) Gives authority to the commissioner to prepare written decisions, opinion letters, and other formal written guidance to be issued to persons seeking clarification regarding the requirements of this division.
- 21) Requires the commissioner to make public on the commissioner's Internet Web site all written decisions, opinion letters, and other formal written guidance issued to persons seeking clarification regarding the requirements of this division. The commissioner may, at his or her discretion or upon request by an applicant or licensee, redact proprietary or other confidential information regarding an applicant or licensee from any decision, letter, or other written guidance issued in connection with an applicant or licensee.
- 22) Allows the commissioner to offer informal guidance to any prospective applicant for a license under this division, regarding the conditions of licensure that may be applied to that person. The commissioner shall inform any applicant that requests that guidance of the licensing requirements that will be required of that applicant, based on the information provided by the applicant concerning its plan to conduct business under this division, and the factors used to make that determination.
- 23) Gives the commissioner authority, if the commissioner deems it necessary for the general welfare of the public, to exercise any power set forth in this division with respect to a virtual currency business, regardless of whether an application for a license has been filed with the commissioner, a license has been issued, or, if issued, the license has been surrendered, suspended, or revoked.
- 24) States that if it appears to the commissioner that a licensee is violating or failing to comply with this division, the commissioner may direct the licensee to comply with the law by an order issued under the commissioner's official seal, or if it appears to the commissioner that any licensee is conducting its business in an unsafe or injurious manner, the commissioner may in like manner direct it to discontinue the unsafe or injurious practices. The order shall require the licensee to show cause before the commissioner, at a time and place to be fixed by the commissioner, as to why the order should not be observed.
- 25) Provides that if, upon any hearing the commissioner finds that the licensee is violating or failing to comply with any law of this state or is conducting its business in an unsafe or injurious manner, the commissioner may make a final order directing it to comply with the law or to discontinue the unsafe or injurious practices. A licensee shall comply with the final order unless, within 10 days after the issuance of the order, its enforcement is restrained in a proceeding brought by the licensee.
- 26) Allows the commissioner to issue an order suspending or revoking a license, or taking possession of and placing a licensee in receivership, if after notice and an opportunity for

hearing, the commissioner finds any of the following:

- a) The licensee does not cooperate with an examination or investigation by the commissioner;
- b) The licensee engages in fraud, intentional misrepresentation, or gross negligence;
- c) The competence, experience, character, or general fitness of the licensee, or any director, officer, employee, or person in control of a licensee, indicates that it is not in the public interest to permit the person to provide virtual currency services;
- d) The licensee engages in an unsafe or unsound practice;
- e) The licensee is insolvent, suspends payment of its obligations, or makes a general assignment for the benefit of its creditors;
- f) The licensee has applied for an adjudication of bankruptcy, reorganization, arrangement, or other relief under any bankruptcy, reorganization, insolvency, or moratorium law, or any person has applied for any such relief under that law against the licensee and the licensee has by any affirmative act approved of or consented to the action or the relief has been granted; or,
- g) Any fact or condition exists that, if it had existed at the time when the licensee applied for its license, would have been grounds for denying the application;

- 27) In determining whether a licensee is engaging in an unsafe or unsound practice, the commissioner may consider the size and condition of the licensee's provision of virtual currency services, the magnitude of the loss, the gravity of the violation, and the previous conduct of the person involved.
- 28) Allows the commissioner to assess a civil penalty against a person that violates this division or a regulation adopted or an order issued under this division in an amount not to exceed one thousand dollars (\$1,000) for each violation or, in the case of a continuing violation, one thousand dollars (\$1,000) for each day or part thereof during which the violation continues, plus this state's costs and expenses for the investigation and prosecution of the matter, including reasonable attorney's fees.
- 29) Specifies that a person that engages in unlicensed activity or intentionally makes a false statement, misrepresentation, or false certification in a record filed or required to be maintained under this division or that intentionally makes a false entry or omits a material entry in such a record is guilty of a felony.
- 30) Allows the commissioner, by order or regulation grant exemptions from this section in cases where the commissioner finds that the requirements of this section are not necessary or may be duplicative.
- 31) Requires a licensee, within 90 days after the end of each fiscal year, or within any extended time as the commissioner may prescribe, file with the commissioner an audit report for the

fiscal year.

- 32) Specifies that each licensee shall, not more than 45 days after the end of each calendar year quarter, or within a longer period as the commissioner may by regulation or order specify, file with the commissioner a report containing all of the following:
- a) Financial statements, including balance sheet, income statement, statement of changes in shareholders' equity, and statement of cashflows, for, or as of the end of, that calendar year quarter, verified by two of the licensee's principal officers. The verification shall state that each of the officers making the verification has a personal knowledge of the matters in the report and that each of them believes that each statement in the report is true; and,
 - b) Other information as the commissioner may by regulation or order require.
- 33) Allows the commissioner to levy an assessment each fiscal year, on a pro rata basis, on those licensees that at any time during the preceding calendar year engaged in this state in the virtual currency business in an amount that is, in his or her judgment, sufficient to meet the commissioner's expenses in administering the provisions of this division and to provide a reasonable reserve for contingencies.
- 34) Requires a licensee to disclose to consumers the following disclosure in a form and manner prescribed by the commissioner:

"Once submitted to the network, a virtual currency transaction will be unconfirmed for a period of time (usually less than one hour, but up to one day or more) pending sufficient confirmation of the transaction by the network. A transaction is not complete while it is in a pending state. Virtual currency associated with transactions that are in a pending state will be designated accordingly, and will not be included in your account balance or be available to conduct transactions.

The risk of loss in trading or holding virtual currency can be substantial. You should therefore carefully consider whether trading or holding virtual currency is suitable for you in light of your financial condition. In considering whether to trade or hold virtual currency, you should be aware that the price or value of virtual currency can change rapidly, decrease, and potentially even fall to zero.

(Insert company name) is licensed by the Department of Business Oversight to do business in California. If you have complaints with respect to any aspect of the virtual currency business conducted by (company name), you may contact the California Department of Business Oversight at its toll-free telephone number, 1-800-622-0620, by email at consumer.services@dbo.ca.gov, or by mail at the Department of Business Oversight, Consumer Services, 1515 K Street, Suite 200, Sacramento, CA 95814."

EXISTING LAW: Regulates the transmission of money under the money transmission act (Financial Code, Section 2000-2175)

FISCAL EFFECT: Unknown

COMMENTS:

The author has introduced this bill to ensure that entities that store virtual currency or offer the exchange of virtual currency with consumers are operated in a safe and sound manner. AB 1326 will protect consumers that utilize virtual currency services by ensuring that these businesses are able to protect consumer's virtual currency from potential loss. Additionally, this bill will provide regulatory certainty as many companies try to engage in the virtual currency business have sought out money transmission licenses only to be denied, or are even unsure if their business model fits into existing licensing structures for other financial services entities.

The New York State Department of Banking was the first regulatory agency to issue regulations concerning virtual currency. This launched nationwide efforts to look at whether the virtual currency business should be regulated. The Conference of State Banking Supervisors (CSBS) formed the CSBS Emerging Payments Task Force ("Task Force") to examine the intersection between state supervision and payments developments, and to identify areas for consistent regulatory approaches among states. This effort includes an assessment of virtual currency activities and outreach with a broad range of stakeholders. After engaging with industry participants, state and federal regulators, and other stakeholders, CSBS recommended that activities involving third party control of virtual currency, including for the purposes of transmitting, exchanging, holding, or otherwise controlling virtual currency, should be subject to state licensure and supervision.

Headlines concerning virtual currency have been dominated by Bitcoin with some of this attention resulting from negative publicity. The high profile *Silk Road* case in which federal law enforcement officials arrested the operator of an online illegal drug market place that facilitated the sale of drugs and other illegal goods through acceptance of Bitcoins. Bitcoins were used because it is a decentralized currency allowing users to be pseudonymous to some extent, even though every Bitcoin transaction is logged. Bitcoin is not the first, nor the only virtual currency. Numerous models of virtual currency have sprouted up over the last decade, and this growth has inspired additional questions by government officials and policy makers.

Bitcoin has received its share of negative attention from its wild price fluctuations, awareness against Bitcoin "Wallets" (as the individual software applications that manage bitcoin holdings) to being credited with being the currency of choice for criminal activity. As to the latter attribution, cash money is still the dominant and preferred source of anonymous payment for illegal activities. Some of the attention, specifically in relation to the risk associated with storing virtual currency has raised the attention of state regulators across the country.

Even though the core program that runs bitcoin has resisted six years of hacking attempts, the successful attacks on associated businesses have created the impression that bitcoin isn't a safe way to store money. Bitcoins exist purely as entries in an accounting system—a transparent public ledger known as the "blockchain" that records balances and transfers among special bitcoin "addresses." With bitcoin, the balances held by every user of the monetary system are instead recorded on a widely distributed, publicly displayed ledger that is kept up-to-date by thousands of independently owned, competing computers known as "miners."

What does a real world transaction look like such as buying a cup of coffee at your local coffee shop? If you pay with a credit card, the transaction seems simple enough: You swipe your card, you grab your cup, and you leave. The financial system is just getting started with you and the coffee shop. Before the store actually gets paid and your bank balance falls, more than a half-

dozen institutions—such as a billing processor, the card association your bank, the coffee shop’s bank, a payment processor, the clearinghouse network managed by the regional Federal Reserve Banks—will have shared part of your account information or otherwise intervened in the flow of money. If all goes well, your bank will confirm your identity and good credit and send payment to the coffee shop’s bank two or three days later. For this privilege, the coffee shop pays a fee of between 2% and 3%.

Now let’s pay in Bitcoin. If you don’t already have bitcoins, you will need to buy some from one of a host of online exchanges and brokerages, using a simple transfer from your regular bank account. You will then assign the bitcoins to a wallet, which functions like an online account. Once inside the coffee shop, you will open your wallet’s smartphone app and hold its QR code reader up to the coffee shop’s device. This allows your embedded secret password to unlock a bitcoin address and publicly informs the bitcoin computer network that you are transferring \$1.75 worth of bitcoin (currently about 0.0075 bitcoin) to the coffee shop’s address. This takes just seconds, and then you walk off with your coffee. Next, in contrast to the pay with credit/debit system, your transaction is immediately broadcast to the world (in alphanumeric data that can’t be traced to you personally). Your information is then gathered up by bitcoin “miners,” the computers that maintain the system and are compensated, roughly every 10 minutes, for their work confirming transactions. The computer that competes successfully to package the data from your coffee purchase adds that information to the blockchain ledger, which prompts all the other miners to investigate the underlying transaction. Once your bona fides are verified, the updated blockchain is considered legitimate, and the miners update their records accordingly. It takes from 10 minutes to an hour for this software-driven network of computers to formally confirm a transfer from your blockchain address to that of the coffee shop—compared with a two- to three-day wait for the settlement of a credit-card transaction. Some new digital currencies are able to finalize transactions within seconds. There are almost zero fees, and the personal information of users isn’t divulged. This bitcoin feature especially appeals to privacy advocates: Nobody learns where you buy coffee. The advantages of digital currency are far more visible in emerging markets. It allows migrant workers, for example, to bypass fees that often run to 10% or more for the international payment services that they use to send money home to their families. Although many companies now accept bitcoin (the latest and biggest being Microsoft Corp.), global usage of the digital currency averaged just \$50 million a day in 2014. Over that same period, Visa and MasterCard processed some \$32 billion a day. The market capitalization for BitCoin is almost at \$4 billion with virtual currency Ripple the next largest at over \$340 million.

FinCEN Guidance on Virtual Currencies

FinCEN issued interpretive guidance earlier this year to clarify how the Bank Secrecy Act (BSA) and FinCEN regulations apply to users, administrators and exchangers of virtual currencies. Under the regulatory framework, virtual currency is defined as having some but not all of the attributes of “real currency” and therefore, virtual currency does not have legal tender status in any jurisdiction. Specifically, the FinCEN guidance addresses convertible virtual currency which either has a real currency equivalent value or serves as a substitute for real currency.

The roles of persons (including legal entities) involved in virtual currency transactions are defined by FinCEN as follows:

- User: A person who obtains virtual currency to purchase goods or services
- Exchanger: A person engaged as a business in the exchange of virtual currency for real currency, funds or other virtual currency
- Administrator: A person engaged as a business in issuing into circulation a virtual currency and who has the authority to redeem and withdraw from circulation such virtual currency

A person, or legal entity, may act in more than one of these capacities. Further, it is important to note that “obtaining” virtual currency covers much more than the scenario of a “user” who merely purchases virtual currency. Depending on the model of the particular currency, a party could “obtain” virtual currency through various acts including earning, harvesting, mining, creating, auto-generating, manufacturing or purchasing.

The threshold issue is whether actions will subject a person or legal entity to BSA’s registration, reporting and recordkeeping regulations that apply to money services businesses (MSBs). A user who obtains convertible virtual currency and uses it to purchase real or virtual goods or services is not subject to MSB compliance because such activity does not meet the definition of “money transmission services” and the user would not be a “money transmitter.”

However, an administrator or exchanger engages in money transmission services and, as a result, is a “money transmitter” under FinCEN definitions by (1) accepting and transmitting convertible virtual currency or (2) buying or selling convertible virtual currency. As a money transmitter, the administrator or exchanger would generally be subject to MSB reporting and recordkeeping.

Further, the FinCEN guidance expressly addresses the category of de-centralized virtual currency – the Bitcoin model – and states that “a person is an exchanger and a money transmitter if the person accepts such de-centralized convertible virtual currency from one person and transmits it to another person as part of the acceptance and transfer of currency, funds, or other value that substitutes for currency.”

In the area of foreign exchange, accepting real currency in exchange for virtual currency is not subject to FinCEN regulations applicable to “dealers in foreign exchange” since a forex transaction involves exchanging the currency of two countries and virtual currency does not constitute legal tender as a currency of a country.

The author's office has been meeting with various stakeholders and will continue to work out the various details of this legislation as it moves forward. Some key issues that still need to be resolved:

- 1) Further strengthen and clarify definition of "virtual currency business."
- 2) Clarify the factors that will be used to determine capitalization requirements.
- 3) Specify clear bonding and security amounts and factors used to make that determination.
- 4) Examine issues relating to start-up companies.

Previous Legislation.

AB 129 (Dickinson), chapter 74, statutes of 2014 clarified California law to ensure that alternative currency, including virtual currency would not be potentially deemed illegal tender.

REGISTERED SUPPORT / OPPOSITION:

Support

None on file.

Opposition

None on file.

Analysis Prepared by: Mark Farouk / B. & F. / (916) 319-3081

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- 24) States that if it appears to the commissioner that a licensee is violating or failing to comply with this division, the commissioner may direct the licensee to comply with the law by an order issued under the commissioner's official seal, or if it appears to the commissioner that any licensee is conducting its business in an unsafe or injurious manner, the commissioner may in like manner direct it to discontinue the unsafe or injurious practices. The order shall require the licensee to show cause before the commissioner, at a time and place to be fixed by the commissioner, as to why the order should not be observed.
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- c) The competence, experience, character, or general fitness of the licensee, or any director, officer, employee, or person in control of a licensee, indicates that it is not in the public interest to permit the person to provide virtual currency services;
- d) The licensee engages in an unsafe or unsound practice;
- e) The licensee is insolvent, suspends payment of its obligations, or makes a general assignment for the benefit of its creditors;
- f) The licensee has applied for an adjudication of bankruptcy, reorganization, arrangement, or other relief under any bankruptcy, reorganization, insolvency, or moratorium law, or any person has applied for any such relief under that law against the licensee and the licensee has by any affirmative act approved of or consented to the action or the relief has been granted; or,
- g) Any fact or condition exists that, if it had existed at the time when the licensee applied for its license, would have been grounds for denying the application;

- 27) In determining whether a licensee is engaging in an unsafe or unsound practice, the commissioner may consider the size and condition of the licensee's provision of virtual currency services, the magnitude of the loss, the gravity of the violation, and the previous conduct of the person involved.
- 28) Allows the commissioner to assess a civil penalty against a person that violates this division or a regulation adopted or an order issued under this division in an amount not to exceed one thousand dollars (\$1,000) for each violation or, in the case of a continuing violation, one thousand dollars (\$1,000) for each day or part thereof during which the violation continues, plus this state's costs and expenses for the investigation and prosecution of the matter, including reasonable attorney's fees.
- 29) Specifies that a person that engages in unlicensed activity or intentionally makes a false statement, misrepresentation, or false certification in a record filed or required to be maintained under this division or that intentionally makes a false entry or omits a material entry in such a record is guilty of a felony.
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- a) Financial statements, including balance sheet, income statement, statement of changes in shareholders' equity, and statement of cashflows, for, or as of the end of, that calendar year quarter, verified by two of the licensee's principal officers. The verification shall state that each of the officers making the verification has a personal knowledge of the matters in the report and that each of them believes that each statement in the report is true; and,
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- 33) Allows the commissioner to levy an assessment each fiscal year, on a pro rata basis, on those licensees that at any time during the preceding calendar year engaged in this state in the virtual currency business in an amount that is, in his or her judgment, sufficient to meet the commissioner's expenses in administering the provisions of this division and to provide a reasonable reserve for contingencies.
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"Once submitted to the network, a virtual currency transaction will be unconfirmed for a period of time (usually less than one hour, but up to one day or more) pending sufficient confirmation of the transaction by the network. A transaction is not complete while it is in a pending state. Virtual currency associated with transactions that are in a pending state will be designated accordingly, and will not be included in your account balance or be available to conduct transactions.

The risk of loss in trading or holding virtual currency can be substantial. You should therefore carefully consider whether trading or holding virtual currency is suitable for you in light of your financial condition. In considering whether to trade or hold virtual currency, you should be aware that the price or value of virtual currency can change rapidly, decrease, and potentially even fall to zero.

(Insert company name) is licensed by the Department of Business Oversight to do business in California. If you have complaints with respect to any aspect of the virtual currency business conducted by (company name), you may contact the California Department of Business Oversight at its toll-free telephone number, 1-800-622-0620, by email at consumer.services@dbo.ca.gov, or by mail at the Department of Business Oversight, Consumer Services, 1515 K Street, Suite 200, Sacramento, CA 95814."

EXISTING LAW: Regulates the transmission of money under the money transmission act (Financial Code, Section 2000-2175)

FISCAL EFFECT: Unknown

COMMENTS:

The author has introduced this bill to ensure that entities that store virtual currency or offer the exchange of virtual currency with consumers are operated in a safe and sound manner. AB 1326 will protect consumers that utilize virtual currency services by ensuring that these businesses are able to protect consumer's virtual currency from potential loss. Additionally, this bill will provide regulatory certainty as many companies try to engage in the virtual currency business have sought out money transmission licenses only to be denied, or are even unsure if their business model fits into existing licensing structures for other financial services entities.

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What does a real world transaction look like such as buying a cup of coffee at your local coffee shop? If you pay with a credit card, the transaction seems simple enough: You swipe your card, you grab your cup, and you leave. The financial system is just getting started with you and the coffee shop. Before the store actually gets paid and your bank balance falls, more than a half-

dozen institutions—such as a billing processor, the card association your bank, the coffee shop’s bank, a payment processor, the clearinghouse network managed by the regional Federal Reserve Banks—will have shared part of your account information or otherwise intervened in the flow of money. If all goes well, your bank will confirm your identity and good credit and send payment to the coffee shop’s bank two or three days later. For this privilege, the coffee shop pays a fee of between 2% and 3%.

Now let’s pay in Bitcoin. If you don’t already have bitcoins, you will need to buy some from one of a host of online exchanges and brokerages, using a simple transfer from your regular bank account. You will then assign the bitcoins to a wallet, which functions like an online account. Once inside the coffee shop, you will open your wallet’s smartphone app and hold its QR code reader up to the coffee shop’s device. This allows your embedded secret password to unlock a bitcoin address and publicly informs the bitcoin computer network that you are transferring \$1.75 worth of bitcoin (currently about 0.0075 bitcoin) to the coffee shop’s address. This takes just seconds, and then you walk off with your coffee. Next, in contrast to the pay with credit/debit system, your transaction is immediately broadcast to the world (in alphanumeric data that can’t be traced to you personally). Your information is then gathered up by bitcoin “miners,” the computers that maintain the system and are compensated, roughly every 10 minutes, for their work confirming transactions. The computer that competes successfully to package the data from your coffee purchase adds that information to the blockchain ledger, which prompts all the other miners to investigate the underlying transaction. Once your bona fides are verified, the updated blockchain is considered legitimate, and the miners update their records accordingly. It takes from 10 minutes to an hour for this software-driven network of computers to formally confirm a transfer from your blockchain address to that of the coffee shop—compared with a two- to three-day wait for the settlement of a credit-card transaction. Some new digital currencies are able to finalize transactions within seconds. There are almost zero fees, and the personal information of users isn’t divulged. This bitcoin feature especially appeals to privacy advocates: Nobody learns where you buy coffee. The advantages of digital currency are far more visible in emerging markets. It allows migrant workers, for example, to bypass fees that often run to 10% or more for the international payment services that they use to send money home to their families. Although many companies now accept bitcoin (the latest and biggest being Microsoft Corp.), global usage of the digital currency averaged just \$50 million a day in 2014. Over that same period, Visa and MasterCard processed some \$32 billion a day. The market capitalization for BitCoin is almost at \$4 billion with virtual currency Ripple the next largest at over \$340 million.

FinCEN Guidance on Virtual Currencies

FinCEN issued interpretive guidance earlier this year to clarify how the Bank Secrecy Act (BSA) and FinCEN regulations apply to users, administrators and exchangers of virtual currencies. Under the regulatory framework, virtual currency is defined as having some but not all of the attributes of “real currency” and therefore, virtual currency does not have legal tender status in any jurisdiction. Specifically, the FinCEN guidance addresses convertible virtual currency which either has a real currency equivalent value or serves as a substitute for real currency.

The roles of persons (including legal entities) involved in virtual currency transactions are defined by FinCEN as follows:

- User: A person who obtains virtual currency to purchase goods or services
- Exchanger: A person engaged as a business in the exchange of virtual currency for real currency, funds or other virtual currency
- Administrator: A person engaged as a business in issuing into circulation a virtual currency and who has the authority to redeem and withdraw from circulation such virtual currency

A person, or legal entity, may act in more than one of these capacities. Further, it is important to note that “obtaining” virtual currency covers much more than the scenario of a “user” who merely purchases virtual currency. Depending on the model of the particular currency, a party could “obtain” virtual currency through various acts including earning, harvesting, mining, creating, auto-generating, manufacturing or purchasing.

The threshold issue is whether actions will subject a person or legal entity to BSA’s registration, reporting and recordkeeping regulations that apply to money services businesses (MSBs). A user who obtains convertible virtual currency and uses it to purchase real or virtual goods or services is not subject to MSB compliance because such activity does not meet the definition of “money transmission services” and the user would not be a “money transmitter.”

However, an administrator or exchanger engages in money transmission services and, as a result, is a “money transmitter” under FinCEN definitions by (1) accepting and transmitting convertible virtual currency or (2) buying or selling convertible virtual currency. As a money transmitter, the administrator or exchanger would generally be subject to MSB reporting and recordkeeping.

Further, the FinCEN guidance expressly addresses the category of de-centralized virtual currency – the Bitcoin model – and states that “a person is an exchanger and a money transmitter if the person accepts such de-centralized convertible virtual currency from one person and transmits it to another person as part of the acceptance and transfer of currency, funds, or other value that substitutes for currency.”

In the area of foreign exchange, accepting real currency in exchange for virtual currency is not subject to FinCEN regulations applicable to “dealers in foreign exchange” since a forex transaction involves exchanging the currency of two countries and virtual currency does not constitute legal tender as a currency of a country.

The author's office has been meeting with various stakeholders and will continue to work out the various details of this legislation as it moves forward. Some key issues that still need to be resolved:

- 1) Further strengthen and clarify definition of "virtual currency business."
- 2) Clarify the factors that will be used to determine capitalization requirements.
- 3) Specify clear bonding and security amounts and factors used to make that determination.
- 4) Examine issues relating to start-up companies.

Previous Legislation.

AB 129 (Dickinson), chapter 74, statutes of 2014 clarified California law to ensure that alternative currency, including virtual currency would not be potentially deemed illegal tender.

REGISTERED SUPPORT / OPPOSITION:

Support

None on file.

Opposition

None on file.

Analysis Prepared by: Mark Farouk / B. & F. / (916) 319-3081

Date of Hearing: April 27, 2015

ASSEMBLY COMMITTEE ON BANKING AND FINANCE

Matthew Dababneh, Chair

AB 1326 (Dababneh) – As Amended April 20, 2015

SUBJECT: Virtual currency

SUMMARY: Requires the licensing of entities engaged in the business of virtual currency by the Department of Business Oversight (DBO). Specifically, **this bill:**

- 1) Defines “virtual currency” as any type of digital unit that is used as a medium of exchange or a form of digitally stored value or that is incorporated into payment system technology. Virtual currency shall be broadly construed to include digital units of exchange that (1) have a centralized repository or administrator, (2) are decentralized and have no centralized repository or administrator, or (3) may be created or obtained by computing or manufacturing effort. Virtual currency shall not be construed to include digital units that are used solely within online gaming platforms with no market or application outside of those gaming platforms, nor shall virtual currency be construed to include digital units that are used exclusively as part of a customer affinity or rewards program, and can be applied solely as payment redeemed for goods, services, or for purchases with the issuer or other designated merchants, but cannot be converted into, or redeemed for, fiat currency.
- 2) Defines “virtual currency business” as the conduct of either of the following types of activities involving a California resident:
 - a) Storing, holding, or maintaining custody or control of virtual currency on behalf of others; or
 - b) Providing conversion or exchange services of fiat currency into virtual currency or the conversion or exchange of virtual currency into fiat currency or other value, or the conversion or exchange of one form of virtual currency into another form of virtual currency.
- 3) Provides for the following exemptions:
 - a) The United States or a department, agency, or instrumentality thereof, including any federal reserve bank and any federal home loan bank;
 - b) Money transmission by the United States Postal Service or by a contractor on behalf of the United States Postal Service;
 - c) A state, city, county, city and county, or any other governmental agency or governmental subdivision of a state;
 - d) A commercial bank or industrial bank, the deposits of which are insured by the Federal Deposit Insurance Corporation (FDIC) or its successor, or any foreign (other nation) bank that is licensed under state law or that is authorized under federal law to maintain a federal agency or federal branch office in this state; a trust company licensed pursuant to

Section 1042 or a national association authorized under federal law to engage in a trust banking business; an association or federal association, as defined in Section 5102, the deposits of which are insured by the FDIC or its successor; and any federally or state chartered credit union, with an office in this state, the member accounts of which are insured or guaranteed as provided in Section 14858;

- e) An entity licensed as a money transmitter under the Money Transmission Act;
 - f) A merchant or consumer that utilizes virtual currency solely for the purchase or sale of goods or services; or
 - g) A transaction in which the recipient of virtual currency is an agent of the payee pursuant to a preexisting written contract and delivery of the virtual currency to the agent satisfies the payor's obligation to the payee. "Agent" has the same meaning as that term as defined in Section 2295 of the Civil Code. "Payee" means the provider of goods or services, who is owed payment of money or other monetary value from the payor for the goods or services. "Payor" means the recipient of goods or services, who owes payment of money or monetary value to the payee for the goods or services.
- 4) Requires an applicant for a license to pay the commissioner of DBO (commissioner) a nonrefundable application fee of five thousand dollars (\$5,000).
 - 5) Provides that an applicant for a license shall do so in a form and in a medium prescribed by the commissioner by order or regulation.
 - 6) Allows for the following licensing fees:
 - a) A nonrefundable application fee for filing an application for licensure and approval to acquire control of a licensee is three thousand five hundred dollars (\$3,500);
 - b) A license renewal fee of two thousand five hundred dollars (\$2,500); and
 - c) A licensee shall pay annually on or before July 1, one hundred twenty-five dollars (\$125) for each licensee branch office in this state.
 - 7) Requires that each licensee shall maintain at all times such capital as the commissioner determines is sufficient to ensure the safety and soundness of the licensee and maintain consumer protection and its ongoing operations.
 - 8) Specifies that a licensee shall not appoint or continue any person as agent, unless the licensee and the person have made a written contract that requires the agent to operate in full compliance with this division.
 - 9) Provides that an agent shall not provide any virtual currency business outside the scope of activity permissible under the written contract between the agent and the licensee.
 - 10) Requires each licensee to exercise reasonable supervision over its agents to ensure compliance with applicable laws, rules, and regulations with regard to the virtual currency

business.

- 11) Prohibits a licensee from appointing any person as an agent unless it has conducted a review of the proposed agent's fitness to act as an agent and has determined that the proposed agent and any persons who control the proposed agent are of good character and sound financial standing.
- 12) Requires a licensee to maintain records of this review for each agent while the agent is providing any virtual currency business on behalf of the licensee, and for three years after the relationship with the agent has terminated.
- 13) Prohibits a person, including an agent, from providing any virtual currency business on behalf of a person not licensed or not exempt from licensure under this division.
- 14) Specifies that a person that engages in that activity provides virtual currency business to the same extent as if the person was a licensee and shall be jointly and severally liable with the unlicensed or nonexempt person.
- 15) Allows the commissioner at any time and from time to time examine the business and any branch office, within or outside this state, of any licensee in order to ascertain whether that business is being conducted in a lawful manner and whether all virtual currency held or exchanged is properly accounted for.
- 16) Requires the directors, officers, and employees of any licensee being examined by the commissioner shall exhibit to the commissioner, on request, any or all of the licensee's accounts, books, correspondence, memoranda, papers, and other records and shall otherwise facilitate the examination so far as it may be in their power to do so.
- 17) Requires a licensee to file a report with the commissioner within five business days after the licensee has reason to know of any occurrence of the following events:
 - a) The filing of a petition by or against the licensee under the United States Bankruptcy Code (11 U.S.C. Secs. 101-110, incl.) for bankruptcy or reorganization;
 - b) The filing of a petition by or against the licensee for receivership, the commencement of any other judicial or administrative proceeding for its dissolution or reorganization, or the making of a general assignment for the benefit of its creditors;
 - c) The commencement of a proceeding to revoke or suspend its virtual currency business license in a state or country in which the licensee engages in such business or is licensed to engage in such business;
 - d) The cancellation or other impairment of the licensee's bond or trust account as required by subdivision (b) of Section 26008; or
 - e) A charge or conviction of the licensee or of an executive officer, manager, director, or person in control of the licensee for a felony.

- 18) Requires a licensee to maintain any records as required by the commissioner for determining its compliance with this division for at least three years.
- 19) Allows a licensee to surrender its license by filing with the commissioner the license and a report with any information as the commissioner requires. The voluntary surrender of the license shall become effective at the time and upon the conditions as the commissioner specifies by order.
- 20) Gives authority to the commissioner to prepare written decisions, opinion letters, and other formal written guidance to be issued to persons seeking clarification regarding the requirements of this division.
- 21) Requires the commissioner to make public on the commissioner's Internet Web site all written decisions, opinion letters, and other formal written guidance issued to persons seeking clarification regarding the requirements of this division. The commissioner may, at his or her discretion or upon request by an applicant or licensee, redact proprietary or other confidential information regarding an applicant or licensee from any decision, letter, or other written guidance issued in connection with an applicant or licensee.
- 22) Allows the commissioner to offer informal guidance to any prospective applicant for a license under this division, regarding the conditions of licensure that may be applied to that person. The commissioner shall inform any applicant that requests that guidance of the licensing requirements that will be required of that applicant, based on the information provided by the applicant concerning its plan to conduct business under this division, and the factors used to make that determination.
- 23) Gives the commissioner authority, if the commissioner deems it necessary for the general welfare of the public, to exercise any power set forth in this division with respect to a virtual currency business, regardless of whether an application for a license has been filed with the commissioner, a license has been issued, or, if issued, the license has been surrendered, suspended, or revoked.
- 24) States that if it appears to the commissioner that a licensee is violating or failing to comply with this division, the commissioner may direct the licensee to comply with the law by an order issued under the commissioner's official seal, or if it appears to the commissioner that any licensee is conducting its business in an unsafe or injurious manner, the commissioner may in like manner direct it to discontinue the unsafe or injurious practices. The order shall require the licensee to show cause before the commissioner, at a time and place to be fixed by the commissioner, as to why the order should not be observed.
- 25) Provides that if, upon any hearing the commissioner finds that the licensee is violating or failing to comply with any law of this state or is conducting its business in an unsafe or injurious manner, the commissioner may make a final order directing it to comply with the law or to discontinue the unsafe or injurious practices. A licensee shall comply with the final order unless, within 10 days after the issuance of the order, its enforcement is restrained in a proceeding brought by the licensee.
- 26) Allows the commissioner to issue an order suspending or revoking a license, or taking possession of and placing a licensee in receivership, if after notice and an opportunity for

hearing, the commissioner finds any of the following:

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- c) The competence, experience, character, or general fitness of the licensee, or any director, officer, employee, or person in control of a licensee, indicates that it is not in the public interest to permit the person to provide virtual currency services;
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Now let’s pay in Bitcoin. If you don’t already have bitcoins, you will need to buy some from one of a host of online exchanges and brokerages, using a simple transfer from your regular bank account. You will then assign the bitcoins to a wallet, which functions like an online account. Once inside the coffee shop, you will open your wallet’s smartphone app and hold its QR code reader up to the coffee shop’s device. This allows your embedded secret password to unlock a bitcoin address and publicly informs the bitcoin computer network that you are transferring \$1.75 worth of bitcoin (currently about 0.0075 bitcoin) to the coffee shop’s address. This takes just seconds, and then you walk off with your coffee. Next, in contrast to the pay with credit/debit system, your transaction is immediately broadcast to the world (in alphanumeric data that can’t be traced to you personally). Your information is then gathered up by bitcoin “miners,” the computers that maintain the system and are compensated, roughly every 10 minutes, for their work confirming transactions. The computer that competes successfully to package the data from your coffee purchase adds that information to the blockchain ledger, which prompts all the other miners to investigate the underlying transaction. Once your bona fides are verified, the updated blockchain is considered legitimate, and the miners update their records accordingly. It takes from 10 minutes to an hour for this software-driven network of computers to formally confirm a transfer from your blockchain address to that of the coffee shop—compared with a two- to three-day wait for the settlement of a credit-card transaction. Some new digital currencies are able to finalize transactions within seconds. There are almost zero fees, and the personal information of users isn’t divulged. This bitcoin feature especially appeals to privacy advocates: Nobody learns where you buy coffee. The advantages of digital currency are far more visible in emerging markets. It allows migrant workers, for example, to bypass fees that often run to 10% or more for the international payment services that they use to send money home to their families. Although many companies now accept bitcoin (the latest and biggest being Microsoft Corp.), global usage of the digital currency averaged just \$50 million a day in 2014. Over that same period, Visa and MasterCard processed some \$32 billion a day. The market capitalization for BitCoin is almost at \$4 billion with virtual currency Ripple the next largest at over \$340 million.

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FinCEN issued interpretive guidance earlier this year to clarify how the Bank Secrecy Act (BSA) and FinCEN regulations apply to users, administrators and exchangers of virtual currencies. Under the regulatory framework, virtual currency is defined as having some but not all of the attributes of “real currency” and therefore, virtual currency does not have legal tender status in any jurisdiction. Specifically, the FinCEN guidance addresses convertible virtual currency which either has a real currency equivalent value or serves as a substitute for real currency.

The roles of persons (including legal entities) involved in virtual currency transactions are defined by FinCEN as follows:

- User: A person who obtains virtual currency to purchase goods or services
- Exchanger: A person engaged as a business in the exchange of virtual currency for real currency, funds or other virtual currency
- Administrator: A person engaged as a business in issuing into circulation a virtual currency and who has the authority to redeem and withdraw from circulation such virtual currency

A person, or legal entity, may act in more than one of these capacities. Further, it is important to note that “obtaining” virtual currency covers much more than the scenario of a “user” who merely purchases virtual currency. Depending on the model of the particular currency, a party could “obtain” virtual currency through various acts including earning, harvesting, mining, creating, auto-generating, manufacturing or purchasing.

The threshold issue is whether actions will subject a person or legal entity to BSA’s registration, reporting and recordkeeping regulations that apply to money services businesses (MSBs). A user who obtains convertible virtual currency and uses it to purchase real or virtual goods or services is not subject to MSB compliance because such activity does not meet the definition of “money transmission services” and the user would not be a “money transmitter.”

However, an administrator or exchanger engages in money transmission services and, as a result, is a “money transmitter” under FinCEN definitions by (1) accepting and transmitting convertible virtual currency or (2) buying or selling convertible virtual currency. As a money transmitter, the administrator or exchanger would generally be subject to MSB reporting and recordkeeping.

Further, the FinCEN guidance expressly addresses the category of de-centralized virtual currency – the Bitcoin model – and states that “a person is an exchanger and a money transmitter if the person accepts such de-centralized convertible virtual currency from one person and transmits it to another person as part of the acceptance and transfer of currency, funds, or other value that substitutes for currency.”

In the area of foreign exchange, accepting real currency in exchange for virtual currency is not subject to FinCEN regulations applicable to “dealers in foreign exchange” since a forex transaction involves exchanging the currency of two countries and virtual currency does not constitute legal tender as a currency of a country.

The author's office has been meeting with various stakeholders and will continue to work out the various details of this legislation as it moves forward. Some key issues that still need to be resolved:

- 1) Further strengthen and clarify definition of "virtual currency business."
- 2) Clarify the factors that will be used to determine capitalization requirements.
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- 4) Examine issues relating to start-up companies.

Previous Legislation.

AB 129 (Dickinson), chapter 74, statutes of 2014 clarified California law to ensure that alternative currency, including virtual currency would not be potentially deemed illegal tender.

REGISTERED SUPPORT / OPPOSITION:

Support

None on file.

Opposition

None on file.

Analysis Prepared by: Mark Farouk / B. & F. / (916) 319-3081

Date of Hearing: April 27, 2015

ASSEMBLY COMMITTEE ON BANKING AND FINANCE

Matthew Dababneh, Chair

AB 1326 (Dababneh) – As Amended April 20, 2015

SUBJECT: Virtual currency

SUMMARY: Requires the licensing of entities engaged in the business of virtual currency by the Department of Business Oversight (DBO). Specifically, **this bill:**

- 1) Defines “virtual currency” as any type of digital unit that is used as a medium of exchange or a form of digitally stored value or that is incorporated into payment system technology. Virtual currency shall be broadly construed to include digital units of exchange that (1) have a centralized repository or administrator, (2) are decentralized and have no centralized repository or administrator, or (3) may be created or obtained by computing or manufacturing effort. Virtual currency shall not be construed to include digital units that are used solely within online gaming platforms with no market or application outside of those gaming platforms, nor shall virtual currency be construed to include digital units that are used exclusively as part of a customer affinity or rewards program, and can be applied solely as payment redeemed for goods, services, or for purchases with the issuer or other designated merchants, but cannot be converted into, or redeemed for, fiat currency.
- 2) Defines “virtual currency business” as the conduct of either of the following types of activities involving a California resident:
 - a) Storing, holding, or maintaining custody or control of virtual currency on behalf of others; or
 - b) Providing conversion or exchange services of fiat currency into virtual currency or the conversion or exchange of virtual currency into fiat currency or other value, or the conversion or exchange of one form of virtual currency into another form of virtual currency.
- 3) Provides for the following exemptions:
 - a) The United States or a department, agency, or instrumentality thereof, including any federal reserve bank and any federal home loan bank;
 - b) Money transmission by the United States Postal Service or by a contractor on behalf of the United States Postal Service;
 - c) A state, city, county, city and county, or any other governmental agency or governmental subdivision of a state;
 - d) A commercial bank or industrial bank, the deposits of which are insured by the Federal Deposit Insurance Corporation (FDIC) or its successor, or any foreign (other nation) bank that is licensed under state law or that is authorized under federal law to maintain a federal agency or federal branch office in this state; a trust company licensed pursuant to

Section 1042 or a national association authorized under federal law to engage in a trust banking business; an association or federal association, as defined in Section 5102, the deposits of which are insured by the FDIC or its successor; and any federally or state chartered credit union, with an office in this state, the member accounts of which are insured or guaranteed as provided in Section 14858;

- e) An entity licensed as a money transmitter under the Money Transmission Act;
 - f) A merchant or consumer that utilizes virtual currency solely for the purchase or sale of goods or services; or
 - g) A transaction in which the recipient of virtual currency is an agent of the payee pursuant to a preexisting written contract and delivery of the virtual currency to the agent satisfies the payor's obligation to the payee. "Agent" has the same meaning as that term as defined in Section 2295 of the Civil Code. "Payee" means the provider of goods or services, who is owed payment of money or other monetary value from the payor for the goods or services. "Payor" means the recipient of goods or services, who owes payment of money or monetary value to the payee for the goods or services.
- 4) Requires an applicant for a license to pay the commissioner of DBO (commissioner) a nonrefundable application fee of five thousand dollars (\$5,000).
 - 5) Provides that an applicant for a license shall do so in a form and in a medium prescribed by the commissioner by order or regulation.
 - 6) Allows for the following licensing fees:
 - a) A nonrefundable application fee for filing an application for licensure and approval to acquire control of a licensee is three thousand five hundred dollars (\$3,500);
 - b) A license renewal fee of two thousand five hundred dollars (\$2,500); and
 - c) A licensee shall pay annually on or before July 1, one hundred twenty-five dollars (\$125) for each licensee branch office in this state.
 - 7) Requires that each licensee shall maintain at all times such capital as the commissioner determines is sufficient to ensure the safety and soundness of the licensee and maintain consumer protection and its ongoing operations.
 - 8) Specifies that a licensee shall not appoint or continue any person as agent, unless the licensee and the person have made a written contract that requires the agent to operate in full compliance with this division.
 - 9) Provides that an agent shall not provide any virtual currency business outside the scope of activity permissible under the written contract between the agent and the licensee.
 - 10) Requires each licensee to exercise reasonable supervision over its agents to ensure compliance with applicable laws, rules, and regulations with regard to the virtual currency

business.

- 11) Prohibits a licensee from appointing any person as an agent unless it has conducted a review of the proposed agent's fitness to act as an agent and has determined that the proposed agent and any persons who control the proposed agent are of good character and sound financial standing.
- 12) Requires a licensee to maintain records of this review for each agent while the agent is providing any virtual currency business on behalf of the licensee, and for three years after the relationship with the agent has terminated.
- 13) Prohibits a person, including an agent, from providing any virtual currency business on behalf of a person not licensed or not exempt from licensure under this division.
- 14) Specifies that a person that engages in that activity provides virtual currency business to the same extent as if the person was a licensee and shall be jointly and severally liable with the unlicensed or nonexempt person.
- 15) Allows the commissioner at any time and from time to time examine the business and any branch office, within or outside this state, of any licensee in order to ascertain whether that business is being conducted in a lawful manner and whether all virtual currency held or exchanged is properly accounted for.
- 16) Requires the directors, officers, and employees of any licensee being examined by the commissioner shall exhibit to the commissioner, on request, any or all of the licensee's accounts, books, correspondence, memoranda, papers, and other records and shall otherwise facilitate the examination so far as it may be in their power to do so.
- 17) Requires a licensee to file a report with the commissioner within five business days after the licensee has reason to know of any occurrence of the following events:
 - a) The filing of a petition by or against the licensee under the United States Bankruptcy Code (11 U.S.C. Secs. 101-110, incl.) for bankruptcy or reorganization;
 - b) The filing of a petition by or against the licensee for receivership, the commencement of any other judicial or administrative proceeding for its dissolution or reorganization, or the making of a general assignment for the benefit of its creditors;
 - c) The commencement of a proceeding to revoke or suspend its virtual currency business license in a state or country in which the licensee engages in such business or is licensed to engage in such business;
 - d) The cancellation or other impairment of the licensee's bond or trust account as required by subdivision (b) of Section 26008; or
 - e) A charge or conviction of the licensee or of an executive officer, manager, director, or person in control of the licensee for a felony.

- 18) Requires a licensee to maintain any records as required by the commissioner for determining its compliance with this division for at least three years.
- 19) Allows a licensee to surrender its license by filing with the commissioner the license and a report with any information as the commissioner requires. The voluntary surrender of the license shall become effective at the time and upon the conditions as the commissioner specifies by order.
- 20) Gives authority to the commissioner to prepare written decisions, opinion letters, and other formal written guidance to be issued to persons seeking clarification regarding the requirements of this division.
- 21) Requires the commissioner to make public on the commissioner's Internet Web site all written decisions, opinion letters, and other formal written guidance issued to persons seeking clarification regarding the requirements of this division. The commissioner may, at his or her discretion or upon request by an applicant or licensee, redact proprietary or other confidential information regarding an applicant or licensee from any decision, letter, or other written guidance issued in connection with an applicant or licensee.
- 22) Allows the commissioner to offer informal guidance to any prospective applicant for a license under this division, regarding the conditions of licensure that may be applied to that person. The commissioner shall inform any applicant that requests that guidance of the licensing requirements that will be required of that applicant, based on the information provided by the applicant concerning its plan to conduct business under this division, and the factors used to make that determination.
- 23) Gives the commissioner authority, if the commissioner deems it necessary for the general welfare of the public, to exercise any power set forth in this division with respect to a virtual currency business, regardless of whether an application for a license has been filed with the commissioner, a license has been issued, or, if issued, the license has been surrendered, suspended, or revoked.
- 24) States that if it appears to the commissioner that a licensee is violating or failing to comply with this division, the commissioner may direct the licensee to comply with the law by an order issued under the commissioner's official seal, or if it appears to the commissioner that any licensee is conducting its business in an unsafe or injurious manner, the commissioner may in like manner direct it to discontinue the unsafe or injurious practices. The order shall require the licensee to show cause before the commissioner, at a time and place to be fixed by the commissioner, as to why the order should not be observed.
- 25) Provides that if, upon any hearing the commissioner finds that the licensee is violating or failing to comply with any law of this state or is conducting its business in an unsafe or injurious manner, the commissioner may make a final order directing it to comply with the law or to discontinue the unsafe or injurious practices. A licensee shall comply with the final order unless, within 10 days after the issuance of the order, its enforcement is restrained in a proceeding brought by the licensee.
- 26) Allows the commissioner to issue an order suspending or revoking a license, or taking possession of and placing a licensee in receivership, if after notice and an opportunity for

hearing, the commissioner finds any of the following:

- a) The licensee does not cooperate with an examination or investigation by the commissioner;
- b) The licensee engages in fraud, intentional misrepresentation, or gross negligence;
- c) The competence, experience, character, or general fitness of the licensee, or any director, officer, employee, or person in control of a licensee, indicates that it is not in the public interest to permit the person to provide virtual currency services;
- d) The licensee engages in an unsafe or unsound practice;
- e) The licensee is insolvent, suspends payment of its obligations, or makes a general assignment for the benefit of its creditors;
- f) The licensee has applied for an adjudication of bankruptcy, reorganization, arrangement, or other relief under any bankruptcy, reorganization, insolvency, or moratorium law, or any person has applied for any such relief under that law against the licensee and the licensee has by any affirmative act approved of or consented to the action or the relief has been granted; or,
- g) Any fact or condition exists that, if it had existed at the time when the licensee applied for its license, would have been grounds for denying the application;

- 27) In determining whether a licensee is engaging in an unsafe or unsound practice, the commissioner may consider the size and condition of the licensee's provision of virtual currency services, the magnitude of the loss, the gravity of the violation, and the previous conduct of the person involved.
- 28) Allows the commissioner to assess a civil penalty against a person that violates this division or a regulation adopted or an order issued under this division in an amount not to exceed one thousand dollars (\$1,000) for each violation or, in the case of a continuing violation, one thousand dollars (\$1,000) for each day or part thereof during which the violation continues, plus this state's costs and expenses for the investigation and prosecution of the matter, including reasonable attorney's fees.
- 29) Specifies that a person that engages in unlicensed activity or intentionally makes a false statement, misrepresentation, or false certification in a record filed or required to be maintained under this division or that intentionally makes a false entry or omits a material entry in such a record is guilty of a felony.
- 30) Allows the commissioner, by order or regulation grant exemptions from this section in cases where the commissioner finds that the requirements of this section are not necessary or may be duplicative.
- 31) Requires a licensee, within 90 days after the end of each fiscal year, or within any extended time as the commissioner may prescribe, file with the commissioner an audit report for the

fiscal year.

- 32) Specifies that each licensee shall, not more than 45 days after the end of each calendar year quarter, or within a longer period as the commissioner may by regulation or order specify, file with the commissioner a report containing all of the following:
- a) Financial statements, including balance sheet, income statement, statement of changes in shareholders' equity, and statement of cashflows, for, or as of the end of, that calendar year quarter, verified by two of the licensee's principal officers. The verification shall state that each of the officers making the verification has a personal knowledge of the matters in the report and that each of them believes that each statement in the report is true; and,
 - b) Other information as the commissioner may by regulation or order require.
- 33) Allows the commissioner to levy an assessment each fiscal year, on a pro rata basis, on those licensees that at any time during the preceding calendar year engaged in this state in the virtual currency business in an amount that is, in his or her judgment, sufficient to meet the commissioner's expenses in administering the provisions of this division and to provide a reasonable reserve for contingencies.
- 34) Requires a licensee to disclose to consumers the following disclosure in a form and manner prescribed by the commissioner:

"Once submitted to the network, a virtual currency transaction will be unconfirmed for a period of time (usually less than one hour, but up to one day or more) pending sufficient confirmation of the transaction by the network. A transaction is not complete while it is in a pending state. Virtual currency associated with transactions that are in a pending state will be designated accordingly, and will not be included in your account balance or be available to conduct transactions.

The risk of loss in trading or holding virtual currency can be substantial. You should therefore carefully consider whether trading or holding virtual currency is suitable for you in light of your financial condition. In considering whether to trade or hold virtual currency, you should be aware that the price or value of virtual currency can change rapidly, decrease, and potentially even fall to zero.

(Insert company name) is licensed by the Department of Business Oversight to do business in California. If you have complaints with respect to any aspect of the virtual currency business conducted by (company name), you may contact the California Department of Business Oversight at its toll-free telephone number, 1-800-622-0620, by email at consumer.services@dbo.ca.gov, or by mail at the Department of Business Oversight, Consumer Services, 1515 K Street, Suite 200, Sacramento, CA 95814."

EXISTING LAW: Regulates the transmission of money under the money transmission act (Financial Code, Section 2000-2175)

FISCAL EFFECT: Unknown

COMMENTS:

The author has introduced this bill to ensure that entities that store virtual currency or offer the exchange of virtual currency with consumers are operated in a safe and sound manner. AB 1326 will protect consumers that utilize virtual currency services by ensuring that these businesses are able to protect consumer's virtual currency from potential loss. Additionally, this bill will provide regulatory certainty as many companies try to engage in the virtual currency business have sought out money transmission licenses only to be denied, or are even unsure if their business model fits into existing licensing structures for other financial services entities.

The New York State Department of Banking was the first regulatory agency to issue regulations concerning virtual currency. This launched nationwide efforts to look at whether the virtual currency business should be regulated. The Conference of State Banking Supervisors (CSBS) formed the CSBS Emerging Payments Task Force ("Task Force") to examine the intersection between state supervision and payments developments, and to identify areas for consistent regulatory approaches among states. This effort includes an assessment of virtual currency activities and outreach with a broad range of stakeholders. After engaging with industry participants, state and federal regulators, and other stakeholders, CSBS recommended that activities involving third party control of virtual currency, including for the purposes of transmitting, exchanging, holding, or otherwise controlling virtual currency, should be subject to state licensure and supervision.

Headlines concerning virtual currency have been dominated by Bitcoin with some of this attention resulting from negative publicity. The high profile *Silk Road* case in which federal law enforcement officials arrested the operator of an online illegal drug market place that facilitated the sale of drugs and other illegal goods through acceptance of Bitcoins. Bitcoins were used because it is a decentralized currency allowing users to be pseudonymous to some extent, even though every Bitcoin transaction is logged. Bitcoin is not the first, nor the only virtual currency. Numerous models of virtual currency have sprouted up over the last decade, and this growth has inspired additional questions by government officials and policy makers.

Bitcoin has received its share of negative attention from its wild price fluctuations, awareness against Bitcoin "Wallets" (as the individual software applications that manage bitcoin holdings) to being credited with being the currency of choice for criminal activity. As to the latter attribution, cash money is still the dominant and preferred source of anonymous payment for illegal activities. Some of the attention, specifically in relation to the risk associated with storing virtual currency has raised the attention of state regulators across the country.

Even though the core program that runs bitcoin has resisted six years of hacking attempts, the successful attacks on associated businesses have created the impression that bitcoin isn't a safe way to store money. Bitcoins exist purely as entries in an accounting system—a transparent public ledger known as the "blockchain" that records balances and transfers among special bitcoin "addresses." With bitcoin, the balances held by every user of the monetary system are instead recorded on a widely distributed, publicly displayed ledger that is kept up-to-date by thousands of independently owned, competing computers known as "miners."

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REGISTERED SUPPORT / OPPOSITION:

Support

None on file.

Opposition

None on file.

Analysis Prepared by: Mark Farouk / B. & F. / (916) 319-3081

Date of Hearing: April 27, 2015

ASSEMBLY COMMITTEE ON BANKING AND FINANCE

Matthew Dababneh, Chair

AB 1326 (Dababneh) – As Amended April 20, 2015

SUBJECT: Virtual currency

SUMMARY: Requires the licensing of entities engaged in the business of virtual currency by the Department of Business Oversight (DBO). Specifically, **this bill:**

- 1) Defines “virtual currency” as any type of digital unit that is used as a medium of exchange or a form of digitally stored value or that is incorporated into payment system technology. Virtual currency shall be broadly construed to include digital units of exchange that (1) have a centralized repository or administrator, (2) are decentralized and have no centralized repository or administrator, or (3) may be created or obtained by computing or manufacturing effort. Virtual currency shall not be construed to include digital units that are used solely within online gaming platforms with no market or application outside of those gaming platforms, nor shall virtual currency be construed to include digital units that are used exclusively as part of a customer affinity or rewards program, and can be applied solely as payment redeemed for goods, services, or for purchases with the issuer or other designated merchants, but cannot be converted into, or redeemed for, fiat currency.
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 - a) The United States or a department, agency, or instrumentality thereof, including any federal reserve bank and any federal home loan bank;
 - b) Money transmission by the United States Postal Service or by a contractor on behalf of the United States Postal Service;
 - c) A state, city, county, city and county, or any other governmental agency or governmental subdivision of a state;
 - d) A commercial bank or industrial bank, the deposits of which are insured by the Federal Deposit Insurance Corporation (FDIC) or its successor, or any foreign (other nation) bank that is licensed under state law or that is authorized under federal law to maintain a federal agency or federal branch office in this state; a trust company licensed pursuant to

Section 1042 or a national association authorized under federal law to engage in a trust banking business; an association or federal association, as defined in Section 5102, the deposits of which are insured by the FDIC or its successor; and any federally or state chartered credit union, with an office in this state, the member accounts of which are insured or guaranteed as provided in Section 14858;

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 - 6) Allows for the following licensing fees:
 - a) A nonrefundable application fee for filing an application for licensure and approval to acquire control of a licensee is three thousand five hundred dollars (\$3,500);
 - b) A license renewal fee of two thousand five hundred dollars (\$2,500); and
 - c) A licensee shall pay annually on or before July 1, one hundred twenty-five dollars (\$125) for each licensee branch office in this state.
 - 7) Requires that each licensee shall maintain at all times such capital as the commissioner determines is sufficient to ensure the safety and soundness of the licensee and maintain consumer protection and its ongoing operations.
 - 8) Specifies that a licensee shall not appoint or continue any person as agent, unless the licensee and the person have made a written contract that requires the agent to operate in full compliance with this division.
 - 9) Provides that an agent shall not provide any virtual currency business outside the scope of activity permissible under the written contract between the agent and the licensee.
 - 10) Requires each licensee to exercise reasonable supervision over its agents to ensure compliance with applicable laws, rules, and regulations with regard to the virtual currency

business.

- 11) Prohibits a licensee from appointing any person as an agent unless it has conducted a review of the proposed agent's fitness to act as an agent and has determined that the proposed agent and any persons who control the proposed agent are of good character and sound financial standing.
- 12) Requires a licensee to maintain records of this review for each agent while the agent is providing any virtual currency business on behalf of the licensee, and for three years after the relationship with the agent has terminated.
- 13) Prohibits a person, including an agent, from providing any virtual currency business on behalf of a person not licensed or not exempt from licensure under this division.
- 14) Specifies that a person that engages in that activity provides virtual currency business to the same extent as if the person was a licensee and shall be jointly and severally liable with the unlicensed or nonexempt person.
- 15) Allows the commissioner at any time and from time to time examine the business and any branch office, within or outside this state, of any licensee in order to ascertain whether that business is being conducted in a lawful manner and whether all virtual currency held or exchanged is properly accounted for.
- 16) Requires the directors, officers, and employees of any licensee being examined by the commissioner shall exhibit to the commissioner, on request, any or all of the licensee's accounts, books, correspondence, memoranda, papers, and other records and shall otherwise facilitate the examination so far as it may be in their power to do so.
- 17) Requires a licensee to file a report with the commissioner within five business days after the licensee has reason to know of any occurrence of the following events:
 - a) The filing of a petition by or against the licensee under the United States Bankruptcy Code (11 U.S.C. Secs. 101-110, incl.) for bankruptcy or reorganization;
 - b) The filing of a petition by or against the licensee for receivership, the commencement of any other judicial or administrative proceeding for its dissolution or reorganization, or the making of a general assignment for the benefit of its creditors;
 - c) The commencement of a proceeding to revoke or suspend its virtual currency business license in a state or country in which the licensee engages in such business or is licensed to engage in such business;
 - d) The cancellation or other impairment of the licensee's bond or trust account as required by subdivision (b) of Section 26008; or
 - e) A charge or conviction of the licensee or of an executive officer, manager, director, or person in control of the licensee for a felony.

- 18) Requires a licensee to maintain any records as required by the commissioner for determining its compliance with this division for at least three years.
- 19) Allows a licensee to surrender its license by filing with the commissioner the license and a report with any information as the commissioner requires. The voluntary surrender of the license shall become effective at the time and upon the conditions as the commissioner specifies by order.
- 20) Gives authority to the commissioner to prepare written decisions, opinion letters, and other formal written guidance to be issued to persons seeking clarification regarding the requirements of this division.
- 21) Requires the commissioner to make public on the commissioner's Internet Web site all written decisions, opinion letters, and other formal written guidance issued to persons seeking clarification regarding the requirements of this division. The commissioner may, at his or her discretion or upon request by an applicant or licensee, redact proprietary or other confidential information regarding an applicant or licensee from any decision, letter, or other written guidance issued in connection with an applicant or licensee.
- 22) Allows the commissioner to offer informal guidance to any prospective applicant for a license under this division, regarding the conditions of licensure that may be applied to that person. The commissioner shall inform any applicant that requests that guidance of the licensing requirements that will be required of that applicant, based on the information provided by the applicant concerning its plan to conduct business under this division, and the factors used to make that determination.
- 23) Gives the commissioner authority, if the commissioner deems it necessary for the general welfare of the public, to exercise any power set forth in this division with respect to a virtual currency business, regardless of whether an application for a license has been filed with the commissioner, a license has been issued, or, if issued, the license has been surrendered, suspended, or revoked.
- 24) States that if it appears to the commissioner that a licensee is violating or failing to comply with this division, the commissioner may direct the licensee to comply with the law by an order issued under the commissioner's official seal, or if it appears to the commissioner that any licensee is conducting its business in an unsafe or injurious manner, the commissioner may in like manner direct it to discontinue the unsafe or injurious practices. The order shall require the licensee to show cause before the commissioner, at a time and place to be fixed by the commissioner, as to why the order should not be observed.
- 25) Provides that if, upon any hearing the commissioner finds that the licensee is violating or failing to comply with any law of this state or is conducting its business in an unsafe or injurious manner, the commissioner may make a final order directing it to comply with the law or to discontinue the unsafe or injurious practices. A licensee shall comply with the final order unless, within 10 days after the issuance of the order, its enforcement is restrained in a proceeding brought by the licensee.
- 26) Allows the commissioner to issue an order suspending or revoking a license, or taking possession of and placing a licensee in receivership, if after notice and an opportunity for

hearing, the commissioner finds any of the following:

- a) The licensee does not cooperate with an examination or investigation by the commissioner;
- b) The licensee engages in fraud, intentional misrepresentation, or gross negligence;
- c) The competence, experience, character, or general fitness of the licensee, or any director, officer, employee, or person in control of a licensee, indicates that it is not in the public interest to permit the person to provide virtual currency services;
- d) The licensee engages in an unsafe or unsound practice;
- e) The licensee is insolvent, suspends payment of its obligations, or makes a general assignment for the benefit of its creditors;
- f) The licensee has applied for an adjudication of bankruptcy, reorganization, arrangement, or other relief under any bankruptcy, reorganization, insolvency, or moratorium law, or any person has applied for any such relief under that law against the licensee and the licensee has by any affirmative act approved of or consented to the action or the relief has been granted; or,
- g) Any fact or condition exists that, if it had existed at the time when the licensee applied for its license, would have been grounds for denying the application;

- 27) In determining whether a licensee is engaging in an unsafe or unsound practice, the commissioner may consider the size and condition of the licensee's provision of virtual currency services, the magnitude of the loss, the gravity of the violation, and the previous conduct of the person involved.
- 28) Allows the commissioner to assess a civil penalty against a person that violates this division or a regulation adopted or an order issued under this division in an amount not to exceed one thousand dollars (\$1,000) for each violation or, in the case of a continuing violation, one thousand dollars (\$1,000) for each day or part thereof during which the violation continues, plus this state's costs and expenses for the investigation and prosecution of the matter, including reasonable attorney's fees.
- 29) Specifies that a person that engages in unlicensed activity or intentionally makes a false statement, misrepresentation, or false certification in a record filed or required to be maintained under this division or that intentionally makes a false entry or omits a material entry in such a record is guilty of a felony.
- 30) Allows the commissioner, by order or regulation grant exemptions from this section in cases where the commissioner finds that the requirements of this section are not necessary or may be duplicative.
- 31) Requires a licensee, within 90 days after the end of each fiscal year, or within any extended time as the commissioner may prescribe, file with the commissioner an audit report for the

fiscal year.

- 32) Specifies that each licensee shall, not more than 45 days after the end of each calendar year quarter, or within a longer period as the commissioner may by regulation or order specify, file with the commissioner a report containing all of the following:
- a) Financial statements, including balance sheet, income statement, statement of changes in shareholders' equity, and statement of cashflows, for, or as of the end of, that calendar year quarter, verified by two of the licensee's principal officers. The verification shall state that each of the officers making the verification has a personal knowledge of the matters in the report and that each of them believes that each statement in the report is true; and,
 - b) Other information as the commissioner may by regulation or order require.
- 33) Allows the commissioner to levy an assessment each fiscal year, on a pro rata basis, on those licensees that at any time during the preceding calendar year engaged in this state in the virtual currency business in an amount that is, in his or her judgment, sufficient to meet the commissioner's expenses in administering the provisions of this division and to provide a reasonable reserve for contingencies.
- 34) Requires a licensee to disclose to consumers the following disclosure in a form and manner prescribed by the commissioner:

"Once submitted to the network, a virtual currency transaction will be unconfirmed for a period of time (usually less than one hour, but up to one day or more) pending sufficient confirmation of the transaction by the network. A transaction is not complete while it is in a pending state. Virtual currency associated with transactions that are in a pending state will be designated accordingly, and will not be included in your account balance or be available to conduct transactions.

The risk of loss in trading or holding virtual currency can be substantial. You should therefore carefully consider whether trading or holding virtual currency is suitable for you in light of your financial condition. In considering whether to trade or hold virtual currency, you should be aware that the price or value of virtual currency can change rapidly, decrease, and potentially even fall to zero.

(Insert company name) is licensed by the Department of Business Oversight to do business in California. If you have complaints with respect to any aspect of the virtual currency business conducted by (company name), you may contact the California Department of Business Oversight at its toll-free telephone number, 1-800-622-0620, by email at consumer.services@dbo.ca.gov, or by mail at the Department of Business Oversight, Consumer Services, 1515 K Street, Suite 200, Sacramento, CA 95814."

EXISTING LAW: Regulates the transmission of money under the money transmission act (Financial Code, Section 2000-2175)

FISCAL EFFECT: Unknown

COMMENTS:

The author has introduced this bill to ensure that entities that store virtual currency or offer the exchange of virtual currency with consumers are operated in a safe and sound manner. AB 1326 will protect consumers that utilize virtual currency services by ensuring that these businesses are able to protect consumer's virtual currency from potential loss. Additionally, this bill will provide regulatory certainty as many companies try to engage in the virtual currency business have sought out money transmission licenses only to be denied, or are even unsure if their business model fits into existing licensing structures for other financial services entities.

The New York State Department of Banking was the first regulatory agency to issue regulations concerning virtual currency. This launched nationwide efforts to look at whether the virtual currency business should be regulated. The Conference of State Banking Supervisors (CSBS) formed the CSBS Emerging Payments Task Force ("Task Force") to examine the intersection between state supervision and payments developments, and to identify areas for consistent regulatory approaches among states. This effort includes an assessment of virtual currency activities and outreach with a broad range of stakeholders. After engaging with industry participants, state and federal regulators, and other stakeholders, CSBS recommended that activities involving third party control of virtual currency, including for the purposes of transmitting, exchanging, holding, or otherwise controlling virtual currency, should be subject to state licensure and supervision.

Headlines concerning virtual currency have been dominated by Bitcoin with some of this attention resulting from negative publicity. The high profile *Silk Road* case in which federal law enforcement officials arrested the operator of an online illegal drug market place that facilitated the sale of drugs and other illegal goods through acceptance of Bitcoins. Bitcoins were used because it is a decentralized currency allowing users to be pseudonymous to some extent, even though every Bitcoin transaction is logged. Bitcoin is not the first, nor the only virtual currency. Numerous models of virtual currency have sprouted up over the last decade, and this growth has inspired additional questions by government officials and policy makers.

Bitcoin has received its share of negative attention from its wild price fluctuations, awareness against Bitcoin "Wallets" (as the individual software applications that manage bitcoin holdings) to being credited with being the currency of choice for criminal activity. As to the latter attribution, cash money is still the dominant and preferred source of anonymous payment for illegal activities. Some of the attention, specifically in relation to the risk associated with storing virtual currency has raised the attention of state regulators across the country.

Even though the core program that runs bitcoin has resisted six years of hacking attempts, the successful attacks on associated businesses have created the impression that bitcoin isn't a safe way to store money. Bitcoins exist purely as entries in an accounting system—a transparent public ledger known as the "blockchain" that records balances and transfers among special bitcoin "addresses." With bitcoin, the balances held by every user of the monetary system are instead recorded on a widely distributed, publicly displayed ledger that is kept up-to-date by thousands of independently owned, competing computers known as "miners."

What does a real world transaction look like such as buying a cup of coffee at your local coffee shop? If you pay with a credit card, the transaction seems simple enough: You swipe your card, you grab your cup, and you leave. The financial system is just getting started with you and the coffee shop. Before the store actually gets paid and your bank balance falls, more than a half-

dozen institutions—such as a billing processor, the card association your bank, the coffee shop’s bank, a payment processor, the clearinghouse network managed by the regional Federal Reserve Banks—will have shared part of your account information or otherwise intervened in the flow of money. If all goes well, your bank will confirm your identity and good credit and send payment to the coffee shop’s bank two or three days later. For this privilege, the coffee shop pays a fee of between 2% and 3%.

Now let’s pay in Bitcoin. If you don’t already have bitcoins, you will need to buy some from one of a host of online exchanges and brokerages, using a simple transfer from your regular bank account. You will then assign the bitcoins to a wallet, which functions like an online account. Once inside the coffee shop, you will open your wallet’s smartphone app and hold its QR code reader up to the coffee shop’s device. This allows your embedded secret password to unlock a bitcoin address and publicly informs the bitcoin computer network that you are transferring \$1.75 worth of bitcoin (currently about 0.0075 bitcoin) to the coffee shop’s address. This takes just seconds, and then you walk off with your coffee. Next, in contrast to the pay with credit/debit system, your transaction is immediately broadcast to the world (in alphanumeric data that can’t be traced to you personally). Your information is then gathered up by bitcoin “miners,” the computers that maintain the system and are compensated, roughly every 10 minutes, for their work confirming transactions. The computer that competes successfully to package the data from your coffee purchase adds that information to the blockchain ledger, which prompts all the other miners to investigate the underlying transaction. Once your bona fides are verified, the updated blockchain is considered legitimate, and the miners update their records accordingly. It takes from 10 minutes to an hour for this software-driven network of computers to formally confirm a transfer from your blockchain address to that of the coffee shop—compared with a two- to three-day wait for the settlement of a credit-card transaction. Some new digital currencies are able to finalize transactions within seconds. There are almost zero fees, and the personal information of users isn’t divulged. This bitcoin feature especially appeals to privacy advocates: Nobody learns where you buy coffee. The advantages of digital currency are far more visible in emerging markets. It allows migrant workers, for example, to bypass fees that often run to 10% or more for the international payment services that they use to send money home to their families. Although many companies now accept bitcoin (the latest and biggest being Microsoft Corp.), global usage of the digital currency averaged just \$50 million a day in 2014. Over that same period, Visa and MasterCard processed some \$32 billion a day. The market capitalization for BitCoin is almost at \$4 billion with virtual currency Ripple the next largest at over \$340 million.

FinCEN Guidance on Virtual Currencies

FinCEN issued interpretive guidance earlier this year to clarify how the Bank Secrecy Act (BSA) and FinCEN regulations apply to users, administrators and exchangers of virtual currencies. Under the regulatory framework, virtual currency is defined as having some but not all of the attributes of “real currency” and therefore, virtual currency does not have legal tender status in any jurisdiction. Specifically, the FinCEN guidance addresses convertible virtual currency which either has a real currency equivalent value or serves as a substitute for real currency.

The roles of persons (including legal entities) involved in virtual currency transactions are defined by FinCEN as follows:

- User: A person who obtains virtual currency to purchase goods or services
- Exchanger: A person engaged as a business in the exchange of virtual currency for real currency, funds or other virtual currency
- Administrator: A person engaged as a business in issuing into circulation a virtual currency and who has the authority to redeem and withdraw from circulation such virtual currency

A person, or legal entity, may act in more than one of these capacities. Further, it is important to note that “obtaining” virtual currency covers much more than the scenario of a “user” who merely purchases virtual currency. Depending on the model of the particular currency, a party could “obtain” virtual currency through various acts including earning, harvesting, mining, creating, auto-generating, manufacturing or purchasing.

The threshold issue is whether actions will subject a person or legal entity to BSA’s registration, reporting and recordkeeping regulations that apply to money services businesses (MSBs). A user who obtains convertible virtual currency and uses it to purchase real or virtual goods or services is not subject to MSB compliance because such activity does not meet the definition of “money transmission services” and the user would not be a “money transmitter.”

However, an administrator or exchanger engages in money transmission services and, as a result, is a “money transmitter” under FinCEN definitions by (1) accepting and transmitting convertible virtual currency or (2) buying or selling convertible virtual currency. As a money transmitter, the administrator or exchanger would generally be subject to MSB reporting and recordkeeping.

Further, the FinCEN guidance expressly addresses the category of de-centralized virtual currency – the Bitcoin model – and states that “a person is an exchanger and a money transmitter if the person accepts such de-centralized convertible virtual currency from one person and transmits it to another person as part of the acceptance and transfer of currency, funds, or other value that substitutes for currency.”

In the area of foreign exchange, accepting real currency in exchange for virtual currency is not subject to FinCEN regulations applicable to “dealers in foreign exchange” since a forex transaction involves exchanging the currency of two countries and virtual currency does not constitute legal tender as a currency of a country.

The author's office has been meeting with various stakeholders and will continue to work out the various details of this legislation as it moves forward. Some key issues that still need to be resolved:

- 1) Further strengthen and clarify definition of "virtual currency business."
- 2) Clarify the factors that will be used to determine capitalization requirements.
- 3) Specify clear bonding and security amounts and factors used to make that determination.
- 4) Examine issues relating to start-up companies.

Previous Legislation.

AB 129 (Dickinson), chapter 74, statutes of 2014 clarified California law to ensure that alternative currency, including virtual currency would not be potentially deemed illegal tender.

REGISTERED SUPPORT / OPPOSITION:

Support

None on file.

Opposition

None on file.

Analysis Prepared by: Mark Farouk / B. & F. / (916) 319-3081

Date of Hearing: April 27, 2015

ASSEMBLY COMMITTEE ON BANKING AND FINANCE

Matthew Dababneh, Chair

AB 1326 (Dababneh) – As Amended April 20, 2015

SUBJECT: Virtual currency

SUMMARY: Requires the licensing of entities engaged in the business of virtual currency by the Department of Business Oversight (DBO). Specifically, **this bill:**

- 1) Defines “virtual currency” as any type of digital unit that is used as a medium of exchange or a form of digitally stored value or that is incorporated into payment system technology. Virtual currency shall be broadly construed to include digital units of exchange that (1) have a centralized repository or administrator, (2) are decentralized and have no centralized repository or administrator, or (3) may be created or obtained by computing or manufacturing effort. Virtual currency shall not be construed to include digital units that are used solely within online gaming platforms with no market or application outside of those gaming platforms, nor shall virtual currency be construed to include digital units that are used exclusively as part of a customer affinity or rewards program, and can be applied solely as payment redeemed for goods, services, or for purchases with the issuer or other designated merchants, but cannot be converted into, or redeemed for, fiat currency.
- 2) Defines “virtual currency business” as the conduct of either of the following types of activities involving a California resident:
 - a) Storing, holding, or maintaining custody or control of virtual currency on behalf of others; or
 - b) Providing conversion or exchange services of fiat currency into virtual currency or the conversion or exchange of virtual currency into fiat currency or other value, or the conversion or exchange of one form of virtual currency into another form of virtual currency.
- 3) Provides for the following exemptions:
 - a) The United States or a department, agency, or instrumentality thereof, including any federal reserve bank and any federal home loan bank;
 - b) Money transmission by the United States Postal Service or by a contractor on behalf of the United States Postal Service;
 - c) A state, city, county, city and county, or any other governmental agency or governmental subdivision of a state;
 - d) A commercial bank or industrial bank, the deposits of which are insured by the Federal Deposit Insurance Corporation (FDIC) or its successor, or any foreign (other nation) bank that is licensed under state law or that is authorized under federal law to maintain a federal agency or federal branch office in this state; a trust company licensed pursuant to

Section 1042 or a national association authorized under federal law to engage in a trust banking business; an association or federal association, as defined in Section 5102, the deposits of which are insured by the FDIC or its successor; and any federally or state chartered credit union, with an office in this state, the member accounts of which are insured or guaranteed as provided in Section 14858;

- e) An entity licensed as a money transmitter under the Money Transmission Act;
 - f) A merchant or consumer that utilizes virtual currency solely for the purchase or sale of goods or services; or
 - g) A transaction in which the recipient of virtual currency is an agent of the payee pursuant to a preexisting written contract and delivery of the virtual currency to the agent satisfies the payor's obligation to the payee. "Agent" has the same meaning as that term as defined in Section 2295 of the Civil Code. "Payee" means the provider of goods or services, who is owed payment of money or other monetary value from the payor for the goods or services. "Payor" means the recipient of goods or services, who owes payment of money or monetary value to the payee for the goods or services.
- 4) Requires an applicant for a license to pay the commissioner of DBO (commissioner) a nonrefundable application fee of five thousand dollars (\$5,000).
 - 5) Provides that an applicant for a license shall do so in a form and in a medium prescribed by the commissioner by order or regulation.
 - 6) Allows for the following licensing fees:
 - a) A nonrefundable application fee for filing an application for licensure and approval to acquire control of a licensee is three thousand five hundred dollars (\$3,500);
 - b) A license renewal fee of two thousand five hundred dollars (\$2,500); and
 - c) A licensee shall pay annually on or before July 1, one hundred twenty-five dollars (\$125) for each licensee branch office in this state.
 - 7) Requires that each licensee shall maintain at all times such capital as the commissioner determines is sufficient to ensure the safety and soundness of the licensee and maintain consumer protection and its ongoing operations.
 - 8) Specifies that a licensee shall not appoint or continue any person as agent, unless the licensee and the person have made a written contract that requires the agent to operate in full compliance with this division.
 - 9) Provides that an agent shall not provide any virtual currency business outside the scope of activity permissible under the written contract between the agent and the licensee.
 - 10) Requires each licensee to exercise reasonable supervision over its agents to ensure compliance with applicable laws, rules, and regulations with regard to the virtual currency

business.

- 11) Prohibits a licensee from appointing any person as an agent unless it has conducted a review of the proposed agent's fitness to act as an agent and has determined that the proposed agent and any persons who control the proposed agent are of good character and sound financial standing.
- 12) Requires a licensee to maintain records of this review for each agent while the agent is providing any virtual currency business on behalf of the licensee, and for three years after the relationship with the agent has terminated.
- 13) Prohibits a person, including an agent, from providing any virtual currency business on behalf of a person not licensed or not exempt from licensure under this division.
- 14) Specifies that a person that engages in that activity provides virtual currency business to the same extent as if the person was a licensee and shall be jointly and severally liable with the unlicensed or nonexempt person.
- 15) Allows the commissioner at any time and from time to time examine the business and any branch office, within or outside this state, of any licensee in order to ascertain whether that business is being conducted in a lawful manner and whether all virtual currency held or exchanged is properly accounted for.
- 16) Requires the directors, officers, and employees of any licensee being examined by the commissioner shall exhibit to the commissioner, on request, any or all of the licensee's accounts, books, correspondence, memoranda, papers, and other records and shall otherwise facilitate the examination so far as it may be in their power to do so.
- 17) Requires a licensee to file a report with the commissioner within five business days after the licensee has reason to know of any occurrence of the following events:
 - a) The filing of a petition by or against the licensee under the United States Bankruptcy Code (11 U.S.C. Secs. 101-110, incl.) for bankruptcy or reorganization;
 - b) The filing of a petition by or against the licensee for receivership, the commencement of any other judicial or administrative proceeding for its dissolution or reorganization, or the making of a general assignment for the benefit of its creditors;
 - c) The commencement of a proceeding to revoke or suspend its virtual currency business license in a state or country in which the licensee engages in such business or is licensed to engage in such business;
 - d) The cancellation or other impairment of the licensee's bond or trust account as required by subdivision (b) of Section 26008; or
 - e) A charge or conviction of the licensee or of an executive officer, manager, director, or person in control of the licensee for a felony.

- 18) Requires a licensee to maintain any records as required by the commissioner for determining its compliance with this division for at least three years.
- 19) Allows a licensee to surrender its license by filing with the commissioner the license and a report with any information as the commissioner requires. The voluntary surrender of the license shall become effective at the time and upon the conditions as the commissioner specifies by order.
- 20) Gives authority to the commissioner to prepare written decisions, opinion letters, and other formal written guidance to be issued to persons seeking clarification regarding the requirements of this division.
- 21) Requires the commissioner to make public on the commissioner's Internet Web site all written decisions, opinion letters, and other formal written guidance issued to persons seeking clarification regarding the requirements of this division. The commissioner may, at his or her discretion or upon request by an applicant or licensee, redact proprietary or other confidential information regarding an applicant or licensee from any decision, letter, or other written guidance issued in connection with an applicant or licensee.
- 22) Allows the commissioner to offer informal guidance to any prospective applicant for a license under this division, regarding the conditions of licensure that may be applied to that person. The commissioner shall inform any applicant that requests that guidance of the licensing requirements that will be required of that applicant, based on the information provided by the applicant concerning its plan to conduct business under this division, and the factors used to make that determination.
- 23) Gives the commissioner authority, if the commissioner deems it necessary for the general welfare of the public, to exercise any power set forth in this division with respect to a virtual currency business, regardless of whether an application for a license has been filed with the commissioner, a license has been issued, or, if issued, the license has been surrendered, suspended, or revoked.
- 24) States that if it appears to the commissioner that a licensee is violating or failing to comply with this division, the commissioner may direct the licensee to comply with the law by an order issued under the commissioner's official seal, or if it appears to the commissioner that any licensee is conducting its business in an unsafe or injurious manner, the commissioner may in like manner direct it to discontinue the unsafe or injurious practices. The order shall require the licensee to show cause before the commissioner, at a time and place to be fixed by the commissioner, as to why the order should not be observed.
- 25) Provides that if, upon any hearing the commissioner finds that the licensee is violating or failing to comply with any law of this state or is conducting its business in an unsafe or injurious manner, the commissioner may make a final order directing it to comply with the law or to discontinue the unsafe or injurious practices. A licensee shall comply with the final order unless, within 10 days after the issuance of the order, its enforcement is restrained in a proceeding brought by the licensee.
- 26) Allows the commissioner to issue an order suspending or revoking a license, or taking possession of and placing a licensee in receivership, if after notice and an opportunity for

hearing, the commissioner finds any of the following:

- a) The licensee does not cooperate with an examination or investigation by the commissioner;
- b) The licensee engages in fraud, intentional misrepresentation, or gross negligence;
- c) The competence, experience, character, or general fitness of the licensee, or any director, officer, employee, or person in control of a licensee, indicates that it is not in the public interest to permit the person to provide virtual currency services;
- d) The licensee engages in an unsafe or unsound practice;
- e) The licensee is insolvent, suspends payment of its obligations, or makes a general assignment for the benefit of its creditors;
- f) The licensee has applied for an adjudication of bankruptcy, reorganization, arrangement, or other relief under any bankruptcy, reorganization, insolvency, or moratorium law, or any person has applied for any such relief under that law against the licensee and the licensee has by any affirmative act approved of or consented to the action or the relief has been granted; or,
- g) Any fact or condition exists that, if it had existed at the time when the licensee applied for its license, would have been grounds for denying the application;

- 27) In determining whether a licensee is engaging in an unsafe or unsound practice, the commissioner may consider the size and condition of the licensee's provision of virtual currency services, the magnitude of the loss, the gravity of the violation, and the previous conduct of the person involved.
- 28) Allows the commissioner to assess a civil penalty against a person that violates this division or a regulation adopted or an order issued under this division in an amount not to exceed one thousand dollars (\$1,000) for each violation or, in the case of a continuing violation, one thousand dollars (\$1,000) for each day or part thereof during which the violation continues, plus this state's costs and expenses for the investigation and prosecution of the matter, including reasonable attorney's fees.
- 29) Specifies that a person that engages in unlicensed activity or intentionally makes a false statement, misrepresentation, or false certification in a record filed or required to be maintained under this division or that intentionally makes a false entry or omits a material entry in such a record is guilty of a felony.
- 30) Allows the commissioner, by order or regulation grant exemptions from this section in cases where the commissioner finds that the requirements of this section are not necessary or may be duplicative.
- 31) Requires a licensee, within 90 days after the end of each fiscal year, or within any extended time as the commissioner may prescribe, file with the commissioner an audit report for the

fiscal year.

- 32) Specifies that each licensee shall, not more than 45 days after the end of each calendar year quarter, or within a longer period as the commissioner may by regulation or order specify, file with the commissioner a report containing all of the following:
- a) Financial statements, including balance sheet, income statement, statement of changes in shareholders' equity, and statement of cashflows, for, or as of the end of, that calendar year quarter, verified by two of the licensee's principal officers. The verification shall state that each of the officers making the verification has a personal knowledge of the matters in the report and that each of them believes that each statement in the report is true; and,
 - b) Other information as the commissioner may by regulation or order require.
- 33) Allows the commissioner to levy an assessment each fiscal year, on a pro rata basis, on those licensees that at any time during the preceding calendar year engaged in this state in the virtual currency business in an amount that is, in his or her judgment, sufficient to meet the commissioner's expenses in administering the provisions of this division and to provide a reasonable reserve for contingencies.
- 34) Requires a licensee to disclose to consumers the following disclosure in a form and manner prescribed by the commissioner:

"Once submitted to the network, a virtual currency transaction will be unconfirmed for a period of time (usually less than one hour, but up to one day or more) pending sufficient confirmation of the transaction by the network. A transaction is not complete while it is in a pending state. Virtual currency associated with transactions that are in a pending state will be designated accordingly, and will not be included in your account balance or be available to conduct transactions.

The risk of loss in trading or holding virtual currency can be substantial. You should therefore carefully consider whether trading or holding virtual currency is suitable for you in light of your financial condition. In considering whether to trade or hold virtual currency, you should be aware that the price or value of virtual currency can change rapidly, decrease, and potentially even fall to zero.

(Insert company name) is licensed by the Department of Business Oversight to do business in California. If you have complaints with respect to any aspect of the virtual currency business conducted by (company name), you may contact the California Department of Business Oversight at its toll-free telephone number, 1-800-622-0620, by email at consumer.services@dbo.ca.gov, or by mail at the Department of Business Oversight, Consumer Services, 1515 K Street, Suite 200, Sacramento, CA 95814."

EXISTING LAW: Regulates the transmission of money under the money transmission act (Financial Code, Section 2000-2175)

FISCAL EFFECT: Unknown

COMMENTS:

The author has introduced this bill to ensure that entities that store virtual currency or offer the exchange of virtual currency with consumers are operated in a safe and sound manner. AB 1326 will protect consumers that utilize virtual currency services by ensuring that these businesses are able to protect consumer's virtual currency from potential loss. Additionally, this bill will provide regulatory certainty as many companies try to engage in the virtual currency business have sought out money transmission licenses only to be denied, or are even unsure if their business model fits into existing licensing structures for other financial services entities.

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What does a real world transaction look like such as buying a cup of coffee at your local coffee shop? If you pay with a credit card, the transaction seems simple enough: You swipe your card, you grab your cup, and you leave. The financial system is just getting started with you and the coffee shop. Before the store actually gets paid and your bank balance falls, more than a half-

dozen institutions—such as a billing processor, the card association your bank, the coffee shop’s bank, a payment processor, the clearinghouse network managed by the regional Federal Reserve Banks—will have shared part of your account information or otherwise intervened in the flow of money. If all goes well, your bank will confirm your identity and good credit and send payment to the coffee shop’s bank two or three days later. For this privilege, the coffee shop pays a fee of between 2% and 3%.

Now let’s pay in Bitcoin. If you don’t already have bitcoins, you will need to buy some from one of a host of online exchanges and brokerages, using a simple transfer from your regular bank account. You will then assign the bitcoins to a wallet, which functions like an online account. Once inside the coffee shop, you will open your wallet’s smartphone app and hold its QR code reader up to the coffee shop’s device. This allows your embedded secret password to unlock a bitcoin address and publicly informs the bitcoin computer network that you are transferring \$1.75 worth of bitcoin (currently about 0.0075 bitcoin) to the coffee shop’s address. This takes just seconds, and then you walk off with your coffee. Next, in contrast to the pay with credit/debit system, your transaction is immediately broadcast to the world (in alphanumeric data that can’t be traced to you personally). Your information is then gathered up by bitcoin “miners,” the computers that maintain the system and are compensated, roughly every 10 minutes, for their work confirming transactions. The computer that competes successfully to package the data from your coffee purchase adds that information to the blockchain ledger, which prompts all the other miners to investigate the underlying transaction. Once your bona fides are verified, the updated blockchain is considered legitimate, and the miners update their records accordingly. It takes from 10 minutes to an hour for this software-driven network of computers to formally confirm a transfer from your blockchain address to that of the coffee shop—compared with a two- to three-day wait for the settlement of a credit-card transaction. Some new digital currencies are able to finalize transactions within seconds. There are almost zero fees, and the personal information of users isn’t divulged. This bitcoin feature especially appeals to privacy advocates: Nobody learns where you buy coffee. The advantages of digital currency are far more visible in emerging markets. It allows migrant workers, for example, to bypass fees that often run to 10% or more for the international payment services that they use to send money home to their families. Although many companies now accept bitcoin (the latest and biggest being Microsoft Corp.), global usage of the digital currency averaged just \$50 million a day in 2014. Over that same period, Visa and MasterCard processed some \$32 billion a day. The market capitalization for BitCoin is almost at \$4 billion with virtual currency Ripple the next largest at over \$340 million.

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The roles of persons (including legal entities) involved in virtual currency transactions are defined by FinCEN as follows:

- User: A person who obtains virtual currency to purchase goods or services
- Exchanger: A person engaged as a business in the exchange of virtual currency for real currency, funds or other virtual currency
- Administrator: A person engaged as a business in issuing into circulation a virtual currency and who has the authority to redeem and withdraw from circulation such virtual currency

A person, or legal entity, may act in more than one of these capacities. Further, it is important to note that “obtaining” virtual currency covers much more than the scenario of a “user” who merely purchases virtual currency. Depending on the model of the particular currency, a party could “obtain” virtual currency through various acts including earning, harvesting, mining, creating, auto-generating, manufacturing or purchasing.

The threshold issue is whether actions will subject a person or legal entity to BSA’s registration, reporting and recordkeeping regulations that apply to money services businesses (MSBs). A user who obtains convertible virtual currency and uses it to purchase real or virtual goods or services is not subject to MSB compliance because such activity does not meet the definition of “money transmission services” and the user would not be a “money transmitter.”

However, an administrator or exchanger engages in money transmission services and, as a result, is a “money transmitter” under FinCEN definitions by (1) accepting and transmitting convertible virtual currency or (2) buying or selling convertible virtual currency. As a money transmitter, the administrator or exchanger would generally be subject to MSB reporting and recordkeeping.

Further, the FinCEN guidance expressly addresses the category of de-centralized virtual currency – the Bitcoin model – and states that “a person is an exchanger and a money transmitter if the person accepts such de-centralized convertible virtual currency from one person and transmits it to another person as part of the acceptance and transfer of currency, funds, or other value that substitutes for currency.”

In the area of foreign exchange, accepting real currency in exchange for virtual currency is not subject to FinCEN regulations applicable to “dealers in foreign exchange” since a forex transaction involves exchanging the currency of two countries and virtual currency does not constitute legal tender as a currency of a country.

The author's office has been meeting with various stakeholders and will continue to work out the various details of this legislation as it moves forward. Some key issues that still need to be resolved:

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Previous Legislation.

AB 129 (Dickinson), chapter 74, statutes of 2014 clarified California law to ensure that alternative currency, including virtual currency would not be potentially deemed illegal tender.

REGISTERED SUPPORT / OPPOSITION:

Support

None on file.

Opposition

None on file.

Analysis Prepared by: Mark Farouk / B. & F. / (916) 319-3081

Date of Hearing: April 27, 2015

ASSEMBLY COMMITTEE ON BANKING AND FINANCE

Matthew Dababneh, Chair

AB 1326 (Dababneh) – As Amended April 20, 2015

SUBJECT: Virtual currency

SUMMARY: Requires the licensing of entities engaged in the business of virtual currency by the Department of Business Oversight (DBO). Specifically, **this bill:**

- 1) Defines “virtual currency” as any type of digital unit that is used as a medium of exchange or a form of digitally stored value or that is incorporated into payment system technology. Virtual currency shall be broadly construed to include digital units of exchange that (1) have a centralized repository or administrator, (2) are decentralized and have no centralized repository or administrator, or (3) may be created or obtained by computing or manufacturing effort. Virtual currency shall not be construed to include digital units that are used solely within online gaming platforms with no market or application outside of those gaming platforms, nor shall virtual currency be construed to include digital units that are used exclusively as part of a customer affinity or rewards program, and can be applied solely as payment redeemed for goods, services, or for purchases with the issuer or other designated merchants, but cannot be converted into, or redeemed for, fiat currency.
- 2) Defines “virtual currency business” as the conduct of either of the following types of activities involving a California resident:
 - a) Storing, holding, or maintaining custody or control of virtual currency on behalf of others; or
 - b) Providing conversion or exchange services of fiat currency into virtual currency or the conversion or exchange of virtual currency into fiat currency or other value, or the conversion or exchange of one form of virtual currency into another form of virtual currency.
- 3) Provides for the following exemptions:
 - a) The United States or a department, agency, or instrumentality thereof, including any federal reserve bank and any federal home loan bank;
 - b) Money transmission by the United States Postal Service or by a contractor on behalf of the United States Postal Service;
 - c) A state, city, county, city and county, or any other governmental agency or governmental subdivision of a state;
 - d) A commercial bank or industrial bank, the deposits of which are insured by the Federal Deposit Insurance Corporation (FDIC) or its successor, or any foreign (other nation) bank that is licensed under state law or that is authorized under federal law to maintain a federal agency or federal branch office in this state; a trust company licensed pursuant to

Section 1042 or a national association authorized under federal law to engage in a trust banking business; an association or federal association, as defined in Section 5102, the deposits of which are insured by the FDIC or its successor; and any federally or state chartered credit union, with an office in this state, the member accounts of which are insured or guaranteed as provided in Section 14858;

- e) An entity licensed as a money transmitter under the Money Transmission Act;
 - f) A merchant or consumer that utilizes virtual currency solely for the purchase or sale of goods or services; or
 - g) A transaction in which the recipient of virtual currency is an agent of the payee pursuant to a preexisting written contract and delivery of the virtual currency to the agent satisfies the payor's obligation to the payee. "Agent" has the same meaning as that term as defined in Section 2295 of the Civil Code. "Payee" means the provider of goods or services, who is owed payment of money or other monetary value from the payor for the goods or services. "Payor" means the recipient of goods or services, who owes payment of money or monetary value to the payee for the goods or services.
- 4) Requires an applicant for a license to pay the commissioner of DBO (commissioner) a nonrefundable application fee of five thousand dollars (\$5,000).
 - 5) Provides that an applicant for a license shall do so in a form and in a medium prescribed by the commissioner by order or regulation.
 - 6) Allows for the following licensing fees:
 - a) A nonrefundable application fee for filing an application for licensure and approval to acquire control of a licensee is three thousand five hundred dollars (\$3,500);
 - b) A license renewal fee of two thousand five hundred dollars (\$2,500); and
 - c) A licensee shall pay annually on or before July 1, one hundred twenty-five dollars (\$125) for each licensee branch office in this state.
 - 7) Requires that each licensee shall maintain at all times such capital as the commissioner determines is sufficient to ensure the safety and soundness of the licensee and maintain consumer protection and its ongoing operations.
 - 8) Specifies that a licensee shall not appoint or continue any person as agent, unless the licensee and the person have made a written contract that requires the agent to operate in full compliance with this division.
 - 9) Provides that an agent shall not provide any virtual currency business outside the scope of activity permissible under the written contract between the agent and the licensee.
 - 10) Requires each licensee to exercise reasonable supervision over its agents to ensure compliance with applicable laws, rules, and regulations with regard to the virtual currency

business.

- 11) Prohibits a licensee from appointing any person as an agent unless it has conducted a review of the proposed agent's fitness to act as an agent and has determined that the proposed agent and any persons who control the proposed agent are of good character and sound financial standing.
- 12) Requires a licensee to maintain records of this review for each agent while the agent is providing any virtual currency business on behalf of the licensee, and for three years after the relationship with the agent has terminated.
- 13) Prohibits a person, including an agent, from providing any virtual currency business on behalf of a person not licensed or not exempt from licensure under this division.
- 14) Specifies that a person that engages in that activity provides virtual currency business to the same extent as if the person was a licensee and shall be jointly and severally liable with the unlicensed or nonexempt person.
- 15) Allows the commissioner at any time and from time to time examine the business and any branch office, within or outside this state, of any licensee in order to ascertain whether that business is being conducted in a lawful manner and whether all virtual currency held or exchanged is properly accounted for.
- 16) Requires the directors, officers, and employees of any licensee being examined by the commissioner shall exhibit to the commissioner, on request, any or all of the licensee's accounts, books, correspondence, memoranda, papers, and other records and shall otherwise facilitate the examination so far as it may be in their power to do so.
- 17) Requires a licensee to file a report with the commissioner within five business days after the licensee has reason to know of any occurrence of the following events:
 - a) The filing of a petition by or against the licensee under the United States Bankruptcy Code (11 U.S.C. Secs. 101-110, incl.) for bankruptcy or reorganization;
 - b) The filing of a petition by or against the licensee for receivership, the commencement of any other judicial or administrative proceeding for its dissolution or reorganization, or the making of a general assignment for the benefit of its creditors;
 - c) The commencement of a proceeding to revoke or suspend its virtual currency business license in a state or country in which the licensee engages in such business or is licensed to engage in such business;
 - d) The cancellation or other impairment of the licensee's bond or trust account as required by subdivision (b) of Section 26008; or
 - e) A charge or conviction of the licensee or of an executive officer, manager, director, or person in control of the licensee for a felony.

- 18) Requires a licensee to maintain any records as required by the commissioner for determining its compliance with this division for at least three years.
- 19) Allows a licensee to surrender its license by filing with the commissioner the license and a report with any information as the commissioner requires. The voluntary surrender of the license shall become effective at the time and upon the conditions as the commissioner specifies by order.
- 20) Gives authority to the commissioner to prepare written decisions, opinion letters, and other formal written guidance to be issued to persons seeking clarification regarding the requirements of this division.
- 21) Requires the commissioner to make public on the commissioner's Internet Web site all written decisions, opinion letters, and other formal written guidance issued to persons seeking clarification regarding the requirements of this division. The commissioner may, at his or her discretion or upon request by an applicant or licensee, redact proprietary or other confidential information regarding an applicant or licensee from any decision, letter, or other written guidance issued in connection with an applicant or licensee.
- 22) Allows the commissioner to offer informal guidance to any prospective applicant for a license under this division, regarding the conditions of licensure that may be applied to that person. The commissioner shall inform any applicant that requests that guidance of the licensing requirements that will be required of that applicant, based on the information provided by the applicant concerning its plan to conduct business under this division, and the factors used to make that determination.
- 23) Gives the commissioner authority, if the commissioner deems it necessary for the general welfare of the public, to exercise any power set forth in this division with respect to a virtual currency business, regardless of whether an application for a license has been filed with the commissioner, a license has been issued, or, if issued, the license has been surrendered, suspended, or revoked.
- 24) States that if it appears to the commissioner that a licensee is violating or failing to comply with this division, the commissioner may direct the licensee to comply with the law by an order issued under the commissioner's official seal, or if it appears to the commissioner that any licensee is conducting its business in an unsafe or injurious manner, the commissioner may in like manner direct it to discontinue the unsafe or injurious practices. The order shall require the licensee to show cause before the commissioner, at a time and place to be fixed by the commissioner, as to why the order should not be observed.
- 25) Provides that if, upon any hearing the commissioner finds that the licensee is violating or failing to comply with any law of this state or is conducting its business in an unsafe or injurious manner, the commissioner may make a final order directing it to comply with the law or to discontinue the unsafe or injurious practices. A licensee shall comply with the final order unless, within 10 days after the issuance of the order, its enforcement is restrained in a proceeding brought by the licensee.
- 26) Allows the commissioner to issue an order suspending or revoking a license, or taking possession of and placing a licensee in receivership, if after notice and an opportunity for

hearing, the commissioner finds any of the following:

- a) The licensee does not cooperate with an examination or investigation by the commissioner;
- b) The licensee engages in fraud, intentional misrepresentation, or gross negligence;
- c) The competence, experience, character, or general fitness of the licensee, or any director, officer, employee, or person in control of a licensee, indicates that it is not in the public interest to permit the person to provide virtual currency services;
- d) The licensee engages in an unsafe or unsound practice;
- e) The licensee is insolvent, suspends payment of its obligations, or makes a general assignment for the benefit of its creditors;
- f) The licensee has applied for an adjudication of bankruptcy, reorganization, arrangement, or other relief under any bankruptcy, reorganization, insolvency, or moratorium law, or any person has applied for any such relief under that law against the licensee and the licensee has by any affirmative act approved of or consented to the action or the relief has been granted; or,
- g) Any fact or condition exists that, if it had existed at the time when the licensee applied for its license, would have been grounds for denying the application;

- 27) In determining whether a licensee is engaging in an unsafe or unsound practice, the commissioner may consider the size and condition of the licensee's provision of virtual currency services, the magnitude of the loss, the gravity of the violation, and the previous conduct of the person involved.
- 28) Allows the commissioner to assess a civil penalty against a person that violates this division or a regulation adopted or an order issued under this division in an amount not to exceed one thousand dollars (\$1,000) for each violation or, in the case of a continuing violation, one thousand dollars (\$1,000) for each day or part thereof during which the violation continues, plus this state's costs and expenses for the investigation and prosecution of the matter, including reasonable attorney's fees.
- 29) Specifies that a person that engages in unlicensed activity or intentionally makes a false statement, misrepresentation, or false certification in a record filed or required to be maintained under this division or that intentionally makes a false entry or omits a material entry in such a record is guilty of a felony.
- 30) Allows the commissioner, by order or regulation grant exemptions from this section in cases where the commissioner finds that the requirements of this section are not necessary or may be duplicative.
- 31) Requires a licensee, within 90 days after the end of each fiscal year, or within any extended time as the commissioner may prescribe, file with the commissioner an audit report for the

fiscal year.

- 32) Specifies that each licensee shall, not more than 45 days after the end of each calendar year quarter, or within a longer period as the commissioner may by regulation or order specify, file with the commissioner a report containing all of the following:
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 - b) Other information as the commissioner may by regulation or order require.
- 33) Allows the commissioner to levy an assessment each fiscal year, on a pro rata basis, on those licensees that at any time during the preceding calendar year engaged in this state in the virtual currency business in an amount that is, in his or her judgment, sufficient to meet the commissioner's expenses in administering the provisions of this division and to provide a reasonable reserve for contingencies.
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Opposition

None on file.

Analysis Prepared by: Mark Farouk / B. & F. / (916) 319-3081

Date of Hearing: April 27, 2015

ASSEMBLY COMMITTEE ON BANKING AND FINANCE

Matthew Dababneh, Chair

AB 1326 (Dababneh) – As Amended April 20, 2015

SUBJECT: Virtual currency

SUMMARY: Requires the licensing of entities engaged in the business of virtual currency by the Department of Business Oversight (DBO). Specifically, **this bill:**

- 1) Defines “virtual currency” as any type of digital unit that is used as a medium of exchange or a form of digitally stored value or that is incorporated into payment system technology. Virtual currency shall be broadly construed to include digital units of exchange that (1) have a centralized repository or administrator, (2) are decentralized and have no centralized repository or administrator, or (3) may be created or obtained by computing or manufacturing effort. Virtual currency shall not be construed to include digital units that are used solely within online gaming platforms with no market or application outside of those gaming platforms, nor shall virtual currency be construed to include digital units that are used exclusively as part of a customer affinity or rewards program, and can be applied solely as payment redeemed for goods, services, or for purchases with the issuer or other designated merchants, but cannot be converted into, or redeemed for, fiat currency.
- 2) Defines “virtual currency business” as the conduct of either of the following types of activities involving a California resident:
 - a) Storing, holding, or maintaining custody or control of virtual currency on behalf of others; or
 - b) Providing conversion or exchange services of fiat currency into virtual currency or the conversion or exchange of virtual currency into fiat currency or other value, or the conversion or exchange of one form of virtual currency into another form of virtual currency.
- 3) Provides for the following exemptions:
 - a) The United States or a department, agency, or instrumentality thereof, including any federal reserve bank and any federal home loan bank;
 - b) Money transmission by the United States Postal Service or by a contractor on behalf of the United States Postal Service;
 - c) A state, city, county, city and county, or any other governmental agency or governmental subdivision of a state;
 - d) A commercial bank or industrial bank, the deposits of which are insured by the Federal Deposit Insurance Corporation (FDIC) or its successor, or any foreign (other nation) bank that is licensed under state law or that is authorized under federal law to maintain a federal agency or federal branch office in this state; a trust company licensed pursuant to

Section 1042 or a national association authorized under federal law to engage in a trust banking business; an association or federal association, as defined in Section 5102, the deposits of which are insured by the FDIC or its successor; and any federally or state chartered credit union, with an office in this state, the member accounts of which are insured or guaranteed as provided in Section 14858;

- e) An entity licensed as a money transmitter under the Money Transmission Act;
 - f) A merchant or consumer that utilizes virtual currency solely for the purchase or sale of goods or services; or
 - g) A transaction in which the recipient of virtual currency is an agent of the payee pursuant to a preexisting written contract and delivery of the virtual currency to the agent satisfies the payor's obligation to the payee. "Agent" has the same meaning as that term as defined in Section 2295 of the Civil Code. "Payee" means the provider of goods or services, who is owed payment of money or other monetary value from the payor for the goods or services. "Payor" means the recipient of goods or services, who owes payment of money or monetary value to the payee for the goods or services.
- 4) Requires an applicant for a license to pay the commissioner of DBO (commissioner) a nonrefundable application fee of five thousand dollars (\$5,000).
 - 5) Provides that an applicant for a license shall do so in a form and in a medium prescribed by the commissioner by order or regulation.
 - 6) Allows for the following licensing fees:
 - a) A nonrefundable application fee for filing an application for licensure and approval to acquire control of a licensee is three thousand five hundred dollars (\$3,500);
 - b) A license renewal fee of two thousand five hundred dollars (\$2,500); and
 - c) A licensee shall pay annually on or before July 1, one hundred twenty-five dollars (\$125) for each licensee branch office in this state.
 - 7) Requires that each licensee shall maintain at all times such capital as the commissioner determines is sufficient to ensure the safety and soundness of the licensee and maintain consumer protection and its ongoing operations.
 - 8) Specifies that a licensee shall not appoint or continue any person as agent, unless the licensee and the person have made a written contract that requires the agent to operate in full compliance with this division.
 - 9) Provides that an agent shall not provide any virtual currency business outside the scope of activity permissible under the written contract between the agent and the licensee.
 - 10) Requires each licensee to exercise reasonable supervision over its agents to ensure compliance with applicable laws, rules, and regulations with regard to the virtual currency

business.

- 11) Prohibits a licensee from appointing any person as an agent unless it has conducted a review of the proposed agent's fitness to act as an agent and has determined that the proposed agent and any persons who control the proposed agent are of good character and sound financial standing.
- 12) Requires a licensee to maintain records of this review for each agent while the agent is providing any virtual currency business on behalf of the licensee, and for three years after the relationship with the agent has terminated.
- 13) Prohibits a person, including an agent, from providing any virtual currency business on behalf of a person not licensed or not exempt from licensure under this division.
- 14) Specifies that a person that engages in that activity provides virtual currency business to the same extent as if the person was a licensee and shall be jointly and severally liable with the unlicensed or nonexempt person.
- 15) Allows the commissioner at any time and from time to time examine the business and any branch office, within or outside this state, of any licensee in order to ascertain whether that business is being conducted in a lawful manner and whether all virtual currency held or exchanged is properly accounted for.
- 16) Requires the directors, officers, and employees of any licensee being examined by the commissioner shall exhibit to the commissioner, on request, any or all of the licensee's accounts, books, correspondence, memoranda, papers, and other records and shall otherwise facilitate the examination so far as it may be in their power to do so.
- 17) Requires a licensee to file a report with the commissioner within five business days after the licensee has reason to know of any occurrence of the following events:
 - a) The filing of a petition by or against the licensee under the United States Bankruptcy Code (11 U.S.C. Secs. 101-110, incl.) for bankruptcy or reorganization;
 - b) The filing of a petition by or against the licensee for receivership, the commencement of any other judicial or administrative proceeding for its dissolution or reorganization, or the making of a general assignment for the benefit of its creditors;
 - c) The commencement of a proceeding to revoke or suspend its virtual currency business license in a state or country in which the licensee engages in such business or is licensed to engage in such business;
 - d) The cancellation or other impairment of the licensee's bond or trust account as required by subdivision (b) of Section 26008; or
 - e) A charge or conviction of the licensee or of an executive officer, manager, director, or person in control of the licensee for a felony.

- 18) Requires a licensee to maintain any records as required by the commissioner for determining its compliance with this division for at least three years.
- 19) Allows a licensee to surrender its license by filing with the commissioner the license and a report with any information as the commissioner requires. The voluntary surrender of the license shall become effective at the time and upon the conditions as the commissioner specifies by order.
- 20) Gives authority to the commissioner to prepare written decisions, opinion letters, and other formal written guidance to be issued to persons seeking clarification regarding the requirements of this division.
- 21) Requires the commissioner to make public on the commissioner's Internet Web site all written decisions, opinion letters, and other formal written guidance issued to persons seeking clarification regarding the requirements of this division. The commissioner may, at his or her discretion or upon request by an applicant or licensee, redact proprietary or other confidential information regarding an applicant or licensee from any decision, letter, or other written guidance issued in connection with an applicant or licensee.
- 22) Allows the commissioner to offer informal guidance to any prospective applicant for a license under this division, regarding the conditions of licensure that may be applied to that person. The commissioner shall inform any applicant that requests that guidance of the licensing requirements that will be required of that applicant, based on the information provided by the applicant concerning its plan to conduct business under this division, and the factors used to make that determination.
- 23) Gives the commissioner authority, if the commissioner deems it necessary for the general welfare of the public, to exercise any power set forth in this division with respect to a virtual currency business, regardless of whether an application for a license has been filed with the commissioner, a license has been issued, or, if issued, the license has been surrendered, suspended, or revoked.
- 24) States that if it appears to the commissioner that a licensee is violating or failing to comply with this division, the commissioner may direct the licensee to comply with the law by an order issued under the commissioner's official seal, or if it appears to the commissioner that any licensee is conducting its business in an unsafe or injurious manner, the commissioner may in like manner direct it to discontinue the unsafe or injurious practices. The order shall require the licensee to show cause before the commissioner, at a time and place to be fixed by the commissioner, as to why the order should not be observed.
- 25) Provides that if, upon any hearing the commissioner finds that the licensee is violating or failing to comply with any law of this state or is conducting its business in an unsafe or injurious manner, the commissioner may make a final order directing it to comply with the law or to discontinue the unsafe or injurious practices. A licensee shall comply with the final order unless, within 10 days after the issuance of the order, its enforcement is restrained in a proceeding brought by the licensee.
- 26) Allows the commissioner to issue an order suspending or revoking a license, or taking possession of and placing a licensee in receivership, if after notice and an opportunity for

hearing, the commissioner finds any of the following:

- a) The licensee does not cooperate with an examination or investigation by the commissioner;
- b) The licensee engages in fraud, intentional misrepresentation, or gross negligence;
- c) The competence, experience, character, or general fitness of the licensee, or any director, officer, employee, or person in control of a licensee, indicates that it is not in the public interest to permit the person to provide virtual currency services;
- d) The licensee engages in an unsafe or unsound practice;
- e) The licensee is insolvent, suspends payment of its obligations, or makes a general assignment for the benefit of its creditors;
- f) The licensee has applied for an adjudication of bankruptcy, reorganization, arrangement, or other relief under any bankruptcy, reorganization, insolvency, or moratorium law, or any person has applied for any such relief under that law against the licensee and the licensee has by any affirmative act approved of or consented to the action or the relief has been granted; or,
- g) Any fact or condition exists that, if it had existed at the time when the licensee applied for its license, would have been grounds for denying the application;

- 27) In determining whether a licensee is engaging in an unsafe or unsound practice, the commissioner may consider the size and condition of the licensee's provision of virtual currency services, the magnitude of the loss, the gravity of the violation, and the previous conduct of the person involved.
- 28) Allows the commissioner to assess a civil penalty against a person that violates this division or a regulation adopted or an order issued under this division in an amount not to exceed one thousand dollars (\$1,000) for each violation or, in the case of a continuing violation, one thousand dollars (\$1,000) for each day or part thereof during which the violation continues, plus this state's costs and expenses for the investigation and prosecution of the matter, including reasonable attorney's fees.
- 29) Specifies that a person that engages in unlicensed activity or intentionally makes a false statement, misrepresentation, or false certification in a record filed or required to be maintained under this division or that intentionally makes a false entry or omits a material entry in such a record is guilty of a felony.
- 30) Allows the commissioner, by order or regulation grant exemptions from this section in cases where the commissioner finds that the requirements of this section are not necessary or may be duplicative.
- 31) Requires a licensee, within 90 days after the end of each fiscal year, or within any extended time as the commissioner may prescribe, file with the commissioner an audit report for the

fiscal year.

- 32) Specifies that each licensee shall, not more than 45 days after the end of each calendar year quarter, or within a longer period as the commissioner may by regulation or order specify, file with the commissioner a report containing all of the following:
- a) Financial statements, including balance sheet, income statement, statement of changes in shareholders' equity, and statement of cashflows, for, or as of the end of, that calendar year quarter, verified by two of the licensee's principal officers. The verification shall state that each of the officers making the verification has a personal knowledge of the matters in the report and that each of them believes that each statement in the report is true; and,
 - b) Other information as the commissioner may by regulation or order require.
- 33) Allows the commissioner to levy an assessment each fiscal year, on a pro rata basis, on those licensees that at any time during the preceding calendar year engaged in this state in the virtual currency business in an amount that is, in his or her judgment, sufficient to meet the commissioner's expenses in administering the provisions of this division and to provide a reasonable reserve for contingencies.
- 34) Requires a licensee to disclose to consumers the following disclosure in a form and manner prescribed by the commissioner:

"Once submitted to the network, a virtual currency transaction will be unconfirmed for a period of time (usually less than one hour, but up to one day or more) pending sufficient confirmation of the transaction by the network. A transaction is not complete while it is in a pending state. Virtual currency associated with transactions that are in a pending state will be designated accordingly, and will not be included in your account balance or be available to conduct transactions.

The risk of loss in trading or holding virtual currency can be substantial. You should therefore carefully consider whether trading or holding virtual currency is suitable for you in light of your financial condition. In considering whether to trade or hold virtual currency, you should be aware that the price or value of virtual currency can change rapidly, decrease, and potentially even fall to zero.

(Insert company name) is licensed by the Department of Business Oversight to do business in California. If you have complaints with respect to any aspect of the virtual currency business conducted by (company name), you may contact the California Department of Business Oversight at its toll-free telephone number, 1-800-622-0620, by email at consumer.services@dbo.ca.gov, or by mail at the Department of Business Oversight, Consumer Services, 1515 K Street, Suite 200, Sacramento, CA 95814."

EXISTING LAW: Regulates the transmission of money under the money transmission act (Financial Code, Section 2000-2175)

FISCAL EFFECT: Unknown

COMMENTS:

The author has introduced this bill to ensure that entities that store virtual currency or offer the exchange of virtual currency with consumers are operated in a safe and sound manner. AB 1326 will protect consumers that utilize virtual currency services by ensuring that these businesses are able to protect consumer's virtual currency from potential loss. Additionally, this bill will provide regulatory certainty as many companies try to engage in the virtual currency business have sought out money transmission licenses only to be denied, or are even unsure if their business model fits into existing licensing structures for other financial services entities.

The New York State Department of Banking was the first regulatory agency to issue regulations concerning virtual currency. This launched nationwide efforts to look at whether the virtual currency business should be regulated. The Conference of State Banking Supervisors (CSBS) formed the CSBS Emerging Payments Task Force ("Task Force") to examine the intersection between state supervision and payments developments, and to identify areas for consistent regulatory approaches among states. This effort includes an assessment of virtual currency activities and outreach with a broad range of stakeholders. After engaging with industry participants, state and federal regulators, and other stakeholders, CSBS recommended that activities involving third party control of virtual currency, including for the purposes of transmitting, exchanging, holding, or otherwise controlling virtual currency, should be subject to state licensure and supervision.

Headlines concerning virtual currency have been dominated by Bitcoin with some of this attention resulting from negative publicity. The high profile *Silk Road* case in which federal law enforcement officials arrested the operator of an online illegal drug market place that facilitated the sale of drugs and other illegal goods through acceptance of Bitcoins. Bitcoins were used because it is a decentralized currency allowing users to be pseudonymous to some extent, even though every Bitcoin transaction is logged. Bitcoin is not the first, nor the only virtual currency. Numerous models of virtual currency have sprouted up over the last decade, and this growth has inspired additional questions by government officials and policy makers.

Bitcoin has received its share of negative attention from its wild price fluctuations, awareness against Bitcoin "Wallets" (as the individual software applications that manage bitcoin holdings) to being credited with being the currency of choice for criminal activity. As to the latter attribution, cash money is still the dominant and preferred source of anonymous payment for illegal activities. Some of the attention, specifically in relation to the risk associated with storing virtual currency has raised the attention of state regulators across the country.

Even though the core program that runs bitcoin has resisted six years of hacking attempts, the successful attacks on associated businesses have created the impression that bitcoin isn't a safe way to store money. Bitcoins exist purely as entries in an accounting system—a transparent public ledger known as the "blockchain" that records balances and transfers among special bitcoin "addresses." With bitcoin, the balances held by every user of the monetary system are instead recorded on a widely distributed, publicly displayed ledger that is kept up-to-date by thousands of independently owned, competing computers known as "miners."

What does a real world transaction look like such as buying a cup of coffee at your local coffee shop? If you pay with a credit card, the transaction seems simple enough: You swipe your card, you grab your cup, and you leave. The financial system is just getting started with you and the coffee shop. Before the store actually gets paid and your bank balance falls, more than a half-

dozen institutions—such as a billing processor, the card association your bank, the coffee shop’s bank, a payment processor, the clearinghouse network managed by the regional Federal Reserve Banks—will have shared part of your account information or otherwise intervened in the flow of money. If all goes well, your bank will confirm your identity and good credit and send payment to the coffee shop’s bank two or three days later. For this privilege, the coffee shop pays a fee of between 2% and 3%.

Now let’s pay in Bitcoin. If you don’t already have bitcoins, you will need to buy some from one of a host of online exchanges and brokerages, using a simple transfer from your regular bank account. You will then assign the bitcoins to a wallet, which functions like an online account. Once inside the coffee shop, you will open your wallet’s smartphone app and hold its QR code reader up to the coffee shop’s device. This allows your embedded secret password to unlock a bitcoin address and publicly informs the bitcoin computer network that you are transferring \$1.75 worth of bitcoin (currently about 0.0075 bitcoin) to the coffee shop’s address. This takes just seconds, and then you walk off with your coffee. Next, in contrast to the pay with credit/debit system, your transaction is immediately broadcast to the world (in alphanumeric data that can’t be traced to you personally). Your information is then gathered up by bitcoin “miners,” the computers that maintain the system and are compensated, roughly every 10 minutes, for their work confirming transactions. The computer that competes successfully to package the data from your coffee purchase adds that information to the blockchain ledger, which prompts all the other miners to investigate the underlying transaction. Once your bona fides are verified, the updated blockchain is considered legitimate, and the miners update their records accordingly. It takes from 10 minutes to an hour for this software-driven network of computers to formally confirm a transfer from your blockchain address to that of the coffee shop—compared with a two- to three-day wait for the settlement of a credit-card transaction. Some new digital currencies are able to finalize transactions within seconds. There are almost zero fees, and the personal information of users isn’t divulged. This bitcoin feature especially appeals to privacy advocates: Nobody learns where you buy coffee. The advantages of digital currency are far more visible in emerging markets. It allows migrant workers, for example, to bypass fees that often run to 10% or more for the international payment services that they use to send money home to their families. Although many companies now accept bitcoin (the latest and biggest being Microsoft Corp.), global usage of the digital currency averaged just \$50 million a day in 2014. Over that same period, Visa and MasterCard processed some \$32 billion a day. The market capitalization for BitCoin is almost at \$4 billion with virtual currency Ripple the next largest at over \$340 million.

FinCEN Guidance on Virtual Currencies

FinCEN issued interpretive guidance earlier this year to clarify how the Bank Secrecy Act (BSA) and FinCEN regulations apply to users, administrators and exchangers of virtual currencies. Under the regulatory framework, virtual currency is defined as having some but not all of the attributes of “real currency” and therefore, virtual currency does not have legal tender status in any jurisdiction. Specifically, the FinCEN guidance addresses convertible virtual currency which either has a real currency equivalent value or serves as a substitute for real currency.

The roles of persons (including legal entities) involved in virtual currency transactions are defined by FinCEN as follows:

- User: A person who obtains virtual currency to purchase goods or services
- Exchanger: A person engaged as a business in the exchange of virtual currency for real currency, funds or other virtual currency
- Administrator: A person engaged as a business in issuing into circulation a virtual currency and who has the authority to redeem and withdraw from circulation such virtual currency

A person, or legal entity, may act in more than one of these capacities. Further, it is important to note that “obtaining” virtual currency covers much more than the scenario of a “user” who merely purchases virtual currency. Depending on the model of the particular currency, a party could “obtain” virtual currency through various acts including earning, harvesting, mining, creating, auto-generating, manufacturing or purchasing.

The threshold issue is whether actions will subject a person or legal entity to BSA’s registration, reporting and recordkeeping regulations that apply to money services businesses (MSBs). A user who obtains convertible virtual currency and uses it to purchase real or virtual goods or services is not subject to MSB compliance because such activity does not meet the definition of “money transmission services” and the user would not be a “money transmitter.”

However, an administrator or exchanger engages in money transmission services and, as a result, is a “money transmitter” under FinCEN definitions by (1) accepting and transmitting convertible virtual currency or (2) buying or selling convertible virtual currency. As a money transmitter, the administrator or exchanger would generally be subject to MSB reporting and recordkeeping.

Further, the FinCEN guidance expressly addresses the category of de-centralized virtual currency – the Bitcoin model – and states that “a person is an exchanger and a money transmitter if the person accepts such de-centralized convertible virtual currency from one person and transmits it to another person as part of the acceptance and transfer of currency, funds, or other value that substitutes for currency.”

In the area of foreign exchange, accepting real currency in exchange for virtual currency is not subject to FinCEN regulations applicable to “dealers in foreign exchange” since a forex transaction involves exchanging the currency of two countries and virtual currency does not constitute legal tender as a currency of a country.

The author's office has been meeting with various stakeholders and will continue to work out the various details of this legislation as it moves forward. Some key issues that still need to be resolved:

- 1) Further strengthen and clarify definition of "virtual currency business."
- 2) Clarify the factors that will be used to determine capitalization requirements.
- 3) Specify clear bonding and security amounts and factors used to make that determination.
- 4) Examine issues relating to start-up companies.

Previous Legislation.

AB 129 (Dickinson), chapter 74, statutes of 2014 clarified California law to ensure that alternative currency, including virtual currency would not be potentially deemed illegal tender.

REGISTERED SUPPORT / OPPOSITION:

Support

None on file.

Opposition

None on file.

Analysis Prepared by: Mark Farouk / B. & F. / (916) 319-3081

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 - c) A state, city, county, city and county, or any other governmental agency or governmental subdivision of a state;
 - d) A commercial bank or industrial bank, the deposits of which are insured by the Federal Deposit Insurance Corporation (FDIC) or its successor, or any foreign (other nation) bank that is licensed under state law or that is authorized under federal law to maintain a federal agency or federal branch office in this state; a trust company licensed pursuant to

Section 1042 or a national association authorized under federal law to engage in a trust banking business; an association or federal association, as defined in Section 5102, the deposits of which are insured by the FDIC or its successor; and any federally or state chartered credit union, with an office in this state, the member accounts of which are insured or guaranteed as provided in Section 14858;

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 - b) The filing of a petition by or against the licensee for receivership, the commencement of any other judicial or administrative proceeding for its dissolution or reorganization, or the making of a general assignment for the benefit of its creditors;
 - c) The commencement of a proceeding to revoke or suspend its virtual currency business license in a state or country in which the licensee engages in such business or is licensed to engage in such business;
 - d) The cancellation or other impairment of the licensee's bond or trust account as required by subdivision (b) of Section 26008; or
 - e) A charge or conviction of the licensee or of an executive officer, manager, director, or person in control of the licensee for a felony.

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- 23) Gives the commissioner authority, if the commissioner deems it necessary for the general welfare of the public, to exercise any power set forth in this division with respect to a virtual currency business, regardless of whether an application for a license has been filed with the commissioner, a license has been issued, or, if issued, the license has been surrendered, suspended, or revoked.
- 24) States that if it appears to the commissioner that a licensee is violating or failing to comply with this division, the commissioner may direct the licensee to comply with the law by an order issued under the commissioner's official seal, or if it appears to the commissioner that any licensee is conducting its business in an unsafe or injurious manner, the commissioner may in like manner direct it to discontinue the unsafe or injurious practices. The order shall require the licensee to show cause before the commissioner, at a time and place to be fixed by the commissioner, as to why the order should not be observed.
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hearing, the commissioner finds any of the following:

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- b) The licensee engages in fraud, intentional misrepresentation, or gross negligence;
- c) The competence, experience, character, or general fitness of the licensee, or any director, officer, employee, or person in control of a licensee, indicates that it is not in the public interest to permit the person to provide virtual currency services;
- d) The licensee engages in an unsafe or unsound practice;
- e) The licensee is insolvent, suspends payment of its obligations, or makes a general assignment for the benefit of its creditors;
- f) The licensee has applied for an adjudication of bankruptcy, reorganization, arrangement, or other relief under any bankruptcy, reorganization, insolvency, or moratorium law, or any person has applied for any such relief under that law against the licensee and the licensee has by any affirmative act approved of or consented to the action or the relief has been granted; or,
- g) Any fact or condition exists that, if it had existed at the time when the licensee applied for its license, would have been grounds for denying the application;

- 27) In determining whether a licensee is engaging in an unsafe or unsound practice, the commissioner may consider the size and condition of the licensee's provision of virtual currency services, the magnitude of the loss, the gravity of the violation, and the previous conduct of the person involved.
- 28) Allows the commissioner to assess a civil penalty against a person that violates this division or a regulation adopted or an order issued under this division in an amount not to exceed one thousand dollars (\$1,000) for each violation or, in the case of a continuing violation, one thousand dollars (\$1,000) for each day or part thereof during which the violation continues, plus this state's costs and expenses for the investigation and prosecution of the matter, including reasonable attorney's fees.
- 29) Specifies that a person that engages in unlicensed activity or intentionally makes a false statement, misrepresentation, or false certification in a record filed or required to be maintained under this division or that intentionally makes a false entry or omits a material entry in such a record is guilty of a felony.
- 30) Allows the commissioner, by order or regulation grant exemptions from this section in cases where the commissioner finds that the requirements of this section are not necessary or may be duplicative.
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fiscal year.

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- a) Financial statements, including balance sheet, income statement, statement of changes in shareholders' equity, and statement of cashflows, for, or as of the end of, that calendar year quarter, verified by two of the licensee's principal officers. The verification shall state that each of the officers making the verification has a personal knowledge of the matters in the report and that each of them believes that each statement in the report is true; and,
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- 34) Requires a licensee to disclose to consumers the following disclosure in a form and manner prescribed by the commissioner:

"Once submitted to the network, a virtual currency transaction will be unconfirmed for a period of time (usually less than one hour, but up to one day or more) pending sufficient confirmation of the transaction by the network. A transaction is not complete while it is in a pending state. Virtual currency associated with transactions that are in a pending state will be designated accordingly, and will not be included in your account balance or be available to conduct transactions.

The risk of loss in trading or holding virtual currency can be substantial. You should therefore carefully consider whether trading or holding virtual currency is suitable for you in light of your financial condition. In considering whether to trade or hold virtual currency, you should be aware that the price or value of virtual currency can change rapidly, decrease, and potentially even fall to zero.

(Insert company name) is licensed by the Department of Business Oversight to do business in California. If you have complaints with respect to any aspect of the virtual currency business conducted by (company name), you may contact the California Department of Business Oversight at its toll-free telephone number, 1-800-622-0620, by email at consumer.services@dbo.ca.gov, or by mail at the Department of Business Oversight, Consumer Services, 1515 K Street, Suite 200, Sacramento, CA 95814."

EXISTING LAW: Regulates the transmission of money under the money transmission act (Financial Code, Section 2000-2175)

FISCAL EFFECT: Unknown

COMMENTS:

The author has introduced this bill to ensure that entities that store virtual currency or offer the exchange of virtual currency with consumers are operated in a safe and sound manner. AB 1326 will protect consumers that utilize virtual currency services by ensuring that these businesses are able to protect consumer's virtual currency from potential loss. Additionally, this bill will provide regulatory certainty as many companies try to engage in the virtual currency business have sought out money transmission licenses only to be denied, or are even unsure if their business model fits into existing licensing structures for other financial services entities.

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What does a real world transaction look like such as buying a cup of coffee at your local coffee shop? If you pay with a credit card, the transaction seems simple enough: You swipe your card, you grab your cup, and you leave. The financial system is just getting started with you and the coffee shop. Before the store actually gets paid and your bank balance falls, more than a half-

dozen institutions—such as a billing processor, the card association your bank, the coffee shop’s bank, a payment processor, the clearinghouse network managed by the regional Federal Reserve Banks—will have shared part of your account information or otherwise intervened in the flow of money. If all goes well, your bank will confirm your identity and good credit and send payment to the coffee shop’s bank two or three days later. For this privilege, the coffee shop pays a fee of between 2% and 3%.

Now let’s pay in Bitcoin. If you don’t already have bitcoins, you will need to buy some from one of a host of online exchanges and brokerages, using a simple transfer from your regular bank account. You will then assign the bitcoins to a wallet, which functions like an online account. Once inside the coffee shop, you will open your wallet’s smartphone app and hold its QR code reader up to the coffee shop’s device. This allows your embedded secret password to unlock a bitcoin address and publicly informs the bitcoin computer network that you are transferring \$1.75 worth of bitcoin (currently about 0.0075 bitcoin) to the coffee shop’s address. This takes just seconds, and then you walk off with your coffee. Next, in contrast to the pay with credit/debit system, your transaction is immediately broadcast to the world (in alphanumeric data that can’t be traced to you personally). Your information is then gathered up by bitcoin “miners,” the computers that maintain the system and are compensated, roughly every 10 minutes, for their work confirming transactions. The computer that competes successfully to package the data from your coffee purchase adds that information to the blockchain ledger, which prompts all the other miners to investigate the underlying transaction. Once your bona fides are verified, the updated blockchain is considered legitimate, and the miners update their records accordingly. It takes from 10 minutes to an hour for this software-driven network of computers to formally confirm a transfer from your blockchain address to that of the coffee shop—compared with a two- to three-day wait for the settlement of a credit-card transaction. Some new digital currencies are able to finalize transactions within seconds. There are almost zero fees, and the personal information of users isn’t divulged. This bitcoin feature especially appeals to privacy advocates: Nobody learns where you buy coffee. The advantages of digital currency are far more visible in emerging markets. It allows migrant workers, for example, to bypass fees that often run to 10% or more for the international payment services that they use to send money home to their families. Although many companies now accept bitcoin (the latest and biggest being Microsoft Corp.), global usage of the digital currency averaged just \$50 million a day in 2014. Over that same period, Visa and MasterCard processed some \$32 billion a day. The market capitalization for BitCoin is almost at \$4 billion with virtual currency Ripple the next largest at over \$340 million.

FinCEN Guidance on Virtual Currencies

FinCEN issued interpretive guidance earlier this year to clarify how the Bank Secrecy Act (BSA) and FinCEN regulations apply to users, administrators and exchangers of virtual currencies. Under the regulatory framework, virtual currency is defined as having some but not all of the attributes of “real currency” and therefore, virtual currency does not have legal tender status in any jurisdiction. Specifically, the FinCEN guidance addresses convertible virtual currency which either has a real currency equivalent value or serves as a substitute for real currency.

The roles of persons (including legal entities) involved in virtual currency transactions are defined by FinCEN as follows:

- User: A person who obtains virtual currency to purchase goods or services
- Exchanger: A person engaged as a business in the exchange of virtual currency for real currency, funds or other virtual currency
- Administrator: A person engaged as a business in issuing into circulation a virtual currency and who has the authority to redeem and withdraw from circulation such virtual currency

A person, or legal entity, may act in more than one of these capacities. Further, it is important to note that “obtaining” virtual currency covers much more than the scenario of a “user” who merely purchases virtual currency. Depending on the model of the particular currency, a party could “obtain” virtual currency through various acts including earning, harvesting, mining, creating, auto-generating, manufacturing or purchasing.

The threshold issue is whether actions will subject a person or legal entity to BSA’s registration, reporting and recordkeeping regulations that apply to money services businesses (MSBs). A user who obtains convertible virtual currency and uses it to purchase real or virtual goods or services is not subject to MSB compliance because such activity does not meet the definition of “money transmission services” and the user would not be a “money transmitter.”

However, an administrator or exchanger engages in money transmission services and, as a result, is a “money transmitter” under FinCEN definitions by (1) accepting and transmitting convertible virtual currency or (2) buying or selling convertible virtual currency. As a money transmitter, the administrator or exchanger would generally be subject to MSB reporting and recordkeeping.

Further, the FinCEN guidance expressly addresses the category of de-centralized virtual currency – the Bitcoin model – and states that “a person is an exchanger and a money transmitter if the person accepts such de-centralized convertible virtual currency from one person and transmits it to another person as part of the acceptance and transfer of currency, funds, or other value that substitutes for currency.”

In the area of foreign exchange, accepting real currency in exchange for virtual currency is not subject to FinCEN regulations applicable to “dealers in foreign exchange” since a forex transaction involves exchanging the currency of two countries and virtual currency does not constitute legal tender as a currency of a country.

The author's office has been meeting with various stakeholders and will continue to work out the various details of this legislation as it moves forward. Some key issues that still need to be resolved:

- 1) Further strengthen and clarify definition of "virtual currency business."
- 2) Clarify the factors that will be used to determine capitalization requirements.
- 3) Specify clear bonding and security amounts and factors used to make that determination.
- 4) Examine issues relating to start-up companies.

Previous Legislation.

AB 129 (Dickinson), chapter 74, statutes of 2014 clarified California law to ensure that alternative currency, including virtual currency would not be potentially deemed illegal tender.

REGISTERED SUPPORT / OPPOSITION:

Support

None on file.

Opposition

None on file.

Analysis Prepared by: Mark Farouk / B. & F. / (916) 319-3081

Date of Hearing: April 27, 2015

ASSEMBLY COMMITTEE ON BANKING AND FINANCE

Matthew Dababneh, Chair

AB 1326 (Dababneh) – As Amended April 20, 2015

SUBJECT: Virtual currency

SUMMARY: Requires the licensing of entities engaged in the business of virtual currency by the Department of Business Oversight (DBO). Specifically, **this bill:**

- 1) Defines “virtual currency” as any type of digital unit that is used as a medium of exchange or a form of digitally stored value or that is incorporated into payment system technology. Virtual currency shall be broadly construed to include digital units of exchange that (1) have a centralized repository or administrator, (2) are decentralized and have no centralized repository or administrator, or (3) may be created or obtained by computing or manufacturing effort. Virtual currency shall not be construed to include digital units that are used solely within online gaming platforms with no market or application outside of those gaming platforms, nor shall virtual currency be construed to include digital units that are used exclusively as part of a customer affinity or rewards program, and can be applied solely as payment redeemed for goods, services, or for purchases with the issuer or other designated merchants, but cannot be converted into, or redeemed for, fiat currency.
- 2) Defines “virtual currency business” as the conduct of either of the following types of activities involving a California resident:
 - a) Storing, holding, or maintaining custody or control of virtual currency on behalf of others; or
 - b) Providing conversion or exchange services of fiat currency into virtual currency or the conversion or exchange of virtual currency into fiat currency or other value, or the conversion or exchange of one form of virtual currency into another form of virtual currency.
- 3) Provides for the following exemptions:
 - a) The United States or a department, agency, or instrumentality thereof, including any federal reserve bank and any federal home loan bank;
 - b) Money transmission by the United States Postal Service or by a contractor on behalf of the United States Postal Service;
 - c) A state, city, county, city and county, or any other governmental agency or governmental subdivision of a state;
 - d) A commercial bank or industrial bank, the deposits of which are insured by the Federal Deposit Insurance Corporation (FDIC) or its successor, or any foreign (other nation) bank that is licensed under state law or that is authorized under federal law to maintain a federal agency or federal branch office in this state; a trust company licensed pursuant to

Section 1042 or a national association authorized under federal law to engage in a trust banking business; an association or federal association, as defined in Section 5102, the deposits of which are insured by the FDIC or its successor; and any federally or state chartered credit union, with an office in this state, the member accounts of which are insured or guaranteed as provided in Section 14858;

- e) An entity licensed as a money transmitter under the Money Transmission Act;
 - f) A merchant or consumer that utilizes virtual currency solely for the purchase or sale of goods or services; or
 - g) A transaction in which the recipient of virtual currency is an agent of the payee pursuant to a preexisting written contract and delivery of the virtual currency to the agent satisfies the payor's obligation to the payee. "Agent" has the same meaning as that term as defined in Section 2295 of the Civil Code. "Payee" means the provider of goods or services, who is owed payment of money or other monetary value from the payor for the goods or services. "Payor" means the recipient of goods or services, who owes payment of money or monetary value to the payee for the goods or services.
- 4) Requires an applicant for a license to pay the commissioner of DBO (commissioner) a nonrefundable application fee of five thousand dollars (\$5,000).
 - 5) Provides that an applicant for a license shall do so in a form and in a medium prescribed by the commissioner by order or regulation.
 - 6) Allows for the following licensing fees:
 - a) A nonrefundable application fee for filing an application for licensure and approval to acquire control of a licensee is three thousand five hundred dollars (\$3,500);
 - b) A license renewal fee of two thousand five hundred dollars (\$2,500); and
 - c) A licensee shall pay annually on or before July 1, one hundred twenty-five dollars (\$125) for each licensee branch office in this state.
 - 7) Requires that each licensee shall maintain at all times such capital as the commissioner determines is sufficient to ensure the safety and soundness of the licensee and maintain consumer protection and its ongoing operations.
 - 8) Specifies that a licensee shall not appoint or continue any person as agent, unless the licensee and the person have made a written contract that requires the agent to operate in full compliance with this division.
 - 9) Provides that an agent shall not provide any virtual currency business outside the scope of activity permissible under the written contract between the agent and the licensee.
 - 10) Requires each licensee to exercise reasonable supervision over its agents to ensure compliance with applicable laws, rules, and regulations with regard to the virtual currency

business.

- 11) Prohibits a licensee from appointing any person as an agent unless it has conducted a review of the proposed agent's fitness to act as an agent and has determined that the proposed agent and any persons who control the proposed agent are of good character and sound financial standing.
- 12) Requires a licensee to maintain records of this review for each agent while the agent is providing any virtual currency business on behalf of the licensee, and for three years after the relationship with the agent has terminated.
- 13) Prohibits a person, including an agent, from providing any virtual currency business on behalf of a person not licensed or not exempt from licensure under this division.
- 14) Specifies that a person that engages in that activity provides virtual currency business to the same extent as if the person was a licensee and shall be jointly and severally liable with the unlicensed or nonexempt person.
- 15) Allows the commissioner at any time and from time to time examine the business and any branch office, within or outside this state, of any licensee in order to ascertain whether that business is being conducted in a lawful manner and whether all virtual currency held or exchanged is properly accounted for.
- 16) Requires the directors, officers, and employees of any licensee being examined by the commissioner shall exhibit to the commissioner, on request, any or all of the licensee's accounts, books, correspondence, memoranda, papers, and other records and shall otherwise facilitate the examination so far as it may be in their power to do so.
- 17) Requires a licensee to file a report with the commissioner within five business days after the licensee has reason to know of any occurrence of the following events:
 - a) The filing of a petition by or against the licensee under the United States Bankruptcy Code (11 U.S.C. Secs. 101-110, incl.) for bankruptcy or reorganization;
 - b) The filing of a petition by or against the licensee for receivership, the commencement of any other judicial or administrative proceeding for its dissolution or reorganization, or the making of a general assignment for the benefit of its creditors;
 - c) The commencement of a proceeding to revoke or suspend its virtual currency business license in a state or country in which the licensee engages in such business or is licensed to engage in such business;
 - d) The cancellation or other impairment of the licensee's bond or trust account as required by subdivision (b) of Section 26008; or
 - e) A charge or conviction of the licensee or of an executive officer, manager, director, or person in control of the licensee for a felony.

- 18) Requires a licensee to maintain any records as required by the commissioner for determining its compliance with this division for at least three years.
- 19) Allows a licensee to surrender its license by filing with the commissioner the license and a report with any information as the commissioner requires. The voluntary surrender of the license shall become effective at the time and upon the conditions as the commissioner specifies by order.
- 20) Gives authority to the commissioner to prepare written decisions, opinion letters, and other formal written guidance to be issued to persons seeking clarification regarding the requirements of this division.
- 21) Requires the commissioner to make public on the commissioner's Internet Web site all written decisions, opinion letters, and other formal written guidance issued to persons seeking clarification regarding the requirements of this division. The commissioner may, at his or her discretion or upon request by an applicant or licensee, redact proprietary or other confidential information regarding an applicant or licensee from any decision, letter, or other written guidance issued in connection with an applicant or licensee.
- 22) Allows the commissioner to offer informal guidance to any prospective applicant for a license under this division, regarding the conditions of licensure that may be applied to that person. The commissioner shall inform any applicant that requests that guidance of the licensing requirements that will be required of that applicant, based on the information provided by the applicant concerning its plan to conduct business under this division, and the factors used to make that determination.
- 23) Gives the commissioner authority, if the commissioner deems it necessary for the general welfare of the public, to exercise any power set forth in this division with respect to a virtual currency business, regardless of whether an application for a license has been filed with the commissioner, a license has been issued, or, if issued, the license has been surrendered, suspended, or revoked.
- 24) States that if it appears to the commissioner that a licensee is violating or failing to comply with this division, the commissioner may direct the licensee to comply with the law by an order issued under the commissioner's official seal, or if it appears to the commissioner that any licensee is conducting its business in an unsafe or injurious manner, the commissioner may in like manner direct it to discontinue the unsafe or injurious practices. The order shall require the licensee to show cause before the commissioner, at a time and place to be fixed by the commissioner, as to why the order should not be observed.
- 25) Provides that if, upon any hearing the commissioner finds that the licensee is violating or failing to comply with any law of this state or is conducting its business in an unsafe or injurious manner, the commissioner may make a final order directing it to comply with the law or to discontinue the unsafe or injurious practices. A licensee shall comply with the final order unless, within 10 days after the issuance of the order, its enforcement is restrained in a proceeding brought by the licensee.
- 26) Allows the commissioner to issue an order suspending or revoking a license, or taking possession of and placing a licensee in receivership, if after notice and an opportunity for

hearing, the commissioner finds any of the following:

- a) The licensee does not cooperate with an examination or investigation by the commissioner;
- b) The licensee engages in fraud, intentional misrepresentation, or gross negligence;
- c) The competence, experience, character, or general fitness of the licensee, or any director, officer, employee, or person in control of a licensee, indicates that it is not in the public interest to permit the person to provide virtual currency services;
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Now let’s pay in Bitcoin. If you don’t already have bitcoins, you will need to buy some from one of a host of online exchanges and brokerages, using a simple transfer from your regular bank account. You will then assign the bitcoins to a wallet, which functions like an online account. Once inside the coffee shop, you will open your wallet’s smartphone app and hold its QR code reader up to the coffee shop’s device. This allows your embedded secret password to unlock a bitcoin address and publicly informs the bitcoin computer network that you are transferring \$1.75 worth of bitcoin (currently about 0.0075 bitcoin) to the coffee shop’s address. This takes just seconds, and then you walk off with your coffee. Next, in contrast to the pay with credit/debit system, your transaction is immediately broadcast to the world (in alphanumeric data that can’t be traced to you personally). Your information is then gathered up by bitcoin “miners,” the computers that maintain the system and are compensated, roughly every 10 minutes, for their work confirming transactions. The computer that competes successfully to package the data from your coffee purchase adds that information to the blockchain ledger, which prompts all the other miners to investigate the underlying transaction. Once your bona fides are verified, the updated blockchain is considered legitimate, and the miners update their records accordingly. It takes from 10 minutes to an hour for this software-driven network of computers to formally confirm a transfer from your blockchain address to that of the coffee shop—compared with a two- to three-day wait for the settlement of a credit-card transaction. Some new digital currencies are able to finalize transactions within seconds. There are almost zero fees, and the personal information of users isn’t divulged. This bitcoin feature especially appeals to privacy advocates: Nobody learns where you buy coffee. The advantages of digital currency are far more visible in emerging markets. It allows migrant workers, for example, to bypass fees that often run to 10% or more for the international payment services that they use to send money home to their families. Although many companies now accept bitcoin (the latest and biggest being Microsoft Corp.), global usage of the digital currency averaged just \$50 million a day in 2014. Over that same period, Visa and MasterCard processed some \$32 billion a day. The market capitalization for BitCoin is almost at \$4 billion with virtual currency Ripple the next largest at over \$340 million.

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FinCEN issued interpretive guidance earlier this year to clarify how the Bank Secrecy Act (BSA) and FinCEN regulations apply to users, administrators and exchangers of virtual currencies. Under the regulatory framework, virtual currency is defined as having some but not all of the attributes of “real currency” and therefore, virtual currency does not have legal tender status in any jurisdiction. Specifically, the FinCEN guidance addresses convertible virtual currency which either has a real currency equivalent value or serves as a substitute for real currency.

The roles of persons (including legal entities) involved in virtual currency transactions are defined by FinCEN as follows:

- User: A person who obtains virtual currency to purchase goods or services
- Exchanger: A person engaged as a business in the exchange of virtual currency for real currency, funds or other virtual currency
- Administrator: A person engaged as a business in issuing into circulation a virtual currency and who has the authority to redeem and withdraw from circulation such virtual currency

A person, or legal entity, may act in more than one of these capacities. Further, it is important to note that “obtaining” virtual currency covers much more than the scenario of a “user” who merely purchases virtual currency. Depending on the model of the particular currency, a party could “obtain” virtual currency through various acts including earning, harvesting, mining, creating, auto-generating, manufacturing or purchasing.

The threshold issue is whether actions will subject a person or legal entity to BSA’s registration, reporting and recordkeeping regulations that apply to money services businesses (MSBs). A user who obtains convertible virtual currency and uses it to purchase real or virtual goods or services is not subject to MSB compliance because such activity does not meet the definition of “money transmission services” and the user would not be a “money transmitter.”

However, an administrator or exchanger engages in money transmission services and, as a result, is a “money transmitter” under FinCEN definitions by (1) accepting and transmitting convertible virtual currency or (2) buying or selling convertible virtual currency. As a money transmitter, the administrator or exchanger would generally be subject to MSB reporting and recordkeeping.

Further, the FinCEN guidance expressly addresses the category of de-centralized virtual currency – the Bitcoin model – and states that “a person is an exchanger and a money transmitter if the person accepts such de-centralized convertible virtual currency from one person and transmits it to another person as part of the acceptance and transfer of currency, funds, or other value that substitutes for currency.”

In the area of foreign exchange, accepting real currency in exchange for virtual currency is not subject to FinCEN regulations applicable to “dealers in foreign exchange” since a forex transaction involves exchanging the currency of two countries and virtual currency does not constitute legal tender as a currency of a country.

The author's office has been meeting with various stakeholders and will continue to work out the various details of this legislation as it moves forward. Some key issues that still need to be resolved:

- 1) Further strengthen and clarify definition of "virtual currency business."
- 2) Clarify the factors that will be used to determine capitalization requirements.
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- 4) Examine issues relating to start-up companies.

Previous Legislation.

AB 129 (Dickinson), chapter 74, statutes of 2014 clarified California law to ensure that alternative currency, including virtual currency would not be potentially deemed illegal tender.

REGISTERED SUPPORT / OPPOSITION:

Support

None on file.

Opposition

None on file.

Analysis Prepared by: Mark Farouk / B. & F. / (916) 319-3081

Date of Hearing: April 27, 2015

ASSEMBLY COMMITTEE ON BANKING AND FINANCE

Matthew Dababneh, Chair

AB 1326 (Dababneh) – As Amended April 20, 2015

SUBJECT: Virtual currency

SUMMARY: Requires the licensing of entities engaged in the business of virtual currency by the Department of Business Oversight (DBO). Specifically, **this bill:**

- 1) Defines “virtual currency” as any type of digital unit that is used as a medium of exchange or a form of digitally stored value or that is incorporated into payment system technology. Virtual currency shall be broadly construed to include digital units of exchange that (1) have a centralized repository or administrator, (2) are decentralized and have no centralized repository or administrator, or (3) may be created or obtained by computing or manufacturing effort. Virtual currency shall not be construed to include digital units that are used solely within online gaming platforms with no market or application outside of those gaming platforms, nor shall virtual currency be construed to include digital units that are used exclusively as part of a customer affinity or rewards program, and can be applied solely as payment redeemed for goods, services, or for purchases with the issuer or other designated merchants, but cannot be converted into, or redeemed for, fiat currency.
- 2) Defines “virtual currency business” as the conduct of either of the following types of activities involving a California resident:
 - a) Storing, holding, or maintaining custody or control of virtual currency on behalf of others; or
 - b) Providing conversion or exchange services of fiat currency into virtual currency or the conversion or exchange of virtual currency into fiat currency or other value, or the conversion or exchange of one form of virtual currency into another form of virtual currency.
- 3) Provides for the following exemptions:
 - a) The United States or a department, agency, or instrumentality thereof, including any federal reserve bank and any federal home loan bank;
 - b) Money transmission by the United States Postal Service or by a contractor on behalf of the United States Postal Service;
 - c) A state, city, county, city and county, or any other governmental agency or governmental subdivision of a state;
 - d) A commercial bank or industrial bank, the deposits of which are insured by the Federal Deposit Insurance Corporation (FDIC) or its successor, or any foreign (other nation) bank that is licensed under state law or that is authorized under federal law to maintain a federal agency or federal branch office in this state; a trust company licensed pursuant to

Section 1042 or a national association authorized under federal law to engage in a trust banking business; an association or federal association, as defined in Section 5102, the deposits of which are insured by the FDIC or its successor; and any federally or state chartered credit union, with an office in this state, the member accounts of which are insured or guaranteed as provided in Section 14858;

- e) An entity licensed as a money transmitter under the Money Transmission Act;
 - f) A merchant or consumer that utilizes virtual currency solely for the purchase or sale of goods or services; or
 - g) A transaction in which the recipient of virtual currency is an agent of the payee pursuant to a preexisting written contract and delivery of the virtual currency to the agent satisfies the payor's obligation to the payee. "Agent" has the same meaning as that term as defined in Section 2295 of the Civil Code. "Payee" means the provider of goods or services, who is owed payment of money or other monetary value from the payor for the goods or services. "Payor" means the recipient of goods or services, who owes payment of money or monetary value to the payee for the goods or services.
- 4) Requires an applicant for a license to pay the commissioner of DBO (commissioner) a nonrefundable application fee of five thousand dollars (\$5,000).
 - 5) Provides that an applicant for a license shall do so in a form and in a medium prescribed by the commissioner by order or regulation.
 - 6) Allows for the following licensing fees:
 - a) A nonrefundable application fee for filing an application for licensure and approval to acquire control of a licensee is three thousand five hundred dollars (\$3,500);
 - b) A license renewal fee of two thousand five hundred dollars (\$2,500); and
 - c) A licensee shall pay annually on or before July 1, one hundred twenty-five dollars (\$125) for each licensee branch office in this state.
 - 7) Requires that each licensee shall maintain at all times such capital as the commissioner determines is sufficient to ensure the safety and soundness of the licensee and maintain consumer protection and its ongoing operations.
 - 8) Specifies that a licensee shall not appoint or continue any person as agent, unless the licensee and the person have made a written contract that requires the agent to operate in full compliance with this division.
 - 9) Provides that an agent shall not provide any virtual currency business outside the scope of activity permissible under the written contract between the agent and the licensee.
 - 10) Requires each licensee to exercise reasonable supervision over its agents to ensure compliance with applicable laws, rules, and regulations with regard to the virtual currency

business.

- 11) Prohibits a licensee from appointing any person as an agent unless it has conducted a review of the proposed agent's fitness to act as an agent and has determined that the proposed agent and any persons who control the proposed agent are of good character and sound financial standing.
- 12) Requires a licensee to maintain records of this review for each agent while the agent is providing any virtual currency business on behalf of the licensee, and for three years after the relationship with the agent has terminated.
- 13) Prohibits a person, including an agent, from providing any virtual currency business on behalf of a person not licensed or not exempt from licensure under this division.
- 14) Specifies that a person that engages in that activity provides virtual currency business to the same extent as if the person was a licensee and shall be jointly and severally liable with the unlicensed or nonexempt person.
- 15) Allows the commissioner at any time and from time to time examine the business and any branch office, within or outside this state, of any licensee in order to ascertain whether that business is being conducted in a lawful manner and whether all virtual currency held or exchanged is properly accounted for.
- 16) Requires the directors, officers, and employees of any licensee being examined by the commissioner shall exhibit to the commissioner, on request, any or all of the licensee's accounts, books, correspondence, memoranda, papers, and other records and shall otherwise facilitate the examination so far as it may be in their power to do so.
- 17) Requires a licensee to file a report with the commissioner within five business days after the licensee has reason to know of any occurrence of the following events:
 - a) The filing of a petition by or against the licensee under the United States Bankruptcy Code (11 U.S.C. Secs. 101-110, incl.) for bankruptcy or reorganization;
 - b) The filing of a petition by or against the licensee for receivership, the commencement of any other judicial or administrative proceeding for its dissolution or reorganization, or the making of a general assignment for the benefit of its creditors;
 - c) The commencement of a proceeding to revoke or suspend its virtual currency business license in a state or country in which the licensee engages in such business or is licensed to engage in such business;
 - d) The cancellation or other impairment of the licensee's bond or trust account as required by subdivision (b) of Section 26008; or
 - e) A charge or conviction of the licensee or of an executive officer, manager, director, or person in control of the licensee for a felony.

- 18) Requires a licensee to maintain any records as required by the commissioner for determining its compliance with this division for at least three years.
- 19) Allows a licensee to surrender its license by filing with the commissioner the license and a report with any information as the commissioner requires. The voluntary surrender of the license shall become effective at the time and upon the conditions as the commissioner specifies by order.
- 20) Gives authority to the commissioner to prepare written decisions, opinion letters, and other formal written guidance to be issued to persons seeking clarification regarding the requirements of this division.
- 21) Requires the commissioner to make public on the commissioner's Internet Web site all written decisions, opinion letters, and other formal written guidance issued to persons seeking clarification regarding the requirements of this division. The commissioner may, at his or her discretion or upon request by an applicant or licensee, redact proprietary or other confidential information regarding an applicant or licensee from any decision, letter, or other written guidance issued in connection with an applicant or licensee.
- 22) Allows the commissioner to offer informal guidance to any prospective applicant for a license under this division, regarding the conditions of licensure that may be applied to that person. The commissioner shall inform any applicant that requests that guidance of the licensing requirements that will be required of that applicant, based on the information provided by the applicant concerning its plan to conduct business under this division, and the factors used to make that determination.
- 23) Gives the commissioner authority, if the commissioner deems it necessary for the general welfare of the public, to exercise any power set forth in this division with respect to a virtual currency business, regardless of whether an application for a license has been filed with the commissioner, a license has been issued, or, if issued, the license has been surrendered, suspended, or revoked.
- 24) States that if it appears to the commissioner that a licensee is violating or failing to comply with this division, the commissioner may direct the licensee to comply with the law by an order issued under the commissioner's official seal, or if it appears to the commissioner that any licensee is conducting its business in an unsafe or injurious manner, the commissioner may in like manner direct it to discontinue the unsafe or injurious practices. The order shall require the licensee to show cause before the commissioner, at a time and place to be fixed by the commissioner, as to why the order should not be observed.
- 25) Provides that if, upon any hearing the commissioner finds that the licensee is violating or failing to comply with any law of this state or is conducting its business in an unsafe or injurious manner, the commissioner may make a final order directing it to comply with the law or to discontinue the unsafe or injurious practices. A licensee shall comply with the final order unless, within 10 days after the issuance of the order, its enforcement is restrained in a proceeding brought by the licensee.
- 26) Allows the commissioner to issue an order suspending or revoking a license, or taking possession of and placing a licensee in receivership, if after notice and an opportunity for

hearing, the commissioner finds any of the following:

- a) The licensee does not cooperate with an examination or investigation by the commissioner;
- b) The licensee engages in fraud, intentional misrepresentation, or gross negligence;
- c) The competence, experience, character, or general fitness of the licensee, or any director, officer, employee, or person in control of a licensee, indicates that it is not in the public interest to permit the person to provide virtual currency services;
- d) The licensee engages in an unsafe or unsound practice;
- e) The licensee is insolvent, suspends payment of its obligations, or makes a general assignment for the benefit of its creditors;
- f) The licensee has applied for an adjudication of bankruptcy, reorganization, arrangement, or other relief under any bankruptcy, reorganization, insolvency, or moratorium law, or any person has applied for any such relief under that law against the licensee and the licensee has by any affirmative act approved of or consented to the action or the relief has been granted; or,
- g) Any fact or condition exists that, if it had existed at the time when the licensee applied for its license, would have been grounds for denying the application;

- 27) In determining whether a licensee is engaging in an unsafe or unsound practice, the commissioner may consider the size and condition of the licensee's provision of virtual currency services, the magnitude of the loss, the gravity of the violation, and the previous conduct of the person involved.
- 28) Allows the commissioner to assess a civil penalty against a person that violates this division or a regulation adopted or an order issued under this division in an amount not to exceed one thousand dollars (\$1,000) for each violation or, in the case of a continuing violation, one thousand dollars (\$1,000) for each day or part thereof during which the violation continues, plus this state's costs and expenses for the investigation and prosecution of the matter, including reasonable attorney's fees.
- 29) Specifies that a person that engages in unlicensed activity or intentionally makes a false statement, misrepresentation, or false certification in a record filed or required to be maintained under this division or that intentionally makes a false entry or omits a material entry in such a record is guilty of a felony.
- 30) Allows the commissioner, by order or regulation grant exemptions from this section in cases where the commissioner finds that the requirements of this section are not necessary or may be duplicative.
- 31) Requires a licensee, within 90 days after the end of each fiscal year, or within any extended time as the commissioner may prescribe, file with the commissioner an audit report for the

fiscal year.

- 32) Specifies that each licensee shall, not more than 45 days after the end of each calendar year quarter, or within a longer period as the commissioner may by regulation or order specify, file with the commissioner a report containing all of the following:
- a) Financial statements, including balance sheet, income statement, statement of changes in shareholders' equity, and statement of cashflows, for, or as of the end of, that calendar year quarter, verified by two of the licensee's principal officers. The verification shall state that each of the officers making the verification has a personal knowledge of the matters in the report and that each of them believes that each statement in the report is true; and,
 - b) Other information as the commissioner may by regulation or order require.
- 33) Allows the commissioner to levy an assessment each fiscal year, on a pro rata basis, on those licensees that at any time during the preceding calendar year engaged in this state in the virtual currency business in an amount that is, in his or her judgment, sufficient to meet the commissioner's expenses in administering the provisions of this division and to provide a reasonable reserve for contingencies.
- 34) Requires a licensee to disclose to consumers the following disclosure in a form and manner prescribed by the commissioner:

"Once submitted to the network, a virtual currency transaction will be unconfirmed for a period of time (usually less than one hour, but up to one day or more) pending sufficient confirmation of the transaction by the network. A transaction is not complete while it is in a pending state. Virtual currency associated with transactions that are in a pending state will be designated accordingly, and will not be included in your account balance or be available to conduct transactions.

The risk of loss in trading or holding virtual currency can be substantial. You should therefore carefully consider whether trading or holding virtual currency is suitable for you in light of your financial condition. In considering whether to trade or hold virtual currency, you should be aware that the price or value of virtual currency can change rapidly, decrease, and potentially even fall to zero.

(Insert company name) is licensed by the Department of Business Oversight to do business in California. If you have complaints with respect to any aspect of the virtual currency business conducted by (company name), you may contact the California Department of Business Oversight at its toll-free telephone number, 1-800-622-0620, by email at consumer.services@dbo.ca.gov, or by mail at the Department of Business Oversight, Consumer Services, 1515 K Street, Suite 200, Sacramento, CA 95814."

EXISTING LAW: Regulates the transmission of money under the money transmission act (Financial Code, Section 2000-2175)

FISCAL EFFECT: Unknown

COMMENTS:

The author has introduced this bill to ensure that entities that store virtual currency or offer the exchange of virtual currency with consumers are operated in a safe and sound manner. AB 1326 will protect consumers that utilize virtual currency services by ensuring that these businesses are able to protect consumer's virtual currency from potential loss. Additionally, this bill will provide regulatory certainty as many companies try to engage in the virtual currency business have sought out money transmission licenses only to be denied, or are even unsure if their business model fits into existing licensing structures for other financial services entities.

The New York State Department of Banking was the first regulatory agency to issue regulations concerning virtual currency. This launched nationwide efforts to look at whether the virtual currency business should be regulated. The Conference of State Banking Supervisors (CSBS) formed the CSBS Emerging Payments Task Force ("Task Force") to examine the intersection between state supervision and payments developments, and to identify areas for consistent regulatory approaches among states. This effort includes an assessment of virtual currency activities and outreach with a broad range of stakeholders. After engaging with industry participants, state and federal regulators, and other stakeholders, CSBS recommended that activities involving third party control of virtual currency, including for the purposes of transmitting, exchanging, holding, or otherwise controlling virtual currency, should be subject to state licensure and supervision.

Headlines concerning virtual currency have been dominated by Bitcoin with some of this attention resulting from negative publicity. The high profile *Silk Road* case in which federal law enforcement officials arrested the operator of an online illegal drug market place that facilitated the sale of drugs and other illegal goods through acceptance of Bitcoins. Bitcoins were used because it is a decentralized currency allowing users to be pseudonymous to some extent, even though every Bitcoin transaction is logged. Bitcoin is not the first, nor the only virtual currency. Numerous models of virtual currency have sprouted up over the last decade, and this growth has inspired additional questions by government officials and policy makers.

Bitcoin has received its share of negative attention from its wild price fluctuations, awareness against Bitcoin "Wallets" (as the individual software applications that manage bitcoin holdings) to being credited with being the currency of choice for criminal activity. As to the latter attribution, cash money is still the dominant and preferred source of anonymous payment for illegal activities. Some of the attention, specifically in relation to the risk associated with storing virtual currency has raised the attention of state regulators across the country.

Even though the core program that runs bitcoin has resisted six years of hacking attempts, the successful attacks on associated businesses have created the impression that bitcoin isn't a safe way to store money. Bitcoins exist purely as entries in an accounting system—a transparent public ledger known as the "blockchain" that records balances and transfers among special bitcoin "addresses." With bitcoin, the balances held by every user of the monetary system are instead recorded on a widely distributed, publicly displayed ledger that is kept up-to-date by thousands of independently owned, competing computers known as "miners."

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REGISTERED SUPPORT / OPPOSITION:

Support

None on file.

Opposition

None on file.

Analysis Prepared by: Mark Farouk / B. & F. / (916) 319-3081

Date of Hearing: April 27, 2015

ASSEMBLY COMMITTEE ON BANKING AND FINANCE

Matthew Dababneh, Chair

AB 1326 (Dababneh) – As Amended April 20, 2015

SUBJECT: Virtual currency

SUMMARY: Requires the licensing of entities engaged in the business of virtual currency by the Department of Business Oversight (DBO). Specifically, **this bill:**

- 1) Defines “virtual currency” as any type of digital unit that is used as a medium of exchange or a form of digitally stored value or that is incorporated into payment system technology. Virtual currency shall be broadly construed to include digital units of exchange that (1) have a centralized repository or administrator, (2) are decentralized and have no centralized repository or administrator, or (3) may be created or obtained by computing or manufacturing effort. Virtual currency shall not be construed to include digital units that are used solely within online gaming platforms with no market or application outside of those gaming platforms, nor shall virtual currency be construed to include digital units that are used exclusively as part of a customer affinity or rewards program, and can be applied solely as payment redeemed for goods, services, or for purchases with the issuer or other designated merchants, but cannot be converted into, or redeemed for, fiat currency.
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 - a) The United States or a department, agency, or instrumentality thereof, including any federal reserve bank and any federal home loan bank;
 - b) Money transmission by the United States Postal Service or by a contractor on behalf of the United States Postal Service;
 - c) A state, city, county, city and county, or any other governmental agency or governmental subdivision of a state;
 - d) A commercial bank or industrial bank, the deposits of which are insured by the Federal Deposit Insurance Corporation (FDIC) or its successor, or any foreign (other nation) bank that is licensed under state law or that is authorized under federal law to maintain a federal agency or federal branch office in this state; a trust company licensed pursuant to

Section 1042 or a national association authorized under federal law to engage in a trust banking business; an association or federal association, as defined in Section 5102, the deposits of which are insured by the FDIC or its successor; and any federally or state chartered credit union, with an office in this state, the member accounts of which are insured or guaranteed as provided in Section 14858;

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 - 6) Allows for the following licensing fees:
 - a) A nonrefundable application fee for filing an application for licensure and approval to acquire control of a licensee is three thousand five hundred dollars (\$3,500);
 - b) A license renewal fee of two thousand five hundred dollars (\$2,500); and
 - c) A licensee shall pay annually on or before July 1, one hundred twenty-five dollars (\$125) for each licensee branch office in this state.
 - 7) Requires that each licensee shall maintain at all times such capital as the commissioner determines is sufficient to ensure the safety and soundness of the licensee and maintain consumer protection and its ongoing operations.
 - 8) Specifies that a licensee shall not appoint or continue any person as agent, unless the licensee and the person have made a written contract that requires the agent to operate in full compliance with this division.
 - 9) Provides that an agent shall not provide any virtual currency business outside the scope of activity permissible under the written contract between the agent and the licensee.
 - 10) Requires each licensee to exercise reasonable supervision over its agents to ensure compliance with applicable laws, rules, and regulations with regard to the virtual currency

business.

- 11) Prohibits a licensee from appointing any person as an agent unless it has conducted a review of the proposed agent's fitness to act as an agent and has determined that the proposed agent and any persons who control the proposed agent are of good character and sound financial standing.
- 12) Requires a licensee to maintain records of this review for each agent while the agent is providing any virtual currency business on behalf of the licensee, and for three years after the relationship with the agent has terminated.
- 13) Prohibits a person, including an agent, from providing any virtual currency business on behalf of a person not licensed or not exempt from licensure under this division.
- 14) Specifies that a person that engages in that activity provides virtual currency business to the same extent as if the person was a licensee and shall be jointly and severally liable with the unlicensed or nonexempt person.
- 15) Allows the commissioner at any time and from time to time examine the business and any branch office, within or outside this state, of any licensee in order to ascertain whether that business is being conducted in a lawful manner and whether all virtual currency held or exchanged is properly accounted for.
- 16) Requires the directors, officers, and employees of any licensee being examined by the commissioner shall exhibit to the commissioner, on request, any or all of the licensee's accounts, books, correspondence, memoranda, papers, and other records and shall otherwise facilitate the examination so far as it may be in their power to do so.
- 17) Requires a licensee to file a report with the commissioner within five business days after the licensee has reason to know of any occurrence of the following events:
 - a) The filing of a petition by or against the licensee under the United States Bankruptcy Code (11 U.S.C. Secs. 101-110, incl.) for bankruptcy or reorganization;
 - b) The filing of a petition by or against the licensee for receivership, the commencement of any other judicial or administrative proceeding for its dissolution or reorganization, or the making of a general assignment for the benefit of its creditors;
 - c) The commencement of a proceeding to revoke or suspend its virtual currency business license in a state or country in which the licensee engages in such business or is licensed to engage in such business;
 - d) The cancellation or other impairment of the licensee's bond or trust account as required by subdivision (b) of Section 26008; or
 - e) A charge or conviction of the licensee or of an executive officer, manager, director, or person in control of the licensee for a felony.

- 18) Requires a licensee to maintain any records as required by the commissioner for determining its compliance with this division for at least three years.
- 19) Allows a licensee to surrender its license by filing with the commissioner the license and a report with any information as the commissioner requires. The voluntary surrender of the license shall become effective at the time and upon the conditions as the commissioner specifies by order.
- 20) Gives authority to the commissioner to prepare written decisions, opinion letters, and other formal written guidance to be issued to persons seeking clarification regarding the requirements of this division.
- 21) Requires the commissioner to make public on the commissioner's Internet Web site all written decisions, opinion letters, and other formal written guidance issued to persons seeking clarification regarding the requirements of this division. The commissioner may, at his or her discretion or upon request by an applicant or licensee, redact proprietary or other confidential information regarding an applicant or licensee from any decision, letter, or other written guidance issued in connection with an applicant or licensee.
- 22) Allows the commissioner to offer informal guidance to any prospective applicant for a license under this division, regarding the conditions of licensure that may be applied to that person. The commissioner shall inform any applicant that requests that guidance of the licensing requirements that will be required of that applicant, based on the information provided by the applicant concerning its plan to conduct business under this division, and the factors used to make that determination.
- 23) Gives the commissioner authority, if the commissioner deems it necessary for the general welfare of the public, to exercise any power set forth in this division with respect to a virtual currency business, regardless of whether an application for a license has been filed with the commissioner, a license has been issued, or, if issued, the license has been surrendered, suspended, or revoked.
- 24) States that if it appears to the commissioner that a licensee is violating or failing to comply with this division, the commissioner may direct the licensee to comply with the law by an order issued under the commissioner's official seal, or if it appears to the commissioner that any licensee is conducting its business in an unsafe or injurious manner, the commissioner may in like manner direct it to discontinue the unsafe or injurious practices. The order shall require the licensee to show cause before the commissioner, at a time and place to be fixed by the commissioner, as to why the order should not be observed.
- 25) Provides that if, upon any hearing the commissioner finds that the licensee is violating or failing to comply with any law of this state or is conducting its business in an unsafe or injurious manner, the commissioner may make a final order directing it to comply with the law or to discontinue the unsafe or injurious practices. A licensee shall comply with the final order unless, within 10 days after the issuance of the order, its enforcement is restrained in a proceeding brought by the licensee.
- 26) Allows the commissioner to issue an order suspending or revoking a license, or taking possession of and placing a licensee in receivership, if after notice and an opportunity for

hearing, the commissioner finds any of the following:

- a) The licensee does not cooperate with an examination or investigation by the commissioner;
- b) The licensee engages in fraud, intentional misrepresentation, or gross negligence;
- c) The competence, experience, character, or general fitness of the licensee, or any director, officer, employee, or person in control of a licensee, indicates that it is not in the public interest to permit the person to provide virtual currency services;
- d) The licensee engages in an unsafe or unsound practice;
- e) The licensee is insolvent, suspends payment of its obligations, or makes a general assignment for the benefit of its creditors;
- f) The licensee has applied for an adjudication of bankruptcy, reorganization, arrangement, or other relief under any bankruptcy, reorganization, insolvency, or moratorium law, or any person has applied for any such relief under that law against the licensee and the licensee has by any affirmative act approved of or consented to the action or the relief has been granted; or,
- g) Any fact or condition exists that, if it had existed at the time when the licensee applied for its license, would have been grounds for denying the application;

- 27) In determining whether a licensee is engaging in an unsafe or unsound practice, the commissioner may consider the size and condition of the licensee's provision of virtual currency services, the magnitude of the loss, the gravity of the violation, and the previous conduct of the person involved.
- 28) Allows the commissioner to assess a civil penalty against a person that violates this division or a regulation adopted or an order issued under this division in an amount not to exceed one thousand dollars (\$1,000) for each violation or, in the case of a continuing violation, one thousand dollars (\$1,000) for each day or part thereof during which the violation continues, plus this state's costs and expenses for the investigation and prosecution of the matter, including reasonable attorney's fees.
- 29) Specifies that a person that engages in unlicensed activity or intentionally makes a false statement, misrepresentation, or false certification in a record filed or required to be maintained under this division or that intentionally makes a false entry or omits a material entry in such a record is guilty of a felony.
- 30) Allows the commissioner, by order or regulation grant exemptions from this section in cases where the commissioner finds that the requirements of this section are not necessary or may be duplicative.
- 31) Requires a licensee, within 90 days after the end of each fiscal year, or within any extended time as the commissioner may prescribe, file with the commissioner an audit report for the

fiscal year.

- 32) Specifies that each licensee shall, not more than 45 days after the end of each calendar year quarter, or within a longer period as the commissioner may by regulation or order specify, file with the commissioner a report containing all of the following:
- a) Financial statements, including balance sheet, income statement, statement of changes in shareholders' equity, and statement of cashflows, for, or as of the end of, that calendar year quarter, verified by two of the licensee's principal officers. The verification shall state that each of the officers making the verification has a personal knowledge of the matters in the report and that each of them believes that each statement in the report is true; and,
 - b) Other information as the commissioner may by regulation or order require.
- 33) Allows the commissioner to levy an assessment each fiscal year, on a pro rata basis, on those licensees that at any time during the preceding calendar year engaged in this state in the virtual currency business in an amount that is, in his or her judgment, sufficient to meet the commissioner's expenses in administering the provisions of this division and to provide a reasonable reserve for contingencies.
- 34) Requires a licensee to disclose to consumers the following disclosure in a form and manner prescribed by the commissioner:

"Once submitted to the network, a virtual currency transaction will be unconfirmed for a period of time (usually less than one hour, but up to one day or more) pending sufficient confirmation of the transaction by the network. A transaction is not complete while it is in a pending state. Virtual currency associated with transactions that are in a pending state will be designated accordingly, and will not be included in your account balance or be available to conduct transactions.

The risk of loss in trading or holding virtual currency can be substantial. You should therefore carefully consider whether trading or holding virtual currency is suitable for you in light of your financial condition. In considering whether to trade or hold virtual currency, you should be aware that the price or value of virtual currency can change rapidly, decrease, and potentially even fall to zero.

(Insert company name) is licensed by the Department of Business Oversight to do business in California. If you have complaints with respect to any aspect of the virtual currency business conducted by (company name), you may contact the California Department of Business Oversight at its toll-free telephone number, 1-800-622-0620, by email at consumer.services@dbo.ca.gov, or by mail at the Department of Business Oversight, Consumer Services, 1515 K Street, Suite 200, Sacramento, CA 95814."

EXISTING LAW: Regulates the transmission of money under the money transmission act (Financial Code, Section 2000-2175)

FISCAL EFFECT: Unknown

COMMENTS:

The author has introduced this bill to ensure that entities that store virtual currency or offer the exchange of virtual currency with consumers are operated in a safe and sound manner. AB 1326 will protect consumers that utilize virtual currency services by ensuring that these businesses are able to protect consumer's virtual currency from potential loss. Additionally, this bill will provide regulatory certainty as many companies try to engage in the virtual currency business have sought out money transmission licenses only to be denied, or are even unsure if their business model fits into existing licensing structures for other financial services entities.

The New York State Department of Banking was the first regulatory agency to issue regulations concerning virtual currency. This launched nationwide efforts to look at whether the virtual currency business should be regulated. The Conference of State Banking Supervisors (CSBS) formed the CSBS Emerging Payments Task Force ("Task Force") to examine the intersection between state supervision and payments developments, and to identify areas for consistent regulatory approaches among states. This effort includes an assessment of virtual currency activities and outreach with a broad range of stakeholders. After engaging with industry participants, state and federal regulators, and other stakeholders, CSBS recommended that activities involving third party control of virtual currency, including for the purposes of transmitting, exchanging, holding, or otherwise controlling virtual currency, should be subject to state licensure and supervision.

Headlines concerning virtual currency have been dominated by Bitcoin with some of this attention resulting from negative publicity. The high profile *Silk Road* case in which federal law enforcement officials arrested the operator of an online illegal drug market place that facilitated the sale of drugs and other illegal goods through acceptance of Bitcoins. Bitcoins were used because it is a decentralized currency allowing users to be pseudonymous to some extent, even though every Bitcoin transaction is logged. Bitcoin is not the first, nor the only virtual currency. Numerous models of virtual currency have sprouted up over the last decade, and this growth has inspired additional questions by government officials and policy makers.

Bitcoin has received its share of negative attention from its wild price fluctuations, awareness against Bitcoin "Wallets" (as the individual software applications that manage bitcoin holdings) to being credited with being the currency of choice for criminal activity. As to the latter attribution, cash money is still the dominant and preferred source of anonymous payment for illegal activities. Some of the attention, specifically in relation to the risk associated with storing virtual currency has raised the attention of state regulators across the country.

Even though the core program that runs bitcoin has resisted six years of hacking attempts, the successful attacks on associated businesses have created the impression that bitcoin isn't a safe way to store money. Bitcoins exist purely as entries in an accounting system—a transparent public ledger known as the "blockchain" that records balances and transfers among special bitcoin "addresses." With bitcoin, the balances held by every user of the monetary system are instead recorded on a widely distributed, publicly displayed ledger that is kept up-to-date by thousands of independently owned, competing computers known as "miners."

What does a real world transaction look like such as buying a cup of coffee at your local coffee shop? If you pay with a credit card, the transaction seems simple enough: You swipe your card, you grab your cup, and you leave. The financial system is just getting started with you and the coffee shop. Before the store actually gets paid and your bank balance falls, more than a half-

dozen institutions—such as a billing processor, the card association your bank, the coffee shop’s bank, a payment processor, the clearinghouse network managed by the regional Federal Reserve Banks—will have shared part of your account information or otherwise intervened in the flow of money. If all goes well, your bank will confirm your identity and good credit and send payment to the coffee shop’s bank two or three days later. For this privilege, the coffee shop pays a fee of between 2% and 3%.

Now let’s pay in Bitcoin. If you don’t already have bitcoins, you will need to buy some from one of a host of online exchanges and brokerages, using a simple transfer from your regular bank account. You will then assign the bitcoins to a wallet, which functions like an online account. Once inside the coffee shop, you will open your wallet’s smartphone app and hold its QR code reader up to the coffee shop’s device. This allows your embedded secret password to unlock a bitcoin address and publicly informs the bitcoin computer network that you are transferring \$1.75 worth of bitcoin (currently about 0.0075 bitcoin) to the coffee shop’s address. This takes just seconds, and then you walk off with your coffee. Next, in contrast to the pay with credit/debit system, your transaction is immediately broadcast to the world (in alphanumeric data that can’t be traced to you personally). Your information is then gathered up by bitcoin “miners,” the computers that maintain the system and are compensated, roughly every 10 minutes, for their work confirming transactions. The computer that competes successfully to package the data from your coffee purchase adds that information to the blockchain ledger, which prompts all the other miners to investigate the underlying transaction. Once your bona fides are verified, the updated blockchain is considered legitimate, and the miners update their records accordingly. It takes from 10 minutes to an hour for this software-driven network of computers to formally confirm a transfer from your blockchain address to that of the coffee shop—compared with a two- to three-day wait for the settlement of a credit-card transaction. Some new digital currencies are able to finalize transactions within seconds. There are almost zero fees, and the personal information of users isn’t divulged. This bitcoin feature especially appeals to privacy advocates: Nobody learns where you buy coffee. The advantages of digital currency are far more visible in emerging markets. It allows migrant workers, for example, to bypass fees that often run to 10% or more for the international payment services that they use to send money home to their families. Although many companies now accept bitcoin (the latest and biggest being Microsoft Corp.), global usage of the digital currency averaged just \$50 million a day in 2014. Over that same period, Visa and MasterCard processed some \$32 billion a day. The market capitalization for BitCoin is almost at \$4 billion with virtual currency Ripple the next largest at over \$340 million.

FinCEN Guidance on Virtual Currencies

FinCEN issued interpretive guidance earlier this year to clarify how the Bank Secrecy Act (BSA) and FinCEN regulations apply to users, administrators and exchangers of virtual currencies. Under the regulatory framework, virtual currency is defined as having some but not all of the attributes of “real currency” and therefore, virtual currency does not have legal tender status in any jurisdiction. Specifically, the FinCEN guidance addresses convertible virtual currency which either has a real currency equivalent value or serves as a substitute for real currency.

The roles of persons (including legal entities) involved in virtual currency transactions are defined by FinCEN as follows:

- User: A person who obtains virtual currency to purchase goods or services
- Exchanger: A person engaged as a business in the exchange of virtual currency for real currency, funds or other virtual currency
- Administrator: A person engaged as a business in issuing into circulation a virtual currency and who has the authority to redeem and withdraw from circulation such virtual currency

A person, or legal entity, may act in more than one of these capacities. Further, it is important to note that “obtaining” virtual currency covers much more than the scenario of a “user” who merely purchases virtual currency. Depending on the model of the particular currency, a party could “obtain” virtual currency through various acts including earning, harvesting, mining, creating, auto-generating, manufacturing or purchasing.

The threshold issue is whether actions will subject a person or legal entity to BSA’s registration, reporting and recordkeeping regulations that apply to money services businesses (MSBs). A user who obtains convertible virtual currency and uses it to purchase real or virtual goods or services is not subject to MSB compliance because such activity does not meet the definition of “money transmission services” and the user would not be a “money transmitter.”

However, an administrator or exchanger engages in money transmission services and, as a result, is a “money transmitter” under FinCEN definitions by (1) accepting and transmitting convertible virtual currency or (2) buying or selling convertible virtual currency. As a money transmitter, the administrator or exchanger would generally be subject to MSB reporting and recordkeeping.

Further, the FinCEN guidance expressly addresses the category of de-centralized virtual currency – the Bitcoin model – and states that “a person is an exchanger and a money transmitter if the person accepts such de-centralized convertible virtual currency from one person and transmits it to another person as part of the acceptance and transfer of currency, funds, or other value that substitutes for currency.”

In the area of foreign exchange, accepting real currency in exchange for virtual currency is not subject to FinCEN regulations applicable to “dealers in foreign exchange” since a forex transaction involves exchanging the currency of two countries and virtual currency does not constitute legal tender as a currency of a country.

The author's office has been meeting with various stakeholders and will continue to work out the various details of this legislation as it moves forward. Some key issues that still need to be resolved:

- 1) Further strengthen and clarify definition of "virtual currency business."
- 2) Clarify the factors that will be used to determine capitalization requirements.
- 3) Specify clear bonding and security amounts and factors used to make that determination.
- 4) Examine issues relating to start-up companies.

Previous Legislation.

AB 129 (Dickinson), chapter 74, statutes of 2014 clarified California law to ensure that alternative currency, including virtual currency would not be potentially deemed illegal tender.

REGISTERED SUPPORT / OPPOSITION:

Support

None on file.

Opposition

None on file.

Analysis Prepared by: Mark Farouk / B. & F. / (916) 319-3081

Date of Hearing: April 27, 2015

ASSEMBLY COMMITTEE ON BANKING AND FINANCE

Matthew Dababneh, Chair

AB 1326 (Dababneh) – As Amended April 20, 2015

SUBJECT: Virtual currency

SUMMARY: Requires the licensing of entities engaged in the business of virtual currency by the Department of Business Oversight (DBO). Specifically, **this bill:**

- 1) Defines “virtual currency” as any type of digital unit that is used as a medium of exchange or a form of digitally stored value or that is incorporated into payment system technology. Virtual currency shall be broadly construed to include digital units of exchange that (1) have a centralized repository or administrator, (2) are decentralized and have no centralized repository or administrator, or (3) may be created or obtained by computing or manufacturing effort. Virtual currency shall not be construed to include digital units that are used solely within online gaming platforms with no market or application outside of those gaming platforms, nor shall virtual currency be construed to include digital units that are used exclusively as part of a customer affinity or rewards program, and can be applied solely as payment redeemed for goods, services, or for purchases with the issuer or other designated merchants, but cannot be converted into, or redeemed for, fiat currency.
- 2) Defines “virtual currency business” as the conduct of either of the following types of activities involving a California resident:
 - a) Storing, holding, or maintaining custody or control of virtual currency on behalf of others; or
 - b) Providing conversion or exchange services of fiat currency into virtual currency or the conversion or exchange of virtual currency into fiat currency or other value, or the conversion or exchange of one form of virtual currency into another form of virtual currency.
- 3) Provides for the following exemptions:
 - a) The United States or a department, agency, or instrumentality thereof, including any federal reserve bank and any federal home loan bank;
 - b) Money transmission by the United States Postal Service or by a contractor on behalf of the United States Postal Service;
 - c) A state, city, county, city and county, or any other governmental agency or governmental subdivision of a state;
 - d) A commercial bank or industrial bank, the deposits of which are insured by the Federal Deposit Insurance Corporation (FDIC) or its successor, or any foreign (other nation) bank that is licensed under state law or that is authorized under federal law to maintain a federal agency or federal branch office in this state; a trust company licensed pursuant to

Section 1042 or a national association authorized under federal law to engage in a trust banking business; an association or federal association, as defined in Section 5102, the deposits of which are insured by the FDIC or its successor; and any federally or state chartered credit union, with an office in this state, the member accounts of which are insured or guaranteed as provided in Section 14858;

- e) An entity licensed as a money transmitter under the Money Transmission Act;
 - f) A merchant or consumer that utilizes virtual currency solely for the purchase or sale of goods or services; or
 - g) A transaction in which the recipient of virtual currency is an agent of the payee pursuant to a preexisting written contract and delivery of the virtual currency to the agent satisfies the payor's obligation to the payee. "Agent" has the same meaning as that term as defined in Section 2295 of the Civil Code. "Payee" means the provider of goods or services, who is owed payment of money or other monetary value from the payor for the goods or services. "Payor" means the recipient of goods or services, who owes payment of money or monetary value to the payee for the goods or services.
- 4) Requires an applicant for a license to pay the commissioner of DBO (commissioner) a nonrefundable application fee of five thousand dollars (\$5,000).
 - 5) Provides that an applicant for a license shall do so in a form and in a medium prescribed by the commissioner by order or regulation.
 - 6) Allows for the following licensing fees:
 - a) A nonrefundable application fee for filing an application for licensure and approval to acquire control of a licensee is three thousand five hundred dollars (\$3,500);
 - b) A license renewal fee of two thousand five hundred dollars (\$2,500); and
 - c) A licensee shall pay annually on or before July 1, one hundred twenty-five dollars (\$125) for each licensee branch office in this state.
 - 7) Requires that each licensee shall maintain at all times such capital as the commissioner determines is sufficient to ensure the safety and soundness of the licensee and maintain consumer protection and its ongoing operations.
 - 8) Specifies that a licensee shall not appoint or continue any person as agent, unless the licensee and the person have made a written contract that requires the agent to operate in full compliance with this division.
 - 9) Provides that an agent shall not provide any virtual currency business outside the scope of activity permissible under the written contract between the agent and the licensee.
 - 10) Requires each licensee to exercise reasonable supervision over its agents to ensure compliance with applicable laws, rules, and regulations with regard to the virtual currency

business.

- 11) Prohibits a licensee from appointing any person as an agent unless it has conducted a review of the proposed agent's fitness to act as an agent and has determined that the proposed agent and any persons who control the proposed agent are of good character and sound financial standing.
- 12) Requires a licensee to maintain records of this review for each agent while the agent is providing any virtual currency business on behalf of the licensee, and for three years after the relationship with the agent has terminated.
- 13) Prohibits a person, including an agent, from providing any virtual currency business on behalf of a person not licensed or not exempt from licensure under this division.
- 14) Specifies that a person that engages in that activity provides virtual currency business to the same extent as if the person was a licensee and shall be jointly and severally liable with the unlicensed or nonexempt person.
- 15) Allows the commissioner at any time and from time to time examine the business and any branch office, within or outside this state, of any licensee in order to ascertain whether that business is being conducted in a lawful manner and whether all virtual currency held or exchanged is properly accounted for.
- 16) Requires the directors, officers, and employees of any licensee being examined by the commissioner shall exhibit to the commissioner, on request, any or all of the licensee's accounts, books, correspondence, memoranda, papers, and other records and shall otherwise facilitate the examination so far as it may be in their power to do so.
- 17) Requires a licensee to file a report with the commissioner within five business days after the licensee has reason to know of any occurrence of the following events:
 - a) The filing of a petition by or against the licensee under the United States Bankruptcy Code (11 U.S.C. Secs. 101-110, incl.) for bankruptcy or reorganization;
 - b) The filing of a petition by or against the licensee for receivership, the commencement of any other judicial or administrative proceeding for its dissolution or reorganization, or the making of a general assignment for the benefit of its creditors;
 - c) The commencement of a proceeding to revoke or suspend its virtual currency business license in a state or country in which the licensee engages in such business or is licensed to engage in such business;
 - d) The cancellation or other impairment of the licensee's bond or trust account as required by subdivision (b) of Section 26008; or
 - e) A charge or conviction of the licensee or of an executive officer, manager, director, or person in control of the licensee for a felony.

- 18) Requires a licensee to maintain any records as required by the commissioner for determining its compliance with this division for at least three years.
- 19) Allows a licensee to surrender its license by filing with the commissioner the license and a report with any information as the commissioner requires. The voluntary surrender of the license shall become effective at the time and upon the conditions as the commissioner specifies by order.
- 20) Gives authority to the commissioner to prepare written decisions, opinion letters, and other formal written guidance to be issued to persons seeking clarification regarding the requirements of this division.
- 21) Requires the commissioner to make public on the commissioner's Internet Web site all written decisions, opinion letters, and other formal written guidance issued to persons seeking clarification regarding the requirements of this division. The commissioner may, at his or her discretion or upon request by an applicant or licensee, redact proprietary or other confidential information regarding an applicant or licensee from any decision, letter, or other written guidance issued in connection with an applicant or licensee.
- 22) Allows the commissioner to offer informal guidance to any prospective applicant for a license under this division, regarding the conditions of licensure that may be applied to that person. The commissioner shall inform any applicant that requests that guidance of the licensing requirements that will be required of that applicant, based on the information provided by the applicant concerning its plan to conduct business under this division, and the factors used to make that determination.
- 23) Gives the commissioner authority, if the commissioner deems it necessary for the general welfare of the public, to exercise any power set forth in this division with respect to a virtual currency business, regardless of whether an application for a license has been filed with the commissioner, a license has been issued, or, if issued, the license has been surrendered, suspended, or revoked.
- 24) States that if it appears to the commissioner that a licensee is violating or failing to comply with this division, the commissioner may direct the licensee to comply with the law by an order issued under the commissioner's official seal, or if it appears to the commissioner that any licensee is conducting its business in an unsafe or injurious manner, the commissioner may in like manner direct it to discontinue the unsafe or injurious practices. The order shall require the licensee to show cause before the commissioner, at a time and place to be fixed by the commissioner, as to why the order should not be observed.
- 25) Provides that if, upon any hearing the commissioner finds that the licensee is violating or failing to comply with any law of this state or is conducting its business in an unsafe or injurious manner, the commissioner may make a final order directing it to comply with the law or to discontinue the unsafe or injurious practices. A licensee shall comply with the final order unless, within 10 days after the issuance of the order, its enforcement is restrained in a proceeding brought by the licensee.
- 26) Allows the commissioner to issue an order suspending or revoking a license, or taking possession of and placing a licensee in receivership, if after notice and an opportunity for

hearing, the commissioner finds any of the following:

- a) The licensee does not cooperate with an examination or investigation by the commissioner;
- b) The licensee engages in fraud, intentional misrepresentation, or gross negligence;
- c) The competence, experience, character, or general fitness of the licensee, or any director, officer, employee, or person in control of a licensee, indicates that it is not in the public interest to permit the person to provide virtual currency services;
- d) The licensee engages in an unsafe or unsound practice;
- e) The licensee is insolvent, suspends payment of its obligations, or makes a general assignment for the benefit of its creditors;
- f) The licensee has applied for an adjudication of bankruptcy, reorganization, arrangement, or other relief under any bankruptcy, reorganization, insolvency, or moratorium law, or any person has applied for any such relief under that law against the licensee and the licensee has by any affirmative act approved of or consented to the action or the relief has been granted; or,
- g) Any fact or condition exists that, if it had existed at the time when the licensee applied for its license, would have been grounds for denying the application;

- 27) In determining whether a licensee is engaging in an unsafe or unsound practice, the commissioner may consider the size and condition of the licensee's provision of virtual currency services, the magnitude of the loss, the gravity of the violation, and the previous conduct of the person involved.
- 28) Allows the commissioner to assess a civil penalty against a person that violates this division or a regulation adopted or an order issued under this division in an amount not to exceed one thousand dollars (\$1,000) for each violation or, in the case of a continuing violation, one thousand dollars (\$1,000) for each day or part thereof during which the violation continues, plus this state's costs and expenses for the investigation and prosecution of the matter, including reasonable attorney's fees.
- 29) Specifies that a person that engages in unlicensed activity or intentionally makes a false statement, misrepresentation, or false certification in a record filed or required to be maintained under this division or that intentionally makes a false entry or omits a material entry in such a record is guilty of a felony.
- 30) Allows the commissioner, by order or regulation grant exemptions from this section in cases where the commissioner finds that the requirements of this section are not necessary or may be duplicative.
- 31) Requires a licensee, within 90 days after the end of each fiscal year, or within any extended time as the commissioner may prescribe, file with the commissioner an audit report for the

fiscal year.

- 32) Specifies that each licensee shall, not more than 45 days after the end of each calendar year quarter, or within a longer period as the commissioner may by regulation or order specify, file with the commissioner a report containing all of the following:
- a) Financial statements, including balance sheet, income statement, statement of changes in shareholders' equity, and statement of cashflows, for, or as of the end of, that calendar year quarter, verified by two of the licensee's principal officers. The verification shall state that each of the officers making the verification has a personal knowledge of the matters in the report and that each of them believes that each statement in the report is true; and,
 - b) Other information as the commissioner may by regulation or order require.
- 33) Allows the commissioner to levy an assessment each fiscal year, on a pro rata basis, on those licensees that at any time during the preceding calendar year engaged in this state in the virtual currency business in an amount that is, in his or her judgment, sufficient to meet the commissioner's expenses in administering the provisions of this division and to provide a reasonable reserve for contingencies.
- 34) Requires a licensee to disclose to consumers the following disclosure in a form and manner prescribed by the commissioner:

"Once submitted to the network, a virtual currency transaction will be unconfirmed for a period of time (usually less than one hour, but up to one day or more) pending sufficient confirmation of the transaction by the network. A transaction is not complete while it is in a pending state. Virtual currency associated with transactions that are in a pending state will be designated accordingly, and will not be included in your account balance or be available to conduct transactions.

The risk of loss in trading or holding virtual currency can be substantial. You should therefore carefully consider whether trading or holding virtual currency is suitable for you in light of your financial condition. In considering whether to trade or hold virtual currency, you should be aware that the price or value of virtual currency can change rapidly, decrease, and potentially even fall to zero.

(Insert company name) is licensed by the Department of Business Oversight to do business in California. If you have complaints with respect to any aspect of the virtual currency business conducted by (company name), you may contact the California Department of Business Oversight at its toll-free telephone number, 1-800-622-0620, by email at consumer.services@dbo.ca.gov, or by mail at the Department of Business Oversight, Consumer Services, 1515 K Street, Suite 200, Sacramento, CA 95814."

EXISTING LAW: Regulates the transmission of money under the money transmission act (Financial Code, Section 2000-2175)

FISCAL EFFECT: Unknown

COMMENTS:

The author has introduced this bill to ensure that entities that store virtual currency or offer the exchange of virtual currency with consumers are operated in a safe and sound manner. AB 1326 will protect consumers that utilize virtual currency services by ensuring that these businesses are able to protect consumer's virtual currency from potential loss. Additionally, this bill will provide regulatory certainty as many companies try to engage in the virtual currency business have sought out money transmission licenses only to be denied, or are even unsure if their business model fits into existing licensing structures for other financial services entities.

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What does a real world transaction look like such as buying a cup of coffee at your local coffee shop? If you pay with a credit card, the transaction seems simple enough: You swipe your card, you grab your cup, and you leave. The financial system is just getting started with you and the coffee shop. Before the store actually gets paid and your bank balance falls, more than a half-

dozen institutions—such as a billing processor, the card association your bank, the coffee shop’s bank, a payment processor, the clearinghouse network managed by the regional Federal Reserve Banks—will have shared part of your account information or otherwise intervened in the flow of money. If all goes well, your bank will confirm your identity and good credit and send payment to the coffee shop’s bank two or three days later. For this privilege, the coffee shop pays a fee of between 2% and 3%.

Now let’s pay in Bitcoin. If you don’t already have bitcoins, you will need to buy some from one of a host of online exchanges and brokerages, using a simple transfer from your regular bank account. You will then assign the bitcoins to a wallet, which functions like an online account. Once inside the coffee shop, you will open your wallet’s smartphone app and hold its QR code reader up to the coffee shop’s device. This allows your embedded secret password to unlock a bitcoin address and publicly informs the bitcoin computer network that you are transferring \$1.75 worth of bitcoin (currently about 0.0075 bitcoin) to the coffee shop’s address. This takes just seconds, and then you walk off with your coffee. Next, in contrast to the pay with credit/debit system, your transaction is immediately broadcast to the world (in alphanumeric data that can’t be traced to you personally). Your information is then gathered up by bitcoin “miners,” the computers that maintain the system and are compensated, roughly every 10 minutes, for their work confirming transactions. The computer that competes successfully to package the data from your coffee purchase adds that information to the blockchain ledger, which prompts all the other miners to investigate the underlying transaction. Once your bona fides are verified, the updated blockchain is considered legitimate, and the miners update their records accordingly. It takes from 10 minutes to an hour for this software-driven network of computers to formally confirm a transfer from your blockchain address to that of the coffee shop—compared with a two- to three-day wait for the settlement of a credit-card transaction. Some new digital currencies are able to finalize transactions within seconds. There are almost zero fees, and the personal information of users isn’t divulged. This bitcoin feature especially appeals to privacy advocates: Nobody learns where you buy coffee. The advantages of digital currency are far more visible in emerging markets. It allows migrant workers, for example, to bypass fees that often run to 10% or more for the international payment services that they use to send money home to their families. Although many companies now accept bitcoin (the latest and biggest being Microsoft Corp.), global usage of the digital currency averaged just \$50 million a day in 2014. Over that same period, Visa and MasterCard processed some \$32 billion a day. The market capitalization for BitCoin is almost at \$4 billion with virtual currency Ripple the next largest at over \$340 million.

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The roles of persons (including legal entities) involved in virtual currency transactions are defined by FinCEN as follows:

- User: A person who obtains virtual currency to purchase goods or services
- Exchanger: A person engaged as a business in the exchange of virtual currency for real currency, funds or other virtual currency
- Administrator: A person engaged as a business in issuing into circulation a virtual currency and who has the authority to redeem and withdraw from circulation such virtual currency

A person, or legal entity, may act in more than one of these capacities. Further, it is important to note that “obtaining” virtual currency covers much more than the scenario of a “user” who merely purchases virtual currency. Depending on the model of the particular currency, a party could “obtain” virtual currency through various acts including earning, harvesting, mining, creating, auto-generating, manufacturing or purchasing.

The threshold issue is whether actions will subject a person or legal entity to BSA’s registration, reporting and recordkeeping regulations that apply to money services businesses (MSBs). A user who obtains convertible virtual currency and uses it to purchase real or virtual goods or services is not subject to MSB compliance because such activity does not meet the definition of “money transmission services” and the user would not be a “money transmitter.”

However, an administrator or exchanger engages in money transmission services and, as a result, is a “money transmitter” under FinCEN definitions by (1) accepting and transmitting convertible virtual currency or (2) buying or selling convertible virtual currency. As a money transmitter, the administrator or exchanger would generally be subject to MSB reporting and recordkeeping.

Further, the FinCEN guidance expressly addresses the category of de-centralized virtual currency – the Bitcoin model – and states that “a person is an exchanger and a money transmitter if the person accepts such de-centralized convertible virtual currency from one person and transmits it to another person as part of the acceptance and transfer of currency, funds, or other value that substitutes for currency.”

In the area of foreign exchange, accepting real currency in exchange for virtual currency is not subject to FinCEN regulations applicable to “dealers in foreign exchange” since a forex transaction involves exchanging the currency of two countries and virtual currency does not constitute legal tender as a currency of a country.

The author's office has been meeting with various stakeholders and will continue to work out the various details of this legislation as it moves forward. Some key issues that still need to be resolved:

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Previous Legislation.

AB 129 (Dickinson), chapter 74, statutes of 2014 clarified California law to ensure that alternative currency, including virtual currency would not be potentially deemed illegal tender.

REGISTERED SUPPORT / OPPOSITION:

Support

None on file.

Opposition

None on file.

Analysis Prepared by: Mark Farouk / B. & F. / (916) 319-3081

Date of Hearing: April 27, 2015

ASSEMBLY COMMITTEE ON BANKING AND FINANCE

Matthew Dababneh, Chair

AB 1326 (Dababneh) – As Amended April 20, 2015

SUBJECT: Virtual currency

SUMMARY: Requires the licensing of entities engaged in the business of virtual currency by the Department of Business Oversight (DBO). Specifically, **this bill:**

- 1) Defines “virtual currency” as any type of digital unit that is used as a medium of exchange or a form of digitally stored value or that is incorporated into payment system technology. Virtual currency shall be broadly construed to include digital units of exchange that (1) have a centralized repository or administrator, (2) are decentralized and have no centralized repository or administrator, or (3) may be created or obtained by computing or manufacturing effort. Virtual currency shall not be construed to include digital units that are used solely within online gaming platforms with no market or application outside of those gaming platforms, nor shall virtual currency be construed to include digital units that are used exclusively as part of a customer affinity or rewards program, and can be applied solely as payment redeemed for goods, services, or for purchases with the issuer or other designated merchants, but cannot be converted into, or redeemed for, fiat currency.
- 2) Defines “virtual currency business” as the conduct of either of the following types of activities involving a California resident:
 - a) Storing, holding, or maintaining custody or control of virtual currency on behalf of others; or
 - b) Providing conversion or exchange services of fiat currency into virtual currency or the conversion or exchange of virtual currency into fiat currency or other value, or the conversion or exchange of one form of virtual currency into another form of virtual currency.
- 3) Provides for the following exemptions:
 - a) The United States or a department, agency, or instrumentality thereof, including any federal reserve bank and any federal home loan bank;
 - b) Money transmission by the United States Postal Service or by a contractor on behalf of the United States Postal Service;
 - c) A state, city, county, city and county, or any other governmental agency or governmental subdivision of a state;
 - d) A commercial bank or industrial bank, the deposits of which are insured by the Federal Deposit Insurance Corporation (FDIC) or its successor, or any foreign (other nation) bank that is licensed under state law or that is authorized under federal law to maintain a federal agency or federal branch office in this state; a trust company licensed pursuant to

Section 1042 or a national association authorized under federal law to engage in a trust banking business; an association or federal association, as defined in Section 5102, the deposits of which are insured by the FDIC or its successor; and any federally or state chartered credit union, with an office in this state, the member accounts of which are insured or guaranteed as provided in Section 14858;

- e) An entity licensed as a money transmitter under the Money Transmission Act;
 - f) A merchant or consumer that utilizes virtual currency solely for the purchase or sale of goods or services; or
 - g) A transaction in which the recipient of virtual currency is an agent of the payee pursuant to a preexisting written contract and delivery of the virtual currency to the agent satisfies the payor's obligation to the payee. "Agent" has the same meaning as that term as defined in Section 2295 of the Civil Code. "Payee" means the provider of goods or services, who is owed payment of money or other monetary value from the payor for the goods or services. "Payor" means the recipient of goods or services, who owes payment of money or monetary value to the payee for the goods or services.
- 4) Requires an applicant for a license to pay the commissioner of DBO (commissioner) a nonrefundable application fee of five thousand dollars (\$5,000).
 - 5) Provides that an applicant for a license shall do so in a form and in a medium prescribed by the commissioner by order or regulation.
 - 6) Allows for the following licensing fees:
 - a) A nonrefundable application fee for filing an application for licensure and approval to acquire control of a licensee is three thousand five hundred dollars (\$3,500);
 - b) A license renewal fee of two thousand five hundred dollars (\$2,500); and
 - c) A licensee shall pay annually on or before July 1, one hundred twenty-five dollars (\$125) for each licensee branch office in this state.
 - 7) Requires that each licensee shall maintain at all times such capital as the commissioner determines is sufficient to ensure the safety and soundness of the licensee and maintain consumer protection and its ongoing operations.
 - 8) Specifies that a licensee shall not appoint or continue any person as agent, unless the licensee and the person have made a written contract that requires the agent to operate in full compliance with this division.
 - 9) Provides that an agent shall not provide any virtual currency business outside the scope of activity permissible under the written contract between the agent and the licensee.
 - 10) Requires each licensee to exercise reasonable supervision over its agents to ensure compliance with applicable laws, rules, and regulations with regard to the virtual currency

business.

- 11) Prohibits a licensee from appointing any person as an agent unless it has conducted a review of the proposed agent's fitness to act as an agent and has determined that the proposed agent and any persons who control the proposed agent are of good character and sound financial standing.
- 12) Requires a licensee to maintain records of this review for each agent while the agent is providing any virtual currency business on behalf of the licensee, and for three years after the relationship with the agent has terminated.
- 13) Prohibits a person, including an agent, from providing any virtual currency business on behalf of a person not licensed or not exempt from licensure under this division.
- 14) Specifies that a person that engages in that activity provides virtual currency business to the same extent as if the person was a licensee and shall be jointly and severally liable with the unlicensed or nonexempt person.
- 15) Allows the commissioner at any time and from time to time examine the business and any branch office, within or outside this state, of any licensee in order to ascertain whether that business is being conducted in a lawful manner and whether all virtual currency held or exchanged is properly accounted for.
- 16) Requires the directors, officers, and employees of any licensee being examined by the commissioner shall exhibit to the commissioner, on request, any or all of the licensee's accounts, books, correspondence, memoranda, papers, and other records and shall otherwise facilitate the examination so far as it may be in their power to do so.
- 17) Requires a licensee to file a report with the commissioner within five business days after the licensee has reason to know of any occurrence of the following events:
 - a) The filing of a petition by or against the licensee under the United States Bankruptcy Code (11 U.S.C. Secs. 101-110, incl.) for bankruptcy or reorganization;
 - b) The filing of a petition by or against the licensee for receivership, the commencement of any other judicial or administrative proceeding for its dissolution or reorganization, or the making of a general assignment for the benefit of its creditors;
 - c) The commencement of a proceeding to revoke or suspend its virtual currency business license in a state or country in which the licensee engages in such business or is licensed to engage in such business;
 - d) The cancellation or other impairment of the licensee's bond or trust account as required by subdivision (b) of Section 26008; or
 - e) A charge or conviction of the licensee or of an executive officer, manager, director, or person in control of the licensee for a felony.

- 18) Requires a licensee to maintain any records as required by the commissioner for determining its compliance with this division for at least three years.
- 19) Allows a licensee to surrender its license by filing with the commissioner the license and a report with any information as the commissioner requires. The voluntary surrender of the license shall become effective at the time and upon the conditions as the commissioner specifies by order.
- 20) Gives authority to the commissioner to prepare written decisions, opinion letters, and other formal written guidance to be issued to persons seeking clarification regarding the requirements of this division.
- 21) Requires the commissioner to make public on the commissioner's Internet Web site all written decisions, opinion letters, and other formal written guidance issued to persons seeking clarification regarding the requirements of this division. The commissioner may, at his or her discretion or upon request by an applicant or licensee, redact proprietary or other confidential information regarding an applicant or licensee from any decision, letter, or other written guidance issued in connection with an applicant or licensee.
- 22) Allows the commissioner to offer informal guidance to any prospective applicant for a license under this division, regarding the conditions of licensure that may be applied to that person. The commissioner shall inform any applicant that requests that guidance of the licensing requirements that will be required of that applicant, based on the information provided by the applicant concerning its plan to conduct business under this division, and the factors used to make that determination.
- 23) Gives the commissioner authority, if the commissioner deems it necessary for the general welfare of the public, to exercise any power set forth in this division with respect to a virtual currency business, regardless of whether an application for a license has been filed with the commissioner, a license has been issued, or, if issued, the license has been surrendered, suspended, or revoked.
- 24) States that if it appears to the commissioner that a licensee is violating or failing to comply with this division, the commissioner may direct the licensee to comply with the law by an order issued under the commissioner's official seal, or if it appears to the commissioner that any licensee is conducting its business in an unsafe or injurious manner, the commissioner may in like manner direct it to discontinue the unsafe or injurious practices. The order shall require the licensee to show cause before the commissioner, at a time and place to be fixed by the commissioner, as to why the order should not be observed.
- 25) Provides that if, upon any hearing the commissioner finds that the licensee is violating or failing to comply with any law of this state or is conducting its business in an unsafe or injurious manner, the commissioner may make a final order directing it to comply with the law or to discontinue the unsafe or injurious practices. A licensee shall comply with the final order unless, within 10 days after the issuance of the order, its enforcement is restrained in a proceeding brought by the licensee.
- 26) Allows the commissioner to issue an order suspending or revoking a license, or taking possession of and placing a licensee in receivership, if after notice and an opportunity for

hearing, the commissioner finds any of the following:

- a) The licensee does not cooperate with an examination or investigation by the commissioner;
- b) The licensee engages in fraud, intentional misrepresentation, or gross negligence;
- c) The competence, experience, character, or general fitness of the licensee, or any director, officer, employee, or person in control of a licensee, indicates that it is not in the public interest to permit the person to provide virtual currency services;
- d) The licensee engages in an unsafe or unsound practice;
- e) The licensee is insolvent, suspends payment of its obligations, or makes a general assignment for the benefit of its creditors;
- f) The licensee has applied for an adjudication of bankruptcy, reorganization, arrangement, or other relief under any bankruptcy, reorganization, insolvency, or moratorium law, or any person has applied for any such relief under that law against the licensee and the licensee has by any affirmative act approved of or consented to the action or the relief has been granted; or,
- g) Any fact or condition exists that, if it had existed at the time when the licensee applied for its license, would have been grounds for denying the application;

- 27) In determining whether a licensee is engaging in an unsafe or unsound practice, the commissioner may consider the size and condition of the licensee's provision of virtual currency services, the magnitude of the loss, the gravity of the violation, and the previous conduct of the person involved.
- 28) Allows the commissioner to assess a civil penalty against a person that violates this division or a regulation adopted or an order issued under this division in an amount not to exceed one thousand dollars (\$1,000) for each violation or, in the case of a continuing violation, one thousand dollars (\$1,000) for each day or part thereof during which the violation continues, plus this state's costs and expenses for the investigation and prosecution of the matter, including reasonable attorney's fees.
- 29) Specifies that a person that engages in unlicensed activity or intentionally makes a false statement, misrepresentation, or false certification in a record filed or required to be maintained under this division or that intentionally makes a false entry or omits a material entry in such a record is guilty of a felony.
- 30) Allows the commissioner, by order or regulation grant exemptions from this section in cases where the commissioner finds that the requirements of this section are not necessary or may be duplicative.
- 31) Requires a licensee, within 90 days after the end of each fiscal year, or within any extended time as the commissioner may prescribe, file with the commissioner an audit report for the

fiscal year.

- 32) Specifies that each licensee shall, not more than 45 days after the end of each calendar year quarter, or within a longer period as the commissioner may by regulation or order specify, file with the commissioner a report containing all of the following:
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 - b) Other information as the commissioner may by regulation or order require.
- 33) Allows the commissioner to levy an assessment each fiscal year, on a pro rata basis, on those licensees that at any time during the preceding calendar year engaged in this state in the virtual currency business in an amount that is, in his or her judgment, sufficient to meet the commissioner's expenses in administering the provisions of this division and to provide a reasonable reserve for contingencies.
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Opposition

None on file.

Analysis Prepared by: Mark Farouk / B. & F. / (916) 319-3081

Date of Hearing: April 27, 2015

ASSEMBLY COMMITTEE ON BANKING AND FINANCE

Matthew Dababneh, Chair

AB 1326 (Dababneh) – As Amended April 20, 2015

SUBJECT: Virtual currency

SUMMARY: Requires the licensing of entities engaged in the business of virtual currency by the Department of Business Oversight (DBO). Specifically, **this bill:**

- 1) Defines “virtual currency” as any type of digital unit that is used as a medium of exchange or a form of digitally stored value or that is incorporated into payment system technology. Virtual currency shall be broadly construed to include digital units of exchange that (1) have a centralized repository or administrator, (2) are decentralized and have no centralized repository or administrator, or (3) may be created or obtained by computing or manufacturing effort. Virtual currency shall not be construed to include digital units that are used solely within online gaming platforms with no market or application outside of those gaming platforms, nor shall virtual currency be construed to include digital units that are used exclusively as part of a customer affinity or rewards program, and can be applied solely as payment redeemed for goods, services, or for purchases with the issuer or other designated merchants, but cannot be converted into, or redeemed for, fiat currency.
- 2) Defines “virtual currency business” as the conduct of either of the following types of activities involving a California resident:
 - a) Storing, holding, or maintaining custody or control of virtual currency on behalf of others; or
 - b) Providing conversion or exchange services of fiat currency into virtual currency or the conversion or exchange of virtual currency into fiat currency or other value, or the conversion or exchange of one form of virtual currency into another form of virtual currency.
- 3) Provides for the following exemptions:
 - a) The United States or a department, agency, or instrumentality thereof, including any federal reserve bank and any federal home loan bank;
 - b) Money transmission by the United States Postal Service or by a contractor on behalf of the United States Postal Service;
 - c) A state, city, county, city and county, or any other governmental agency or governmental subdivision of a state;
 - d) A commercial bank or industrial bank, the deposits of which are insured by the Federal Deposit Insurance Corporation (FDIC) or its successor, or any foreign (other nation) bank that is licensed under state law or that is authorized under federal law to maintain a federal agency or federal branch office in this state; a trust company licensed pursuant to

Section 1042 or a national association authorized under federal law to engage in a trust banking business; an association or federal association, as defined in Section 5102, the deposits of which are insured by the FDIC or its successor; and any federally or state chartered credit union, with an office in this state, the member accounts of which are insured or guaranteed as provided in Section 14858;

- e) An entity licensed as a money transmitter under the Money Transmission Act;
 - f) A merchant or consumer that utilizes virtual currency solely for the purchase or sale of goods or services; or
 - g) A transaction in which the recipient of virtual currency is an agent of the payee pursuant to a preexisting written contract and delivery of the virtual currency to the agent satisfies the payor's obligation to the payee. "Agent" has the same meaning as that term as defined in Section 2295 of the Civil Code. "Payee" means the provider of goods or services, who is owed payment of money or other monetary value from the payor for the goods or services. "Payor" means the recipient of goods or services, who owes payment of money or monetary value to the payee for the goods or services.
- 4) Requires an applicant for a license to pay the commissioner of DBO (commissioner) a nonrefundable application fee of five thousand dollars (\$5,000).
 - 5) Provides that an applicant for a license shall do so in a form and in a medium prescribed by the commissioner by order or regulation.
 - 6) Allows for the following licensing fees:
 - a) A nonrefundable application fee for filing an application for licensure and approval to acquire control of a licensee is three thousand five hundred dollars (\$3,500);
 - b) A license renewal fee of two thousand five hundred dollars (\$2,500); and
 - c) A licensee shall pay annually on or before July 1, one hundred twenty-five dollars (\$125) for each licensee branch office in this state.
 - 7) Requires that each licensee shall maintain at all times such capital as the commissioner determines is sufficient to ensure the safety and soundness of the licensee and maintain consumer protection and its ongoing operations.
 - 8) Specifies that a licensee shall not appoint or continue any person as agent, unless the licensee and the person have made a written contract that requires the agent to operate in full compliance with this division.
 - 9) Provides that an agent shall not provide any virtual currency business outside the scope of activity permissible under the written contract between the agent and the licensee.
 - 10) Requires each licensee to exercise reasonable supervision over its agents to ensure compliance with applicable laws, rules, and regulations with regard to the virtual currency

business.

- 11) Prohibits a licensee from appointing any person as an agent unless it has conducted a review of the proposed agent's fitness to act as an agent and has determined that the proposed agent and any persons who control the proposed agent are of good character and sound financial standing.
- 12) Requires a licensee to maintain records of this review for each agent while the agent is providing any virtual currency business on behalf of the licensee, and for three years after the relationship with the agent has terminated.
- 13) Prohibits a person, including an agent, from providing any virtual currency business on behalf of a person not licensed or not exempt from licensure under this division.
- 14) Specifies that a person that engages in that activity provides virtual currency business to the same extent as if the person was a licensee and shall be jointly and severally liable with the unlicensed or nonexempt person.
- 15) Allows the commissioner at any time and from time to time examine the business and any branch office, within or outside this state, of any licensee in order to ascertain whether that business is being conducted in a lawful manner and whether all virtual currency held or exchanged is properly accounted for.
- 16) Requires the directors, officers, and employees of any licensee being examined by the commissioner shall exhibit to the commissioner, on request, any or all of the licensee's accounts, books, correspondence, memoranda, papers, and other records and shall otherwise facilitate the examination so far as it may be in their power to do so.
- 17) Requires a licensee to file a report with the commissioner within five business days after the licensee has reason to know of any occurrence of the following events:
 - a) The filing of a petition by or against the licensee under the United States Bankruptcy Code (11 U.S.C. Secs. 101-110, incl.) for bankruptcy or reorganization;
 - b) The filing of a petition by or against the licensee for receivership, the commencement of any other judicial or administrative proceeding for its dissolution or reorganization, or the making of a general assignment for the benefit of its creditors;
 - c) The commencement of a proceeding to revoke or suspend its virtual currency business license in a state or country in which the licensee engages in such business or is licensed to engage in such business;
 - d) The cancellation or other impairment of the licensee's bond or trust account as required by subdivision (b) of Section 26008; or
 - e) A charge or conviction of the licensee or of an executive officer, manager, director, or person in control of the licensee for a felony.

- 18) Requires a licensee to maintain any records as required by the commissioner for determining its compliance with this division for at least three years.
- 19) Allows a licensee to surrender its license by filing with the commissioner the license and a report with any information as the commissioner requires. The voluntary surrender of the license shall become effective at the time and upon the conditions as the commissioner specifies by order.
- 20) Gives authority to the commissioner to prepare written decisions, opinion letters, and other formal written guidance to be issued to persons seeking clarification regarding the requirements of this division.
- 21) Requires the commissioner to make public on the commissioner's Internet Web site all written decisions, opinion letters, and other formal written guidance issued to persons seeking clarification regarding the requirements of this division. The commissioner may, at his or her discretion or upon request by an applicant or licensee, redact proprietary or other confidential information regarding an applicant or licensee from any decision, letter, or other written guidance issued in connection with an applicant or licensee.
- 22) Allows the commissioner to offer informal guidance to any prospective applicant for a license under this division, regarding the conditions of licensure that may be applied to that person. The commissioner shall inform any applicant that requests that guidance of the licensing requirements that will be required of that applicant, based on the information provided by the applicant concerning its plan to conduct business under this division, and the factors used to make that determination.
- 23) Gives the commissioner authority, if the commissioner deems it necessary for the general welfare of the public, to exercise any power set forth in this division with respect to a virtual currency business, regardless of whether an application for a license has been filed with the commissioner, a license has been issued, or, if issued, the license has been surrendered, suspended, or revoked.
- 24) States that if it appears to the commissioner that a licensee is violating or failing to comply with this division, the commissioner may direct the licensee to comply with the law by an order issued under the commissioner's official seal, or if it appears to the commissioner that any licensee is conducting its business in an unsafe or injurious manner, the commissioner may in like manner direct it to discontinue the unsafe or injurious practices. The order shall require the licensee to show cause before the commissioner, at a time and place to be fixed by the commissioner, as to why the order should not be observed.
- 25) Provides that if, upon any hearing the commissioner finds that the licensee is violating or failing to comply with any law of this state or is conducting its business in an unsafe or injurious manner, the commissioner may make a final order directing it to comply with the law or to discontinue the unsafe or injurious practices. A licensee shall comply with the final order unless, within 10 days after the issuance of the order, its enforcement is restrained in a proceeding brought by the licensee.
- 26) Allows the commissioner to issue an order suspending or revoking a license, or taking possession of and placing a licensee in receivership, if after notice and an opportunity for

hearing, the commissioner finds any of the following:

- a) The licensee does not cooperate with an examination or investigation by the commissioner;
- b) The licensee engages in fraud, intentional misrepresentation, or gross negligence;
- c) The competence, experience, character, or general fitness of the licensee, or any director, officer, employee, or person in control of a licensee, indicates that it is not in the public interest to permit the person to provide virtual currency services;
- d) The licensee engages in an unsafe or unsound practice;
- e) The licensee is insolvent, suspends payment of its obligations, or makes a general assignment for the benefit of its creditors;
- f) The licensee has applied for an adjudication of bankruptcy, reorganization, arrangement, or other relief under any bankruptcy, reorganization, insolvency, or moratorium law, or any person has applied for any such relief under that law against the licensee and the licensee has by any affirmative act approved of or consented to the action or the relief has been granted; or,
- g) Any fact or condition exists that, if it had existed at the time when the licensee applied for its license, would have been grounds for denying the application;

- 27) In determining whether a licensee is engaging in an unsafe or unsound practice, the commissioner may consider the size and condition of the licensee's provision of virtual currency services, the magnitude of the loss, the gravity of the violation, and the previous conduct of the person involved.
- 28) Allows the commissioner to assess a civil penalty against a person that violates this division or a regulation adopted or an order issued under this division in an amount not to exceed one thousand dollars (\$1,000) for each violation or, in the case of a continuing violation, one thousand dollars (\$1,000) for each day or part thereof during which the violation continues, plus this state's costs and expenses for the investigation and prosecution of the matter, including reasonable attorney's fees.
- 29) Specifies that a person that engages in unlicensed activity or intentionally makes a false statement, misrepresentation, or false certification in a record filed or required to be maintained under this division or that intentionally makes a false entry or omits a material entry in such a record is guilty of a felony.
- 30) Allows the commissioner, by order or regulation grant exemptions from this section in cases where the commissioner finds that the requirements of this section are not necessary or may be duplicative.
- 31) Requires a licensee, within 90 days after the end of each fiscal year, or within any extended time as the commissioner may prescribe, file with the commissioner an audit report for the

fiscal year.

- 32) Specifies that each licensee shall, not more than 45 days after the end of each calendar year quarter, or within a longer period as the commissioner may by regulation or order specify, file with the commissioner a report containing all of the following:
- a) Financial statements, including balance sheet, income statement, statement of changes in shareholders' equity, and statement of cashflows, for, or as of the end of, that calendar year quarter, verified by two of the licensee's principal officers. The verification shall state that each of the officers making the verification has a personal knowledge of the matters in the report and that each of them believes that each statement in the report is true; and,
 - b) Other information as the commissioner may by regulation or order require.
- 33) Allows the commissioner to levy an assessment each fiscal year, on a pro rata basis, on those licensees that at any time during the preceding calendar year engaged in this state in the virtual currency business in an amount that is, in his or her judgment, sufficient to meet the commissioner's expenses in administering the provisions of this division and to provide a reasonable reserve for contingencies.
- 34) Requires a licensee to disclose to consumers the following disclosure in a form and manner prescribed by the commissioner:

"Once submitted to the network, a virtual currency transaction will be unconfirmed for a period of time (usually less than one hour, but up to one day or more) pending sufficient confirmation of the transaction by the network. A transaction is not complete while it is in a pending state. Virtual currency associated with transactions that are in a pending state will be designated accordingly, and will not be included in your account balance or be available to conduct transactions.

The risk of loss in trading or holding virtual currency can be substantial. You should therefore carefully consider whether trading or holding virtual currency is suitable for you in light of your financial condition. In considering whether to trade or hold virtual currency, you should be aware that the price or value of virtual currency can change rapidly, decrease, and potentially even fall to zero.

(Insert company name) is licensed by the Department of Business Oversight to do business in California. If you have complaints with respect to any aspect of the virtual currency business conducted by (company name), you may contact the California Department of Business Oversight at its toll-free telephone number, 1-800-622-0620, by email at consumer.services@dbo.ca.gov, or by mail at the Department of Business Oversight, Consumer Services, 1515 K Street, Suite 200, Sacramento, CA 95814."

EXISTING LAW: Regulates the transmission of money under the money transmission act (Financial Code, Section 2000-2175)

FISCAL EFFECT: Unknown

COMMENTS:

The author has introduced this bill to ensure that entities that store virtual currency or offer the exchange of virtual currency with consumers are operated in a safe and sound manner. AB 1326 will protect consumers that utilize virtual currency services by ensuring that these businesses are able to protect consumer's virtual currency from potential loss. Additionally, this bill will provide regulatory certainty as many companies try to engage in the virtual currency business have sought out money transmission licenses only to be denied, or are even unsure if their business model fits into existing licensing structures for other financial services entities.

The New York State Department of Banking was the first regulatory agency to issue regulations concerning virtual currency. This launched nationwide efforts to look at whether the virtual currency business should be regulated. The Conference of State Banking Supervisors (CSBS) formed the CSBS Emerging Payments Task Force ("Task Force") to examine the intersection between state supervision and payments developments, and to identify areas for consistent regulatory approaches among states. This effort includes an assessment of virtual currency activities and outreach with a broad range of stakeholders. After engaging with industry participants, state and federal regulators, and other stakeholders, CSBS recommended that activities involving third party control of virtual currency, including for the purposes of transmitting, exchanging, holding, or otherwise controlling virtual currency, should be subject to state licensure and supervision.

Headlines concerning virtual currency have been dominated by Bitcoin with some of this attention resulting from negative publicity. The high profile *Silk Road* case in which federal law enforcement officials arrested the operator of an online illegal drug market place that facilitated the sale of drugs and other illegal goods through acceptance of Bitcoins. Bitcoins were used because it is a decentralized currency allowing users to be pseudonymous to some extent, even though every Bitcoin transaction is logged. Bitcoin is not the first, nor the only virtual currency. Numerous models of virtual currency have sprouted up over the last decade, and this growth has inspired additional questions by government officials and policy makers.

Bitcoin has received its share of negative attention from its wild price fluctuations, awareness against Bitcoin "Wallets" (as the individual software applications that manage bitcoin holdings) to being credited with being the currency of choice for criminal activity. As to the latter attribution, cash money is still the dominant and preferred source of anonymous payment for illegal activities. Some of the attention, specifically in relation to the risk associated with storing virtual currency has raised the attention of state regulators across the country.

Even though the core program that runs bitcoin has resisted six years of hacking attempts, the successful attacks on associated businesses have created the impression that bitcoin isn't a safe way to store money. Bitcoins exist purely as entries in an accounting system—a transparent public ledger known as the "blockchain" that records balances and transfers among special bitcoin "addresses." With bitcoin, the balances held by every user of the monetary system are instead recorded on a widely distributed, publicly displayed ledger that is kept up-to-date by thousands of independently owned, competing computers known as "miners."

What does a real world transaction look like such as buying a cup of coffee at your local coffee shop? If you pay with a credit card, the transaction seems simple enough: You swipe your card, you grab your cup, and you leave. The financial system is just getting started with you and the coffee shop. Before the store actually gets paid and your bank balance falls, more than a half-

dozen institutions—such as a billing processor, the card association your bank, the coffee shop’s bank, a payment processor, the clearinghouse network managed by the regional Federal Reserve Banks—will have shared part of your account information or otherwise intervened in the flow of money. If all goes well, your bank will confirm your identity and good credit and send payment to the coffee shop’s bank two or three days later. For this privilege, the coffee shop pays a fee of between 2% and 3%.

Now let’s pay in Bitcoin. If you don’t already have bitcoins, you will need to buy some from one of a host of online exchanges and brokerages, using a simple transfer from your regular bank account. You will then assign the bitcoins to a wallet, which functions like an online account. Once inside the coffee shop, you will open your wallet’s smartphone app and hold its QR code reader up to the coffee shop’s device. This allows your embedded secret password to unlock a bitcoin address and publicly informs the bitcoin computer network that you are transferring \$1.75 worth of bitcoin (currently about 0.0075 bitcoin) to the coffee shop’s address. This takes just seconds, and then you walk off with your coffee. Next, in contrast to the pay with credit/debit system, your transaction is immediately broadcast to the world (in alphanumeric data that can’t be traced to you personally). Your information is then gathered up by bitcoin “miners,” the computers that maintain the system and are compensated, roughly every 10 minutes, for their work confirming transactions. The computer that competes successfully to package the data from your coffee purchase adds that information to the blockchain ledger, which prompts all the other miners to investigate the underlying transaction. Once your bona fides are verified, the updated blockchain is considered legitimate, and the miners update their records accordingly. It takes from 10 minutes to an hour for this software-driven network of computers to formally confirm a transfer from your blockchain address to that of the coffee shop—compared with a two- to three-day wait for the settlement of a credit-card transaction. Some new digital currencies are able to finalize transactions within seconds. There are almost zero fees, and the personal information of users isn’t divulged. This bitcoin feature especially appeals to privacy advocates: Nobody learns where you buy coffee. The advantages of digital currency are far more visible in emerging markets. It allows migrant workers, for example, to bypass fees that often run to 10% or more for the international payment services that they use to send money home to their families. Although many companies now accept bitcoin (the latest and biggest being Microsoft Corp.), global usage of the digital currency averaged just \$50 million a day in 2014. Over that same period, Visa and MasterCard processed some \$32 billion a day. The market capitalization for BitCoin is almost at \$4 billion with virtual currency Ripple the next largest at over \$340 million.

FinCEN Guidance on Virtual Currencies

FinCEN issued interpretive guidance earlier this year to clarify how the Bank Secrecy Act (BSA) and FinCEN regulations apply to users, administrators and exchangers of virtual currencies. Under the regulatory framework, virtual currency is defined as having some but not all of the attributes of “real currency” and therefore, virtual currency does not have legal tender status in any jurisdiction. Specifically, the FinCEN guidance addresses convertible virtual currency which either has a real currency equivalent value or serves as a substitute for real currency.

The roles of persons (including legal entities) involved in virtual currency transactions are defined by FinCEN as follows:

- User: A person who obtains virtual currency to purchase goods or services
- Exchanger: A person engaged as a business in the exchange of virtual currency for real currency, funds or other virtual currency
- Administrator: A person engaged as a business in issuing into circulation a virtual currency and who has the authority to redeem and withdraw from circulation such virtual currency

A person, or legal entity, may act in more than one of these capacities. Further, it is important to note that “obtaining” virtual currency covers much more than the scenario of a “user” who merely purchases virtual currency. Depending on the model of the particular currency, a party could “obtain” virtual currency through various acts including earning, harvesting, mining, creating, auto-generating, manufacturing or purchasing.

The threshold issue is whether actions will subject a person or legal entity to BSA’s registration, reporting and recordkeeping regulations that apply to money services businesses (MSBs). A user who obtains convertible virtual currency and uses it to purchase real or virtual goods or services is not subject to MSB compliance because such activity does not meet the definition of “money transmission services” and the user would not be a “money transmitter.”

However, an administrator or exchanger engages in money transmission services and, as a result, is a “money transmitter” under FinCEN definitions by (1) accepting and transmitting convertible virtual currency or (2) buying or selling convertible virtual currency. As a money transmitter, the administrator or exchanger would generally be subject to MSB reporting and recordkeeping.

Further, the FinCEN guidance expressly addresses the category of de-centralized virtual currency – the Bitcoin model – and states that “a person is an exchanger and a money transmitter if the person accepts such de-centralized convertible virtual currency from one person and transmits it to another person as part of the acceptance and transfer of currency, funds, or other value that substitutes for currency.”

In the area of foreign exchange, accepting real currency in exchange for virtual currency is not subject to FinCEN regulations applicable to “dealers in foreign exchange” since a forex transaction involves exchanging the currency of two countries and virtual currency does not constitute legal tender as a currency of a country.

The author's office has been meeting with various stakeholders and will continue to work out the various details of this legislation as it moves forward. Some key issues that still need to be resolved:

- 1) Further strengthen and clarify definition of "virtual currency business."
- 2) Clarify the factors that will be used to determine capitalization requirements.
- 3) Specify clear bonding and security amounts and factors used to make that determination.
- 4) Examine issues relating to start-up companies.

Previous Legislation.

AB 129 (Dickinson), chapter 74, statutes of 2014 clarified California law to ensure that alternative currency, including virtual currency would not be potentially deemed illegal tender.

REGISTERED SUPPORT / OPPOSITION:

Support

None on file.

Opposition

None on file.

Analysis Prepared by: Mark Farouk / B. & F. / (916) 319-3081

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 - c) A state, city, county, city and county, or any other governmental agency or governmental subdivision of a state;
 - d) A commercial bank or industrial bank, the deposits of which are insured by the Federal Deposit Insurance Corporation (FDIC) or its successor, or any foreign (other nation) bank that is licensed under state law or that is authorized under federal law to maintain a federal agency or federal branch office in this state; a trust company licensed pursuant to

Section 1042 or a national association authorized under federal law to engage in a trust banking business; an association or federal association, as defined in Section 5102, the deposits of which are insured by the FDIC or its successor; and any federally or state chartered credit union, with an office in this state, the member accounts of which are insured or guaranteed as provided in Section 14858;

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 - b) The filing of a petition by or against the licensee for receivership, the commencement of any other judicial or administrative proceeding for its dissolution or reorganization, or the making of a general assignment for the benefit of its creditors;
 - c) The commencement of a proceeding to revoke or suspend its virtual currency business license in a state or country in which the licensee engages in such business or is licensed to engage in such business;
 - d) The cancellation or other impairment of the licensee's bond or trust account as required by subdivision (b) of Section 26008; or
 - e) A charge or conviction of the licensee or of an executive officer, manager, director, or person in control of the licensee for a felony.

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- 23) Gives the commissioner authority, if the commissioner deems it necessary for the general welfare of the public, to exercise any power set forth in this division with respect to a virtual currency business, regardless of whether an application for a license has been filed with the commissioner, a license has been issued, or, if issued, the license has been surrendered, suspended, or revoked.
- 24) States that if it appears to the commissioner that a licensee is violating or failing to comply with this division, the commissioner may direct the licensee to comply with the law by an order issued under the commissioner's official seal, or if it appears to the commissioner that any licensee is conducting its business in an unsafe or injurious manner, the commissioner may in like manner direct it to discontinue the unsafe or injurious practices. The order shall require the licensee to show cause before the commissioner, at a time and place to be fixed by the commissioner, as to why the order should not be observed.
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hearing, the commissioner finds any of the following:

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- b) The licensee engages in fraud, intentional misrepresentation, or gross negligence;
- c) The competence, experience, character, or general fitness of the licensee, or any director, officer, employee, or person in control of a licensee, indicates that it is not in the public interest to permit the person to provide virtual currency services;
- d) The licensee engages in an unsafe or unsound practice;
- e) The licensee is insolvent, suspends payment of its obligations, or makes a general assignment for the benefit of its creditors;
- f) The licensee has applied for an adjudication of bankruptcy, reorganization, arrangement, or other relief under any bankruptcy, reorganization, insolvency, or moratorium law, or any person has applied for any such relief under that law against the licensee and the licensee has by any affirmative act approved of or consented to the action or the relief has been granted; or,
- g) Any fact or condition exists that, if it had existed at the time when the licensee applied for its license, would have been grounds for denying the application;

- 27) In determining whether a licensee is engaging in an unsafe or unsound practice, the commissioner may consider the size and condition of the licensee's provision of virtual currency services, the magnitude of the loss, the gravity of the violation, and the previous conduct of the person involved.
- 28) Allows the commissioner to assess a civil penalty against a person that violates this division or a regulation adopted or an order issued under this division in an amount not to exceed one thousand dollars (\$1,000) for each violation or, in the case of a continuing violation, one thousand dollars (\$1,000) for each day or part thereof during which the violation continues, plus this state's costs and expenses for the investigation and prosecution of the matter, including reasonable attorney's fees.
- 29) Specifies that a person that engages in unlicensed activity or intentionally makes a false statement, misrepresentation, or false certification in a record filed or required to be maintained under this division or that intentionally makes a false entry or omits a material entry in such a record is guilty of a felony.
- 30) Allows the commissioner, by order or regulation grant exemptions from this section in cases where the commissioner finds that the requirements of this section are not necessary or may be duplicative.
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fiscal year.

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- a) Financial statements, including balance sheet, income statement, statement of changes in shareholders' equity, and statement of cashflows, for, or as of the end of, that calendar year quarter, verified by two of the licensee's principal officers. The verification shall state that each of the officers making the verification has a personal knowledge of the matters in the report and that each of them believes that each statement in the report is true; and,
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- 34) Requires a licensee to disclose to consumers the following disclosure in a form and manner prescribed by the commissioner:

"Once submitted to the network, a virtual currency transaction will be unconfirmed for a period of time (usually less than one hour, but up to one day or more) pending sufficient confirmation of the transaction by the network. A transaction is not complete while it is in a pending state. Virtual currency associated with transactions that are in a pending state will be designated accordingly, and will not be included in your account balance or be available to conduct transactions.

The risk of loss in trading or holding virtual currency can be substantial. You should therefore carefully consider whether trading or holding virtual currency is suitable for you in light of your financial condition. In considering whether to trade or hold virtual currency, you should be aware that the price or value of virtual currency can change rapidly, decrease, and potentially even fall to zero.

(Insert company name) is licensed by the Department of Business Oversight to do business in California. If you have complaints with respect to any aspect of the virtual currency business conducted by (company name), you may contact the California Department of Business Oversight at its toll-free telephone number, 1-800-622-0620, by email at consumer.services@dbo.ca.gov, or by mail at the Department of Business Oversight, Consumer Services, 1515 K Street, Suite 200, Sacramento, CA 95814."

EXISTING LAW: Regulates the transmission of money under the money transmission act (Financial Code, Section 2000-2175)

FISCAL EFFECT: Unknown

COMMENTS:

The author has introduced this bill to ensure that entities that store virtual currency or offer the exchange of virtual currency with consumers are operated in a safe and sound manner. AB 1326 will protect consumers that utilize virtual currency services by ensuring that these businesses are able to protect consumer's virtual currency from potential loss. Additionally, this bill will provide regulatory certainty as many companies try to engage in the virtual currency business have sought out money transmission licenses only to be denied, or are even unsure if their business model fits into existing licensing structures for other financial services entities.

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What does a real world transaction look like such as buying a cup of coffee at your local coffee shop? If you pay with a credit card, the transaction seems simple enough: You swipe your card, you grab your cup, and you leave. The financial system is just getting started with you and the coffee shop. Before the store actually gets paid and your bank balance falls, more than a half-

dozen institutions—such as a billing processor, the card association your bank, the coffee shop’s bank, a payment processor, the clearinghouse network managed by the regional Federal Reserve Banks—will have shared part of your account information or otherwise intervened in the flow of money. If all goes well, your bank will confirm your identity and good credit and send payment to the coffee shop’s bank two or three days later. For this privilege, the coffee shop pays a fee of between 2% and 3%.

Now let’s pay in Bitcoin. If you don’t already have bitcoins, you will need to buy some from one of a host of online exchanges and brokerages, using a simple transfer from your regular bank account. You will then assign the bitcoins to a wallet, which functions like an online account. Once inside the coffee shop, you will open your wallet’s smartphone app and hold its QR code reader up to the coffee shop’s device. This allows your embedded secret password to unlock a bitcoin address and publicly informs the bitcoin computer network that you are transferring \$1.75 worth of bitcoin (currently about 0.0075 bitcoin) to the coffee shop’s address. This takes just seconds, and then you walk off with your coffee. Next, in contrast to the pay with credit/debit system, your transaction is immediately broadcast to the world (in alphanumeric data that can’t be traced to you personally). Your information is then gathered up by bitcoin “miners,” the computers that maintain the system and are compensated, roughly every 10 minutes, for their work confirming transactions. The computer that competes successfully to package the data from your coffee purchase adds that information to the blockchain ledger, which prompts all the other miners to investigate the underlying transaction. Once your bona fides are verified, the updated blockchain is considered legitimate, and the miners update their records accordingly. It takes from 10 minutes to an hour for this software-driven network of computers to formally confirm a transfer from your blockchain address to that of the coffee shop—compared with a two- to three-day wait for the settlement of a credit-card transaction. Some new digital currencies are able to finalize transactions within seconds. There are almost zero fees, and the personal information of users isn’t divulged. This bitcoin feature especially appeals to privacy advocates: Nobody learns where you buy coffee. The advantages of digital currency are far more visible in emerging markets. It allows migrant workers, for example, to bypass fees that often run to 10% or more for the international payment services that they use to send money home to their families. Although many companies now accept bitcoin (the latest and biggest being Microsoft Corp.), global usage of the digital currency averaged just \$50 million a day in 2014. Over that same period, Visa and MasterCard processed some \$32 billion a day. The market capitalization for BitCoin is almost at \$4 billion with virtual currency Ripple the next largest at over \$340 million.

FinCEN Guidance on Virtual Currencies

FinCEN issued interpretive guidance earlier this year to clarify how the Bank Secrecy Act (BSA) and FinCEN regulations apply to users, administrators and exchangers of virtual currencies. Under the regulatory framework, virtual currency is defined as having some but not all of the attributes of “real currency” and therefore, virtual currency does not have legal tender status in any jurisdiction. Specifically, the FinCEN guidance addresses convertible virtual currency which either has a real currency equivalent value or serves as a substitute for real currency.

The roles of persons (including legal entities) involved in virtual currency transactions are defined by FinCEN as follows:

- User: A person who obtains virtual currency to purchase goods or services
- Exchanger: A person engaged as a business in the exchange of virtual currency for real currency, funds or other virtual currency
- Administrator: A person engaged as a business in issuing into circulation a virtual currency and who has the authority to redeem and withdraw from circulation such virtual currency

A person, or legal entity, may act in more than one of these capacities. Further, it is important to note that “obtaining” virtual currency covers much more than the scenario of a “user” who merely purchases virtual currency. Depending on the model of the particular currency, a party could “obtain” virtual currency through various acts including earning, harvesting, mining, creating, auto-generating, manufacturing or purchasing.

The threshold issue is whether actions will subject a person or legal entity to BSA’s registration, reporting and recordkeeping regulations that apply to money services businesses (MSBs). A user who obtains convertible virtual currency and uses it to purchase real or virtual goods or services is not subject to MSB compliance because such activity does not meet the definition of “money transmission services” and the user would not be a “money transmitter.”

However, an administrator or exchanger engages in money transmission services and, as a result, is a “money transmitter” under FinCEN definitions by (1) accepting and transmitting convertible virtual currency or (2) buying or selling convertible virtual currency. As a money transmitter, the administrator or exchanger would generally be subject to MSB reporting and recordkeeping.

Further, the FinCEN guidance expressly addresses the category of de-centralized virtual currency – the Bitcoin model – and states that “a person is an exchanger and a money transmitter if the person accepts such de-centralized convertible virtual currency from one person and transmits it to another person as part of the acceptance and transfer of currency, funds, or other value that substitutes for currency.”

In the area of foreign exchange, accepting real currency in exchange for virtual currency is not subject to FinCEN regulations applicable to “dealers in foreign exchange” since a forex transaction involves exchanging the currency of two countries and virtual currency does not constitute legal tender as a currency of a country.

The author's office has been meeting with various stakeholders and will continue to work out the various details of this legislation as it moves forward. Some key issues that still need to be resolved:

- 1) Further strengthen and clarify definition of "virtual currency business."
- 2) Clarify the factors that will be used to determine capitalization requirements.
- 3) Specify clear bonding and security amounts and factors used to make that determination.
- 4) Examine issues relating to start-up companies.

Previous Legislation.

AB 129 (Dickinson), chapter 74, statutes of 2014 clarified California law to ensure that alternative currency, including virtual currency would not be potentially deemed illegal tender.

REGISTERED SUPPORT / OPPOSITION:

Support

None on file.

Opposition

None on file.

Analysis Prepared by: Mark Farouk / B. & F. / (916) 319-3081

Date of Hearing: April 27, 2015

ASSEMBLY COMMITTEE ON BANKING AND FINANCE

Matthew Dababneh, Chair

AB 1326 (Dababneh) – As Amended April 20, 2015

SUBJECT: Virtual currency

SUMMARY: Requires the licensing of entities engaged in the business of virtual currency by the Department of Business Oversight (DBO). Specifically, **this bill:**

- 1) Defines “virtual currency” as any type of digital unit that is used as a medium of exchange or a form of digitally stored value or that is incorporated into payment system technology. Virtual currency shall be broadly construed to include digital units of exchange that (1) have a centralized repository or administrator, (2) are decentralized and have no centralized repository or administrator, or (3) may be created or obtained by computing or manufacturing effort. Virtual currency shall not be construed to include digital units that are used solely within online gaming platforms with no market or application outside of those gaming platforms, nor shall virtual currency be construed to include digital units that are used exclusively as part of a customer affinity or rewards program, and can be applied solely as payment redeemed for goods, services, or for purchases with the issuer or other designated merchants, but cannot be converted into, or redeemed for, fiat currency.
- 2) Defines “virtual currency business” as the conduct of either of the following types of activities involving a California resident:
 - a) Storing, holding, or maintaining custody or control of virtual currency on behalf of others; or
 - b) Providing conversion or exchange services of fiat currency into virtual currency or the conversion or exchange of virtual currency into fiat currency or other value, or the conversion or exchange of one form of virtual currency into another form of virtual currency.
- 3) Provides for the following exemptions:
 - a) The United States or a department, agency, or instrumentality thereof, including any federal reserve bank and any federal home loan bank;
 - b) Money transmission by the United States Postal Service or by a contractor on behalf of the United States Postal Service;
 - c) A state, city, county, city and county, or any other governmental agency or governmental subdivision of a state;
 - d) A commercial bank or industrial bank, the deposits of which are insured by the Federal Deposit Insurance Corporation (FDIC) or its successor, or any foreign (other nation) bank that is licensed under state law or that is authorized under federal law to maintain a federal agency or federal branch office in this state; a trust company licensed pursuant to

Section 1042 or a national association authorized under federal law to engage in a trust banking business; an association or federal association, as defined in Section 5102, the deposits of which are insured by the FDIC or its successor; and any federally or state chartered credit union, with an office in this state, the member accounts of which are insured or guaranteed as provided in Section 14858;

- e) An entity licensed as a money transmitter under the Money Transmission Act;
 - f) A merchant or consumer that utilizes virtual currency solely for the purchase or sale of goods or services; or
 - g) A transaction in which the recipient of virtual currency is an agent of the payee pursuant to a preexisting written contract and delivery of the virtual currency to the agent satisfies the payor's obligation to the payee. "Agent" has the same meaning as that term as defined in Section 2295 of the Civil Code. "Payee" means the provider of goods or services, who is owed payment of money or other monetary value from the payor for the goods or services. "Payor" means the recipient of goods or services, who owes payment of money or monetary value to the payee for the goods or services.
- 4) Requires an applicant for a license to pay the commissioner of DBO (commissioner) a nonrefundable application fee of five thousand dollars (\$5,000).
 - 5) Provides that an applicant for a license shall do so in a form and in a medium prescribed by the commissioner by order or regulation.
 - 6) Allows for the following licensing fees:
 - a) A nonrefundable application fee for filing an application for licensure and approval to acquire control of a licensee is three thousand five hundred dollars (\$3,500);
 - b) A license renewal fee of two thousand five hundred dollars (\$2,500); and
 - c) A licensee shall pay annually on or before July 1, one hundred twenty-five dollars (\$125) for each licensee branch office in this state.
 - 7) Requires that each licensee shall maintain at all times such capital as the commissioner determines is sufficient to ensure the safety and soundness of the licensee and maintain consumer protection and its ongoing operations.
 - 8) Specifies that a licensee shall not appoint or continue any person as agent, unless the licensee and the person have made a written contract that requires the agent to operate in full compliance with this division.
 - 9) Provides that an agent shall not provide any virtual currency business outside the scope of activity permissible under the written contract between the agent and the licensee.
 - 10) Requires each licensee to exercise reasonable supervision over its agents to ensure compliance with applicable laws, rules, and regulations with regard to the virtual currency

business.

- 11) Prohibits a licensee from appointing any person as an agent unless it has conducted a review of the proposed agent's fitness to act as an agent and has determined that the proposed agent and any persons who control the proposed agent are of good character and sound financial standing.
- 12) Requires a licensee to maintain records of this review for each agent while the agent is providing any virtual currency business on behalf of the licensee, and for three years after the relationship with the agent has terminated.
- 13) Prohibits a person, including an agent, from providing any virtual currency business on behalf of a person not licensed or not exempt from licensure under this division.
- 14) Specifies that a person that engages in that activity provides virtual currency business to the same extent as if the person was a licensee and shall be jointly and severally liable with the unlicensed or nonexempt person.
- 15) Allows the commissioner at any time and from time to time examine the business and any branch office, within or outside this state, of any licensee in order to ascertain whether that business is being conducted in a lawful manner and whether all virtual currency held or exchanged is properly accounted for.
- 16) Requires the directors, officers, and employees of any licensee being examined by the commissioner shall exhibit to the commissioner, on request, any or all of the licensee's accounts, books, correspondence, memoranda, papers, and other records and shall otherwise facilitate the examination so far as it may be in their power to do so.
- 17) Requires a licensee to file a report with the commissioner within five business days after the licensee has reason to know of any occurrence of the following events:
 - a) The filing of a petition by or against the licensee under the United States Bankruptcy Code (11 U.S.C. Secs. 101-110, incl.) for bankruptcy or reorganization;
 - b) The filing of a petition by or against the licensee for receivership, the commencement of any other judicial or administrative proceeding for its dissolution or reorganization, or the making of a general assignment for the benefit of its creditors;
 - c) The commencement of a proceeding to revoke or suspend its virtual currency business license in a state or country in which the licensee engages in such business or is licensed to engage in such business;
 - d) The cancellation or other impairment of the licensee's bond or trust account as required by subdivision (b) of Section 26008; or
 - e) A charge or conviction of the licensee or of an executive officer, manager, director, or person in control of the licensee for a felony.

- 18) Requires a licensee to maintain any records as required by the commissioner for determining its compliance with this division for at least three years.
- 19) Allows a licensee to surrender its license by filing with the commissioner the license and a report with any information as the commissioner requires. The voluntary surrender of the license shall become effective at the time and upon the conditions as the commissioner specifies by order.
- 20) Gives authority to the commissioner to prepare written decisions, opinion letters, and other formal written guidance to be issued to persons seeking clarification regarding the requirements of this division.
- 21) Requires the commissioner to make public on the commissioner's Internet Web site all written decisions, opinion letters, and other formal written guidance issued to persons seeking clarification regarding the requirements of this division. The commissioner may, at his or her discretion or upon request by an applicant or licensee, redact proprietary or other confidential information regarding an applicant or licensee from any decision, letter, or other written guidance issued in connection with an applicant or licensee.
- 22) Allows the commissioner to offer informal guidance to any prospective applicant for a license under this division, regarding the conditions of licensure that may be applied to that person. The commissioner shall inform any applicant that requests that guidance of the licensing requirements that will be required of that applicant, based on the information provided by the applicant concerning its plan to conduct business under this division, and the factors used to make that determination.
- 23) Gives the commissioner authority, if the commissioner deems it necessary for the general welfare of the public, to exercise any power set forth in this division with respect to a virtual currency business, regardless of whether an application for a license has been filed with the commissioner, a license has been issued, or, if issued, the license has been surrendered, suspended, or revoked.
- 24) States that if it appears to the commissioner that a licensee is violating or failing to comply with this division, the commissioner may direct the licensee to comply with the law by an order issued under the commissioner's official seal, or if it appears to the commissioner that any licensee is conducting its business in an unsafe or injurious manner, the commissioner may in like manner direct it to discontinue the unsafe or injurious practices. The order shall require the licensee to show cause before the commissioner, at a time and place to be fixed by the commissioner, as to why the order should not be observed.
- 25) Provides that if, upon any hearing the commissioner finds that the licensee is violating or failing to comply with any law of this state or is conducting its business in an unsafe or injurious manner, the commissioner may make a final order directing it to comply with the law or to discontinue the unsafe or injurious practices. A licensee shall comply with the final order unless, within 10 days after the issuance of the order, its enforcement is restrained in a proceeding brought by the licensee.
- 26) Allows the commissioner to issue an order suspending or revoking a license, or taking possession of and placing a licensee in receivership, if after notice and an opportunity for

hearing, the commissioner finds any of the following:

- a) The licensee does not cooperate with an examination or investigation by the commissioner;
- b) The licensee engages in fraud, intentional misrepresentation, or gross negligence;
- c) The competence, experience, character, or general fitness of the licensee, or any director, officer, employee, or person in control of a licensee, indicates that it is not in the public interest to permit the person to provide virtual currency services;
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Now let’s pay in Bitcoin. If you don’t already have bitcoins, you will need to buy some from one of a host of online exchanges and brokerages, using a simple transfer from your regular bank account. You will then assign the bitcoins to a wallet, which functions like an online account. Once inside the coffee shop, you will open your wallet’s smartphone app and hold its QR code reader up to the coffee shop’s device. This allows your embedded secret password to unlock a bitcoin address and publicly informs the bitcoin computer network that you are transferring \$1.75 worth of bitcoin (currently about 0.0075 bitcoin) to the coffee shop’s address. This takes just seconds, and then you walk off with your coffee. Next, in contrast to the pay with credit/debit system, your transaction is immediately broadcast to the world (in alphanumeric data that can’t be traced to you personally). Your information is then gathered up by bitcoin “miners,” the computers that maintain the system and are compensated, roughly every 10 minutes, for their work confirming transactions. The computer that competes successfully to package the data from your coffee purchase adds that information to the blockchain ledger, which prompts all the other miners to investigate the underlying transaction. Once your bona fides are verified, the updated blockchain is considered legitimate, and the miners update their records accordingly. It takes from 10 minutes to an hour for this software-driven network of computers to formally confirm a transfer from your blockchain address to that of the coffee shop—compared with a two- to three-day wait for the settlement of a credit-card transaction. Some new digital currencies are able to finalize transactions within seconds. There are almost zero fees, and the personal information of users isn’t divulged. This bitcoin feature especially appeals to privacy advocates: Nobody learns where you buy coffee. The advantages of digital currency are far more visible in emerging markets. It allows migrant workers, for example, to bypass fees that often run to 10% or more for the international payment services that they use to send money home to their families. Although many companies now accept bitcoin (the latest and biggest being Microsoft Corp.), global usage of the digital currency averaged just \$50 million a day in 2014. Over that same period, Visa and MasterCard processed some \$32 billion a day. The market capitalization for BitCoin is almost at \$4 billion with virtual currency Ripple the next largest at over \$340 million.

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FinCEN issued interpretive guidance earlier this year to clarify how the Bank Secrecy Act (BSA) and FinCEN regulations apply to users, administrators and exchangers of virtual currencies. Under the regulatory framework, virtual currency is defined as having some but not all of the attributes of “real currency” and therefore, virtual currency does not have legal tender status in any jurisdiction. Specifically, the FinCEN guidance addresses convertible virtual currency which either has a real currency equivalent value or serves as a substitute for real currency.

The roles of persons (including legal entities) involved in virtual currency transactions are defined by FinCEN as follows:

- User: A person who obtains virtual currency to purchase goods or services
- Exchanger: A person engaged as a business in the exchange of virtual currency for real currency, funds or other virtual currency
- Administrator: A person engaged as a business in issuing into circulation a virtual currency and who has the authority to redeem and withdraw from circulation such virtual currency

A person, or legal entity, may act in more than one of these capacities. Further, it is important to note that “obtaining” virtual currency covers much more than the scenario of a “user” who merely purchases virtual currency. Depending on the model of the particular currency, a party could “obtain” virtual currency through various acts including earning, harvesting, mining, creating, auto-generating, manufacturing or purchasing.

The threshold issue is whether actions will subject a person or legal entity to BSA’s registration, reporting and recordkeeping regulations that apply to money services businesses (MSBs). A user who obtains convertible virtual currency and uses it to purchase real or virtual goods or services is not subject to MSB compliance because such activity does not meet the definition of “money transmission services” and the user would not be a “money transmitter.”

However, an administrator or exchanger engages in money transmission services and, as a result, is a “money transmitter” under FinCEN definitions by (1) accepting and transmitting convertible virtual currency or (2) buying or selling convertible virtual currency. As a money transmitter, the administrator or exchanger would generally be subject to MSB reporting and recordkeeping.

Further, the FinCEN guidance expressly addresses the category of de-centralized virtual currency – the Bitcoin model – and states that “a person is an exchanger and a money transmitter if the person accepts such de-centralized convertible virtual currency from one person and transmits it to another person as part of the acceptance and transfer of currency, funds, or other value that substitutes for currency.”

In the area of foreign exchange, accepting real currency in exchange for virtual currency is not subject to FinCEN regulations applicable to “dealers in foreign exchange” since a forex transaction involves exchanging the currency of two countries and virtual currency does not constitute legal tender as a currency of a country.

The author's office has been meeting with various stakeholders and will continue to work out the various details of this legislation as it moves forward. Some key issues that still need to be resolved:

- 1) Further strengthen and clarify definition of "virtual currency business."
- 2) Clarify the factors that will be used to determine capitalization requirements.
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- 4) Examine issues relating to start-up companies.

Previous Legislation.

AB 129 (Dickinson), chapter 74, statutes of 2014 clarified California law to ensure that alternative currency, including virtual currency would not be potentially deemed illegal tender.

REGISTERED SUPPORT / OPPOSITION:

Support

None on file.

Opposition

None on file.

Analysis Prepared by: Mark Farouk / B. & F. / (916) 319-3081

Date of Hearing: April 27, 2015

ASSEMBLY COMMITTEE ON BANKING AND FINANCE

Matthew Dababneh, Chair

AB 1326 (Dababneh) – As Amended April 20, 2015

SUBJECT: Virtual currency

SUMMARY: Requires the licensing of entities engaged in the business of virtual currency by the Department of Business Oversight (DBO). Specifically, **this bill:**

- 1) Defines “virtual currency” as any type of digital unit that is used as a medium of exchange or a form of digitally stored value or that is incorporated into payment system technology. Virtual currency shall be broadly construed to include digital units of exchange that (1) have a centralized repository or administrator, (2) are decentralized and have no centralized repository or administrator, or (3) may be created or obtained by computing or manufacturing effort. Virtual currency shall not be construed to include digital units that are used solely within online gaming platforms with no market or application outside of those gaming platforms, nor shall virtual currency be construed to include digital units that are used exclusively as part of a customer affinity or rewards program, and can be applied solely as payment redeemed for goods, services, or for purchases with the issuer or other designated merchants, but cannot be converted into, or redeemed for, fiat currency.
- 2) Defines “virtual currency business” as the conduct of either of the following types of activities involving a California resident:
 - a) Storing, holding, or maintaining custody or control of virtual currency on behalf of others; or
 - b) Providing conversion or exchange services of fiat currency into virtual currency or the conversion or exchange of virtual currency into fiat currency or other value, or the conversion or exchange of one form of virtual currency into another form of virtual currency.
- 3) Provides for the following exemptions:
 - a) The United States or a department, agency, or instrumentality thereof, including any federal reserve bank and any federal home loan bank;
 - b) Money transmission by the United States Postal Service or by a contractor on behalf of the United States Postal Service;
 - c) A state, city, county, city and county, or any other governmental agency or governmental subdivision of a state;
 - d) A commercial bank or industrial bank, the deposits of which are insured by the Federal Deposit Insurance Corporation (FDIC) or its successor, or any foreign (other nation) bank that is licensed under state law or that is authorized under federal law to maintain a federal agency or federal branch office in this state; a trust company licensed pursuant to

Section 1042 or a national association authorized under federal law to engage in a trust banking business; an association or federal association, as defined in Section 5102, the deposits of which are insured by the FDIC or its successor; and any federally or state chartered credit union, with an office in this state, the member accounts of which are insured or guaranteed as provided in Section 14858;

- e) An entity licensed as a money transmitter under the Money Transmission Act;
 - f) A merchant or consumer that utilizes virtual currency solely for the purchase or sale of goods or services; or
 - g) A transaction in which the recipient of virtual currency is an agent of the payee pursuant to a preexisting written contract and delivery of the virtual currency to the agent satisfies the payor's obligation to the payee. "Agent" has the same meaning as that term as defined in Section 2295 of the Civil Code. "Payee" means the provider of goods or services, who is owed payment of money or other monetary value from the payor for the goods or services. "Payor" means the recipient of goods or services, who owes payment of money or monetary value to the payee for the goods or services.
- 4) Requires an applicant for a license to pay the commissioner of DBO (commissioner) a nonrefundable application fee of five thousand dollars (\$5,000).
 - 5) Provides that an applicant for a license shall do so in a form and in a medium prescribed by the commissioner by order or regulation.
 - 6) Allows for the following licensing fees:
 - a) A nonrefundable application fee for filing an application for licensure and approval to acquire control of a licensee is three thousand five hundred dollars (\$3,500);
 - b) A license renewal fee of two thousand five hundred dollars (\$2,500); and
 - c) A licensee shall pay annually on or before July 1, one hundred twenty-five dollars (\$125) for each licensee branch office in this state.
 - 7) Requires that each licensee shall maintain at all times such capital as the commissioner determines is sufficient to ensure the safety and soundness of the licensee and maintain consumer protection and its ongoing operations.
 - 8) Specifies that a licensee shall not appoint or continue any person as agent, unless the licensee and the person have made a written contract that requires the agent to operate in full compliance with this division.
 - 9) Provides that an agent shall not provide any virtual currency business outside the scope of activity permissible under the written contract between the agent and the licensee.
 - 10) Requires each licensee to exercise reasonable supervision over its agents to ensure compliance with applicable laws, rules, and regulations with regard to the virtual currency

business.

- 11) Prohibits a licensee from appointing any person as an agent unless it has conducted a review of the proposed agent's fitness to act as an agent and has determined that the proposed agent and any persons who control the proposed agent are of good character and sound financial standing.
- 12) Requires a licensee to maintain records of this review for each agent while the agent is providing any virtual currency business on behalf of the licensee, and for three years after the relationship with the agent has terminated.
- 13) Prohibits a person, including an agent, from providing any virtual currency business on behalf of a person not licensed or not exempt from licensure under this division.
- 14) Specifies that a person that engages in that activity provides virtual currency business to the same extent as if the person was a licensee and shall be jointly and severally liable with the unlicensed or nonexempt person.
- 15) Allows the commissioner at any time and from time to time examine the business and any branch office, within or outside this state, of any licensee in order to ascertain whether that business is being conducted in a lawful manner and whether all virtual currency held or exchanged is properly accounted for.
- 16) Requires the directors, officers, and employees of any licensee being examined by the commissioner shall exhibit to the commissioner, on request, any or all of the licensee's accounts, books, correspondence, memoranda, papers, and other records and shall otherwise facilitate the examination so far as it may be in their power to do so.
- 17) Requires a licensee to file a report with the commissioner within five business days after the licensee has reason to know of any occurrence of the following events:
 - a) The filing of a petition by or against the licensee under the United States Bankruptcy Code (11 U.S.C. Secs. 101-110, incl.) for bankruptcy or reorganization;
 - b) The filing of a petition by or against the licensee for receivership, the commencement of any other judicial or administrative proceeding for its dissolution or reorganization, or the making of a general assignment for the benefit of its creditors;
 - c) The commencement of a proceeding to revoke or suspend its virtual currency business license in a state or country in which the licensee engages in such business or is licensed to engage in such business;
 - d) The cancellation or other impairment of the licensee's bond or trust account as required by subdivision (b) of Section 26008; or
 - e) A charge or conviction of the licensee or of an executive officer, manager, director, or person in control of the licensee for a felony.

- 18) Requires a licensee to maintain any records as required by the commissioner for determining its compliance with this division for at least three years.
- 19) Allows a licensee to surrender its license by filing with the commissioner the license and a report with any information as the commissioner requires. The voluntary surrender of the license shall become effective at the time and upon the conditions as the commissioner specifies by order.
- 20) Gives authority to the commissioner to prepare written decisions, opinion letters, and other formal written guidance to be issued to persons seeking clarification regarding the requirements of this division.
- 21) Requires the commissioner to make public on the commissioner's Internet Web site all written decisions, opinion letters, and other formal written guidance issued to persons seeking clarification regarding the requirements of this division. The commissioner may, at his or her discretion or upon request by an applicant or licensee, redact proprietary or other confidential information regarding an applicant or licensee from any decision, letter, or other written guidance issued in connection with an applicant or licensee.
- 22) Allows the commissioner to offer informal guidance to any prospective applicant for a license under this division, regarding the conditions of licensure that may be applied to that person. The commissioner shall inform any applicant that requests that guidance of the licensing requirements that will be required of that applicant, based on the information provided by the applicant concerning its plan to conduct business under this division, and the factors used to make that determination.
- 23) Gives the commissioner authority, if the commissioner deems it necessary for the general welfare of the public, to exercise any power set forth in this division with respect to a virtual currency business, regardless of whether an application for a license has been filed with the commissioner, a license has been issued, or, if issued, the license has been surrendered, suspended, or revoked.
- 24) States that if it appears to the commissioner that a licensee is violating or failing to comply with this division, the commissioner may direct the licensee to comply with the law by an order issued under the commissioner's official seal, or if it appears to the commissioner that any licensee is conducting its business in an unsafe or injurious manner, the commissioner may in like manner direct it to discontinue the unsafe or injurious practices. The order shall require the licensee to show cause before the commissioner, at a time and place to be fixed by the commissioner, as to why the order should not be observed.
- 25) Provides that if, upon any hearing the commissioner finds that the licensee is violating or failing to comply with any law of this state or is conducting its business in an unsafe or injurious manner, the commissioner may make a final order directing it to comply with the law or to discontinue the unsafe or injurious practices. A licensee shall comply with the final order unless, within 10 days after the issuance of the order, its enforcement is restrained in a proceeding brought by the licensee.
- 26) Allows the commissioner to issue an order suspending or revoking a license, or taking possession of and placing a licensee in receivership, if after notice and an opportunity for

hearing, the commissioner finds any of the following:

- a) The licensee does not cooperate with an examination or investigation by the commissioner;
- b) The licensee engages in fraud, intentional misrepresentation, or gross negligence;
- c) The competence, experience, character, or general fitness of the licensee, or any director, officer, employee, or person in control of a licensee, indicates that it is not in the public interest to permit the person to provide virtual currency services;
- d) The licensee engages in an unsafe or unsound practice;
- e) The licensee is insolvent, suspends payment of its obligations, or makes a general assignment for the benefit of its creditors;
- f) The licensee has applied for an adjudication of bankruptcy, reorganization, arrangement, or other relief under any bankruptcy, reorganization, insolvency, or moratorium law, or any person has applied for any such relief under that law against the licensee and the licensee has by any affirmative act approved of or consented to the action or the relief has been granted; or,
- g) Any fact or condition exists that, if it had existed at the time when the licensee applied for its license, would have been grounds for denying the application;

- 27) In determining whether a licensee is engaging in an unsafe or unsound practice, the commissioner may consider the size and condition of the licensee's provision of virtual currency services, the magnitude of the loss, the gravity of the violation, and the previous conduct of the person involved.
- 28) Allows the commissioner to assess a civil penalty against a person that violates this division or a regulation adopted or an order issued under this division in an amount not to exceed one thousand dollars (\$1,000) for each violation or, in the case of a continuing violation, one thousand dollars (\$1,000) for each day or part thereof during which the violation continues, plus this state's costs and expenses for the investigation and prosecution of the matter, including reasonable attorney's fees.
- 29) Specifies that a person that engages in unlicensed activity or intentionally makes a false statement, misrepresentation, or false certification in a record filed or required to be maintained under this division or that intentionally makes a false entry or omits a material entry in such a record is guilty of a felony.
- 30) Allows the commissioner, by order or regulation grant exemptions from this section in cases where the commissioner finds that the requirements of this section are not necessary or may be duplicative.
- 31) Requires a licensee, within 90 days after the end of each fiscal year, or within any extended time as the commissioner may prescribe, file with the commissioner an audit report for the

fiscal year.

- 32) Specifies that each licensee shall, not more than 45 days after the end of each calendar year quarter, or within a longer period as the commissioner may by regulation or order specify, file with the commissioner a report containing all of the following:
- a) Financial statements, including balance sheet, income statement, statement of changes in shareholders' equity, and statement of cashflows, for, or as of the end of, that calendar year quarter, verified by two of the licensee's principal officers. The verification shall state that each of the officers making the verification has a personal knowledge of the matters in the report and that each of them believes that each statement in the report is true; and,
 - b) Other information as the commissioner may by regulation or order require.
- 33) Allows the commissioner to levy an assessment each fiscal year, on a pro rata basis, on those licensees that at any time during the preceding calendar year engaged in this state in the virtual currency business in an amount that is, in his or her judgment, sufficient to meet the commissioner's expenses in administering the provisions of this division and to provide a reasonable reserve for contingencies.
- 34) Requires a licensee to disclose to consumers the following disclosure in a form and manner prescribed by the commissioner:

"Once submitted to the network, a virtual currency transaction will be unconfirmed for a period of time (usually less than one hour, but up to one day or more) pending sufficient confirmation of the transaction by the network. A transaction is not complete while it is in a pending state. Virtual currency associated with transactions that are in a pending state will be designated accordingly, and will not be included in your account balance or be available to conduct transactions.

The risk of loss in trading or holding virtual currency can be substantial. You should therefore carefully consider whether trading or holding virtual currency is suitable for you in light of your financial condition. In considering whether to trade or hold virtual currency, you should be aware that the price or value of virtual currency can change rapidly, decrease, and potentially even fall to zero.

(Insert company name) is licensed by the Department of Business Oversight to do business in California. If you have complaints with respect to any aspect of the virtual currency business conducted by (company name), you may contact the California Department of Business Oversight at its toll-free telephone number, 1-800-622-0620, by email at consumer.services@dbo.ca.gov, or by mail at the Department of Business Oversight, Consumer Services, 1515 K Street, Suite 200, Sacramento, CA 95814."

EXISTING LAW: Regulates the transmission of money under the money transmission act (Financial Code, Section 2000-2175)

FISCAL EFFECT: Unknown

COMMENTS:

The author has introduced this bill to ensure that entities that store virtual currency or offer the exchange of virtual currency with consumers are operated in a safe and sound manner. AB 1326 will protect consumers that utilize virtual currency services by ensuring that these businesses are able to protect consumer's virtual currency from potential loss. Additionally, this bill will provide regulatory certainty as many companies try to engage in the virtual currency business have sought out money transmission licenses only to be denied, or are even unsure if their business model fits into existing licensing structures for other financial services entities.

The New York State Department of Banking was the first regulatory agency to issue regulations concerning virtual currency. This launched nationwide efforts to look at whether the virtual currency business should be regulated. The Conference of State Banking Supervisors (CSBS) formed the CSBS Emerging Payments Task Force ("Task Force") to examine the intersection between state supervision and payments developments, and to identify areas for consistent regulatory approaches among states. This effort includes an assessment of virtual currency activities and outreach with a broad range of stakeholders. After engaging with industry participants, state and federal regulators, and other stakeholders, CSBS recommended that activities involving third party control of virtual currency, including for the purposes of transmitting, exchanging, holding, or otherwise controlling virtual currency, should be subject to state licensure and supervision.

Headlines concerning virtual currency have been dominated by Bitcoin with some of this attention resulting from negative publicity. The high profile *Silk Road* case in which federal law enforcement officials arrested the operator of an online illegal drug market place that facilitated the sale of drugs and other illegal goods through acceptance of Bitcoins. Bitcoins were used because it is a decentralized currency allowing users to be pseudonymous to some extent, even though every Bitcoin transaction is logged. Bitcoin is not the first, nor the only virtual currency. Numerous models of virtual currency have sprouted up over the last decade, and this growth has inspired additional questions by government officials and policy makers.

Bitcoin has received its share of negative attention from its wild price fluctuations, awareness against Bitcoin "Wallets" (as the individual software applications that manage bitcoin holdings) to being credited with being the currency of choice for criminal activity. As to the latter attribution, cash money is still the dominant and preferred source of anonymous payment for illegal activities. Some of the attention, specifically in relation to the risk associated with storing virtual currency has raised the attention of state regulators across the country.

Even though the core program that runs bitcoin has resisted six years of hacking attempts, the successful attacks on associated businesses have created the impression that bitcoin isn't a safe way to store money. Bitcoins exist purely as entries in an accounting system—a transparent public ledger known as the "blockchain" that records balances and transfers among special bitcoin "addresses." With bitcoin, the balances held by every user of the monetary system are instead recorded on a widely distributed, publicly displayed ledger that is kept up-to-date by thousands of independently owned, competing computers known as "miners."

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REGISTERED SUPPORT / OPPOSITION:

Support

None on file.

Opposition

None on file.

Analysis Prepared by: Mark Farouk / B. & F. / (916) 319-3081

Date of Hearing: April 27, 2015

ASSEMBLY COMMITTEE ON BANKING AND FINANCE

Matthew Dababneh, Chair

AB 1326 (Dababneh) – As Amended April 20, 2015

SUBJECT: Virtual currency

SUMMARY: Requires the licensing of entities engaged in the business of virtual currency by the Department of Business Oversight (DBO). Specifically, **this bill:**

- 1) Defines “virtual currency” as any type of digital unit that is used as a medium of exchange or a form of digitally stored value or that is incorporated into payment system technology. Virtual currency shall be broadly construed to include digital units of exchange that (1) have a centralized repository or administrator, (2) are decentralized and have no centralized repository or administrator, or (3) may be created or obtained by computing or manufacturing effort. Virtual currency shall not be construed to include digital units that are used solely within online gaming platforms with no market or application outside of those gaming platforms, nor shall virtual currency be construed to include digital units that are used exclusively as part of a customer affinity or rewards program, and can be applied solely as payment redeemed for goods, services, or for purchases with the issuer or other designated merchants, but cannot be converted into, or redeemed for, fiat currency.
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 - a) The United States or a department, agency, or instrumentality thereof, including any federal reserve bank and any federal home loan bank;
 - b) Money transmission by the United States Postal Service or by a contractor on behalf of the United States Postal Service;
 - c) A state, city, county, city and county, or any other governmental agency or governmental subdivision of a state;
 - d) A commercial bank or industrial bank, the deposits of which are insured by the Federal Deposit Insurance Corporation (FDIC) or its successor, or any foreign (other nation) bank that is licensed under state law or that is authorized under federal law to maintain a federal agency or federal branch office in this state; a trust company licensed pursuant to

Section 1042 or a national association authorized under federal law to engage in a trust banking business; an association or federal association, as defined in Section 5102, the deposits of which are insured by the FDIC or its successor; and any federally or state chartered credit union, with an office in this state, the member accounts of which are insured or guaranteed as provided in Section 14858;

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 - 6) Allows for the following licensing fees:
 - a) A nonrefundable application fee for filing an application for licensure and approval to acquire control of a licensee is three thousand five hundred dollars (\$3,500);
 - b) A license renewal fee of two thousand five hundred dollars (\$2,500); and
 - c) A licensee shall pay annually on or before July 1, one hundred twenty-five dollars (\$125) for each licensee branch office in this state.
 - 7) Requires that each licensee shall maintain at all times such capital as the commissioner determines is sufficient to ensure the safety and soundness of the licensee and maintain consumer protection and its ongoing operations.
 - 8) Specifies that a licensee shall not appoint or continue any person as agent, unless the licensee and the person have made a written contract that requires the agent to operate in full compliance with this division.
 - 9) Provides that an agent shall not provide any virtual currency business outside the scope of activity permissible under the written contract between the agent and the licensee.
 - 10) Requires each licensee to exercise reasonable supervision over its agents to ensure compliance with applicable laws, rules, and regulations with regard to the virtual currency

business.

- 11) Prohibits a licensee from appointing any person as an agent unless it has conducted a review of the proposed agent's fitness to act as an agent and has determined that the proposed agent and any persons who control the proposed agent are of good character and sound financial standing.
- 12) Requires a licensee to maintain records of this review for each agent while the agent is providing any virtual currency business on behalf of the licensee, and for three years after the relationship with the agent has terminated.
- 13) Prohibits a person, including an agent, from providing any virtual currency business on behalf of a person not licensed or not exempt from licensure under this division.
- 14) Specifies that a person that engages in that activity provides virtual currency business to the same extent as if the person was a licensee and shall be jointly and severally liable with the unlicensed or nonexempt person.
- 15) Allows the commissioner at any time and from time to time examine the business and any branch office, within or outside this state, of any licensee in order to ascertain whether that business is being conducted in a lawful manner and whether all virtual currency held or exchanged is properly accounted for.
- 16) Requires the directors, officers, and employees of any licensee being examined by the commissioner shall exhibit to the commissioner, on request, any or all of the licensee's accounts, books, correspondence, memoranda, papers, and other records and shall otherwise facilitate the examination so far as it may be in their power to do so.
- 17) Requires a licensee to file a report with the commissioner within five business days after the licensee has reason to know of any occurrence of the following events:
 - a) The filing of a petition by or against the licensee under the United States Bankruptcy Code (11 U.S.C. Secs. 101-110, incl.) for bankruptcy or reorganization;
 - b) The filing of a petition by or against the licensee for receivership, the commencement of any other judicial or administrative proceeding for its dissolution or reorganization, or the making of a general assignment for the benefit of its creditors;
 - c) The commencement of a proceeding to revoke or suspend its virtual currency business license in a state or country in which the licensee engages in such business or is licensed to engage in such business;
 - d) The cancellation or other impairment of the licensee's bond or trust account as required by subdivision (b) of Section 26008; or
 - e) A charge or conviction of the licensee or of an executive officer, manager, director, or person in control of the licensee for a felony.

- 18) Requires a licensee to maintain any records as required by the commissioner for determining its compliance with this division for at least three years.
- 19) Allows a licensee to surrender its license by filing with the commissioner the license and a report with any information as the commissioner requires. The voluntary surrender of the license shall become effective at the time and upon the conditions as the commissioner specifies by order.
- 20) Gives authority to the commissioner to prepare written decisions, opinion letters, and other formal written guidance to be issued to persons seeking clarification regarding the requirements of this division.
- 21) Requires the commissioner to make public on the commissioner's Internet Web site all written decisions, opinion letters, and other formal written guidance issued to persons seeking clarification regarding the requirements of this division. The commissioner may, at his or her discretion or upon request by an applicant or licensee, redact proprietary or other confidential information regarding an applicant or licensee from any decision, letter, or other written guidance issued in connection with an applicant or licensee.
- 22) Allows the commissioner to offer informal guidance to any prospective applicant for a license under this division, regarding the conditions of licensure that may be applied to that person. The commissioner shall inform any applicant that requests that guidance of the licensing requirements that will be required of that applicant, based on the information provided by the applicant concerning its plan to conduct business under this division, and the factors used to make that determination.
- 23) Gives the commissioner authority, if the commissioner deems it necessary for the general welfare of the public, to exercise any power set forth in this division with respect to a virtual currency business, regardless of whether an application for a license has been filed with the commissioner, a license has been issued, or, if issued, the license has been surrendered, suspended, or revoked.
- 24) States that if it appears to the commissioner that a licensee is violating or failing to comply with this division, the commissioner may direct the licensee to comply with the law by an order issued under the commissioner's official seal, or if it appears to the commissioner that any licensee is conducting its business in an unsafe or injurious manner, the commissioner may in like manner direct it to discontinue the unsafe or injurious practices. The order shall require the licensee to show cause before the commissioner, at a time and place to be fixed by the commissioner, as to why the order should not be observed.
- 25) Provides that if, upon any hearing the commissioner finds that the licensee is violating or failing to comply with any law of this state or is conducting its business in an unsafe or injurious manner, the commissioner may make a final order directing it to comply with the law or to discontinue the unsafe or injurious practices. A licensee shall comply with the final order unless, within 10 days after the issuance of the order, its enforcement is restrained in a proceeding brought by the licensee.
- 26) Allows the commissioner to issue an order suspending or revoking a license, or taking possession of and placing a licensee in receivership, if after notice and an opportunity for

hearing, the commissioner finds any of the following:

- a) The licensee does not cooperate with an examination or investigation by the commissioner;
- b) The licensee engages in fraud, intentional misrepresentation, or gross negligence;
- c) The competence, experience, character, or general fitness of the licensee, or any director, officer, employee, or person in control of a licensee, indicates that it is not in the public interest to permit the person to provide virtual currency services;
- d) The licensee engages in an unsafe or unsound practice;
- e) The licensee is insolvent, suspends payment of its obligations, or makes a general assignment for the benefit of its creditors;
- f) The licensee has applied for an adjudication of bankruptcy, reorganization, arrangement, or other relief under any bankruptcy, reorganization, insolvency, or moratorium law, or any person has applied for any such relief under that law against the licensee and the licensee has by any affirmative act approved of or consented to the action or the relief has been granted; or,
- g) Any fact or condition exists that, if it had existed at the time when the licensee applied for its license, would have been grounds for denying the application;

- 27) In determining whether a licensee is engaging in an unsafe or unsound practice, the commissioner may consider the size and condition of the licensee's provision of virtual currency services, the magnitude of the loss, the gravity of the violation, and the previous conduct of the person involved.
- 28) Allows the commissioner to assess a civil penalty against a person that violates this division or a regulation adopted or an order issued under this division in an amount not to exceed one thousand dollars (\$1,000) for each violation or, in the case of a continuing violation, one thousand dollars (\$1,000) for each day or part thereof during which the violation continues, plus this state's costs and expenses for the investigation and prosecution of the matter, including reasonable attorney's fees.
- 29) Specifies that a person that engages in unlicensed activity or intentionally makes a false statement, misrepresentation, or false certification in a record filed or required to be maintained under this division or that intentionally makes a false entry or omits a material entry in such a record is guilty of a felony.
- 30) Allows the commissioner, by order or regulation grant exemptions from this section in cases where the commissioner finds that the requirements of this section are not necessary or may be duplicative.
- 31) Requires a licensee, within 90 days after the end of each fiscal year, or within any extended time as the commissioner may prescribe, file with the commissioner an audit report for the

fiscal year.

- 32) Specifies that each licensee shall, not more than 45 days after the end of each calendar year quarter, or within a longer period as the commissioner may by regulation or order specify, file with the commissioner a report containing all of the following:
- a) Financial statements, including balance sheet, income statement, statement of changes in shareholders' equity, and statement of cashflows, for, or as of the end of, that calendar year quarter, verified by two of the licensee's principal officers. The verification shall state that each of the officers making the verification has a personal knowledge of the matters in the report and that each of them believes that each statement in the report is true; and,
 - b) Other information as the commissioner may by regulation or order require.
- 33) Allows the commissioner to levy an assessment each fiscal year, on a pro rata basis, on those licensees that at any time during the preceding calendar year engaged in this state in the virtual currency business in an amount that is, in his or her judgment, sufficient to meet the commissioner's expenses in administering the provisions of this division and to provide a reasonable reserve for contingencies.
- 34) Requires a licensee to disclose to consumers the following disclosure in a form and manner prescribed by the commissioner:

"Once submitted to the network, a virtual currency transaction will be unconfirmed for a period of time (usually less than one hour, but up to one day or more) pending sufficient confirmation of the transaction by the network. A transaction is not complete while it is in a pending state. Virtual currency associated with transactions that are in a pending state will be designated accordingly, and will not be included in your account balance or be available to conduct transactions.

The risk of loss in trading or holding virtual currency can be substantial. You should therefore carefully consider whether trading or holding virtual currency is suitable for you in light of your financial condition. In considering whether to trade or hold virtual currency, you should be aware that the price or value of virtual currency can change rapidly, decrease, and potentially even fall to zero.

(Insert company name) is licensed by the Department of Business Oversight to do business in California. If you have complaints with respect to any aspect of the virtual currency business conducted by (company name), you may contact the California Department of Business Oversight at its toll-free telephone number, 1-800-622-0620, by email at consumer.services@dbo.ca.gov, or by mail at the Department of Business Oversight, Consumer Services, 1515 K Street, Suite 200, Sacramento, CA 95814."

EXISTING LAW: Regulates the transmission of money under the money transmission act (Financial Code, Section 2000-2175)

FISCAL EFFECT: Unknown

COMMENTS:

The author has introduced this bill to ensure that entities that store virtual currency or offer the exchange of virtual currency with consumers are operated in a safe and sound manner. AB 1326 will protect consumers that utilize virtual currency services by ensuring that these businesses are able to protect consumer's virtual currency from potential loss. Additionally, this bill will provide regulatory certainty as many companies try to engage in the virtual currency business have sought out money transmission licenses only to be denied, or are even unsure if their business model fits into existing licensing structures for other financial services entities.

The New York State Department of Banking was the first regulatory agency to issue regulations concerning virtual currency. This launched nationwide efforts to look at whether the virtual currency business should be regulated. The Conference of State Banking Supervisors (CSBS) formed the CSBS Emerging Payments Task Force ("Task Force") to examine the intersection between state supervision and payments developments, and to identify areas for consistent regulatory approaches among states. This effort includes an assessment of virtual currency activities and outreach with a broad range of stakeholders. After engaging with industry participants, state and federal regulators, and other stakeholders, CSBS recommended that activities involving third party control of virtual currency, including for the purposes of transmitting, exchanging, holding, or otherwise controlling virtual currency, should be subject to state licensure and supervision.

Headlines concerning virtual currency have been dominated by Bitcoin with some of this attention resulting from negative publicity. The high profile *Silk Road* case in which federal law enforcement officials arrested the operator of an online illegal drug market place that facilitated the sale of drugs and other illegal goods through acceptance of Bitcoins. Bitcoins were used because it is a decentralized currency allowing users to be pseudonymous to some extent, even though every Bitcoin transaction is logged. Bitcoin is not the first, nor the only virtual currency. Numerous models of virtual currency have sprouted up over the last decade, and this growth has inspired additional questions by government officials and policy makers.

Bitcoin has received its share of negative attention from its wild price fluctuations, awareness against Bitcoin "Wallets" (as the individual software applications that manage bitcoin holdings) to being credited with being the currency of choice for criminal activity. As to the latter attribution, cash money is still the dominant and preferred source of anonymous payment for illegal activities. Some of the attention, specifically in relation to the risk associated with storing virtual currency has raised the attention of state regulators across the country.

Even though the core program that runs bitcoin has resisted six years of hacking attempts, the successful attacks on associated businesses have created the impression that bitcoin isn't a safe way to store money. Bitcoins exist purely as entries in an accounting system—a transparent public ledger known as the "blockchain" that records balances and transfers among special bitcoin "addresses." With bitcoin, the balances held by every user of the monetary system are instead recorded on a widely distributed, publicly displayed ledger that is kept up-to-date by thousands of independently owned, competing computers known as "miners."

What does a real world transaction look like such as buying a cup of coffee at your local coffee shop? If you pay with a credit card, the transaction seems simple enough: You swipe your card, you grab your cup, and you leave. The financial system is just getting started with you and the coffee shop. Before the store actually gets paid and your bank balance falls, more than a half-

dozen institutions—such as a billing processor, the card association your bank, the coffee shop’s bank, a payment processor, the clearinghouse network managed by the regional Federal Reserve Banks—will have shared part of your account information or otherwise intervened in the flow of money. If all goes well, your bank will confirm your identity and good credit and send payment to the coffee shop’s bank two or three days later. For this privilege, the coffee shop pays a fee of between 2% and 3%.

Now let’s pay in Bitcoin. If you don’t already have bitcoins, you will need to buy some from one of a host of online exchanges and brokerages, using a simple transfer from your regular bank account. You will then assign the bitcoins to a wallet, which functions like an online account. Once inside the coffee shop, you will open your wallet’s smartphone app and hold its QR code reader up to the coffee shop’s device. This allows your embedded secret password to unlock a bitcoin address and publicly informs the bitcoin computer network that you are transferring \$1.75 worth of bitcoin (currently about 0.0075 bitcoin) to the coffee shop’s address. This takes just seconds, and then you walk off with your coffee. Next, in contrast to the pay with credit/debit system, your transaction is immediately broadcast to the world (in alphanumeric data that can’t be traced to you personally). Your information is then gathered up by bitcoin “miners,” the computers that maintain the system and are compensated, roughly every 10 minutes, for their work confirming transactions. The computer that competes successfully to package the data from your coffee purchase adds that information to the blockchain ledger, which prompts all the other miners to investigate the underlying transaction. Once your bona fides are verified, the updated blockchain is considered legitimate, and the miners update their records accordingly. It takes from 10 minutes to an hour for this software-driven network of computers to formally confirm a transfer from your blockchain address to that of the coffee shop—compared with a two- to three-day wait for the settlement of a credit-card transaction. Some new digital currencies are able to finalize transactions within seconds. There are almost zero fees, and the personal information of users isn’t divulged. This bitcoin feature especially appeals to privacy advocates: Nobody learns where you buy coffee. The advantages of digital currency are far more visible in emerging markets. It allows migrant workers, for example, to bypass fees that often run to 10% or more for the international payment services that they use to send money home to their families. Although many companies now accept bitcoin (the latest and biggest being Microsoft Corp.), global usage of the digital currency averaged just \$50 million a day in 2014. Over that same period, Visa and MasterCard processed some \$32 billion a day. The market capitalization for BitCoin is almost at \$4 billion with virtual currency Ripple the next largest at over \$340 million.

FinCEN Guidance on Virtual Currencies

FinCEN issued interpretive guidance earlier this year to clarify how the Bank Secrecy Act (BSA) and FinCEN regulations apply to users, administrators and exchangers of virtual currencies. Under the regulatory framework, virtual currency is defined as having some but not all of the attributes of “real currency” and therefore, virtual currency does not have legal tender status in any jurisdiction. Specifically, the FinCEN guidance addresses convertible virtual currency which either has a real currency equivalent value or serves as a substitute for real currency.

The roles of persons (including legal entities) involved in virtual currency transactions are defined by FinCEN as follows:

- User: A person who obtains virtual currency to purchase goods or services
- Exchanger: A person engaged as a business in the exchange of virtual currency for real currency, funds or other virtual currency
- Administrator: A person engaged as a business in issuing into circulation a virtual currency and who has the authority to redeem and withdraw from circulation such virtual currency

A person, or legal entity, may act in more than one of these capacities. Further, it is important to note that “obtaining” virtual currency covers much more than the scenario of a “user” who merely purchases virtual currency. Depending on the model of the particular currency, a party could “obtain” virtual currency through various acts including earning, harvesting, mining, creating, auto-generating, manufacturing or purchasing.

The threshold issue is whether actions will subject a person or legal entity to BSA’s registration, reporting and recordkeeping regulations that apply to money services businesses (MSBs). A user who obtains convertible virtual currency and uses it to purchase real or virtual goods or services is not subject to MSB compliance because such activity does not meet the definition of “money transmission services” and the user would not be a “money transmitter.”

However, an administrator or exchanger engages in money transmission services and, as a result, is a “money transmitter” under FinCEN definitions by (1) accepting and transmitting convertible virtual currency or (2) buying or selling convertible virtual currency. As a money transmitter, the administrator or exchanger would generally be subject to MSB reporting and recordkeeping.

Further, the FinCEN guidance expressly addresses the category of de-centralized virtual currency – the Bitcoin model – and states that “a person is an exchanger and a money transmitter if the person accepts such de-centralized convertible virtual currency from one person and transmits it to another person as part of the acceptance and transfer of currency, funds, or other value that substitutes for currency.”

In the area of foreign exchange, accepting real currency in exchange for virtual currency is not subject to FinCEN regulations applicable to “dealers in foreign exchange” since a forex transaction involves exchanging the currency of two countries and virtual currency does not constitute legal tender as a currency of a country.

The author's office has been meeting with various stakeholders and will continue to work out the various details of this legislation as it moves forward. Some key issues that still need to be resolved:

- 1) Further strengthen and clarify definition of "virtual currency business."
- 2) Clarify the factors that will be used to determine capitalization requirements.
- 3) Specify clear bonding and security amounts and factors used to make that determination.
- 4) Examine issues relating to start-up companies.

Previous Legislation.

AB 129 (Dickinson), chapter 74, statutes of 2014 clarified California law to ensure that alternative currency, including virtual currency would not be potentially deemed illegal tender.

REGISTERED SUPPORT / OPPOSITION:

Support

None on file.

Opposition

None on file.

Analysis Prepared by: Mark Farouk / B. & F. / (916) 319-3081

Date of Hearing: April 27, 2015

ASSEMBLY COMMITTEE ON BANKING AND FINANCE

Matthew Dababneh, Chair

AB 1326 (Dababneh) – As Amended April 20, 2015

SUBJECT: Virtual currency

SUMMARY: Requires the licensing of entities engaged in the business of virtual currency by the Department of Business Oversight (DBO). Specifically, **this bill:**

- 1) Defines “virtual currency” as any type of digital unit that is used as a medium of exchange or a form of digitally stored value or that is incorporated into payment system technology. Virtual currency shall be broadly construed to include digital units of exchange that (1) have a centralized repository or administrator, (2) are decentralized and have no centralized repository or administrator, or (3) may be created or obtained by computing or manufacturing effort. Virtual currency shall not be construed to include digital units that are used solely within online gaming platforms with no market or application outside of those gaming platforms, nor shall virtual currency be construed to include digital units that are used exclusively as part of a customer affinity or rewards program, and can be applied solely as payment redeemed for goods, services, or for purchases with the issuer or other designated merchants, but cannot be converted into, or redeemed for, fiat currency.
- 2) Defines “virtual currency business” as the conduct of either of the following types of activities involving a California resident:
 - a) Storing, holding, or maintaining custody or control of virtual currency on behalf of others; or
 - b) Providing conversion or exchange services of fiat currency into virtual currency or the conversion or exchange of virtual currency into fiat currency or other value, or the conversion or exchange of one form of virtual currency into another form of virtual currency.
- 3) Provides for the following exemptions:
 - a) The United States or a department, agency, or instrumentality thereof, including any federal reserve bank and any federal home loan bank;
 - b) Money transmission by the United States Postal Service or by a contractor on behalf of the United States Postal Service;
 - c) A state, city, county, city and county, or any other governmental agency or governmental subdivision of a state;
 - d) A commercial bank or industrial bank, the deposits of which are insured by the Federal Deposit Insurance Corporation (FDIC) or its successor, or any foreign (other nation) bank that is licensed under state law or that is authorized under federal law to maintain a federal agency or federal branch office in this state; a trust company licensed pursuant to

Section 1042 or a national association authorized under federal law to engage in a trust banking business; an association or federal association, as defined in Section 5102, the deposits of which are insured by the FDIC or its successor; and any federally or state chartered credit union, with an office in this state, the member accounts of which are insured or guaranteed as provided in Section 14858;

- e) An entity licensed as a money transmitter under the Money Transmission Act;
 - f) A merchant or consumer that utilizes virtual currency solely for the purchase or sale of goods or services; or
 - g) A transaction in which the recipient of virtual currency is an agent of the payee pursuant to a preexisting written contract and delivery of the virtual currency to the agent satisfies the payor's obligation to the payee. "Agent" has the same meaning as that term as defined in Section 2295 of the Civil Code. "Payee" means the provider of goods or services, who is owed payment of money or other monetary value from the payor for the goods or services. "Payor" means the recipient of goods or services, who owes payment of money or monetary value to the payee for the goods or services.
- 4) Requires an applicant for a license to pay the commissioner of DBO (commissioner) a nonrefundable application fee of five thousand dollars (\$5,000).
 - 5) Provides that an applicant for a license shall do so in a form and in a medium prescribed by the commissioner by order or regulation.
 - 6) Allows for the following licensing fees:
 - a) A nonrefundable application fee for filing an application for licensure and approval to acquire control of a licensee is three thousand five hundred dollars (\$3,500);
 - b) A license renewal fee of two thousand five hundred dollars (\$2,500); and
 - c) A licensee shall pay annually on or before July 1, one hundred twenty-five dollars (\$125) for each licensee branch office in this state.
 - 7) Requires that each licensee shall maintain at all times such capital as the commissioner determines is sufficient to ensure the safety and soundness of the licensee and maintain consumer protection and its ongoing operations.
 - 8) Specifies that a licensee shall not appoint or continue any person as agent, unless the licensee and the person have made a written contract that requires the agent to operate in full compliance with this division.
 - 9) Provides that an agent shall not provide any virtual currency business outside the scope of activity permissible under the written contract between the agent and the licensee.
 - 10) Requires each licensee to exercise reasonable supervision over its agents to ensure compliance with applicable laws, rules, and regulations with regard to the virtual currency

business.

- 11) Prohibits a licensee from appointing any person as an agent unless it has conducted a review of the proposed agent's fitness to act as an agent and has determined that the proposed agent and any persons who control the proposed agent are of good character and sound financial standing.
- 12) Requires a licensee to maintain records of this review for each agent while the agent is providing any virtual currency business on behalf of the licensee, and for three years after the relationship with the agent has terminated.
- 13) Prohibits a person, including an agent, from providing any virtual currency business on behalf of a person not licensed or not exempt from licensure under this division.
- 14) Specifies that a person that engages in that activity provides virtual currency business to the same extent as if the person was a licensee and shall be jointly and severally liable with the unlicensed or nonexempt person.
- 15) Allows the commissioner at any time and from time to time examine the business and any branch office, within or outside this state, of any licensee in order to ascertain whether that business is being conducted in a lawful manner and whether all virtual currency held or exchanged is properly accounted for.
- 16) Requires the directors, officers, and employees of any licensee being examined by the commissioner shall exhibit to the commissioner, on request, any or all of the licensee's accounts, books, correspondence, memoranda, papers, and other records and shall otherwise facilitate the examination so far as it may be in their power to do so.
- 17) Requires a licensee to file a report with the commissioner within five business days after the licensee has reason to know of any occurrence of the following events:
 - a) The filing of a petition by or against the licensee under the United States Bankruptcy Code (11 U.S.C. Secs. 101-110, incl.) for bankruptcy or reorganization;
 - b) The filing of a petition by or against the licensee for receivership, the commencement of any other judicial or administrative proceeding for its dissolution or reorganization, or the making of a general assignment for the benefit of its creditors;
 - c) The commencement of a proceeding to revoke or suspend its virtual currency business license in a state or country in which the licensee engages in such business or is licensed to engage in such business;
 - d) The cancellation or other impairment of the licensee's bond or trust account as required by subdivision (b) of Section 26008; or
 - e) A charge or conviction of the licensee or of an executive officer, manager, director, or person in control of the licensee for a felony.

- 18) Requires a licensee to maintain any records as required by the commissioner for determining its compliance with this division for at least three years.
- 19) Allows a licensee to surrender its license by filing with the commissioner the license and a report with any information as the commissioner requires. The voluntary surrender of the license shall become effective at the time and upon the conditions as the commissioner specifies by order.
- 20) Gives authority to the commissioner to prepare written decisions, opinion letters, and other formal written guidance to be issued to persons seeking clarification regarding the requirements of this division.
- 21) Requires the commissioner to make public on the commissioner's Internet Web site all written decisions, opinion letters, and other formal written guidance issued to persons seeking clarification regarding the requirements of this division. The commissioner may, at his or her discretion or upon request by an applicant or licensee, redact proprietary or other confidential information regarding an applicant or licensee from any decision, letter, or other written guidance issued in connection with an applicant or licensee.
- 22) Allows the commissioner to offer informal guidance to any prospective applicant for a license under this division, regarding the conditions of licensure that may be applied to that person. The commissioner shall inform any applicant that requests that guidance of the licensing requirements that will be required of that applicant, based on the information provided by the applicant concerning its plan to conduct business under this division, and the factors used to make that determination.
- 23) Gives the commissioner authority, if the commissioner deems it necessary for the general welfare of the public, to exercise any power set forth in this division with respect to a virtual currency business, regardless of whether an application for a license has been filed with the commissioner, a license has been issued, or, if issued, the license has been surrendered, suspended, or revoked.
- 24) States that if it appears to the commissioner that a licensee is violating or failing to comply with this division, the commissioner may direct the licensee to comply with the law by an order issued under the commissioner's official seal, or if it appears to the commissioner that any licensee is conducting its business in an unsafe or injurious manner, the commissioner may in like manner direct it to discontinue the unsafe or injurious practices. The order shall require the licensee to show cause before the commissioner, at a time and place to be fixed by the commissioner, as to why the order should not be observed.
- 25) Provides that if, upon any hearing the commissioner finds that the licensee is violating or failing to comply with any law of this state or is conducting its business in an unsafe or injurious manner, the commissioner may make a final order directing it to comply with the law or to discontinue the unsafe or injurious practices. A licensee shall comply with the final order unless, within 10 days after the issuance of the order, its enforcement is restrained in a proceeding brought by the licensee.
- 26) Allows the commissioner to issue an order suspending or revoking a license, or taking possession of and placing a licensee in receivership, if after notice and an opportunity for

hearing, the commissioner finds any of the following:

- a) The licensee does not cooperate with an examination or investigation by the commissioner;
- b) The licensee engages in fraud, intentional misrepresentation, or gross negligence;
- c) The competence, experience, character, or general fitness of the licensee, or any director, officer, employee, or person in control of a licensee, indicates that it is not in the public interest to permit the person to provide virtual currency services;
- d) The licensee engages in an unsafe or unsound practice;
- e) The licensee is insolvent, suspends payment of its obligations, or makes a general assignment for the benefit of its creditors;
- f) The licensee has applied for an adjudication of bankruptcy, reorganization, arrangement, or other relief under any bankruptcy, reorganization, insolvency, or moratorium law, or any person has applied for any such relief under that law against the licensee and the licensee has by any affirmative act approved of or consented to the action or the relief has been granted; or,
- g) Any fact or condition exists that, if it had existed at the time when the licensee applied for its license, would have been grounds for denying the application;

- 27) In determining whether a licensee is engaging in an unsafe or unsound practice, the commissioner may consider the size and condition of the licensee's provision of virtual currency services, the magnitude of the loss, the gravity of the violation, and the previous conduct of the person involved.
- 28) Allows the commissioner to assess a civil penalty against a person that violates this division or a regulation adopted or an order issued under this division in an amount not to exceed one thousand dollars (\$1,000) for each violation or, in the case of a continuing violation, one thousand dollars (\$1,000) for each day or part thereof during which the violation continues, plus this state's costs and expenses for the investigation and prosecution of the matter, including reasonable attorney's fees.
- 29) Specifies that a person that engages in unlicensed activity or intentionally makes a false statement, misrepresentation, or false certification in a record filed or required to be maintained under this division or that intentionally makes a false entry or omits a material entry in such a record is guilty of a felony.
- 30) Allows the commissioner, by order or regulation grant exemptions from this section in cases where the commissioner finds that the requirements of this section are not necessary or may be duplicative.
- 31) Requires a licensee, within 90 days after the end of each fiscal year, or within any extended time as the commissioner may prescribe, file with the commissioner an audit report for the

fiscal year.

- 32) Specifies that each licensee shall, not more than 45 days after the end of each calendar year quarter, or within a longer period as the commissioner may by regulation or order specify, file with the commissioner a report containing all of the following:
- a) Financial statements, including balance sheet, income statement, statement of changes in shareholders' equity, and statement of cashflows, for, or as of the end of, that calendar year quarter, verified by two of the licensee's principal officers. The verification shall state that each of the officers making the verification has a personal knowledge of the matters in the report and that each of them believes that each statement in the report is true; and,
 - b) Other information as the commissioner may by regulation or order require.
- 33) Allows the commissioner to levy an assessment each fiscal year, on a pro rata basis, on those licensees that at any time during the preceding calendar year engaged in this state in the virtual currency business in an amount that is, in his or her judgment, sufficient to meet the commissioner's expenses in administering the provisions of this division and to provide a reasonable reserve for contingencies.
- 34) Requires a licensee to disclose to consumers the following disclosure in a form and manner prescribed by the commissioner:

"Once submitted to the network, a virtual currency transaction will be unconfirmed for a period of time (usually less than one hour, but up to one day or more) pending sufficient confirmation of the transaction by the network. A transaction is not complete while it is in a pending state. Virtual currency associated with transactions that are in a pending state will be designated accordingly, and will not be included in your account balance or be available to conduct transactions.

The risk of loss in trading or holding virtual currency can be substantial. You should therefore carefully consider whether trading or holding virtual currency is suitable for you in light of your financial condition. In considering whether to trade or hold virtual currency, you should be aware that the price or value of virtual currency can change rapidly, decrease, and potentially even fall to zero.

(Insert company name) is licensed by the Department of Business Oversight to do business in California. If you have complaints with respect to any aspect of the virtual currency business conducted by (company name), you may contact the California Department of Business Oversight at its toll-free telephone number, 1-800-622-0620, by email at consumer.services@dbo.ca.gov, or by mail at the Department of Business Oversight, Consumer Services, 1515 K Street, Suite 200, Sacramento, CA 95814."

EXISTING LAW: Regulates the transmission of money under the money transmission act (Financial Code, Section 2000-2175)

FISCAL EFFECT: Unknown

COMMENTS:

The author has introduced this bill to ensure that entities that store virtual currency or offer the exchange of virtual currency with consumers are operated in a safe and sound manner. AB 1326 will protect consumers that utilize virtual currency services by ensuring that these businesses are able to protect consumer's virtual currency from potential loss. Additionally, this bill will provide regulatory certainty as many companies try to engage in the virtual currency business have sought out money transmission licenses only to be denied, or are even unsure if their business model fits into existing licensing structures for other financial services entities.

The New York State Department of Banking was the first regulatory agency to issue regulations concerning virtual currency. This launched nationwide efforts to look at whether the virtual currency business should be regulated. The Conference of State Banking Supervisors (CSBS) formed the CSBS Emerging Payments Task Force ("Task Force") to examine the intersection between state supervision and payments developments, and to identify areas for consistent regulatory approaches among states. This effort includes an assessment of virtual currency activities and outreach with a broad range of stakeholders. After engaging with industry participants, state and federal regulators, and other stakeholders, CSBS recommended that activities involving third party control of virtual currency, including for the purposes of transmitting, exchanging, holding, or otherwise controlling virtual currency, should be subject to state licensure and supervision.

Headlines concerning virtual currency have been dominated by Bitcoin with some of this attention resulting from negative publicity. The high profile *Silk Road* case in which federal law enforcement officials arrested the operator of an online illegal drug market place that facilitated the sale of drugs and other illegal goods through acceptance of Bitcoins. Bitcoins were used because it is a decentralized currency allowing users to be pseudonymous to some extent, even though every Bitcoin transaction is logged. Bitcoin is not the first, nor the only virtual currency. Numerous models of virtual currency have sprouted up over the last decade, and this growth has inspired additional questions by government officials and policy makers.

Bitcoin has received its share of negative attention from its wild price fluctuations, awareness against Bitcoin "Wallets" (as the individual software applications that manage bitcoin holdings) to being credited with being the currency of choice for criminal activity. As to the latter attribution, cash money is still the dominant and preferred source of anonymous payment for illegal activities. Some of the attention, specifically in relation to the risk associated with storing virtual currency has raised the attention of state regulators across the country.

Even though the core program that runs bitcoin has resisted six years of hacking attempts, the successful attacks on associated businesses have created the impression that bitcoin isn't a safe way to store money. Bitcoins exist purely as entries in an accounting system—a transparent public ledger known as the "blockchain" that records balances and transfers among special bitcoin "addresses." With bitcoin, the balances held by every user of the monetary system are instead recorded on a widely distributed, publicly displayed ledger that is kept up-to-date by thousands of independently owned, competing computers known as "miners."

What does a real world transaction look like such as buying a cup of coffee at your local coffee shop? If you pay with a credit card, the transaction seems simple enough: You swipe your card, you grab your cup, and you leave. The financial system is just getting started with you and the coffee shop. Before the store actually gets paid and your bank balance falls, more than a half-

dozen institutions—such as a billing processor, the card association your bank, the coffee shop’s bank, a payment processor, the clearinghouse network managed by the regional Federal Reserve Banks—will have shared part of your account information or otherwise intervened in the flow of money. If all goes well, your bank will confirm your identity and good credit and send payment to the coffee shop’s bank two or three days later. For this privilege, the coffee shop pays a fee of between 2% and 3%.

Now let’s pay in Bitcoin. If you don’t already have bitcoins, you will need to buy some from one of a host of online exchanges and brokerages, using a simple transfer from your regular bank account. You will then assign the bitcoins to a wallet, which functions like an online account. Once inside the coffee shop, you will open your wallet’s smartphone app and hold its QR code reader up to the coffee shop’s device. This allows your embedded secret password to unlock a bitcoin address and publicly informs the bitcoin computer network that you are transferring \$1.75 worth of bitcoin (currently about 0.0075 bitcoin) to the coffee shop’s address. This takes just seconds, and then you walk off with your coffee. Next, in contrast to the pay with credit/debit system, your transaction is immediately broadcast to the world (in alphanumeric data that can’t be traced to you personally). Your information is then gathered up by bitcoin “miners,” the computers that maintain the system and are compensated, roughly every 10 minutes, for their work confirming transactions. The computer that competes successfully to package the data from your coffee purchase adds that information to the blockchain ledger, which prompts all the other miners to investigate the underlying transaction. Once your bona fides are verified, the updated blockchain is considered legitimate, and the miners update their records accordingly. It takes from 10 minutes to an hour for this software-driven network of computers to formally confirm a transfer from your blockchain address to that of the coffee shop—compared with a two- to three-day wait for the settlement of a credit-card transaction. Some new digital currencies are able to finalize transactions within seconds. There are almost zero fees, and the personal information of users isn’t divulged. This bitcoin feature especially appeals to privacy advocates: Nobody learns where you buy coffee. The advantages of digital currency are far more visible in emerging markets. It allows migrant workers, for example, to bypass fees that often run to 10% or more for the international payment services that they use to send money home to their families. Although many companies now accept bitcoin (the latest and biggest being Microsoft Corp.), global usage of the digital currency averaged just \$50 million a day in 2014. Over that same period, Visa and MasterCard processed some \$32 billion a day. The market capitalization for BitCoin is almost at \$4 billion with virtual currency Ripple the next largest at over \$340 million.

FinCEN Guidance on Virtual Currencies

FinCEN issued interpretive guidance earlier this year to clarify how the Bank Secrecy Act (BSA) and FinCEN regulations apply to users, administrators and exchangers of virtual currencies. Under the regulatory framework, virtual currency is defined as having some but not all of the attributes of “real currency” and therefore, virtual currency does not have legal tender status in any jurisdiction. Specifically, the FinCEN guidance addresses convertible virtual currency which either has a real currency equivalent value or serves as a substitute for real currency.

The roles of persons (including legal entities) involved in virtual currency transactions are defined by FinCEN as follows:

- User: A person who obtains virtual currency to purchase goods or services
- Exchanger: A person engaged as a business in the exchange of virtual currency for real currency, funds or other virtual currency
- Administrator: A person engaged as a business in issuing into circulation a virtual currency and who has the authority to redeem and withdraw from circulation such virtual currency

A person, or legal entity, may act in more than one of these capacities. Further, it is important to note that “obtaining” virtual currency covers much more than the scenario of a “user” who merely purchases virtual currency. Depending on the model of the particular currency, a party could “obtain” virtual currency through various acts including earning, harvesting, mining, creating, auto-generating, manufacturing or purchasing.

The threshold issue is whether actions will subject a person or legal entity to BSA’s registration, reporting and recordkeeping regulations that apply to money services businesses (MSBs). A user who obtains convertible virtual currency and uses it to purchase real or virtual goods or services is not subject to MSB compliance because such activity does not meet the definition of “money transmission services” and the user would not be a “money transmitter.”

However, an administrator or exchanger engages in money transmission services and, as a result, is a “money transmitter” under FinCEN definitions by (1) accepting and transmitting convertible virtual currency or (2) buying or selling convertible virtual currency. As a money transmitter, the administrator or exchanger would generally be subject to MSB reporting and recordkeeping.

Further, the FinCEN guidance expressly addresses the category of de-centralized virtual currency – the Bitcoin model – and states that “a person is an exchanger and a money transmitter if the person accepts such de-centralized convertible virtual currency from one person and transmits it to another person as part of the acceptance and transfer of currency, funds, or other value that substitutes for currency.”

In the area of foreign exchange, accepting real currency in exchange for virtual currency is not subject to FinCEN regulations applicable to “dealers in foreign exchange” since a forex transaction involves exchanging the currency of two countries and virtual currency does not constitute legal tender as a currency of a country.

The author's office has been meeting with various stakeholders and will continue to work out the various details of this legislation as it moves forward. Some key issues that still need to be resolved:

- 1) Further strengthen and clarify definition of "virtual currency business."
- 2) Clarify the factors that will be used to determine capitalization requirements.
- 3) Specify clear bonding and security amounts and factors used to make that determination.
- 4) Examine issues relating to start-up companies.

Previous Legislation.

AB 129 (Dickinson), chapter 74, statutes of 2014 clarified California law to ensure that alternative currency, including virtual currency would not be potentially deemed illegal tender.

REGISTERED SUPPORT / OPPOSITION:

Support

None on file.

Opposition

None on file.

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