

Date of Hearing: April 24, 2023

ASSEMBLY COMMITTEE ON BANKING AND FINANCE

Timothy Grayson, Chair

AB 39 (Grayson) – As Amended January 30, 2023

As Proposed to be Amended

SUBJECT: Digital financial asset businesses: regulatory oversight

SUMMARY: Establishes a licensing and regulatory framework, administered by the Department of Financial Protection and Innovation (DFPI) for digital financial asset business activity, as specified.

Specifically, **this bill:**

- 1) Establishes the Digital Financial Assets Law to be administered by DFPI and prohibits a person from engaging in digital financial asset business activity beginning on January 1, 2025, without a license with DFPI, as specified.
- 2) Defines a “covered person” as a person required to obtain a license, and requires a covered person to comply with specified provisions beginning on January 1, 2024, including provisions related to disclosures (described in #17, below) and stablecoins (#18).
- 3) Exempts from the new division: registered or qualified securities; banks and credit unions; and persons providing only specified computing, network, data storage or security services; and persons whose digital financial asset business activity is reasonably expected to be valued at \$50,000 or less, among other specified exemptions.
- 4) Authorizes DFPI to issue a conditional license to a person with a valid license or charter to conduct virtual currency activity under New York Law, provided that the license or charter was issued or approved prior to January 1, 2023.
- 5) Establishes requirements of an application for licensure, authorizes DFPI to charge a fee to cover the reasonable costs of regulation, and requires DFPI to investigate specified characteristics of the applicant before making a decision on the application.
- 6) Requires a licensee to maintain a surety bond or trust account for the benefit of its customers in a form and amount as determined by DFPI for the protection of the licensee’s customers, as specified.
- 7) Requires a licensee to maintain capital in an amount and form as DFPI determines is sufficient to ensure the financial integrity of the licensee and its ongoing operations based on an assessment of specific risks applicable to the licensee, as specified.
- 8) Establishes a process for a licensee to renew its license on an annual basis.
- 9) Authorizes DFPI to adopt rules necessary to implement the division and issue guidance as appropriate.

- 10) Requires a licensee to file with DFPI a report related to a material change in the information provided in the application for licensure, a material change in the licensee's digital financial asset business activity, or a change of an executive officer, responsible individual, or person in control of the licensee.
- 11) Provides specified applicable rules in determining whether a person has control over a licensee; requires that, at least 30 days prior to a proposed change in control of a licensee, the proposed person to be in control submit an application with the information required by this division for an application for licensure, as applicable; and requires DFPI to decide whether to approve the application, as specified.
- 12) Establishes a process for an application of a proposed merger or consolidation of a licensee with another person.
- 13) Defines "enforcement measure" as an action that contains, but is not limited to the following: (a) suspend or revoke a license; (b) order a person to cease and desist from doing digital financial asset business activity; and (c) request the court to appoint a receiver for the assets of a person doing digital financial asset business activity
- 14) Specifies processes related to enforcement actions, including a person's rights to notice and opportunity for a hearing as appropriate, when revocation of a license is effective, and when a suspension of a license is effective.
- 15) Authorizes DFPI to enter into a consent order with a person regarding an enforcement measure and permits the order to provide that it does not constitute an admission of fact.
- 16) Requires a covered exchange, as defined, prior to listing or offering a digital financial asset, to certify on a form provided by DFPI that the exchange has conducted a comprehensive risk assessment, established policies and procedures to evaluate the appropriateness of the listing, and provided full and fair disclosure of all materials related to conflicts of interest, among other topics.
- 17) Requires a covered person to provide disclosures, as specified, to its customers. Information required to be disclosed includes but is not limited to the following, as specified: (a) a schedule of fees and charges; (b) whether the product or service provided is covered by insurance or other guarantees from loss; (c) a description of specified terms related to their customers' rights and responsibilities and processes associated with transfers or exchanges; (d) that no digital financial asset is currently recognized as legal tender by California or the United States; and (e) a list of instances over the past 12 months when the licensee's service was unavailable to 10,000 or more customers due to a service outage, as specified.
- 18) Provides that a covered person may not exchange, transfer, or store a digital financial asset or engage in digital financial asset administration, whether directly or through an agreement with a digital financial asset control services vendor, if that digital financial asset is a stablecoin unless the issuer of the stablecoin is licensed pursuant to this bill or is a bank and the issuer at all times owns eligible securities having an aggregate market value calculated in accordance with generally accepted accounting principles of not less than the amount of its outstanding stablecoins issued or sold in the United States.

EXISTING LAW:

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

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

COMMENTS:

1) Purpose.

According to the author:

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

2) Background.

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

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

The most commonly used technology that produces and supports virtual currency is distributed ledger technology, which is a decentralized database managed by multiple parties within a network. Blockchain is the most well-known type of distributed ledger technology and supports Bitcoin and many other types of virtual currencies on the market today. Blockchain also enables decentralized finance (DeFi), which is an effort to replicate traditional finance systems through the use of blockchain-enabled contracts. DeFi is built on one of a dozen or so blockchains, including Ethereum, and DeFi applications allow cryptocurrency holders to lend or borrow from other users and engage in other financial activities, such as entering into derivative markets.

Cryptocurrency and DeFi proponents believe that these products and systems are viable alternatives to those found in the traditional financial system. They argue that cryptocurrency is beneficial because it is decentralized, allows peer-to-peer transactions, makes transactions easy and fast, diversifies portfolios, acts as an inflation hedge, encourages cross-border payments, promotes financial inclusion, and provides transactional freedom.

3) Is cryptocurrency money?

As cryptocurrency has grown from a small group of early adopters and hobbyists into a trillion dollar market, a lingering question has been: how should policymakers classify cryptocurrency and regulate it?

There is doubt that cryptocurrency, as it works today, could work well as money. First, as a matter of definition, cryptocurrency is not issued by a central government, and there is no obligation for the government to accept it. Moreover, as a practical matter, it remains doubtful that cryptocurrency could be a viable privately-issued legal tender or facilitate everyday payments. Cryptocurrency can function as a unit of account, a store of value, and a medium of exchange, three necessary features of money. But, unlike most fiat currencies, cryptocurrency also appears to be highly vulnerable to confidence shocks, fraud, and price instability, and consumers must navigate a host of technological and practical obstacles when using it. These are not desirable features of money.

Moreover, many holders of cryptocurrencies use these digital assets to engage in speculative investment activities or other types of financial services activities rather than facilitating payments and conducting everyday transactions. Most cryptocurrency trading happening today treats it as an asset class – a group of investments with particular characteristics – owned for purposes other than payments for goods and services.

4) What are the consumer risks for Californians?

As cryptocurrency proponents note, digital assets, and the accompanying decentralized network of alternative financial systems that support them, present a number of opportunities that could lead to a more efficient financial system.

However, these assets pose significant risks to consumers given the lack of regulatory clarity and established rules for companies operating in this space. These risks have been highlighted in the last year and a half amid the market turmoil of high-profile cases of fraud

(discussed in greater detail below) that have led to multiple firms to declare bankruptcy or reduce operations. Those consumer risks include:

- Fraud, hacks, and scams. Given the newness of the cryptocurrency market and its rapid adoption worldwide, it is not surprising that fraud and scams are widespread. Based on complaints to the Consumer Financial Protection Bureau (CFPB), cryptocurrency wallets and exchanges are often the target of fraud and theft, with some consumers reporting having lost thousands of dollars to unauthorized account access. DeFi is also rife with hacks and theft, with more than \$10.5 billion lost in 2021 alone.¹
- Volatility. Digital financial assets can see their value decline or increase sharply in short periods of time. Unlike a stock or a treasury bond, a cryptocurrency's value is not derived from the market's faith in the underlying company or country; instead, its value is derived from the number of people who believe it has value. As such, cryptocurrency appears particularly susceptible to sell-offs and scares.
- Insider trading and lack of information. A significant risk to consumers is their informational disadvantage compared to industry insiders. This informational disadvantage can manifest in acute terms, such as with insider trading. Media reports and federal investigations suggest that insider trading is a widespread problem in markets for digital financial assets.²

These risks have resulted in significant consumer harm over the last few years, and commentators have highlighted the specific adverse impact on disadvantaged consumers. Crypto industry stakeholders often discuss the role crypto assets can play in promoting financial inclusion, and some studies show that Black and Latino investors are more likely to own cryptocurrency. Unfortunately, this has also meant that recent market events, described below, have likely disproportionately harmed these groups.³

5) Recent events in crypto.

The notorious volatility of the crypto market made major headlines in 2022 and 2023. Last year began on a high note for many industry participants with token prices near all-time highs and venture capital investment pouring into the space. However, beginning in early Spring 2022, a series of major crypto projects collapsed, including:

- In May 2022, the so-called “stablecoin” TerraUSD was unable to maintain its 1:1 peg with the US dollar, precipitating a \$60 billion crash that reverberated across the crypto ecosystem. By mid-May, the Terra collapse had triggered an estimated \$300 billion loss industrywide.

¹ Elleptic, *DeFi: Risk, Regulation, and the Rise of DeCrime* (November 2021), available at <https://www.elliptic.co/resources/defi-risk-regulation-and-the-rise-of-decrime>.

² See, e.g., Ben Foldy and Caitlin Ostroff, “Crypto Might Have an Insider Trading Problem,” Wall Street Journal (May 2022), available at: <https://www.wsj.com/articles/crypto-might-have-an-insider-trading-problem-11653084398>

³ Paulina Cachero, “Crypto Collapse Threatens to Leave Black, Hispanic Investors Further Behind.” Bloomberg (July 2022), available at: <https://www.bloomberg.com/news/articles/2022-07-07/crypto-collapse-threatens-to-leave-black-hispanic-investors-further-behind#xj4y7vzkg>

- In June 2022, Celsius, a crypto lender that marketed itself as an alternative to traditional banks, froze withdrawals and would eventually file for bankruptcy the following month. Three Arrows Capital, a crypto hedge fund, was the next shoe to drop as it was unable to repay its debt obligations, which triggered Voyager, another crypto lender, to file for bankruptcy in early July.
- In November 2022, Sam Bankman-Fried's FTX and Alameda Research empire collapsed, resulting in the eventual arrest of Sam Bankman-Fried himself. In essence, the closely tied companies that Bankman-Fried controlled, led by FTX and Alameda Research, were little more than a fraudulent scheme to steal money from customers and investors. While the specific details of the scheme are currently under investigation by law enforcement across the globe, Bankman-Fried and his co-conspirators apparently had been duping their customers and investors for years and using their customers' assets to make risky bets in crypto markets and to support lavish spending on advertising, international real estate, and political contributions.
- In March 2023, Silvergate Capital Corp, a California-chartered bank that specialized in crypto-related services, announced it would wind down operations and liquidate after it was hit with losses following the collapse of FTX.

6) An update on federal oversight.

Rapid digital asset adoption has led to calls for greater clarity regarding how the federal government should regulate this new and complex world. In March 2022, President Biden signed an executive order (EO) aimed at ensuring the responsible development of digital assets. However, following that EO and the subsequent reports, the Biden Administration's public stance on crypto ranges from disinterest to outright hostility. For example, in March 2023 the Council of Economic Advisors (CEA) released its annual Economic Report to the President, and this report included a dedicated section on digital financial assets. CEA says:

It has been argued that crypto assets may provide other benefits, such as improving payment systems, increasing financial inclusion and creating mechanisms for the distribution of intellectual property and financial value that bypass intermediaries that extract value from both the provider and recipient. Looking under the hood at these arguments, however, shows a more complicated picture. So far, crypto assets have brought none of these benefits.⁴

As the Biden Administration remains publicly skeptical of crypto, the Securities and Exchange Commission (SEC) has ramped up its enforcement against crypto companies for their alleged violations of securities laws. Recent SEC actions include:

- A February 2023 settlement with crypto exchange Kraken related to unregistered securities, with Kraken agreeing to cease offering or selling securities through the crypto

⁴ Council of Economic Advisors, Economic Report to the President (March 2023), available at: <https://www.whitehouse.gov/briefing-room/statements-releases/2023/03/20/statement-from-cea-chair-cecilia-rouse-on-the-economic-report-of-the-president/>

asset staking services or staking programs and pay \$30 million in disgorgement, prejudgment interest, and civil penalties.⁵

- A February 2023 settlement with NBA Hall of Famer Paul Pierce for unlawfully touting crypto asset securities, with Pierce agreeing to pay \$1.3 million in penalties, disgorgement, and interest.⁶
- An April 2023 complaint against crypto asset trading platform Bittrex, Inc., for operating as an unregistered national securities exchange, broker, and clearing agency.⁷

In addition to SEC enforcement actions, in January 2023 the Federal Reserve Board, Federal Deposit Insurance Corporation, and the Office of the Comptroller of the Currency sent a letter to banking organizations highlighting the risks associated with crypto assets. The letter identifies a hosts of risks and warns that “It is important that risks related to the crypto-asset sector that cannot be mitigated or controlled do not migrate to the banking system.”⁸

Congress, on the other hand, does not appear to be nearing any particular agreement on how to address crypto-related risks. Several bills received considerable attention in 2022, including a bill to regulate stablecoins and a bill to regulate the spot markets of certain crypto assets. Neither bill was taken up by either the House or the Senate. In the current Congress, several crypto-related bills have been introduced, but the prospects of any becoming law are unclear given the partisan divide in leadership and increased skepticism of the crypto industry due to the bankruptcy of FTX.

7) An update on state oversight.

Until 2022, the state of California had not taken a proactive stance on regulating crypto, but the activities in the crypto market last year sparked action from the Newsom Administration and Legislature.

On May 4, 2022, Governor Newsom issued EO N-9-22 with the aim of “creat[ing] a transparent regulatory and business environment for web3 companies which harmonizes federal and California approaches, balances the benefits and risks to consumers, and incorporates California values such as equity, inclusivity, and environmental protection.”

As the Administration conducted its activities under the executive order, the Legislature considered its own response to the chaotic conditions of the crypto market. In June 2022, AB 2269 (Grayson), which is similar to this bill, was introduced. The Legislature broadly

⁵ “Kraken to Discontinue Unregistered Offer and Sale of Crypto Asset Staking-As-A-Service Program and Pay \$30 Million to Settle SEC Charges.” Securities and Exchange Commission (February 2023), available at: <https://www.sec.gov/news/press-release/2023-25>

⁶ “SEC Charges NBA Hall of Famer Paul Pierce for Unlawfully Touting and Making Misleading Statements about Crypto Security,” Securities and Exchange Commission Press Release (February 2023), available at: <https://www.sec.gov/news/press-release/2023-34>

⁷ “SEC Charges Crypto Asset Trading Platform Bittrex and its Former CEO for Operating an Unregistered Exchange, Broker, and Clearing Agency,” Securities and Exchange Commission (April 2023), available at: <https://www.sec.gov/news/press-release/2023-78>

⁸ Federal Reserve et al, “Joint Statement on Crypto-Asset Risks to Banking Organizations,” (January 2023), available at: <https://www.federalreserve.gov/newsevents/pressreleases/files/bcreg20230103a1.pdf>

supported AB 2269, with the Senate passing the bill 31-6 and the Assembly supporting it 71-0. AB 2269 was vetoed by the Governor, whose veto message read, in part:

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

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

In December 2022, the Governor's Office released an interagency report reflecting the Administration's work to implement the executive order.⁹ The report summarizes DFPI's work aimed at creating clear and responsible regulatory frameworks. The department met with a variety of federal regulatory agencies and other states' financial regulators to align with government agencies beyond California. DFPI also solicited public comments for feedback on how California should regulate the crypto industry.

On February 22, 2023, the Senate Committee on Banking and Financial Institutions and the Assembly Committee on Banking and Finance convened an oversight hearing to evaluate the state's approach to regulating the crypto industry following the high-profile bankruptcies discussed in Comment #5. DFPI staff presented an update on their role in implementing the EO, and legislators voiced concerns about crypto's harm to consumers and the slow response from the state to adequately protect consumers.

8) What would AB 39 do?

AB 39 would broadly regulate crypto activities through a licensing framework that gives DFPI additional tools to address predatory activities in the crypto market while protecting Californians from bad actors in the industry.

Many provisions found in AB 39 originate from model law drafted by the Uniform Law Commission (ULC). In July 2017 the ULC adopted the Uniform Regulation of Virtual-Currency Businesses Act after an extensive stakeholder process and multiple rounds of drafting, review, and amendments.

AB 39 is substantively similar to last year's AB 2269, though there are several differences that will provide more flexibility for DFPI and licensees. For example, AB 39 allows for

⁹ Business Consumer Services and Housing Agency et al, "Towards Responsible Innovation: An Interagency Web3, Crypto Asset, and Blockchain Progress Report to the Governor of California," (December 2022), available at: https://dfpi.ca.gov/wp-content/uploads/sites/337/2022/12/TowardsResponsibleInnovation_221202.pdf

conditional licenses for companies with a valid New York BitLicense, a licensing program that remains the most robust state-level regulatory framework in the country. AB 39 also replaces AB 2269’s “Best Interest” standard with a more straightforward process by which a company must certify that a digital financial asset meets specified standards, thereby reducing unnecessary complexity for all stakeholders.

The below table highlights key differences between AB 39 and AB 2269.

COMPARISON OF KEY PROVISIONS IN AB 39 (2023) VS AB 2269 (2022)

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

Permanently requires stablecoins to be fully backed by reserves.	Temporarily required stablecoins to be fully backed by reserves.
AB 39 prohibits crypto companies from making a so-called “stablecoin” available for exchange, transfer, or storage unless the stablecoin’s value is backed by reserve assets.	AB 2269 would have also prohibited crypto companies from making a so-called “stablecoin” available for exchange, transfer, or storage unless the stablecoin’s value is backed by reserve assets, but only until January 1, 2028.

9) Support

AB 36 is sponsored by the Consumer Federation of California and is supported by a coalition of consumer advocacy organizations the California Low-Income Consumer Coalition, and Consumer Reports, who argue:

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

AB 36 is also supported by the California Credit Union League (CCUL) and the California Bankers Association (CBA). In their letter, CBA argues:

We believe that a comprehensive regulatory framework that applies the same standards to digital assets that are equivalent to those that apply to depository financial institutions when engaged in functionally similar activities is essential to the safety and soundness of the digital assets’ ecosystem.

Finally, groups representing technology companies and crypto traders write in support. Chamber of Progress, a tech industry association, writes:

The United States has been in need of clear rules of the road for the incredibly nascent digital asset industry, which has faced recent challenges with fraud, hackers, bank runs and liquidity. This bill gives California a seminal moment to showcase its regulatory model across the nation, testing a permission-based licensing model’s effectiveness of maintaining innovation and attracting competition to the state. With the licensing model, California would establish strong consumer protections.

The Digital Currency Traders Alliance (DCTA), a pro-cryptocurrency consumer protection group dedicated to representing retail investors writes in support, citing the need for regulatory clarity. DCTA writes:

AB 39 also prioritizes efficient program administration through provisions that will give flexibility to both licensees and the regulator. These provisions also include flexibility for specified small actors by exempting them from certain provisions of the bill – allowing the state to incubate and spur innovation in the sector.

Although we support the bill and hope it is passed into law, we do have some thoughts on potential exempted entities, and we look forward to working with your office to further clarify the entities that are exempt from the bill's licensing requirements.

10) Support if amended.

Dapper Labs, Inc. and Sorare, Inc. support AB 39 if amended to clarify that non-financial digital consumer products such as NFTs sports trading cards be exempt. They write:

...We are concerned that some may interpret AB 39 to regulate digital assets even if they are not financial, payment, monetary, or investment products. Thus, we request that AB 39 be amended to explicitly clarify that non-financial digital consumer products such as NFT sports trading cards and concert tickets will not be regulated by DFPI. We acknowledge that in the future there may be NFTs used for securities and financial services, and we agree that those would fall within the scope of this legislation and be subject to regulation by DFPI.

11) Oppose unless amended

The Crypto Council for Innovation (CCI), an alliance of crypto companies whose membership includes Coinbase, Block, Gemini, Paradigm, and Andreessen Horowitz, to name some, opposes AB 39 unless amended, writing:

The legislature must work to increase clarity and improve communication structures in the bill, so that expectations for potential licensees and regulators are better aligned. In order to ensure regulated entities are best positioned to compete in a crowded marketplace, the legislature should provide concrete application and review timelines, narrow the scope of the overly broad digital financial asset business activity definition, and ensure licensees are provided written notice before examinations. Additionally, the legislature must expand the federal registration exemption to include entities registered with the Commodity Futures Trading Commission (CFTC) and clarify the mergers and consolidation approval authority it is granting regulators

CCI also lists the 24/7 hour customer service requirement and AB 39's stablecoin provisions as problematic for crypto industry stakeholders.

12) Other

The Blockchain Advocacy Coalition (BAC) does not take a position but has sent a letter expressing concern that AB 39 is overly prescriptive. Among AB 39's provisions, BAC appears to be most concerned with the stablecoin provisions, and concludes that policymakers and stakeholders must try to "strike a balance between protecting California's

consumers while also sending a market signal that our state embraces new technologies that foster financial inclusion, empowerment, and innovation.”

13) Next steps and committee amendments.

The author’s office and sponsor indicate they are still holding meetings with stakeholders and reviewing feedback, and that additional changes may be forthcoming as the bill moves through the legislative process. Moreover, to address the Governor’s concerns about implementation and costs, as stated in the AB 2269 veto message, the author’s office indicates that it is reviewing other licensing laws to identify ways to make AB 39 more consistent with how DFPI currently administers such programs.

The committee also recommends the below amendments. These amendments: (a) Narrow the customer service requirement from 24 hours a day, 7 days a week to 10 hours a day, 5 days a week; (b) Establish the NMLS process, as seen in other licensing programs; (b) Eliminate the requirement that operational and informational security policies be disclosed to customers; (d): Expand conditional licensing opportunities to companies with a New York State limited purpose trust charter; and, (e): Make a variety of technical changes.

Specifically, the committee recommends:

- On page 12, in line 24, strike out “3209.” and insert: 3207.

Rationale: Correct drafting error.

- On page 12, in line 29, strike out “paragraph (1) of”, in line 29, strike out “(d)” and insert: (a)
- On page 12, in line 29, strike out “6254” and insert: 7929.000

Rationale: Correct outdated reference to the Public Records Act (PRA).

- On page 12, in line 35, strike out “Regulations,” and insert: Regulations or a charter as a New York state limited purpose trust company with approval to conduct a virtual currency business under New York law.

On page 12, in line 35, after “license” insert: or approved

On page 13, in line 3, strike out “Regulations.” and insert: Regulations or disapproval or revocation of a charter as a New York state limited purpose trust company with approval to a conduct virtual currency business under New York law.

Rationale: Include companies chartered under New York’s limited purpose trust regime as those companies eligible for conditional licensing.

- On page 13, in line 36, strike out “department”, strike out lines 37 and 38 and insert: commissioner.

Rationale: Fix a drafting error.

- On page 18, between lines 3 and 4, insert:

3217. (a) The commissioner may establish relationships or contracts with the Nationwide Multistate Licensing System & Registry or other entities designated by the Nationwide Multistate Licensing System & Registry to collect and maintain records and process transaction fees or other fees related to licensees or other persons subject to this division.

(b) For the purpose of participating in the Nationwide Multistate Licensing System & Registry, the commissioner may waive or modify, in whole or in part, by rule, regulation, or order, any or all of the requirements of this division and to establish new requirements as reasonably necessary to participate in the Nationwide Multistate Licensing System & Registry.

(c) The commissioner may use the Nationwide Multistate Licensing System & Registry as a channeling agent for requesting information from, and distributing information to, the Department of Justice, any other governmental agency, or any other source, as directed by the commissioner.

(d) The commissioner shall establish a process through which applicants and licensees may challenge information entered into the Nationwide Multistate Licensing System & Registry by the commissioner.

3219. (a) Except as otherwise provided in Section 1512 of the SAFE Act (12 U.S.C. Sec. 5111(a)), the requirements under any federal law or the Information Practices Act of 1977 (Chapter 1 (commencing with Section 1798) of Part 4 of Division 3 of the Civil Code) regarding the privacy or confidentiality of any information or material provided to the Nationwide Multistate Licensing System & Registry, and any privilege arising under federal or state law, including the rules of any state court, with respect to that information or material, shall continue to apply to the information or material after the information or material has been disclosed to the Nationwide Multistate Licensing System & Registry. The information and material may be shared with all state and federal regulatory officials with industry oversight authority without the loss of privilege or the loss of confidentiality protections provided by federal law or the Information Practices Act.

(b) Information or material that is subject to a privilege or confidentiality under subdivision (a) shall not be subject to any of the following:

(1) Disclosure under any federal or state law governing the disclosure to the public of information held by an officer or an agency of the federal government or the state.

(2) Subpoena or discovery, or admission into evidence, in any private civil action or administrative process, unless with respect to any privilege held by the Nationwide Multistate Licensing System & Registry with respect to the information or material, the person to whom the information or material pertains waives, in whole or in part, in the discretion of that person, that privilege.

(c) This section shall not apply with respect to the information or material relating

to the employment history of, and publicly adjudicated disciplinary and enforcement actions included in, the Nationwide Multistate Licensing System & Registry for access by the public.

3221. The commissioner shall regularly report violations of this division, enforcement actions under this division, and other relevant information to the Nationwide Multistate Licensing System & Registry, but only to the extent that the information is publicly available.

Rationale: Align DFPI’s administration with other licensing programs, including the Debt Collector Licensing Act (DCLA), the most recent addition to the Financial Code that incorporates NMLS-related authorization.

- On page 31, in line 8, strike out “coin” and insert: digital financial asset

Rationale: Fixes a drafting error.

- On page 32, in line 22, strike out “24” and insert: 10

On page 32, in line 23, strike out “Sunday,” and insert: Friday,

Rationale: Align customer service provisions with requirements under current law for licensed money transmitters.

- On page 33, in line 33, strike out “or registrant” and in line 34, strike out “or registrant”

Rationale: Fixes a drafting error.

- On page 35, strike out line 28 and insert: section, and may request a determination from the department that a policy or procedure is not subject to the disclosure requirement described in subdivision (k) due to potential security risks.

On page 35, in line 35, strike out “Policies” and insert: (1) Except as provided in paragraph (2), policies

On page 35, between lines 38 and 39, insert:

(2) This subdivision does not apply to either of the following: (A) An adopted information security program or an operational security program described in subdivision (a).

(B) Any policy or procedure the department previously determined is not subject to this subdivision due to potential security risks.

Rationale: AB 39 requires the disclosure of information and operational policies and programs, along with a variety of policies such as antifraud policies. Stakeholders have expressed concerns this would create security risks for companies and their customers. These amendments exempt those information and operational security policies and procedures from disclosure.

REGISTERED SUPPORT / OPPOSITION:

Support

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

Support If Amended

Dapper Labs, INC
Sorare

Oppose Unless Amended

Crypto Council for Innovation

Other

Blockchain Advocacy Coalition

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