BLOCKCHAIN
ADVOCACY
COALITION

March 8th, 2021

The Honorable Manuel P. Alvarez
Commissioner, Department of Financial Protection and Innovation
2101 Arena Boulevard
Sacramento, CA 95834

Re: INVITATION FOR COMMENTS ON PROPOSED RULEMAKING UNDER THE CALIFORNIA CONSUMER FINANCIAL PROTECTION LAW (PRO 01-21)

Dear Commissioner Alvarez:

Thank you for the opportunity to provide comments on the CCFPL Proposed Rulemaking. On behalf of the Blockchain Advocacy Coalition, we offer the following suggestions as you consider regulations that balance important consumer protections while promoting technological innovation in the financial services sector. The Blockchain Advocacy Coalition was founded in 2018 and consists of a number of virtual currency and blockchain companies that offer cutting edge financial technologies.

1. ***Definitions***
a. Financial Code section 90005 establishes definitions that apply to the CCFPL. Are additional definitions needed? For the terms already defined, are any of the definitions unclear, and if so, why? Does any definition result in ambiguity regarding whether an individual or entity, or product or service, falls within the scope of the CCFPL?

If the DFPI chooses to regulate virtual currency/digital assets, the first step should be to create clear definitions for various asset types with industry input. The array of digital assets is dizzying. At a federal level they have been categorized as securities, commodities, currency and property by various agencies. There is little clarity at which token types fall under which regulatory frameworks. This quote from CFTC Commissioner Heath Tarbert illustrates the problem the industry faces:

(THE CFTC) usually defers to the SEC’s views on [what is] a security, so if the SEC says, ‘This is not a security,’ then we’re generally confident we can come in at that point and say it’s a commodity,”

Through this convoluted process of waiting for one agency to confirm it's out of their jurisdiction and another agency to claim it's in theirs, the two most commonly held cryptocurrencies-- Bitcoin and Ethereum-- are generally understood to be commodities after years of uncertainty. The issue remains that there are thousands of other digital assets and their creators, users, and businesses who provide them platforms don't know exactly which regulatory framework they fall under at a state or federal level.

The California Blockchain Working Group report suggests the state "Define digital assets based on their function and regulate them separately. California could create three categories: i) payment, ii) consumptive/utility tokens, and iii) asset tokens, and exempt consumptive or utility tokens from state securities laws." The Blockchain Advocacy Coalition supports this suggestion but notes there may be a few more categories to consider.

Digital asset types include: cryptocurrencies, stablecoins, security tokens, utility tokens, governance tokens, non-fungible tokens (NFT's). However, the technology is constantly innovating and evolving with new applications and use cases coming out frequently. By creating clear definitions that outline either what each of these technologies is, OR by clarifying which types of assets fall into existing regulatory frameworks the DFPI can provide innovative businesses the clarity needed to create and offer products in California. This is extremely important for retention of virtual currency companies within the state.

<u>Cryptocurrency:</u> Commonly used as a store of value or means of transaction. Examples: Bitcoin, Ethereum.
<u>Security Tokens:</u> Tokenization of securities. Security Token Offerings sell tokenized equity to accredited investors on platforms like Securitze/Polymath/Tokensoft. Example: Luxury car maker Mazzanti aims to raise 999,999 euros ($1.2 million) on STOKR to develop a special edition of its hypercar model Evantra Millecavalli.
<u>Utility/Consumptive Token:</u> Utility tokens allow users to provide or receive goods, services, or content including access to goods, services, or content. States such as Wyoming, Colorado and Montana have all exempted utility tokens from securities regulations. Example: Filecoin is a platform where users can exchange a token (FIL) for data storage space.
<u>Governance Tokens</u>: These are tokens that are typically earned by active users of the platform that incentivize participation and give users a voice over how a decentralized platform is governed: Example: MKR (MAKER) tokens allow holders to vote on the economic rules that govern the stability of the protocol's stablecoin (DAI) including what the debt ceiling for the protocol should be set at.
<u>Stable coins</u>: Stable coins are virtual currencies designed to hold constant value so that they function as a medium of exchange, but with low transaction fees and friction. Stable coins are particularly useful for low value, high volume payments. For example, where one might pay up to 15% in fees sending a remittance payment from the US to the Philippines, a transaction with a stable coin can cost a fraction of a penny and be delivered within seconds. These innovations can be especially powerful for unbanked and underbanked populations. Stable coins have several varieties. One class of stable coins are those that are centralized with 1:1 backing with the US Dollar or other fiat, other classes are algorithmic or enabled by smart contracts, and

others are a hybrid of of these two varieties, with reserves to reflect value supporting the stable coin with algorithmic trading and smart contract features to further support stability. Examples include: Celo Dollar, USDC, MakerDao

Non Fungible Tokens (NFTs): Tokens representing unique digital items such as collectibles, artwork and games. NFTs use blockchain to prove ownership of the items. Examples: NFTs are sold on marketplaces like Rarible and Open Sea. Christie's listed an NFT for auction on Feb 25th, 2021 with a current bid of $3 million as of March 1st.

Hybrid tokens: Regulators face a particular challenge with tokens that change in function over their lifecycle. Some tokens may be considered a security during the initial sale but once a network is fully functional and sufficiently decentralized, operate as a utility token. In other cases, tokens like CELO give holders governance rights but also can be used for gas or network fees.

While we've seen states pass definitions of utility tokens, there has yet to be a comprehensive taxonomy of these assets. California has the opportunity to set an industry standard for the entire country to follow. While state legislatures have been active on the matter of definitions, some regulatory agencies have also provided clarity. The Texas Department of Banking has provided guidance that outlines which assets and services fall under which existing regulation. This level of detail and clarity is welcomed by the industry. We urge the DFPI to consider definitions before substantive regulation to give businesses the ability to build products towards an understood standard and ensure that the regulations accurately reflect the products on the market.

3. Registration Requirements

a. For what industries should the DFPI first establish registration requirements under Financial Code section 90009, subdivision

The mission of the DFPI is to protect California's consumers, and we support the agency focusing on that goal by prioritizing products that are predatory and abusive in nature. To the contrary, blockchain and virtual currencies are still a nascent industry rapidly evolving. This technology provides opportunities to create better financial products for un-or-underbanked communities by removing intermediaries and providing more efficient and accessible services. We understand that the agency has been waiting for industry maturity before offering more specific regulatory guidance which has allowed our state to avoid industry flight such as New York's "Great Bitcoin Exodus". The Blockchain Advocacy Coalition supports this approach and agrees that virtual currency products are not in immediate need of a new regulatory framework.

What the blockchain industry needs is clarity. When the agency makes time to address these products we suggest first looking to definitions and then offering guidance on how to fit within the existing framework. Of course, with Blue Sky laws virtual currency companies that wish to offer products across the US must comply with both federal and state laws. This means millions of dollars in legal costs being pulled away from innovation and investments in California employees. We suggest the agency begin to study the applicability of an intrastate pathway or onramp to compliance as outlined in AB 2150 (Calderon) last year that would allow companies who register with the state to provide access to services to California customers under California consumer protection guidelines.

(a)? What consumer protection risks do those industries present to consumers that would make it appropriate to prioritize the registration of those industries over others? The DFPI invites stakeholders to submit examples of acts or practices in those industries that stakeholders find concerning. b. For each industry that a stakeholder states should be a priority for registration, what rules should the DFPI establish to facilitate oversight of the industry, what records should the DFPI require those registrants to maintain, and what requirements should the DFPI impose to ensure that covered persons are legitimate? (Fin. Code § 90009, subd.

(b).) What data should the DFPI require registrants to submit in annual or special reports to the DFPI? (Fin. Code § 90009, subd. (f)(2).) Why should the DFPI collect this data?

Economic Impact For any recommendation relating to rulemaking, the DFPI invites stakeholders to provide a description of the economic impact (if known) of the recommendation for California businesses and consumers.

The federal government has not yet provided a clear taxonomy of digital assets, and that uncertainty has caused many businesses to leave the United States, taking those jobs and innovation with them. Those that choose to stay have to tackle uncertainty about securities regulation at both a state and federal level. As a consequence of the regulatory confusion in this space, California has been steadily losing market share of the cryptocurrency and blockchain industry since 2012, from nearly 20% to just below 10% in 2020. As we enter a significant budget crisis, the state must consider innovative approaches to bolstering our economy and attracting businesses that will employ Californians.

Regulatory clarity is the key to retaining and creating jobs in the blockchain industry. In March of 2019 Hong Kong's Securities and Futures Commission released detailed guidance on which tokens qualify as securities and how they would be regulated. In December of 2019 they provided further regulatory guidance for exchanges. The industry response was immediate. A report released by the Hong Kong Financial Services and Treasury Bureau determined that in 2019 more blockchain companies set up shop in Hong Kong than any other fintech sector, and Invest HK's percentage of blockchain companies rose from 27% to 39%. At the same time, a Linkedin report showed that Hong Kong had **four times** the average demand for blockchain professionals. Singapore, which also has released extremely clear regulation for the industry, shows similar demand for blockchain professionals. There is a clear connection between regulatory clarity and an increase in investment and job opportunities in blockchain. We urge the DFPI to consider the economic benefits of providing clarity and a pathway to compliance to the blockchain industry.

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Thank you for your consideration of these comments as you move forward with implementing the CCFPL. We welcome further discussions about this important topic with you and your team. If I can ever be of any assistance or if you have any further questions, please do not hesitate to contact me at 916-743-1099 or Ally@blockadvocacy.org.

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Cc: Charles Carriere, Senior Counsel for the Commissioner