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Submitted electronically via regulations@dfpi.ca.gov

California Department of Financial Protection and Innovation, Legal
Attn: Sandra Navarro
2101 Arena Boulevard
Sacramento, CA 95834

Re: Invitation for Comments on Crypto Asset-Related Financial Products and Services under the California Consumer Financial Protection Law

Dear Commissioner Hewlett:

Anchor Labs, Incorporated appreciates the opportunity to offer comments on the questions posed by the California Department of Financial Protection and Innovation (DFPI) in its Invitation for Comments on Crypto Asset-Related Financial Products and Services under the California Consumer Financial Protection Law.

Anchor Labs, Incorporated also known as Anchorage Digital, and referred to as "Anchorage" in this letter, is a global regulated digital asset platform that provides institutions with integrated digital asset financial services and infrastructure solutions. One of Anchorage's subsidiaries, Anchorage Digital Bank National Association (ADB) is a federally-chartered trust bank, regulated by the United States Office of the Comptroller of the Currency (the "OCC"). ADB has fiduciary powers under 12 CFR 9 and pursuant to our Approval Letter from the OCC. ADB provides digital asset custody and related services to institutional clients, such as banks, sovereign wealth funds, family offices, and financial technology, private equity, and venture capital firms. ADB has not always been a federally regulated bank. Prior to its conversion on January 19, 2021, it was operating as a South Dakota chartered Trust Company since July 12, 2019.

Anchorage's headquarters is in San Francisco, California, and as a crypto platform that has had to extensively navigate the complexities of laws and regulations at both the federal and state levels in order to offer all of our digital-asset services and products, we bring a unique perspective to this conversation.

1. What steps should the DFPI take to better protect consumers from scams and frauds associated with crypto asset-related financial products and services?

To better protect consumers from scams and frauds associated with crypto asset-related financial products and services DFPI should (1) promote digital-asset financial literacy, (2) make public information on how to detect and avoid scams and fraudulent activity; (3) proportionately punish illegal activity to deter future bad actors, (4) work closely and meet regularly with

respected members of the crypto industry to share information on detection practices and the latest scams and other fraudulent activities, and (5) encourage consumers to work with reputable, well-regulated digital-asset companies that meet government standards.

Together these five actions would help consumers detect scams and fraudulent activities, deter future scammers and fraudsters, increase information sharing between businesses and DFPI, increase the number of consumers doing business with reputable businesses, and promote financial stability in digital-asset markets.

2. What steps should the DFPI take to improve consumer education and outreach for crypto asset-related financial products and services?

DFPI should work closely with the digital-asset community to help improve digital-asset financial literacy among California residents. This can be achieved through private-public partnerships and other educational programming provided solely by DFPI and the Government of California. DFPI, with the help of industry, should consider a pilot program on digital-asset financial literacy that helps educate students across the state. While improving the financial literacy of young Californians is a must, it would also be wise to consider a financial literacy pilot program that would focus its efforts on people that may remit money back to family and friends outside of the United States.

This latter pilot program could have an immediate impact on equity and inclusion goals that DFPI has: accessibility. As you know, one of the great benefits of crypto—and more specifically, certain stablecoins—is that they can help people send money internationally more quickly and affordably. Californians, once they have a deeper understanding of stablecoins, could send more of their hard earned money to loved ones around the world due to lower transaction fees and greater accessibility.

DFPI should also consider a third pilot program that focuses on digital-asset financial literacy for the un/underbanked. The digital-asset industry is increasing access to financial services and products, through technological innovations, that help to create new efficiencies that reduce costs for consumers. For instance, financial institutions no longer need as many physical locations which means the associated costs needed for maintaining those locations (e.g., rent, mortgage, heat, electricity, and insurance) are much lower and these savings can be passed on to consumers or invested in the business to make even better products, services, and associated technology infrastructure.

Another benefit of greater digital-asset financial literacy among Californians is enhanced abilities to identify and avoid crypto related scams and frauds. This is because as knowledge and awareness of common industry practices, products and services heighten, consumers can more easily spot irregularities or offers that are too good to be true. Finally, one other important benefit of greater digital-asset financial literacy is that as more and more products enter the industry—whether its crypto related loans, investment opportunities via retirement accounts, or

native tokens for web3 and the metaverse—more California consumers will be able to thrive in our rapidly evolving and increasing technical economy.

3. What steps should the DFPI take to better ensure consumer protection in the offering and provision of crypto asset-related financial products and services?

Anchorage's customers are institutions that have a deep understanding of the products and services we offer. Nonetheless, consumer protection is of the utmost importance to Anchorage. Anchorage makes it a priority to be transparent about important policies that impact customers and risks associated with certain services we provide such as investing, staking, and custody.

DFPI can prudently maximize consumer protection by encouraging, and where necessary, requiring firms to disclose information to their customers about risks and company policies. However, disclosure requirements, while thorough, must not be redundant. If federal law or regulation already requires a similar disclosure, California must seek to properly curtail its disclosure requirements of federally compliant firms. Too much information can be as detrimental as no information, as it will similarly never be read.

In light of recent crypto-market events the DFPI should consider requiring digital-asset companies to disclose their respective following policies and practices to consumers:

1. What happens to the consumer assets in the event of the firm's bankruptcy;
2. If consumers' assets are held in segregated accounts or commingled with other consumers' assets and/or assets of the firm;
3. Where and how assets are custodied;
4. How fees are calculated and charged;
5. What the firm's withdrawal and transfer policies are;
6. Which jurisdictions the entity operates in;
7. Which regulatory agencies have oversight over the entity, if any do;
8. What counterparty risks are present;
9. What conflicts of interest related to a service or product exist.

Clear disclosures on these matters may help consumers more easily evaluate which companies meet their standards.

4. What steps should the DFPI take to better ensure investor protection in the offering and provision of crypto asset-related financial products and services?

To better ensure investor protection, DFPI should look at our response to question three about protecting consumers.

5. What steps should the DFPI take to better ensure financial stability in the market from risks posed in the offering and provision of crypto asset-related financial products and services?

To better ensure financial stability from risks posed in the crypto market, DFPI should encourage strong custody practices of digital assets. Anchorage, through its federally-chartered bank, meets and exceeds the standards for digital-assets custody required by its prudential regulator, the OCC. Unfortunately, many digital asset companies do not meet the high custody standards of the OCC.

As a result, many companies commingle customers' digital assets with company owned digital assets—and in moments of market turbulence—this commingling creates uncertainty as to who actually has a claim to customer assets. Such uncertainty will only exacerbate market volatility as market participants rush to seek physical certainty of their assets. Further, because it's not entirely certain if in bankruptcy these commingled assets would be considered assets of the customer or the commingling firm, these investors could face long pending litigation before ever receiving a portion or any of their funds. To enhance financial stability, DFPI should strongly consider requiring digital-asset companies to segregate customer and company digital assets. However, the DFPI should not go so far as prohibiting the commingling of customer assets. This is because there are benefits of commingling customer assets, such as material reductions in transaction fees or “gas fees” as they are often referred to in the digital-asset industry. The practice of commingling customer assets to create efficiencies is common practice in traditional finance, too, and the digital-asset industry must not be treated differently or its customers will be disadvantaged.

6. What steps should the DFPI take to address climate risks posed in the offering and provision of crypto asset-related financial products and services?

DFPI should take a tech-neutral position on blockchain consensus mechanisms and look at the net value the technology provides, while also considering climate risks. Consumers, businesses, and governments need to weigh all of the benefits and drawbacks of digital-asset technology. For example, stakeholders need to consider the potential positive and negative impacts of technology on the environment, and stakeholders must also discern its impact on financial stability, affordability, financial inclusion, and ease of access and use, among other factors.

Much has been written comparing and contrasting the environmental impact of proof-of-work, versus proof-of-stake, versus traditional financial payment systems, with many studies pointing out concerns that proof-of-work can be more energy intensive than its peers.¹ However, the nascent industry of blockchain mining is evolving quickly and imprudent intervention may prematurely stifle advancements that would substantially reduce emissions or stymie enhanced

¹ Digital Currencies, and Energy Consumptions, International Monetary Fund, Multiple Authors, June 7, 2022, <https://www.imf.org/en/Publications/fintech-notes/Issues/2022/06/07/Digital-Currencies-and-Energy-Consumption-517866>

capabilities that may help the proliferation of green energy over hydrocarbon fuel sources. The environmental impact of a consensus mechanism is considerably impacted by its source of energy. Proof-of-work can and does use green energy sources and has demonstrated that it can help reduce greenhouse gas emissions from fossil fuels through novel “flare mitigation.” This process takes gas produced as a byproduct of the oil production process and puts it to use creating electricity for crypto mining, which helps reduce emissions by about 63 percent relative to the alternative of burning the gas off which is typically done.²

Recently, the European Union and its member states reached an agreement in principle on a new law called Markets in Crypto-Assets (MiCA). Climate risks were debated thoroughly leading up to this landmark agreement and ultimately parties agreed not to ban proof-of-work, but did agree to carefully watch environmental risk of digital assets as the industry continues to mature. DFPI should consider a similar approach to digital asset climate risks as the European Union. DFPI should carefully watch developments impacting the climate, but also allow the industry to continue to experiment, for the foreseeable future, while it continues to innovate toward green energy solutions and other approaches that help fight climate change.

7. How should the DFPI strive to harmonize its regulatory approach to crypto asset-related financial products and services with federal authorities?

Anchorage expects Congress to enact legislation in the coming years related to digital assets, and for federal regulators to use existing and future authority granted by Congress, to promulgate new rules and regulations on digital assets.

Because digital assets do not stop at state borders, DFPI should adopt an approach that harmonizes its rules and regulations on crypto assets-related financial products and services with federal authorities, by requiring DFPI to review the federal approach to digital assets every three years. As part of the review, DFPI should consider reforms to its own regulations and publicly propose them for stakeholder comment. After stakeholders have an opportunity to thoroughly respond, DFPI should move to reconcile differences between Federal and DFPI regulations, where it is possible.

This ongoing reconciliation process will help ensure that DFPI can create a California regulatory environment for responsible digital asset innovation that is competitive with other states while the industry continues to evolve and technology advances.

8. In developing a comprehensive regulatory approach to crypto asset-related financial products and services, how should the DFPI work with other state financial regulators to promote a common approach that increases the reach of DFPI’s consumer protection efforts and reduces unnecessary burdens, if any, on companies seeking to operate nationwide?

² Understanding the Problem Crusoe Solves, Crusoe, September 23, 2021, <https://www.crusoeenergy.com/blog/3MyNTKiT6wqsEWKhP0BeY/understanding-the-problem-crusoe-solves>

Where possible California should grant full reciprocity to digital-asset companies that have authorization to do business in another state. Where reciprocity between states is not possible, due to a material difference in standards, a streamlined application process for license or registration should be adopted by DFPI to account for the fact that these may already meet some of DFPI's standards.

9. How can the DFPI make California the most desirable home state for responsible companies when developing guidance and, as appropriate, regulatory clarity and supervision of persons involved in the offering and provision of crypto asset-related financial products and services in California?

If California wants to be the most desirable state for responsible companies, then it needs to appropriately balance innovation and customer protection. Like few other states, California has seen the benefits and burdens of technology and therefore may be uniquely suited to perform such a task. To do this, it must harmonize its regulations and laws with federal laws and regulations and those of other states, where possible. It also must be technology neutral when it comes to the debate on the propriety of consensus mechanisms, such as proof-of-work and proof-of-stake. If it is determined that a licensure or registration process is necessary, the subject activities must be made extremely clear and California needs to efficiently process applications. That means dedicating general fund resources to staff up and provide adequate resources to expeditiously, but carefully consider applications. Relying on industry fees alone probably will not be enough to supply the resources DFPI needs to carry out many of the rules and regulations it implements.

DFPI also should consider a digital asset sandbox where it allows businesses to experiment in a limited way without requiring licensure if the business is limited to institutional clients, or a specified number of clients or for a limited period of time.

10. How should the DFPI ensure that California values of inclusive innovation and equity focused consumer protection are core components of crypto asset-related financial products and services as it develops guidance and, as appropriate, regulatory clarity and supervision of those persons involved in the offering and provision of crypto asset related financial products and services in California?

Inclusive innovation and equity focused consumer protection are of utmost importance to Anchorage. As mentioned earlier, one innovation that helps people is stablecoins. Diaspora communities stand to benefit from stablecoins, too. With stablecoins, they can send money more quickly and more affordably to loved ones around the world. It's important that DFPI carefully considers stablecoin regulation to ensure that diaspora communities can make full use of this promising new product and its associated services. To that end DFPI should consider the following stablecoin principles if it were to enact regulations around them: (1) stablecoins should be fully reserved against with U.S. Dollar cash or cash equivalents, (2) non-banks must be able to issue stablecoins – in fact it is preferable that non-banks issue them because most banks do

not have the human capital necessary to issue and maintain the associated networks, and (3) reserves for stablecoins should be regularly audited.

In terms of promoting equity via consumer protection, DFPI must make digital asset financial literacy of critical importance for all communities, but especially in minority or other historically disadvantaged communities. To improve financial literacy the DFPI can look at our ideas proposed in question number two.

CCFPL Regulation and Supervision Scope and Definitions

11. Financial Code section 90009, subdivision (a) of the CCFPL authorizes the DFPI to “prescribe rules regarding registration requirements applicable to a covered person engaged in the business of offering or providing a consumer financial product or service.” Are regulations needed to require registration of crypto asset-related financial products and services with the DFPI under Financial Code section 90009, subdivision (a) of the CCFPL? What factors should be considered in determining whether the offer or provision of a crypto asset-related financial product or service should trigger registration?

No, there must not be a requirement to register crypto asset-related financial products and services. However, DFPI does have a responsibility to make sure that risks of crypto assets-related financial products and services are properly disclosed to end users. Instead of registration requirements, a light framework that guides covered persons on which products and services they can offer is highly preferable.

This enables businesses to self-assess which products and services they can offer. With over 20,000 cryptocurrencies, more than 11 million non-fungible tokens (NFTs), and more cryptos and NFTs coming, It’s unlikely that DFPI could move at the pace necessary to consider the propriety of all new digital assets products and services in a timely matter. If California developed a reputation for being slow, digital-asset companies would likely move on to other jurisdictions that have more favorable regulation.

12. Financial Code section 90005, subdivision (k)(12) of the CCFPL states that “financial product or service” includes “offering another financial product or service as may be defined by the department, by regulation,” subject to certain criteria. Are regulations needed to specify crypto asset-related financial products and services that should be included in the definition of a “financial product or service” subject to CCFPL authority?

The more transparency that the CCFPL can provide about what is and what is not a financial product or service, the better. This is because companies thrive when there is regulatory certainty. They can plan ahead and work within the regulations. If companies do not know the rules, they face uncertain regulator risks that make it easier for founders to start or expand their businesses in other jurisdictions with more concrete definitions for financial products and services.

13. Financial Code section 90009, subdivision (c) of the CCFPL authorizes the DFPI to “prescribe rules applicable to any covered person or service provider identifying as unlawful, unfair, deceptive, or abusive acts or practices in connection with any transaction with a consumer for a consumer financial product or service, or the offering of a consumer financial product or service.” Are regulations needed to identify any unlawful, unfair, deceptive, or abusive acts or practices in connection with the offering of crypto asset-related financial products and services?

Anchorage believes that any unlawful, unfair, deceptive, or abusive acts or practices in connection with the offering of crypto asset-related financial products and services not only hurts the consumers in the short term, but also the long-term growth and prosperity of the digital-asset industry and its customers. That is why Anchorage fully supports the enforcement of laws already in existence prohibiting fraudulent activities in the financial services industry and encourages the application of those same laws to the digital-asset industry, where it is appropriate to do so.

14. Financial Code section 90009, subdivision (d) of the CCFPL authorizes the DFPI to “prescribe rules applicable to any covered person to ensure that the features of any consumer financial product or service, both initially and over the term of the product or service, are fully, accurately, and effectively disclosed to consumers in a manner that permits consumers to understand the costs, benefits, and risks associated with the product or service, in light of the facts and circumstances.” Are regulations needed to ensure that features of crypto asset-related financial products and services are fully, accurately, and effectively disclosed?

As mentioned in question three, in light of recent crypto-market events, the DFPI should consider requiring digital-asset companies to disclose these policies and practices to consumers:

1. What happens to the consumer assets in the event of the firm's bankruptcy;
2. If consumers' assets are held in segregated accounts or commingled with other consumers' assets and/or assets of the firm;
3. Where and how assets are custodied;
4. How fees are calculated and charged;
5. What the firm's withdrawal and transfer policies are;
6. Which jurisdictions the entity operates in;
7. Which regulatory agencies have oversight over the entity, if any do;
8. What counterparty risks are present;
9. What conflicts of interest related to a service or product exist.

Anchorage believes that these enhanced disclosures will enable consumers to make better and more well-informed decisions.

15. Financial Code section 90009, subdivision (f)(2) of the CCFPL authorizes the DFPI to “require any covered persons and service providers participating in consumer financial services markets to file . . . annual or special reports, or answers in writing to specific questions, as necessary for the department to fulfill its monitoring, assessment, and reporting responsibilities.” Are regulations needed to require the filing of reports in connection with the offering crypto asset-related financial products and services? A. Should the DFPI adopt rules requiring covered persons to file reports related the offering and provision of crypto asset-related financial products and services? If so, what should such reports contain, and which report responses should be made publicly available? B. Should the DFPI adopt rules requiring service providers to file reports related the offering and provision of crypto asset-related financial products and services? If so, what should such reports contain, and which report responses should be made publicly available?

Anchorage encourages the DFPI to require digital-asset companies to disclose material financial information that is currently required of firms in the traditional financial services industry such as financial statements. However, these reporting requirements must not be overly burdensome. Additionally, DFPI should consider requiring disclosures of digital-asset companies that were listed in questions three and fourteen.

16. Market-Monitoring

The Executive Order directs the DFPI to conduct a market-monitoring inquiry to solicit voluntary information from companies and licensees about their cryptocurrency-related financial products and services to assist DFPI in carefully undertaking any future efforts, including formal rulemaking under the CCFPL. The DFPI invites input and comments on the market-monitoring inquiry, including in response to the following questions: a. Which companies should the DFPI include in the inquiry? b. What products and services should be included in the inquiry? c. What information, if any, should the DFPI collect and publish in the aggregate? d. Should the DFPI publicly post its inquiry online and allow any company to voluntarily respond?

For the reasons detailed in question five, DFPI as part of its market-monitor inquiry should strongly consider asking digital-asset companies to voluntarily provide detailed information about their custody practices due the the significant impact they can have on financial stability of the industry. This information should be published in aggregate as a form of public disclosure to stakeholders about typical custody practices of the industry. Narrowly solicited requests for voluntary information may come across as not actually voluntary, so the DFPI posting its inquiries online for any company to respond avoids any potential misunderstandings.

Anchorage thanks DFPI for this opportunity to respond to important questions related to digital assets and looks forward to working with the DFPI as it discerns further regulation of this

industry. If DFPI, would like to ask Anchorage any follow-up questions, or ask new questions, please do not hesitate to contact us at your earliest convenience.

Sincerely,



Nathan McCauley
Co-Founder and CEO
Anchor Labs Inc.



Georgia Quinn
General Counsel
Anchor Labs Inc.