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California
Reinvestment
Coalition



CALIFORNIANS
for
ECONOMIC
JUSTICE

August 5, 2022

Department of Financial Protection and Innovation, Legal Division
Attention: Araceli Dyson, Regulations Coordinator
2101 Arena Boulevard
Sacramento, CA 95834
Transmission via electronic means to regulations@dfpi.ca.gov

Invitation for Comments – Crypto Asset-Related Financial Products and Services

Dear Commissioner Hewlett,

Thank you for the opportunity to provide input regarding the best way to provide consumer protection and appropriate oversight of crypto asset-related financial products and services. As you are no doubt aware, the California Consumer Financial Protection Law (CCFPL), a law which a number of the organizations signing onto this letter strongly supported and worked on in

2020, represented an important step forward for consumer protection of financial products and services, broadly defined¹.

Our coalition represents a cross-section of consumer and small business interests and believes strongly that of foremost importance is that the California Department of Financial Protection and Innovation (hereafter “DFPI” or “The Department” or “Department”) be the lead entity to protect consumers and investors in the digital assets/crypto asset-related space. To that end we will provide an overview of the thrust of our comments, followed by slightly more detailed answers to each of the 16 questions that the Department posed to interested parties. (We are aware that not all questions had to be answered, per DFPI communication, but ultimately our coalition decided to at least provide some response to each of the preliminary questions posed by the Department.)

OVERVIEW

While our coalition strongly supports DFPI’s authority pursuant to the CCFPL, we believe that when it comes to digital financial assets/crypto asset-related financial products and services the optimal path to maximally protect consumers, investors, and small businesses while simultaneously providing stability to what has been a historically volatile market, is for companies operating in this space to be fully licensed by DFPI². Licensing provides the most robust opportunity for consumer protection. The vision that our coalition supports in this space generally correlates to California [Assembly Bill 2269 \(Grayson\)](#), currently pending in the California Legislature.

As members of our coalition have similarly communicated to the Department previously in the context of the Department’s efforts to implement a licensing program for debt collectors, vigorous pre-licensing due diligence and investigation as to the marketplace actions of potential licensees is critical to protect consumers, investors, and businesses. Some small businesses have now become reluctant to accept digital assets as payment given the wild volatility in the industry. This is even more important in the digital assets space, where market value has gone from \$3 trillion down to around \$1 trillion and the news is rife with reports of scams, frauds and so-called “pump and dump” schemes against both consumers and some small businesses³. The

¹ Limón, Monique. 2020. *AB 1864 - Financial Institutions: regulation: Department of Financial Protection and Innovation*. https://leginfo.legislature.ca.gov/faces/billTextClient.xhtml?bill_id=201920200AB1864

² Ponciano, J. (2022). “Crypto winter watch: All the big layoffs, record withdrawals and bankruptcies sparked by the \$2 trillion crash.” *Forbes*, <https://www.forbes.com/sites/jonathanponciano/2022/07/14/crypto-winter-watch-all-the-big-layoffs-record-withdrawals-and-bankruptcies-sparked-by-the-2-trillion-crash/?sh=44b75cd520f5>

³ Hamrick, J. T., et al (2021). “An examination of the cryptocurrency pump-and-dump ecosystem.” *Journal of Information Processing & Management*, <https://www.sciencedirect.com/science/article/pii/S0306457321000169>

massive amount of money spent by the digital assets/crypto asset industry to encourage consumers to invest in crypto-related assets because “fortune favors the brave” lacks the context whereby consumers need to be informed that reasonable consumer protections that exist at both the federal and state level for other financial products and services are largely nonexistent in the crypto space⁴. While our coalition certainly supports registration and robust actions by DFPI for many financial products and services, a licensing regime is the appropriate public policy response to protect consumers in the digital assets space.

Moving forward with a state licensing program would allow DFPI to not only protect consumers but would immediately put California in a leading national role as Congress contemplates potential national legislation⁵. As we submit this comment letter it appears that federal legislative action is unlikely in the near future. States including California should therefore lead the way, much like some states took action to respond to the economic frauds, scams and get-rich quick schemes of the 1920s, where investors lost large sums of money due to lack of regulations and rules to protect investors. Indeed the phrase “Ponzi Scheme” was coined in this era pursuant to Mr. Ponzi’s investor scams⁶. Ultimately the stock market crash of 1929 and the Great Depression that followed directly led to the creation of the Securities and Exchange Commission (SEC) to protect the interests of investors both small and large. While it is a different era and we are not suggesting that digital assets and cryptocurrencies are Ponzi schemes, it is certainly true that scams, frauds, and security failures are not uncommon within the cryptocurrency/digital assets marketplace⁷. California can also learn important lessons from other states that have already taken some action, such as New York.

Enacting a California licensing program would in no way conflict with the still-emerging role that relevant federal regulators such as the Securities and Exchange Commission (SEC), Commodity Futures Trading Commission (CFTC), Consumer Financial Protection Bureau (CFPB) and many other federal entities are playing. A California licensing program would also not be inconsistent

⁴ Gura, D. (2022). “Amid the hype, they bought crypto near its peak. Now, they cope with painful losses.” *NPR*, <https://www.npr.org/2022/07/26/1112439917/amid-the-hype-they-bought-crypto-near-its-peak-now-they-cope-with-painful-losses>

⁵ Farrell, J. (2022). “California leads the way in consumer protection; especially with debt collectors, obtaining close to \$1 million in restitutions.” *HVY Journals*, <https://www.hvy.com/jonathan-farrell/california-leads-the-way-in-consumer-protection-especially-with-debt-collectors-obtaining-close-to-1-million-in-restitutions>

⁶ Kiger, P. J. (2022). “The shady, get-rich scams of the roaring twenties: As Americans dreamed of amassing fabulous fortunes, many became vulnerable to cons.” *History*, <https://www.history.com/news/roaring-twenties-scams-ponzi-wall-street#a-millionaire-oil-baron-who-wasn-t>

⁷ Berwick, A., & Wilson, T. (2022). “How crypto giant Binance became a hub for hackers, fraudsters and drug traffickers.” *Reuters Investigate*, <https://www.reuters.com/investigates/special-report/fintech-crypto-binance-dirtymoney/>

with the Executive Order issued by the Biden Administration at the federal level⁸. It would also be completely consistent with Governor Newsom’s May 2022 Executive Order, which led to this request for comments from interested parties that this letter responds to⁹.

Our answers to the 16 questions posed by the Department will be relatively brief, but our coalition is eager to discuss this matter in more detail with the Department.

PRELIMINARY RESPONSES TO QUESTION FROM THE DEPARTMENT

Regulatory Priorities

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

ANSWER: In order to best protect consumers from scams and frauds associated with crypto asset related financial products and services DFPI needs to implement a licensing program. Pursuant to action by the Legislature similar to the contents of [AB 2269](#) (Grayson). Prior to that action the Department should be very assertive from an enforcement perspective, since the Department has the authority to enforce not only a panoply of state laws, but also [federal law \(Dodd-Frank\)](#) enacted pursuant to The Great Recession¹⁰. Specifically, DFPI should be aggressive in enforcing UDAAP violations (unlawful, unfair, and deceptive acts and practices, also referred to as UDAP). DFPI has had this power since Dodd-Frank was enacted, but the authority was confirmed and clarified in AB 1864 of 2020, which remade the Department into DFPI¹¹. We applaud the actions and investigations already undertaken by DFPI in this area¹².

⁸ Exec. Order. Ensuring Responsible Development of Digital Assets, Fed. Reg. (March 09, 2022), <https://www.whitehouse.gov/briefing-room/presidential-actions/2022/03/09/executive-order-on-ensuring-responsible-development-of-digital-assets/>

⁹ Exec. Order. No. 9-22, State of CA (May 04, 2022), <https://www.gov.ca.gov/wp-content/uploads/2022/05/5.4.22-Blockchain-EO-N-9-22-signed.pdf>

¹⁰ United States. 2010. *Dodd-Frank Wall Street Reform and Consumer Protection Act (to accompany H.R. 4173)*. Washington, U.S. G.P.O.

https://www.cftc.gov/sites/default/files/idc/groups/public/@swaps/documents/file/hr4173_enrolledbill.pdf

¹¹ Ballard CFS Group (2020). “California legislature passes AB-1864 setting the state for the ‘Department of Financial Protection and Innovation’ and the California Consumer Financial Protection Law; Ballard Spahr to hold webinar on September 29.” *Ballard Spahr*, <https://www.consumerfinancemonitor.com/2020/09/08/california-legislature-passes-ab-1864-setting-the-stage-for-the-department-of-financial-protection-and-innovation-and-the-california-consumer-financial-protection-law/>

¹² “California investor targeted in online crypto fraud.” *Department of Financial Protection & Innovation*, <https://dfpi.ca.gov/2022/06/15/california-investor-targeted-in-online-crypto-fraud/>

Licensing would enhance DFPI's authority during the application process such that companies involved in scams and frauds could be denied a license, which significantly protects consumers from predatory market participants, or, at a minimum, granted a limited or provisional license with additional scrutiny on their actions in the short term. Licensing is superior to registration in that it provides more control on the front end to make sure that the licensing applicant does not have a history of participating in this kind of behavior in the past.

In addition to licensing there should be a significant campaign for the public to factually discuss consumer rights in the crypto/digital assets space to counteract the millions of dollars being spent by the crypto industry aimed at convincing the public that they are "missing out" if they're not investing in crypto. Crypto companies like FTX and Crypto.com have used huge celebrities such as Matt Damon, Larry David and Tom Brady to star in advertisements where they push investment in these digital assets by telling the public that "Fortune favors the brave" and appealing to FOMO (fear of missing out)¹³. The Super Bowl, the most-watched television event in the United States every year, featured a plethora of such ads¹⁴. Now, many of those first-time buyers that invested after those advertisements faced great losses on their initial investment only weeks after those ads were released in what is being known as the "crypto winter". The volatility of the market and lack of basic consumer protections were all ignored in the ads¹⁵. DFPI should be part of a high-profile effort to let consumers know that these consumer protections are largely lacking in the crypto space. This should occur no matter what may happen in the short-term to pending federal legislation.

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

ANSWER: While educating the public is important, DFPI needs to make it as easy as possible for people to learn and understand crypto asset-related financial products and services. As was stated above, crypto companies push their products onto the general public but fail to provide them with information on the volatility of crypto investments and a basic understanding of what their product is. It is important that DFPI help fill those gaps in consumer education. Our coalition is well aware that any consumer

¹³ Rosen, J. (2022). "Why is Matt Damon shilling for crypto?" *The New York Times Magazine*, <https://www.nytimes.com/2022/02/02/magazine/matt-damon-crypto.html>

¹⁴ Perez, S. (2022). "Super Bowl ads boosted crypto app downloads by 279%, led by Coinbase." *Tech Crunch*, <https://techcrunch.com/2022/02/17/super-bowl-ads-boosted-crypto-app-downloads-by-279-led-by-coinbase/>

¹⁵ Baur, D., & Dimpfl, T. (2021). "The Volatility of Bitcoin and its role as a medium of exchange and a store of value." *The Journal of Empirical Economics*, <https://link.springer.com/article/10.1007/s00181-020-01990-5>

education campaign will only have a fraction of the resources that the crypto industry has spent on their advertising campaigns, both in traditional media and in utilizing social media “influencers” to make crypto investments seem cool and risk-free¹⁶. Such a campaign (part of which could be financed as part of a licensing program, particularly if it is linked to opportunities for consumers to make complaints to DFPI) would be important.

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

ANSWER: The department can maximize consumer protection in the offering and provision of crypto asset-related financial products and services via a licensing program. DFPI has already indicated that crypto is not money. Providers of financial products and services often communicate to regulators what they are not in order to evade or avoid meaningful regulatory oversight and scrutiny. (Financial products or services claiming they are not “credit” in order to avoid the consumer protection provisions of the federal Truth in Lending Act, or TILA, is an example of this.) DFPI has clearly stated that “the sale and purchase of cryptocurrency directly between any digital asset platform and the customer, where it does not facilitate the exchange of the fiat currency or cryptocurrency with a third party, does not meet the definition of money transmission because it does not involve the sale or issuance or payment instrument, the sale or issuance of store value, or receiving money for transmission,”¹⁷ the Department has laid a clear marker in this area which our coalition applauds. The [digital assets licensing bill](#) also addresses other areas, to be more fully fleshed out by the Department, where consumer protection standards should be part of any pre-licensing application review. Examples include complaint standards and procedures, prohibitions on insider trading and the like.

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

ANSWER: Licensing of digital assets companies is the most important first step. At the state level, California has the benefit with DFPI of a clear lead regulator in this area (in contrast to the more complicated situation at the federal level). Unlike traditional

¹⁶ Yaffe-Bellany, D. (2022). “How influencers hype crypto, without disclosing their financial ties.” *The New York Times*, <https://www.nytimes.com/2022/05/27/technology/crypto-influencers.html>

¹⁷ “Digital asset trading platform services.” *Department of Financial Protection & Innovation*, <https://dfpi.ca.gov/2022/03/29/digital-asset-trading-platform-services/>

banking, crypto lending platforms offer no protection, such as deposit insurance and error resolution rights to their customers¹⁸. In July of this year, platforms including Celsius and Voyager went bankrupt with no promise that customers will get their money back¹⁹. In fact, shortly before their bankruptcy filings customers were frozen out of their accounts. As a part of any licensing application investor protection provisions being undertaken by the applicant should be an important part of the application. We additionally would like to emphasize the importance of investor protections in the area of so-called “stablecoins”. Crypto companies have been very aggressive in attempting to persuade consumers that by offering “stablecoins” investors have a “safe” crypto investment supposedly “pegged” to a more “stable” currency or commodity, such as the US dollar, Japanese yen, euro, or gold when in reality when frequently this is not true²⁰. This is why, in addition to a robust licensing application review procedure, DFPI should act to ensure that any so-called “stablecoins” are actually backed by sufficient reserves, otherwise they should not be legally allowed to be sold to California consumers or investors. This is also contained in [AB 2269](#).

5. QUESTION: *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?*

ANSWER: When investors encounter the grim news of their crypto accounts being hacked and their investments (including those in so-called “stablecoins,” as discussed above) being wiped clean, many companies currently offer little to no customer service or guidance. Many investors report weeks of sending emails and calling into customer service where their call is often answered by automated messages with no avail or assurance that their issues will be solved²¹. Therefore, in an effort to offer better financial stability in the market from risks posed in the offering and provision of crypto asset-related financial products and services there needs to one, be a clear definition to what a digital financial asset is, such as the one provided by AB 2269 which defines it as “a digital representation of value that is used as a medium of exchange, unit of account, or store of value, and that is not legal tender, whether or not denominated in legal

¹⁸ “Crypto assets,” (2022) Department of Financial Insurance, <https://dfpi.ca.gov/2021/10/22/crypto-assets/>

¹⁹ Morrison, Sara (2022). “The crypto crackdown begins.” Vox, <https://www.vox.com/recode/2022/8/3/23290388/crypto-illegal-scams-lawsuit-sec>

²⁰ Wintermeyer, L. (2022). “From hero to zero: How Terra was toppled in crypto’s darkest hour.” Forbes, <https://www.forbes.com/sites/lawrencewintermeyer/2022/05/25/from-hero-to-zero-how-terra-was-toppled-in-cryptos-darkest-hour/?sh=3fd8d39b389e>

²¹ Zamost, S, et al. (2022). “Coinbase slammed for what users say is terrible customer service after hackers drain their accounts.” CNBC, <https://www.cnbc.com/2021/08/24/coinbase-slammed-for-terrible-customer-service-after-hackers-drain-user-accounts.html>

tender, except as specified”²². Additionally, robust and enforceable data protection measures should be an important component of any application for digital asset licensure.

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

ANSWER: While our coalition is more focused on fundamental protections for consumers and small businesses, we are certainly aware of and sympathetic to the significant negative climate impact that has been associated with crypto asset-related financial products and services, particularly as it relates to the energy needed to mine a Bitcoin token²³. To address the climate risks posed by crypto asset-related financial products and services, DFPI should discourage the ceaseless energy usage in mining so that these digital asset related services do not exacerbate our losing battle to combat climate change. Lessons should be learned from the law in New York, for example. This would be also an area where DFPI would need to partner with other California departments and agencies that carry more climate change expertise due to their distinct mission and focus.

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

ANSWER: Consistent with the [Executive Order of the Biden administration](#) released in March of 2022, there are a number of relevant federal authorities that may have some role in overseeing digital asset/crypto asset-related financial products and services. As we have seen in the past, there is nothing inconsistent with California taking a leading role in regulation (and, we have asserted repeatedly in this letter, licensing) while also coordinating with relevant federal authorities. DFPI has existing expertise, for example, in working with the FDIC and OCC in dealing with its banking licensees. There is no reason that this area should be dramatically different. While California cannot control what may or may not happen legislatively on Capitol Hill, California would immediately have outside influence and become a leader by licensing participants in this market. (Registration is insufficient to not only protect consumers but place California in a

²² Grayson, Timothy. 2022. *Digital Financial Asset Businesses: Regulation*. https://leginfo.legislature.ca.gov/faces/billVersionsCompareClient.xhtml?bill_id=202120220AB2269.

²³ Gonzalez, O. (2022). “Bitcoin mining: How much electricity it takes and why people are worried”. CNET, <https://www.cnet.com/personal-finance/crypto/bitcoin-mining-how-much-electricity-it-takes-and-why-people-are-worried/>

leading position to significantly influence regulatory action in this area.) For example, when it comes to examinations DFPI regularly coordinates with federal authorities as appropriate. [AB 2269](#), for example, explicitly states that, beyond licensing authority, DFPI would be authorized “to conduct examinations of a licensee, as prescribed, and would require a licensee or registrant to maintain, for all digital financial asset business activity with, or on behalf of, a resident”²⁴. This would, of course, require some coordination and harmonization with federal authorities. Overall, the general path here would be completely consistent with DFPI’s current harmonization activities with federal authorities for related purveyors of financial products and services, including current licensees in the banking space.

8. QUESTION: *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?*

ANSWER: In developing a comprehensive regulatory approach to crypto asset-related financial products and services, we acknowledge that DFPI will of course need to collaborate with other state financial regulators. Until and unless additional federal law exists in this space, coordinating with the financial regulators of other states will somewhat resemble the coordination with federal regulatory entities exploring the boundaries of their current authority under existing federal laws.

With other state financial regulators, the important distinction is that market participants not be allowed to find the “lowest common denominator,” which often winds up allowing market participants to effectively pick their regulator²⁵. Often times industries choose certain states to avoid and evade robust enforcement and regulation, or they seek to be characterized as a certain type of business to minimize their regulatory obligations. In the digital assets/crypto space that has manifested itself with a number of entities seeking to be characterized as money transmission companies due to the relatively low level of regulatory oversight for that industry in some states (this is not the case in California). While it is obviously unrealistic to expect anything resembling a uniform set of guidelines among the states, it is certainly attainable to have certain

²⁴ Grayson, Timothy. 2022. *Digital Financial Asset Businesses: Regulation*. https://leginfo.legislature.ca.gov/faces/billVersionsCompareClient.xhtml?bill_id=202120220AB2269.

²⁵ Hsu, S. (2022). “U.S. issues charges in first criminal cryptocurrency sanctions case.” *The Washington Post*, <https://www.washingtonpost.com/dc-md-va/2022/05/16/first-us-criminal-cryptocurrency-sanctions/>

blocks of states similarly committed to robust consumer protection and enforcement to work together under the common purpose of consumer protection. As is the case in other areas of the law, California must always make clear that in order for companies to serve California consumers and investors our laws and regulations must be followed. Our coalition would not look favorably upon any efforts to introduce strong reciprocity provisions with states that do not share California's commitment to protecting consumers. The Governor himself has made this clear when he has discussed California values²⁶.

9. QUESTION: *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?*

ANSWER: Although it is certainly desirable for California to be an attractive home state for responsible companies, we need to ensure that we do not do this at the expense of consumer protection. That is why our coalition recommends a licensing program for the digital asset space similar to [AB 2269](#). Our coalition is aware that market participants often seek clarity so as to avoid any confusion about their legal or regulatory obligations. However, sometimes this manifests itself with too many detailed definitions that wind up limiting the power of a regulator to respond effectively to market conditions and assertively protect consumers. Leading figures in the digital asset space have acknowledged that regulation, even licensing, is necessary to boost the severely lagging consumer confidence in the digital assets/crypto market²⁷. This is particularly true given the wild volatility of this marketplace in 2022 alone. DFPI needs to ensure that they have adequate regulatory flexibility while providing to digital asset/crypto asset-related financial product and service providers the level of clarity that will boost confidence with consumers and investors and thereby stabilize an industry which currently is significantly under regulated. California must not be drawn into a digital asset "race to the bottom" where consumers are an afterthought and protections are lacking.

²⁶ "Governor Newsom presents \$300.7 billion blueprint paving the California way forward." (2022), *Office of Governor Gavin Newsom*, <https://www.gov.ca.gov/2022/05/13/governor-newsom-presents-300-7-billion-blueprint-paving-the-california-way-forward/>

²⁷ Gailey, A. (2022). "Why cryptocurrency regulation is actually a good thing for investors, according to these experts." *Time*, <https://time.com/nextadvisor/investing/cryptocurrency/why-crypto-regulation-is-good-for-investors/>

10. QUESTION: *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?*

ANSWER: In order for DFPI to ensure that “California values” of inclusive innovation and equity-focused consumer protection are core components of crypto asset-related financial products and services it must meaningfully engage with lower-income communities and communities of color to guarantee economic justice. Discrimination against these communities can be seen via the history of traditional financial institutions, and despite talk about “decentralized finance,” or “defi,” the data showing that this is actually happening in our low-income communities and communities of color (or BIPOC communities) is lacking. Research on DeFi applications showcased that even though these applications have the potential to potentially improve financial equity, their current designs “are built on permissionless and pseudonymous blockchains [that] generate formidable challenges for tax enforcements, aggravates issues of money laundering and other kinds of financial malfeasance [that] generate negative externalities on the rest of the economy”²⁸. In this area DFPI should become more forward-facing and less like a traditional banking regulator. Our coalition urges DFPI to make meaningful connections with these historically overlooked communities²⁹. Low-and-moderate income communities and communities of color must not be taken advantage of³⁰. Part of the answer is sustained engagement, and also strong rules and enforcement of those rules to protect those historically underserved communities. This is part of the reason why our coalition believes that DFPI needs to oversee a licensing regime to ensure that these communities do not fall victim to crypto’s promises of providing financial inclusion that have yet to be realized³¹.

²⁸ Makarov, I., & Schoar, A. (2022). “Cryptocurrencies and decentralized finance.” *Brookings Papers on Economic Activity*, https://www.brookings.edu/wp-content/uploads/2022/03/SP22_BPEA_MakarovSchoar_conf-draft.pdf

²⁹ Foster-Frau, S. (2021). “Locked out of traditional financial industry more people of color are turning to cryptocurrency.” *The Washington Post*, https://www.washingtonpost.com/national/locked-out-of-traditional-financial-industry-more-people-of-color-are-turning-to-cryptocurrency/2021/12/01/a21df3fa-37fe-11ec-9bc4-86107e7b0ab1_story.html

³⁰ Luthi, S. (2022). “Why bitcoin ATMs are vexing rulemakers.” *Politico*, <https://www.politico.com/news/magazine/2022/07/06/bitcoin-atms-regulations-00035083>

³¹ Fredman, A. (2022). “Claims that crypto bolsters financial inclusion are dubious.” *Center for American Progress*, <https://www.americanprogress.org/article/claims-that-crypto-bolsters-financial-inclusion-are-dubious/>

CCFPL Regulation and Supervision

11. QUESTION: *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?*
- a. *What factors should be considered in determining whether the offer or provision of a crypto asset-related financial product or service should trigger registration?*

ANSWER: The fundamental premise of our coalition’s comments to the Department is that registration alone is insufficient to meet the current need for consumer protections in the digital assets/crypto space. Licensing offers more protection to not only consumers, investors and small businesses but it additionally would help create the foundations of stability for this extremely volatile industry. To that end we have previously outlined in this letter some of the major components of the factors that are to be considered by DFPI prior to approving any license. Many of those factors are outlined in [AB 2269](#), which also ensures and reiterates sufficient DFPI regulatory authority to further delineate the rules and consumer protections necessary in the digital asset/crypto industry and largely lacking at both the federal and state level as of this moment. AB 2269 seeks to protect consumers from risky and unsafe transactions by requiring that digital financial asset companies such as cryptocurrency exchanges be licensed and overseen by DFPI, which will provide necessary regulatory clarity for both industry and California consumers, investors, and small businesses.

As it pertains to sub-question a, some of the factors that would improve critical financial protection for consumers by boosting the transparency of cryptocurrency transactions include new disclosures regarding prices, fees, and detailed information regarding a prospective licensee’s history of service outages, among other critical information. It is also important that California require cryptocurrency exchanges to act in the best interest of the customer when requesting, selling, or buying cryptocurrencies, something that is largely lacking for much of the industry as currently constructed³². Clear rules relating to so-called “stablecoins,” such as standard disclosure requirements, sufficient reserve backing and other basic consumer protections are also important.

12. QUESTION: *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*

³² (2022). “New analysis finds consumers reported losing more than \$1 billion in cryptocurrency to scams since 2021.” *Federal Trade Commission*, <https://www.ftc.gov/news-events/news/press-releases/2022/06/new-analysis-finds-consumers-reported-losing-more-1-billion-cryptocurrency-scams-2021>

should be included in the definition of a “financial product or service” subject to CCFPL authority?

ANSWER: Regulation pursuant to a licensing program will be necessary. As repeatedly mentioned in this comment letter, DFPI should take a broad view of what entities and covered persons need to be licensed, as evidenced in [AB 2269](#). DFPI should resist efforts to overly define that line, as over time this will merely create regulatory and licensing holes through which some market participants will attempt to assert that they should not be licensed nor subject to certain regulations.

13. QUESTION: *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?*

ANSWER: Similar to our response to question 12, DFPI should not overly define what specifically are UDAAP violations, because in doing so DFPI would unnecessarily limit its authority to take strong enforcement actions when violations are uncovered. Our coalition has made this point to the Department in other contexts, and we stand by our view on this matter³³. The more detailed a UDAAP violation definition is the more limiting it is on a department or agency’s ability to adequately protect consumers, investors and small businesses. Therefore, the definitions of the terms “unfair,” “deceptive,” and “abusive” should remain flexible and inclusive. This affords the Department the broadest amount of latitude to act against UDAAP violations when uncovered. The more that regulators try to overly define UDAAP, the more they limit their ability to counter unfair, deceptive, and abusive actions in the marketplace. Some companies target and take advantage of consumers, investors, and small businesses changes over time and DFPI needs to have the flexibility to deal with those issues as they arise.

14. QUESTION: *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*

³³ (2021). “PRO 02-21: Comments, analysis, and recommendations from small business, consumer, financial services industry, and low-income groups to proposed regulations implementing financial code section 90009(e).” <https://dfpi.ca.gov/wp-content/uploads/sites/337/2021/10/Responsible-Business-Lending-Coalition-9.17.21.pdf>

ensure that features of crypto asset-related financial products and services are fully, accurately, and effectively disclosed?

ANSWER: The overall objective of the Department in the critical area of disclosure should be to provide clear and understandable information to consumers, investors and small businesses that allows them to make as much of an “apples to apples” comparison as is possible in the marketplace. As we have generally seen in the financial products and services industry, far too often disclosure is either minimal, nonexistent, or so shrouded in confusing and legalistic language that consumers do not understand what they are precisely signing up for³⁴. It is also important that the Department utilize readability experts and standardized formats as much as possible to enhance consumer understanding of the disclosures they should be required to receive. All of this should be part of a pre-licensing application process for market participants, to be utilized (and occasionally updated) when new products and services enter the marketplace. Recently DFPI explicitly warned “California consumers and investors that many crypto-interest account providers may not have adequately disclosed risks customers face when they deposit crypto assets onto these platforms”³⁵. DFPI needs to fill those gaps and make an apples-to-apples comparison of these types of crypto asset-related financial products and services and make it easily accessible to consumers.

15. QUESTION: *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?*

ANSWER: DFPI should require the filing of reports in connection with the offering of digital assets/crypto asset-related financial products and services. This is best handled as part of a licensing program and should be a required part of any pre-licensing

³⁴Gingiss, D. (2019). “Major banks are speaking a language their customers don’t understand.” *Forbes*, <https://www.forbes.com/sites/dangingiss/2019/04/26/major-banks-are-speaking-a-language-their-customers-dont-understand/?sh=781dd1f33d38>

³⁵ “DFPI is actively investigating multiple companies offering ‘crypto-interest accounts’.” *Department of Financial Protection & Innovation*, <https://dfpi.ca.gov/2022/07/12/dfpi-is-actively-investigating-multiple-companies-offering-crypto-interest-accounts/>

application. In the current marketplace consumers are being scammed on a daily basis by digital asset/crypto asset-related financial companies who try to evade reporting. Based on recent actions it appears that the Department agrees with this general premise. For example, on July 12 of this year DFPI released a statement informing the public of active investigation of market participants BlockFi and Voyager Digital. These companies offered “crypto interest accounts” to consumers but due to the significant decrease in market value of many digital assets, sometimes referred to as the “crypto winter,” the companies were “preventing customers from withdrawing from and transferring between their accounts”³⁶. This is, of course, the equivalent of a bank closing their doors to prevent a run on the bank, and it often is a precursor to either a bankruptcy filing or other severe action that harms consumers, investors, and small businesses. While not a panacea, a robust licensing program would weed out market participants on the front end who do not have sufficient reserves, stability or strong consumer protective programs to avoid these kinds of situations.

Additionally, part of any licensing program should include explicit requirements for licensees to provide detailed information to DFPI on their market performance, operational systems, and much more. In this regard DFPI would be acting similarly to how it licenses and regulates traditional financial institutions such as some banks and credit unions under its purview. This is also similar to how other types of financial products and services, such as insurance, are licensed and regulated. Detailed reports on all aspects of a company’s operation regularly flow to the regulator, and the regulator reserves the right to ask any licensee or prospective licensee just about any question relevant to that business.

Many times, licensees or prospective licensees attempt to broadly assert that information provided to regulators are “trade secrets.” This assertion has been generally overused to shield from regulator and public view important information that often times is in the public interest to know. Our coalition understands that some information may, in fact, be a “trade secret” but DFPI should be skeptical when encountering such broad assertions.

As to the sub-question asked in item 15a, the answer in the affirmative has previously been provided but our coalition would like to emphasize that DFPI should make as much of the information it receives public as is possible. The more information that is publicly available the better informed consumers, investors and small businesses will be when making critical individual and business decisions relating to the digital assets/crypto industry and their potential participation in it. The reports should contain as much information as possible to not only allow DFPI to do their job efficiently and successfully but also allow consumers to easily understand what is happening with the market. We

³⁶ “DFPI is actively investigating multiple companies offering ‘crypto-interest accounts’.” *Department of Financial Protection & Innovation*, <https://dfpi.ca.gov/2022/07/12/dfpi-is-actively-investigating-multiple-companies-offering-crypto-interest-accounts/>

want the department to be aware of all that is happening within the industry; when consumers are being taken advantage of; and when UDAAP regulations are being adhered to.

As to the question asked in 15b, it is critically important that DFPI include service providers in all reporting requirements, and make it clear that licensees are responsible for the actions of their service providers. In far too many cases regulators have been limited in their ability to right wrongs in the marketplace due to provisions allowing service providers to evade reporting and other requirements. While our coalition understands that, broadly defined, service providers play an important role in the digital asset/crypto industry (as they do in all aspects of the financial services industry writ large), this should not be interpreted and regulated to allow licensees to utilize service provider loopholes to evade legal and regulatory scrutiny.

Most consumers have no idea what service providers are involved in the products and services they may use in the digital assets/crypto space, and these distinctions should not provide differing levels of responsibility simply because a service provider is involved. Reporting to DFPI by service providers should be robust and detailed, and as much of that information as possible should be made public. Companies must be aware that they cannot escape responsibility by using service providers and DFPI needs to ensure that they take a strong stance to ensure the ultimate goal, which is consumer, investor and small business protections.

16. QUESTION: *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?*

ANSWER: As repeatedly reiterated throughout this comment letter, our consumer and small business coalition believes that the best response by the State of California and DFPI is one that involves licensing of companies operating in the digital assets/crypto-related space.

As to the scope of that licensing (sub-question b of question 16), [AB 2269](#) lays it out in some detail, while also providing necessary latitude for DFPI to ensure that consumers are protected. Generally speaking, we recommend casting a broad net when determining the types of companies that should be licensed. It is also important to

emphasize that concurrent licensing based not on what a company says it is but on what it *actually does in the marketplace* is critically important. A rapidly growing list of companies is getting involved in the digital assets/crypto space, and this necessitates that DFPI take a broad view of their role as the lead California financial regulator in this space.

As to sub-question c of question 16, our coalition's view is that DFPI should collect and publish as much information as possible, not only in the aggregate but, where appropriate, at the individual company level. Maximum transparency strongly correlates to enhanced consumer, investor and small business protection.

Finally, for sub-question d of question 16, we believe that transparency is not only good for market participants but for regulators as well. Of course, we understand that there are certain things a regulator cannot disclose (pending enforcement actions, etc.) but making as much as possible publicly available and making it easily accessible online to enhance consumer protections are "North Star" principles that DFPI should adhere to.

Conclusion

Our coalition of consumer organizations and small business groups wants DFPI to succeed in the effective regulation and enforcement in the digital assets/crypto space, and we greatly value our partnership with DFPI in that regard. We applaud where DFPI has taken strong action and initiated investigations to protect consumers in this space. It is our view that to adequately meet this moment and maximize protection of consumers, investors and small businesses, a licensing program, similar to that contained in [AB 2269](#), with robust pre-licensing requirements and substantial enforcement capabilities is necessary. While registration has some value it is insufficient to meet the desperate need for consumer protection in this wildly volatile and significantly underregulated industry. Our coalition stands ready, willing and able to work with the Department to achieve this important consumer protection goal.

If you have additional questions or comments or wish to discuss elements of this letter further, please contact Robert Herrell of the Consumer Federation of California at [REDACTED] or [REDACTED].

Thank you again for your solicitation of our input and we look forward to continuing to work with you on this critical endeavor.

Sincerely,

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