Virtual Currency Hearing Testimony

I'm Alexandra Medina, Director of the Blockchain Advocacy Coalition. The BAC was formed over a year ago after a group of mid size blockchain and virtual currency companies in the state realized that there was no organized effort to engage with policymakers in the 5th largest economy in the world on behalf of the blockchain community. Last year we supported the passage of SB 838 and AB 2658 as small but meaningful steps towards acknowledging the impact of the blockchain industry in CA and starting to develop policy around that.

I've provided a FAQ sheet about CA's blockchain industry. It's by no means exhaustive, but it's a high level view of what the industry looks like both here and abroad. We currently have 734 blockchain companies in this state. That's a number that surprised me because last year in August we had only 315. That sounds like healthy industry growth until you compare it globally. The number of blockchain businesses globally increased from 2017 to 7370 in the same time frame. We've actually lost ground in the state. Last year the US had 27.2% of the global market share and CA accounted for 11.7% of that. Currently the US has 25.9% and CA just under 10%. If you look at the chart I've provided this is a continuation of a trend, we've lost marketshare since 2012. We have a significantly smaller marketshare in CA than in any other technology industry I looked at. Most hover around 20% and we are down to half that. The point I'm trying to hammer here is that CA has a much smaller amount of the blockchain industry than we should being the home of Silicon Valley and Silicon Beach. And more concerningly, we are consistently losing that industry.

Most of you are familiar with the concept of Bitcoin and probably Facebook's Libra and perhaps even the businesses the other panelists up here represent. But here are some other examples of how this technology is used in California: Propy streamlines real estate transactions on blockchain, Civic is creating secure identity platforms, IBM and Sweetsense teamed up to create a platform for farmers in areas with overdrafted aquifers to trade water.

The vast majority of blockchain businesses in this state are not extremely large and well funded. Nearly ⅔ of them have 10 or fewer employees. Only 47 of the 734 have more than 50 employees. These companies have a median funding amount of 2.5 million, according to Crunchbase. The average company has a median funding amount of 4.5 million. So why are we losing blockchain companies as a nation and a state? Pretty simple- it's the regulatory uncertainty.

A Morgan Stanley report indicated the greatest predictor of where a business chooses to locate is regulatory clarity. We do not have clarity here. There are 4 definitions of cryptocurrency at a federal level. SEC sees some as securities, the CFTC has claimed commodities, the treasury considers them a currency and the IRS taxes them as...a property. In addition to obtaining necessary federal MSB licenses companies that wish to engage all US customers must seek comply with individual licensing requirements in all 50 states.

To obtain licenses at a federal level and then in every state requires an inordinate amount of a start ups resources. And some of those individual state requirements are extremely onerous. The most infamous one being New Yorks' 2015 BitLicense. In the first 3 years the New York issued a mere 5 licenses. They make the DMV look expeditious. Headlines sprung up about the "Great Bitcoin Exodus". Many companies left New York rather than devote resources to languishing in a regulatory bottleneck. Washington state many businesses left after the passage of SB 5031 in 2017. The key issues cited were bond and data collection requirements.

When blockchain businesses leave our state or country they mostly go to a handful of other countries. Singapore is a popular destination for california companies to register in. The Singaporean government is working to attract blockchain companies and investment. Their taxation agency is proposing to remove the 7% goods and services tax from cryptocurrency transactions that function or are aimed to function as a medium of exchange. They issued a set of guidelines last November that clarified regulations that pertain specifically to digital assets representing securities or derivatives contracts.

Switzerland similarly differentiates between types of tokens, creating 3 categories: payment, utility, and asset tokens. They have attracted many companies with this framework and recently awarded the first banking license to a crypto company. Neither country has lax standards and both still have strict kyc/aml requirements, but the clarity of the regulatory framework is attractive for businesses.

In April of this year Texas released guidance for virtual currency companies stating that cryptocurrencies as currently implemented cannot be considered money or monetary value under their Money Services Act. It goes on to clarify which sorts of business might be considered a money transmitter. For example: Exchange of cryptocurrency for sovereign currency through a third-party exchanger is generally money transmission but clarifies that bitcoin atms that facilitate a sale or purchase of Bitcoins by the machine's operator directly with the customer would be exempt.

Colorado, Montana and Wyoming- a state that's really trying to get a crypto market going- have all defined consumptive or utility tokens as exempt from state securities law. This is a step toward the structures Singapore and Switzerland have enacted.

I applaud Asm. Calderon's commitment to understanding and engaging on blockchain issues in the legislature. The language he has proposed in AB 1489 came from the Uniform Law Commission's Supplemental Act. However, the same language has faced roadblocks in Nevada, Hawaii and Oklahoma.

The goal of creating a streamlined, reciprocal licensing system across states is admirable. Reducing the amount of individual states that a company needs to apply for would reduce costs and encourage mid-size companies to stay in the US. Even if it did pass in all 4 states it would do little good to the industry here and as currently written and could accelerate the loss of the blockchain businesses.

Here are some issues I'd ask the committees to consider when discussing virtual currency regulation:

1. If a company already has a lenders license or MTL in this state would they also have to apply for this even if their license covers the scope of their business? That should be clarified to remove redundancy.
2. Should the state consider defining digital assets based on their function and regulate them separately as other states and countries have done?
3. Are wallet to wallet transactions or bitcoin atm transactions as detailed in the Texas guidance captured unintentionally under this framework?
4. Are the surety bond and personal wealth requirements prohibitive to small businesses? I know there is the 35k exemption but that's just extremely low for a state like California. I do not know who would even take advantage of that.
5. Are the data requirements tailored to increase consumer protection rather than create a potential security risk?