

November 18, 2024

BY E-MAIL

Department of Financial Protection and Innovation
 Clothilde V. Hewlett
 Commissioner
 One Sansome Street, Suite 600
 San Francisco, CA 94104-4428

Re: Invitation for Comments on Proposed Application-Related Rulemaking under the Money Transmitter Law and Digital Financial Assets Law (PRO 02-23)

Dear Commissioner Hewlett:

Andreessen Horowitz (“a16z”) appreciates the opportunity to respond to the California Department of Financial Protection and Innovation’s (the “Department”) invitation for comments, dated October 2, 2024 (the “Consultation”), regarding the Money Transmitter Law and the Digital Financial Assets Law (the “DFAL”).¹ We appreciate the Department’s commitment to soliciting information from the public through a second public comment request, and we look forward to working with the Department as it considers promulgating rules to facilitate the implementation of the DFAL.²

In addition to the comments provided below, we refer the Department to the letter that we previously provided in response to the first public comment request.³ While we recognize that these concerns go beyond the scope of the Consultation, as we discussed in our previous response, we believe that the Department has an opportunity to rectify significant issues with the DFAL regime with targeted rules and guidance that:

- Exempt video game companies and other particular activities from the definition of “digital financial asset business activity” under Section 3103;⁴
- Provide a formal approval process for algorithmic stablecoins under Section 3603(b);⁵

¹ Dep’t Fin. Prot. & Innovation, *Invitation for Comments on Proposed Application-Related Rulemaking under the Money Transmitter Law and Digital Financial Assets Law* (Oct. 2, 2024), <https://dfpi.ca.gov/wp-content/uploads/2024/10/PRO-02-23-Second-Invitation-for-Comments.pdf>.

² Assem. Bill 39, 2023 Reg. Sess., ch. 792 (Cal. 2023), https://leginfo.legislature.ca.gov/faces/billTextClient.xhtml?bill_id=202320240AB39. In signing the DFAL, Governor Gavin Newsom stated that “ambiguity of certain terms and the scope of this bill will require further refinement in both the regulatory process and in statute to provide clarity to both consumers, regulators and businesses subject to this licensure framework.” Press Release, Office of the Governor, Signing Message (Oct. 13, 2023), <https://www.gov.ca.gov/wp-content/uploads/2023/10/AB-39-Signing-Message.pdf>.

³ Andreessen Horowitz, *Response to Invitation for Comments on Proposed Application-Related Rulemaking Under the Digital Financial Assets Law* (Jan. 12, 2024), <https://dfpi.ca.gov/wp-content/uploads/sites/337/2024/02/Andreessen-Horowitz-a16z-1.12.24.pdf>.

⁴ *Id.* at Pg. 10.

⁵ *Id.* at Pg. 5.

- Interpret the definition of “digital financial asset” in Section 3102(g) to exclude certain non-fungible tokens;⁶
- Clarify the “reasonable expectation or belief” standard under Section 3601(b)(3);⁷
- Adopt a “commercially reasonable” standard for determinations of amounts and value for surety bonds, trust accounts, and capital minimums;⁸ and
- Raise the minimum revenue requirements under Section 3211 that trigger audited financial statement reporting requirements.⁹

We would welcome the opportunity to meet with you and your staff to answer any questions that you may have and discuss both our comments below and our previously submitted comments in more detail.

I. Executive Summary

In this letter, we have focused on those topics where our experience is directly relevant, and where we believe that we have useful insights to share as you consider potential rulemaking and guidance. Our comments and observations are summarized below.

- The \$20,000 non-refundable application fee should be reduced to a figure commensurate with other state licensing regimes.
- Application information requirements should be narrowly tailored and based on the risk-profile of the applicant, and clear parameters should be developed for the Department’s application investigation fees.
- As mentioned in our previous comment letter, the definition of “control” in Section 3102(c) should not be interpreted to include developers who have limited emergency authority over a protocol.

II. About a16z

A16z is a venture capital firm that invests in seed, venture, and late-stage technology companies, focused on bio and healthcare, consumer, crypto, enterprise, fintech, and games. A16z currently has more than \$63 billion in committed capital under management across multiple funds, with more than \$7.6 billion in crypto funds. In crypto, we primarily invest in companies using blockchain technology to develop protocols that people will be able to build upon to launch Internet businesses. Our funds typically have a 10-year time horizon, as we take a long-term view of our investments, and we do not speculate in short-term crypto-asset price fluctuations.

At a16z, we believe we need an Internet that can foster competition and mitigate the dominance of large technology companies, unlock opportunities in the innovation economy, and enable people to take control of their digital information. The solution is web3 — the third generation of the Internet — a group of technologies that encompasses blockchains, digital

⁶ *Id.* at Pg. 8.

⁷ *Id.* at Pg. 4.

⁸ *Id.* at Pg. 2.

⁹ *Id.* at Pg. 13.

assets, decentralized applications and finance, and decentralized autonomous organizations. Together, these tools enable new forms of collaboration that can help communities make better collective decisions about critical issues, such as how networks will evolve and how economic benefits will be distributed. We are optimistic about the potential of web3 to strengthen trust in institutions and expand access to opportunity.

III. Comments in Response to the Department’s Draft Proposed Rules

A. The \$20,000 non-refundable application fee should be reduced to a figure commensurate with other state licensing regimes.

We suggest that the Department reduce the \$20,000 non-refundable application fee to a figure commensurate with other state licensing regimes. New York and Louisiana, the two other U.S. states with crypto-specific business licensing regimes, both require non-refundable \$5,000 application fees.¹⁰ Other states do not have crypto-specific licensing regimes, but sometimes require crypto companies to obtain other licenses, like money transmitter licenses, which tend to have application fees of \$5,000 or less.¹¹ Accordingly, requiring a non-refundable application fee that is four times higher than other state licensing regimes, as the Department has proposed, would be disproportionate, harm startups and other small businesses, and make California less attractive and competitive.

Enacting a reasonable application fee is especially important considering the large peripheral costs that applicants may incur in preparing the license application and meeting capital requirements. New York’s BitLicense regime is illustrative of this point. Following its passage, various industry participants expressed concerns about the high cost of the application process. One chief legal officer at a large crypto exchange, for example, estimated that the total cost of the exchange’s application had been \$100,000, including time allocation, legal, and compliance fees.¹² Imposing similarly high costs in California could lead companies to shut down and relocate out of state, or worse, abroad to foreign jurisdictions that do not have the same strong consumer protection laws that exist in the United States.

¹⁰ 23 CRR-NY 200.5 (“As part of an application for licensing under this Part, each applicant must submit an initial application fee, in the amount of \$5,000, to cover the cost of processing the application, reviewing application materials, and investigating the financial condition and responsibility, financial and business experience, and character and general fitness of the applicant.”); *see also* La. Admin. Code tit. 10 § XV-1933.

¹¹ We understand that the Department’s proposed exemption under § 80.3002 would exempt applicants from requirements to obtain both a DFAL license and a money transmitter license. We appreciate and commend this exemption. However, even with the potential fee savings from the exemption, the total application cost would still be higher than in other states.

¹² Yessi Bello Perez, *The Real Cost of Applying for a New York BitLicense*, CoinDesk (Aug. 13, 2015), <https://www.coindesk.com/markets/2015/08/13/the-real-cost-of-applying-for-a-new-york-bitlicense/> (last updated Apr. 9, 2024).

B. Application information requirements should be narrowly tailored and based on the risk-profile of the applicant, and clear parameters should be developed for the Department’s application investigation fees.

We recommend that the Department adopt a narrowly tailored and risk-based approach to its application information requirements. Specifically, information requirements that are based on an applicant’s size, transaction volume, potential risks from the applicant’s business, and consumer-facing activities will allow the Department to obtain the requisite information for doing diligence on its applicants, while not being overly burdensome for industry.

Relatedly, we suggest that the Department consider establishing clear parameters for the “reasonable costs” of its application investigations under Financial Code section 3203, subdivision (e).¹³ The Department should also tailor such fees based on the risk profile of applicants. While we understand the importance of the Department’s need to do diligence on applicants, we urge the Department to issue guidance on how applicants can minimize such costs, and what the Department can do to streamline its process. Keeping costs contained at this early stage of the process can help applicants better plan the resources that will be needed to engage with the Department after it has started to review the application.

C. As mentioned in our previous comment letter, the definition of “control” in Section 3102(c) should not be interpreted to include developers who have limited emergency authority over a protocol.

As we explained in our response to the Department’s first request for public comment on the DFAL, the DFAL’s definition of “control” includes overbroad language that runs counter to the goal of increasing consumer protection in California. We note that, while the Department addressed the definition of “control” in this set of proposed rules, it did not address the concerns that we previously raised. Given the importance of this issue, we hope the Department reconsiders its approach, and we reiterate our main concerns here.

As drafted, the definition of “control” includes the power to “prevent indefinitely a digital financial asset transaction.”¹⁴ This expansive definition is problematic because it may capture developers who program code into smart contracts that allows them to take limited emergency actions in the event of a hack or other attack on a protocol without otherwise retaining material control over the smart contracts. In general, this power is limited to an ability to “pause” the smart contract to prevent an attacker from withdrawing the smart contract’s funds, and it does not extend to enabling the developer to withdraw the actual funds, which makes this feature a significant benefit to consumers without subjecting them to additional risk. As we previously recommended, the Department should consider rules or guidance that specifically exempt such developers from the definition of “control,” while including developers who retain the power to manipulate transactions, reverse them, or do anything other than temporarily suspend operations of the smart contracts.

¹³ Proposed § 2048 (“(c) The application fee required in subdivision (b) of this section does not include the reasonable costs of the Department’s investigation authorized by Financial Code section 3203, subdivision (e).”).

¹⁴ DFAL, Section 3102(c)(1) (“When used in reference to a transaction or relationship involving a digital financial asset, power to execute unilaterally or prevent indefinitely a digital financial asset transaction.”).

* * *

We greatly appreciate the opportunity to provide comments on these matters, and we look forward to continued engagement with the Department.

Respectfully submitted,

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