

**TESTIMONY OF BRIAN P. BROOKS
CHIEF LEGAL OFFICER, COINBASE GLOBAL, INC.
BEFORE THE ASSEMBLY JOINT HEARING, BANKING AND FINANCE AND SELECT
COMMITTEE ON TECHNOLOGICAL ADVANCES**

October 17, 2019

Leader Calderon, Chair Limon, and Committee Members:

My name is Brian Brooks and since September 2018 I have served as Chief Legal Officer of Coinbase Global, Inc. I am pleased to have the opportunity to appear before you to discuss the structure of the virtual currency market, the regulatory structure currently in place to protect investors and consumers from potential risks, and our views on the Uniform Law Commission's work in this area.

Coinbase Background

Before addressing the Committee's specific areas of interest, please permit me to address the perspective Coinbase brings to the discussion. Among other businesses, Coinbase, which is headquartered in San Francisco, is the largest virtual currency trading platform in the United States. We have more than 30 million accounts for more than 14 million distinct customers who collectively have traded more than \$150 billion in cryptoassets. Our investors include not only well-known Silicon Valley names such as Andreessen Horowitz and DFJ, but also traditional banks and securities firms such as the New York Stock Exchange and the Japanese bank MUFG. Coinbase has more than 800 employees, the majority of them based in California and the remainder based in offices in Portland, Chicago, New York, London, Dublin, and Tokyo.

While we are best known as a platform for buying and selling virtual currencies, we are also the largest custodian of cryptoassets in the world, with over \$20 billion in assets under custody. Our stablecoin, which is built on blockchain technology but whose value is backed 100 percent by U.S. dollar balances held in FDIC-insured bank deposit accounts, is one of the 25 most widely traded virtual currencies in the world, with almost \$475 million in circulating supply and daily transaction volume of over \$150 million. We have pioneered a number of innovations designed to make it easier for everyday customers to access, use, and earn returns on virtual currency holdings, including paying rewards on our stablecoin balances, creating a "staking" platform that allows our customers to earn a rate of return on their proof-of-stake tokens, and other products that make cryptocurrency safer, more valuable, and easier to use.

Market Structure

The market structure of the cryptocurrency market is relatively straightforward.

The manufacturers of the product in this market are referred to as **project developers** or **asset issuers**. At present there are more than 2,000 cryptocurrencies in circulation globally. These tokens represent projects in a wide range of areas, ranging from tokens used to make purchases inside of video games to tokens used to power polling and prediction markets to tokens used in payments systems and lending platforms. It is important to remember that the core purpose of cryptocurrency is not investment returns or even necessarily financial transactions; the core purpose of cryptocurrency is to enable ledgers to be maintained for various purposes without the need for banks or other intermediaries that historically imposed costs and other frictions on the system. Some assets are referred to **security tokens** and are registered with the Securities and Exchange Commission like any securities, while others are not regulated as securities.

Asset issuers generally distribute cryptoassets either through **airdrops** (distributions of assets for free to large numbers of wallet addresses); **initial coin offerings** (often through a Simple Agreement for Future Tokens (“SAFT”)), though these have become less common due to their potential for securities law compliance issues; **initial exchange offerings**; or **Regulation D or other exempt offerings** under the securities laws.

Following the initial distribution of a particular cryptoasset, secondary trading occurs on **crypto exchanges** like Coinbase. Crypto exchanges maintain order books that match buy/sell orders for various asset pairs. Order books that match different pairs of crypto assets are referred to as **crypto-to-crypto** trades, while order books that allow exchanges of crypto assets and fiat currencies are referred to as **fiat-to-crypto** trades. Some crypto exchanges make **margin loans** to allow the purchase of limited amounts of cryptoassets subject to the exchanges’ credit policies.

Participants in cryptocurrency transactions including both **retail and institutional investors** as well as users of cryptoassets for specific use cases. Coinbase alone has more than 14 million retail investors on its platform. In addition, institutional investment in crypto has been on the rise over the past several years and now includes Ivy League and other major university endowments, hedge funds and asset managers, mutual funds, and other significant institutions. Once an investor buys a particular token, the investor can hold it; can sell it on an exchange; can send it to another person on the original exchange or to a recipient on a different exchange; or can send it to a **private or user-controlled wallet** that is not associated with an exchange.

These investors and users must safeguard their **private keys** which allow them to access the cryptographic codes that represent their individual cryptoassets. These private keys can be custodied either in a **hosted wallet** typically maintained by a **custodian** which may also be an exchange (Coinbase is the largest custodian of cryptoassets in the world, as noted above), or in a **user-controlled wallet**. To provide custody to SEC-registered investment advisers, a custodian must meet the requirements of the SEC’s **qualified custodian rule**.

Regulatory Structure

Contrary to popular belief, the cryptocurrency market is subject to a complex web of state and federal regulatory oversight.

At the federal level, investor protection oversight is provided by the Securities and Exchange Commission and the Commodity Futures Trading Commission. The SEC polices both compliance with the Securities Act of 1933, which imposes disclosure and other requirements on assets that qualify as “securities” under federal law, and the Securities Exchange Act of 1934, which imposes requirements on national securities exchanges and alternative trading systems. In addition, the SEC promulgates regulations that govern crypto custodians under the Investment Advisers Act. The SEC has used its authority to issue extensive guidance to asset issuers and crypto exchanges, and has brought a number of high-profile enforcement actions against asset issuers.

One key regulatory gap has been a lack of clarity concerning which specific tokens constitute securities under the Securities Act and related SEC guidance. To address this gap and operationalize case law and SEC guidance, Coinbase and seven other exchanges, investors, and custodians formed the Crypto Rating Council to assess the likelihood that any given token could be deemed to be a security under existing law. The founding members expect that the Crypto Rating Council will aid the SEC in allocating enforcement resources to those assets most likely to qualify as securities and away from other assets, and will also aid investors in understanding the legally safe areas of crypto.

The CFTC, in turn, regulates spot markets, margin lending, and derivatives, among other things. Like the SEC, the CFTC has issued extensive guidance on major crypto regulatory issues, and has also approved various innovative crypto products such as crypto futures markets.

Other federal regulators are also playing an active role in crypto markets. The Federal Trade Commission has brought enforcement actions under the consumer protection laws. The Treasury Department’s Financial Crimes Enforcement Network has brought money-laundering and other actions against bad actors in the crypto sector.

At the state level, most states, including California, regulate certain cryptocurrency activities as money transmission activity requiring a money transmitter license. Some states impose separate licensure requirements on crypto exchanges that offer margin loans to their customers. A few states, most notably New York but also a few others, have crypto-specific legislation that licenses cryptocurrency trading activity separately from other money transmission activity. And a similarly small number of states have specific trust company laws that allow trust companies to serve as custodians of cryptoassets.

The theme that should emerge from this recitation is that crypto activity is far from un- or under-regulated; on the contrary, regulation of crypto activity is arguably more complicated than it needs to be, with overlapping and sometimes inconsistent regulation from state to state, the need to obtain multiple licenses to conduct crypto activity even within a single state, and a bizarre lack of reciprocity among the various states. What is needed is clarity and simplicity.

Coinbase believes that, in this complexity, there is an opportunity for California to lead. The opportunity is not in passing yet more layers of license requirements, but in creating a single charter for crypto companies that would allow such companies to operate within a single corporate entity that is supervised in a rigorous manner but without the ambiguity and complexity that characterizes the status quo. California could successfully compete with New York for crypto businesses if it solved a few discrete problems.

First, California could offer a single charter that simultaneously authorized the holder to trade, lend, and custody crypto assets. Currently, these activities require three different licenses in both California and New York.

Second, California could provide business-plan approval for its charter holders, allowing them, for example, to trade all crypto tokens, or all crypto tokens that do not constitute securities under federal law, or all tokens within other specified categories. Currently, New York's BitLicense requires licensees to seek individual approval for each new asset they propose to list -- meaning that the BitLicense itself is not sufficient to conduct any crypto business until that individual business is approved separate from approval of the BitLicense itself.

Third, California could include lending powers in its crypto charter. Currently, to lend for margin purposes or other purposes, a company requires a separate consumer or commercial lending license. Since the supervisor of those licenses is the same as the supervisor for money transmission licenses, it makes little sense to require a separate license for each activity.

Fourth, California could authorize custody activities to be conducted inside of a single crypto charter instead of requiring a separate trust company license to conduct such activities. Again, since the same agency regulates both money transmission and custody, it makes little sense to require separate licensure for the two activities. Like New York has already done, California should specify that crypto custody is a fiduciary activity. That designation is important for purposes of complying with the SEC's qualified custodian rule.

We believe the power to consolidate all these authorities within one single, rigorously supervised charter is within the Department of Business Oversight's existing authority, and we thank Commissioner Alvarez for engaging with the industry on these ideas since he took office.

The Uniform Law Commission's Model Virtual Currency Business Act

Coinbase has appreciated the opportunity to comment on earlier drafts of the Uniform Law Commission's work. Some of our comments have been reflected in revisions to the most recent version. Among our most important concerns have been:

- As noted above, there is already significant state and federal licensure and regulation in this area. At a minimum, the Model Act needs to exempt companies currently operating under money transmitter licenses so as to avoid literally duplicative regulation of the same activity.
- The Model Act should allow licensees to maintain the value of customer crypto assets *in like crypto holdings*, without requiring that they be collateralized in fiat currency.
- The Model Act should regulate crypto activity separate and apart from UCC Article 8, since most crypto assets are not securities for any other purpose and application of a long-established commercial rule set designed for investment securities to non-securities could have unintended and unanticipated consequences both in the crypto market and in the securities market.

As noted above, we believe a better focus for California would be to adopt a clearer and more streamlined regulatory regime -- focused on a single charter for crypto activities that allows trading, lending, and custody to occur inside of a single charter -- that would position California favorably to compete with New York to be the hub of the crypto ecosystem. This is appropriate since much of the technology and many of the companies involved in this area were built here.

Thank for the opportunity to speak with you today. I look forward to answering your questions.