

August 5th, 2022

The Honorable Clothilde “Cloey” V. Hewlett
Commissioner, Department of Financial Protection and Innovation
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:

Thank you for the opportunity to provide comments on crypto asset related financial products and for hosting a venue to engage stakeholder input. On behalf of the Blockchain Advocacy Coalition (BAC), we are pleased to offer the following suggestions as you consider regulations that balance important consumer protections while promoting technological innovation in the financial services sector.

BAC was founded in 2018 and consists of a number of virtual currency and blockchain companies that offer cutting edge financial technologies across the Web3 and blockchain spectrum. BAC believes that transparent, concise and instructive regulatory clarity can be of great value to the virtual currency industry, and praises Governor Newsom and the Department of Financial Protection and Innovation (DFPI) for offering the opportunity for California to lead in a space where other jurisdictions have come up short.

The vital role California plays in the virtual currency industry cannot be understated. California is the biggest market in the US for cryptocurrency. As a frontier for product development and innovation, the state has a high proportion of residents significantly impacted by potential use cases like international transfer of value. Enabling responsible blockchain and virtual asset development in California will lead to further innovation with exciting potential for impactful applications beyond cryptocurrency, including applications that can solve some of the largest challenges currently faced by communities and consumers. Engaging industry experts and keeping them at the table is essential in finding the important balance of safeguarding consumers while encouraging robust markets.

Regulatory Priorities

1. Clear, consistent definitions

The first step taken by the Department when considering a rulemaking on virtual currency should be to provide and 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, with interpretations evolving almost daily. There is little clarity on which token types fall under which regulatory frameworks. 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 businesses the clarity needed to create and offer products in California. This is extremely important for retention of virtual currency companies within the state.

The variance in definitions across states and federal agencies further increases the difficulty and cost of compliance for startups in this space. We recommend that the DFPI consider the definitions already in use in other jurisdictions with the goal of creating a more reciprocal framework.

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 and associated risk they take on in the market. We also encourage flexibility and onramps as new products and services are adopted, allowing DFPI to adjust as necessary.

2. Consumer Protections:

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. Generally, blockchain and virtual currency technology provides opportunities to create better financial products for un-or-underbanked communities by removing intermediaries and providing more efficient and accessible services. Products within the digital asset realm vary greatly, and as such, there should be appropriate consumer protections to match the risk and potential consumer impact or harm. BAC offers the below concepts to consider when weighing robust consumer protections.

Disclosures:

- Disclosures can be a powerful tool of informing users before they elect to purchase or engage in any good or service. That said, disclosures must be meaningful, concise and have true consumer protection objectives. Disclosures should be shared with consumers in the most applicable format and method ahead of establishing an official transactional relationship. For example, if a customer interfaces with a product via app, the disclosure should match that experience. Moreover, given products evolve and improve frequently, advance notice of certain changes should not be required if customers consent to those changes at the time of a transaction.

- As we have experienced with other disclosures meant to inform customers on the privacy front, too much information on one page results in customer fatigue, and important information can often be water down in lengthy text and ignored. There should be flexibility among different platforms to allow for a seamless and approachable user experience.
- Fees: It is important for customers to be aware of fees prior to execution of a transaction, including transaction cost and service fees. Disclosures around Legal tender are not useful as they can cause confusion and box in technology ahead of future innovations.
- Disclosures around irrevocability are prudent and can provide customers with helpful reminders on how currency on a blockchain is executed.
- Disclosures around disruptions in service do not account for site maintenance or other minor outage issues and should only focus on major events.

Customer support

- Trust is a key tenant of a decentralized cryptocurrency system, and as such, BAC advocates for customer support services that are transparent, accessible and drive best practices. However, given the diversity of scope and size in this budding industry, customer support functions should be permitted to have flexibility in the method of communication most applicable for the relationship with a company and their customer. This includes chat functions, email, phone and other modes of communication.

Capital Requirements

- Any capital requirements should allow for smaller companies to participate on an even playing field, and requirements should be appropriate to the size of said company. They also should be capped and based on the risk of the company's specific product.
- There is precedent already in certain capital requirements, and instead of creating an entirely new threshold for a nascent industry, we suggest alignment with existing money transmitter requirements.

3. CCFPL Licensing Process

Given the new expansive authority granted to DFPI via the CCFPL, the agency's staff resources, expertise and capacity must be considered and any sort of licensing framework or requirement should be as narrow, concise and streamlined as possible. Overly burdensome and unclear registration requirements have led to the shut down of the entire industry in some states, and it is imperative California does not follow suit. The millions of dollars spent on legal costs to comply with lengthy registration requirements pulls money away from innovation and investments in California employees. To avoid such stifling of the market, any sort of licensing process:

- Should be narrowed to the products in the market that provide the most potential for risk and all information gathered should be necessary for the sole purpose of preventing consumer harm or abusive trading practices. Data gathering should be as limited as possible to decrease burden on applicants and on the department
- Should have an on-ramp process for new technologies to develop and allow for a grace period or approval default to allow for such evolution to occur organically, or else innovations can be stifled and Californians will be at a competitive disadvantage
- Should streamline with existing licenses authorized by DFPI
- Should have clear, expedient timelines and delays in resources or staff within the Department should not impact product approval.

- Certain applications of consumer protections when it comes to specific products (ie pure exchanges operating in a spot market) are untested given the rapid evolution of products, therefore must have the appropriate applicability based on associated market risk of that product. This includes best interest/execution standards.

If companies are willing to make the investment (which will not be insignificant, it is reported that the NY BitLicense process cost millions to secure) to register products and innovations with the DFPI, if certain agreed upon standards are met, there must be compliance assurances (ie safeharbors) to provide for regulatory certainty.

In particular:

- Should a company be in compliance with certain federal standards, including disclosure standards, best interest/execution/AML standards (ie FDIC Reg E, SEC Reg BI, FINRA Rule 5310), safe harbors should be granted
- BAC suggests DFPI study and consider a [Safe Harbor for intrastate token offerings](#) if a robust regulatory license is obtained in the state. Such a safe harbor concept seeks to provide network developers with a three-year grace period within which, under certain conditions, they can facilitate participation in and the development of a functional or decentralized network, exempted from the registration provisions of the federal securities laws. Such a proposal would provide clarity in a landscape that changes daily and otherwise leads to regulation by enforcement.

Other considerations:

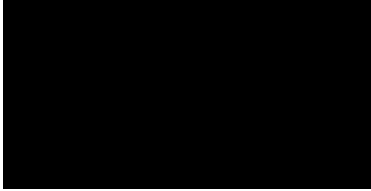
- Regulatory action should not be reactionary via banning of specific technologies and instead be considered with appropriate, risk based consumer protections. This includes technologies that are pegged to specific values, commodities or financial instruments.

Economic Impact

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 increasingly uncertain times when it comes to state revenues, 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 reasonable and concise pathway to compliance for the blockchain industry.

Thank you for your consideration of these comments as you move forward with implementing the CCFPL and Executive Order N-9-22. We welcome further discussions about this important topic with you and your team. If we can ever be of any assistance or if you have any further questions, please do not hesitate to contact Jaime Minor at [REDACTED].



Alexandra Medina
Executive Director, Blockchain Advocacy Coalition

Cc:

Araceli Dyson, Regulations Coordinator, DFPI
Jennifer Rumberger, Senior Counsel for the Commissioner, DFPI