January 12, 2024

Department of Financial Protection and Innovation
Attn: Legal Division
2101 Arena Boulevard
Sacramento, CA 95834
PRO 02-23
VIA E-MAIL

The following organizations representing consumer, small businesses, and low-income communities respectfully submit the following comments and suggestions in responding to the California Department of Financial Protection and Innovation's (DFPI's) "invitation for comments on proposed application-related rule making under the Digital Financial Assets Law (PRO 02-23)." We will attempt to be as brief as possible with our responses to the 14 questions asked by your department.

First off, our organizations would like to thank the Newsom Administration for signing into law AB 39 and SB 401 of 2023, and also thank DFPI for working with many of our organizations on these important bills and the issues raised therein. These two bills, known collectively by DFPI as the Digital Financial Assets Law (DFAL), provide fundamental consumer protections in the digital assets/cryptocurrency space. The digital financial assets marketplace has been rife with significant problems befitting an industry lacking meaningful guardrails to not only protect consumers but provide additional clarity to digital financial assets marketplace participants.[1] The significant

[1] Hiltzik, M. (2022). "Column: Shame, suicide attempts, 'financial death'—the devastating toll of a crypto firm's failure." Los Angeles Times, https://www.latimes.com/business/story/2022-08-12/column-celsius-bankruptcy-shows-how-small-crypto-investors-lost-out.

harm that has been done to millions of consumers clearly merited the approach contained in the two DFAL bills.

In crafting the signed version of these two bills, many of our organizations participated actively with the Legislature in encouraging them to provide strong leadership via the statutes involved to protect consumers and encourage responsible innovation while also providing DFPI with sufficient flexibility to nimbly implement the laws without overly prescriptive statutes as marketplaces evolve and change.

Generally speaking our organizations would additionally like to align our comments with those provided under separate cover to DFPI by the author of AB 39, Assemblymember Grayson. One of the most important takeaways from Assemblymember Grayson's comments is that the flexibility provided to DFPI pursuant to the DFAL statutes is primarily aimed at ensuring that DFPI can keep up with a rapidly evolving industry. As Assemblymember Grayson writes "the digital financial asset industry is evolving quickly, and this rapid pace of change requires an empowered regulator that can keep up accordingly…This was an intentional decision to ensure the DFAL is durable and relevant." We agree. This is especially important in the face of persistent efforts from market participants to minimize and evade, via exemptions or definitional narrowing or other means, the intended scope of the DFAL statutes.

To that end, we turn our attention to the questions asked by DFPI in your invitation for comments. Again, we will attempt to be as brief as possible in our responses and our organizations welcome the opportunity to speak with your team at DFPI to discuss these matters in more detail.

QUESTIONS

1. Financial Code section 3203, subdivision (a)(2)(X) requires the license application to include "any other information" the DFPI reasonably requires by rule. In addition to the information that is listed in the law, what other information should the application include?

The list contained in subdivision (a) of newly created Section 3203 of the Financial Code is a fairly comprehensive listing of minimally required information that should be provided by any license applicant. However, in contemplating augmenting this list DFPI should consider previous behavior and any enforcement actions, prosecutions or consumer/business complaints pertaining to the organizational leaders of the applicant. This may include information with other California entities, other states, or, given the global nature of the digital financial asset industry, information other countries or economic blocks (such as the European Union, or EU) may have.

Generally speaking, our view is that the greater, more rigorous and thorough a pre-licensing effort is on behalf of DFPI, the smaller the risk that the licensee applicant in question will systematically violate consumer trust, California law and sound business practices that put consumers first.

2. Financial Code section 3203, subdivision (a)(3) requires the license application to be accompanied by a nonrefundable fee to cover the reasonable costs of application review. Additionally, Financial Code section 3203, subdivision (e) requires the applicant to pay the reasonable costs of the DFPI's investigation under section 3203, subdivision (b).
a. Are there aspects of the costs and fees in Financial Code section 3203 that should be clarified through rulemaking?
b. Are there factors the DFPI should consider in determining these reasonable costs and fees? For example, should the DFPI charge every applicant the same application fee, or charge different fees depending on the type or complexity of the application? Where applicable, please provide information about the methodology and impact of costs and fees in other state or federal regulatory environments.

Our coalition believes that a proper interpretation of current law (DFAL and elsewhere, including pursuant to California Proposition 26 of 2010, which amended the California Constitution's Article XIII in two places) requires that license application fees cover the reasonable costs of application review.[2] A more rigorous application review should result in a higher application fee. This need must be balanced with the desire of DFPI to not create an overly complex application fee scale. We prefer that, to preserve administrative flexibility in a rapidly changing industry, DFPI not overly detail via rulemaking the elements of application fees.

We concur with the author of AB 39, who wrote to DFPI regarding this very question stating that "[a]n application fee that reflects an application's complexity is preferable if such a fee can be implemented with minimal disruption in the early years of DFAL implementation." Assemblymember Grayson goes on to note that AB 39 was structured the way it is to avoid some of the resource gaps and staffing challenges that other jurisdictions (such as New York's Department of Financial Services (NYDFS)) faced early on in their implementation.

[2] CA. Const. art. XIII C § 1. https://leginfo.legislature.ca.gov/faces/codes_displayText.xhtml?lawCode=CONS&article=XIII%20C.

3. What factors should the DFPI consider in determining the dollar amount of surety bond or trust account it may require under Financial Code section 3207, subdivision (a)?

The main factor that should guide DFPI in determining the dollar amount of surety bond or trust account required pursuant the DFAL is the complexity, amount and quantity of the activities and transactions a potential licensee would be facilitating. Extremely large sums of money are likely to be transacted by future DFAL licensees. By means of comparison, California licensed contractors subject to the jurisdiction of the California Contractors State License Board (CSLB) are required to have a license bond of $25,000. California auto dealers are required to post a $50,000 surety bond (same for used car dealers), freight brokers $75,000 and immigration consultants a $100,000 bond. Given that digital financial assets are more than a trillion dollar industry the relevant amounts should be commensurate with equally complex industry requirements for sizable financial transactions such as those under DFAL.

4. Should the DFPI require a minimum amount of surety bond or trust account? Please explain.

Yes, there should be a minimum amount required. See the answer above to question #3 for more detail. To preserve administrative flexibility DFPI should resist for now placing the minimum amount in regulation. Perhaps after a few years of DFAL administrative experience with DFPI this could be revised.

5. Should surety bond or trust account amounts vary by the type of activity requiring licensure? Please explain.

Yes, the short answer is that the rule of thumb DFPI should use is that the more complex the activity the higher the surety bond or trust account amounts should be. Not all DFAL activities are equal. Complexity should guide the required amounts, but DFPI should resist creating a Kafkaesque myriad of requirements that overly complicate the situation and would lead to concerns raised by the regulated entities.

6. How should specific activity requirements provided for in DFAL, such as the custody requirements of Financial Code section 3503 or the reserve requirements of Financial Code section 3601, impact surety bond or trust account amounts?

Generally speaking the higher the custody and/or reserve requirements required the more flexibility DFPI has with regards to the surety bond or trust account amounts.

Overall the public policy requirement, as clearly reaffirmed in AB 39, that DFPI must follow vigorously is that consumers who are taken advantage of, defrauded or otherwise disadvantaged must be made whole, and it is DFPI's obligation to protect consumers in those situations utilizing the tools provided to the department in DFAL, CCFPL and other relevant laws.

7. Financial Code section 3207, subdivision (b) requires a licensee to maintain capital "in an amount and form as the [DFPI] determines is sufficient to ensure the financial integrity of the licensee and its ongoing operations based on an assessment of the specific risks applicable to the licensee." It provides nine factors the DFPI may, but is not required to, consider when determining the minimum amount of capital required of a licensee. Are the factors provided in Financial Code section 3207, subdivision (b) sufficient, or are additional factors needed and if so, what should those potential additional factors be and why?

Our view is that the "list of nine" contained in subdivision (b) of Section 3207 of the Financial Code are a list of items that, particularly in the first few years of implementation, DFPI should consider as a "shall" than a "may." Beyond that list of nine DFPI may wish to consider items relating to the global nature of many DFAL licensees, as well as their history of interactions with consumers, including complaints and restitution. Additionally a licensees interactions with state entities, including departments and agencies globally tasked with consumer and investor protection, should be considered.

8. Should capital minimums vary by the type of activity requiring licensure?

In a word, yes. Simply put, different activities have different levels of risk and our coalition would expect that DFPI would account for these risk variants as it determines the appropriate capital minimums. Capital minimums may also need to vary based on the licensee itself. For example, entities with a history or higher risk or anti-consumer behavior should either be rejected as licensees or receive a provisional license subject to significantly higher amounts of surety bonds or capital minimums.

9. Under Financial Code section 3603, subdivision (b)(2)(B), in determining whether to approve a stablecoin the Commissioner must consider "[t]he amount, nature, and quality of assets owned or held by the issuer of the stablecoin that may be used to fund any redemption requests from residents." Subdivision (a)(2) of Financial Code section 3601 requires that the "issuer of the stablecoin at all times own[] eligible securities having an aggregate market value computed in accordance with United

States generally accepted accounting principles of not less than the aggregate amount of all of its outstanding stablecoins issued or sold." Subdivision (b)(1) of Financial Code section 3601 specifies that "eligible securities" means those described in subdivision (b) of Financial Code section 2082 or foreign currency eligible securities described in subdivision (c) of section 2082.
a. Given that Financial Code section 3601 already restricts the types of assets that qualify as eligible securities (and can therefore be used to fund redemption requests) that an issuer may hold to those assets described in Financial Code section 2082, are there other criteria that the DFPI should consider in evaluating "quality of assets" under Financial Code section 3603, subdivision (b)(2)(B)?
b. Regarding the amount and nature of assets, is there particular information that the DFPI should consider?

On this matter our coalition would like to associate ourselves with the comments provided to DFPI by Assemblymember Grayson, the author of AB 39. As DFPI is well aware, stablecoin oversight is an extremely important part of AB 39 and arguably was the trigger as to the creation of AB 39 (along with other scandals that racked the digital financial asset/crypto industry in 2022 and 2023, scandals that have found many of the leading crypto industry titans either behind bars[3], facing serious allegations of wrongdoing, or bankrupt)[4].

As Assemblymember Grayson summarized in his letter to DFPI answering this very question, there are two paths to stablecoin approval - pursuant to Section 3601 or pursuant to 3603. We agree that DFPI may be conflating the two in this question.

Having said that, our coalition wishes to make it quite clear that should DFPI generously grant wholesale permissions pursuant to Section 3603 based on factors that run contrary to strong consumer protection in an area that has been rife with consumer fraud and abuse, our organizations would assert that such actions would be completely contrary to both the spirit and letter of AB 39. We trust that DFPI will grant such approvals sparingly and pursuant to exceedingly good cause and evidence on behalf of the applicant.

10. Under Financial Code section 3603, subdivision (b)(2)(C), in determining whether to

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[3] Hiltzik, M. (2023). "Column: Sam Bankman-Fried's seven guilty verdicts expose crypto as a swindle through and trhough." Los Angeles Times, https://www.latimes.com/business/story/2023-11-03/hiltzik-sam-bankman-fried-seven-guilty-verdicts-crypto-swindle.
[4] Office of Public Affairs. (2023). Binance and CEO plead guilty to Federal charged in $4B resolution. Department of Justice, https://www.justice.gov/opa/pr/binance-and-ceo-plead-guilty-federal-charges-4b-resolution.

approve a stablecoin the Commissioner must consider "[a]ny risks related to how the assets described in subparagraph (B) are owned or held by the issuer that may impair the ability of the issuer of the stablecoin to meet any redemption requests from residents." Are there particular risks regarding how assets are owned or held that the DFPI should consider?

The history of stablecoins and significant bankruptcies and financial/psychological pain caused to consumers and families pursuant to those bankruptcies (one merely need read submissions to various bankruptcy judges to get a sense of the hurt and harm caused, particularly to low-and-moderate income consumers and consumers of color) have been immense. Correspondingly, jurisdictional challenges and evasion of governmental actors should be at the top of the list of the risks that DFPI should consider in this space.[5] Justice evaded is justice denied.

11. Under Financial Code section 3603, subdivision (b)(2)(F), in determining whether to approve a stablecoin, the Commissioner must consider "any other factors the commissioner deems material to making their determination."
a. To what extent should the DFPI consider the amount and type or quality of the issuer's other liabilities before approving a stablecoin?
b. What "other factors" should the DFPI consider?
c. Should the DFPI consider whether the stablecoin is listed on the "Greenlist" maintained by the New York State Department of Financial Services? Please explain why or why not.

Briefly, pursuant to 11a, DFPI should absolutely consider other liabilities of the issuer as the department contemplates potential approval of a stablecoin. Millions of consumers found out the hard way that a stablecoin "pegged" to the US dollar, or Euro or Japanese yen as not actually directly connected to any of those fiat currencies. Other liabilities (and, broadly speaking, additional obligations or promises) of the issuer are absolutely relevant to the kind of sound, thorough due diligence process that DFPI must undertake prior to any potential stablecoin approval pursuant to Section 3603 (which again assumes that the stablecoin does not meet the reserving requirement criteria spelled out in Financial Code Section 3601).

As to 11b, our answer to question #10 and also to #11a above should be sufficient (for now) to govern DFPI as it ramps up its DFAL efforts. Complexity and history, particularly when it comes to prior consumer experiences, matter greatly.

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[5] U.S. Securities and Exchange Commission. (2023). "SEC charges Genesis and Geminin for the unregistered offer and sale of crypto asset securities through the Gemini Earn Lenging Program". https://www.sec.gov/news/press-release/2023-7.

Finally, as to 11c, we do believe that a stablecoin that is listed on the "Greenlist" maintained by NYDFS is relevant. That alone should definitely not be determinative of DFPI's decision, but this information is important to show that, in the recent past, such prior"approval" does help inform DFPI conduct its due diligence. However, much like a healthy person can quickly succumb to an illness, rigorous check-ups from DFPI are extremely important to protect consumers and their assets potentially being invested in any stablecoin or similar digital financial asset instrument.

12. Under Financial Code section 3603, subdivision (c), the Commissioner may impose conditions, restrictions, or other requirements on an issuer or a covered person as a condition of approval of a stablecoin.
a. Are there restrictions or requirements that should be imposed generally on all issuers or covered persons? If so, why?
b. Should there be a general requirement that all issuers certify that they meet requirements similar to those for covered exchanges under Financial Code section 3505, subdivision (a)?

For 12a, our coalition generally believes that the overall structure of AB 39 and the DFAL two-bill package should help inform DFPI as to the types of concerns the author, Legislature, and sponsor and supporters of the bills had in mind. That is to say that when sparingly utilizing the authority provided to DFPI pursuant to Section 3603, the department should cast a wide net when it comes to history, behavior, activities, regulatory friction, lawsuits, enforcement actions in other jurisdictions and other relevant information prior to approving a stablecoin.

With regards to 12b, we think that the certification pursuant to Section 3505, subdivision (a) represents a good start for the department as it judiciously endeavors to utilize the authority provided to it pursuant to Section 3603 in approving stablecoins that do not meet the reserving requirements of Section 3601. We would note that, similar to our comments pursuant to question #11c, previous NYDFS certification should be relevant, but not determinative, information relating to DFPI's authority granted in Section 3603.

13. Are there any additional matters related to the DFAL license application, licensure requirements, or stablecoin approval that the DFPI should consider when proposing regulations?

We generally believe that the items we have highlighted throughout our answers to questions #1-12, inclusive, should help govern DFPI's thinking about relevant information that is materially important to DFAL license applications. Our strongly held

view is that the stronger the pre-licensing investigation by DFPI, the lesser the chance of future consumer harm at the hands of a licensee. Many problematic licensees in various areas and professions, we would assert, should have been denied a license in the first place had avoiding consumer harm been the primary consideration of the licensing entity in question. DFPI, as a relatively newly reorganized department modeled on the important reforms to the financial marketplace pursuant to the Great Recession of 2008-2011 and laws such as Dodd-Frank that implemented said reforms at the federal level, has an even higher obligation to protect consumers.

14. What future rulemaking actions related to the administration of the DFAL should the DFPI consider, and why?

The DFPI should preserve maximum departmental flexibility when it comes to other areas not covered by these questions, such as examinations and enforcement. DFPI should resist the persistent requests from industry stakeholders to overly define items within DFAL such that it would jeopardize DFPI's ability to keep up with a rapidly-changing marketplace in the digital financial assets/crypto space, particularly as it may complicate DFPI's ability to vigorously enforce the DFAL's provisions and protect consumers and investors.

Our organizations thank you for your leadership and collaboration with us on these important laws and their effective implementation. We stand ready to work with DFPI in any way we can to show that California is taking a national and international leadership role in protecting consumers and fostering responsible innovation in the digital financial asset/cryptocurrency space.

Sincerely,

Consumer Federation of California
CAMEO - California Association for Micro Enterprise Opportunity
California Low-Income Consumer Coalition (CLICC)
Office of Kat Taylor