January 12, 2024

Clothilde V. Hewlett
Commissioner
California Department of Financial Protection & Innovation
2101 Arena Blvd.
Sacramento, CA 95834

Commissioner Hewlett:

Thank you for the opportunity to provide our thoughts in response to the invitation from the California Department of Financial Protection and Innovation (the "Department" or "DFPI") on the proposed application-related rulemaking under the Digital Financial Assets Law (PRO 02-23).

The Crypto Council for Innovation (CCI) is a global alliance of industry leaders in the digital asset and Web3 sectors that serves to educate consumers and policymakers and advocate for policy that spurs responsible innovation. We use an evidence-based approach to support governments worldwide that are shaping and encouraging the responsible regulation of this innovative technology. We believe that constructive partnership between government and business stakeholders is critical to crafting sound policy and regulation that benefits consumers and innovators.

Digital assets and blockchain applications more generally are significant and evolving technological innovations with many use cases developed under a variety of business models. These innovations are bringing increased transparency, security, efficiency, and inclusion not only to financial services, but to other sectors as well. To this end, CCI continues to advocate for the development of modern, coherent, and fit-for-purpose policy frameworks to foster responsible digital asset innovation in the United States.

Fortunately, the States have led in engaging with the digital assets industry and establishing proper state-based frameworks for digital asset market participants. Indeed, state-based frameworks can serve as an efficient and effective regulatory model for our industry, and now California can further this effort.

As DFPI considers promulgating rules to facilitate the DFAL licensure process, CCI respectfully submits the following principles and recommendations on certain of the topics outlined in the request.

As a general matter, DFPI should consider how best to harmonize licensing standards with states utilizing similar licensing regimes, including, for example, New York's regulations governing virtual currency business activity. Reciprocity and licensing passports can result in improved efficiency across state frameworks while protecting consumers and allowing for responsible innovation. However, DFPI has an important opportunity to improve upon existing regulatory frameworks, including establishing clear and consistent application and review timelines,

addressing the ambiguity of certain terms, and ensuring the DFPI is adequately resourced to effectively supervise regulated entities while approving new applications efficiently. DFPI can also lead by fostering a level playing field, while enabling innovation amongst the burgeoning and distinctive digital asset startups throughout the state.

License application form and related fees (Fin. Code, § 3203)

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?*

CCI Response: CCI encourages DFPI to limit the scope of information collected through its license application process to information that is necessary and pertinent to the applicant's digital asset business activity and the stability of the applicant. This can avoid imposing undue burdens on applicants, straining DFPI staff resources in reviewing extraneous information, and creating precedent that makes numerous state-based licensing processes untenable for industry.

For illustrative purposes, a "necessary and pertinent" qualifier would be similar to guidance[1] issued by the New York Department of Financial Services ("NYDFS") regarding New York's BitLicense regime.[2] For example, the NYDFS guidance states, "[a] Covered Institution should provide the [NYDFS] sufficient information for the [NYDFS] to assess the scope of the proposal and any impact on the institution's safety and soundness, including implications for New York customers of the Covered Institution and other users of the proposed product or service." Additionally, NYDFS guidance encourages BitLicense applicants to tailor their submissions to their specific business activity. If an applicant does not think that a particular request for information pertains to its particular business activity, then the applicant may exclude the requested information and provide a clear explanation for the exclusion.

DFPI should similarly encourage applicants to tailor their applications to reflect such activities. This will allow for greater efficiency for the DFPI as it will only receive relevant and necessary information to review and assess as part of its licensure process. While the majority of information requirements listed under Fin. Code § 3203 (a)(2) aligns with these principles and with DFPI's goals for the regulatory scheme, the requirement of "any other information" in § (a)(2)(X) does not.

The breadth of such a requirement could also lead to the unintended outcome of discouraging applications, particularly since potential applicants will lack certainty as to exactly what types of

---

[1] *Industry Letter: Prior Approval for Covered Institutions' Virtual Currency Related Activity*, New York State Department of Financial Services (Dec. 15, 2022), available at https://www.dfs.ny.gov/system/files/documents/2022/12/il20221215_prior_approval.pdf.

[2] In 2015, the NYDFS adopted 23 NYCRR Part 200, which required persons engaged in virtual currency business activity, as defined in 23 NYCRR 200.2(q), to obtain a license, subject to certain exemptions, before engaging in such activity in New York. This licensing regime was created under the authority granted to the Department by the Financial Services Law.

information will actually need to be collected. Given this uncertainty, applicants may not be able to properly comply with the requirements—not because they do not want to, but because the request for information could be unduly burdensome (while not providing DFPI with the necessary relevant information for purposes of its review process). It will be challenging—if not impossible—for potential applicants to adequately prepare their applications if additional swaths of information could be requested at any time. Stated otherwise, potential applicants would not know when and what types of additional information may be required, which would make for an ambiguous and burdensome application process.[3]

DFPI should consider tailoring information requirements to (1) the size of the applicant's organization and (2) any potential risks that the applicant's business activities actually pose. For example, DFPI could define risk categories depending on the applicant's particular set of business activities.

For purposes of a new license application, DFPI should confirm that 25% is the relevant threshold that will be applied to determine if a person is in "control" of a company and, therefore, required to (i) submit fingerprints pursuant to 3219(a)(2) and (ii) provide the information specified in 3203 for "persons that have control of the applicant."

As background, Section 3102(c)(2) defines control under the Digital Financial Assets Law as the power to vote 25% or more of a class of voting securities. However, Section 3309 establishes a different percentage threshold to be applied for proposed changes in control (e.g., sale of the business, mergers, etc.). DFPI should clarify that the 10% threshold set forth in 3309(b) applies only to the change-in-control provisions, not initial licensing applications.

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.*

CCI Responses to Questions 2.a. & b: DFPI should require a reasonable flat fee for completion of the license application. However, with respect to any ongoing assessments, DFPI should take an individual organization's size and covered business activity into consideration. Given DFPI's continued leadership in both the banking and digital asset space, it is important for the

---

[3] Such a requirement could also pose potential risks to privacy, as it could lead to the requirement to share large amounts of sensitive data with DFPI.

Department to set the standard for other state regulators. DFPI should consider that setting an application fee too high may set a problematic precedent as additional states move to follow California's model. Costly application fees may stifle responsible innovation and pose a steep barrier to entry for future licensees seeking to comply with fifty different digital asset licensing regimes.

CCI believes that DFPI should require an applicant to pay a flat fee to complete submission of its license application. Here, DFPI has the opportunity to promote innovation in California by ensuring that additional costs associated with the application and investigation processes fairly reflect an applicant's business activities. DFPI should consider the fact that, in addition to the application fee, applicants will have to bear the costs of completing the application process. This may entail hiring an additional staff member—or, at the very least, dedicating significant existing organizational resources—to collect the requested information and compile such information into a coherent application. Given the amount of requested information under Fin. Code § 3203 (a)(2), the final application could easily consist of hundreds of pages of disclosures.

The amount of resources that must be dedicated to the completion of the application could result in a significant strain on smaller businesses, who lack the assets and manpower of their larger counterparts. Not only will this burden discourage early stage applicants from entering the California market, but it will also create an unlevel playing field, whereby only the most well-resourced applicants can do business in California. DFPI should also strive to avoid certain shortcomings of other jurisdictions' digital asset licensing regimes, which have inadvertently discouraged business in their states.

Surety bond or trust account (Fin. Code, § 3207, subd. (a))

> 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)?*

CCI Response: DFPI should allow applicants to propose a bond amount and the rationale as to why such amount is sufficient to best protect their customers. This makes particular sense as the applicants will best understand their business model and activities and how to quantify the appropriate bond amount to best protect customers.[4]

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

CCI Response: Licensees should be allowed to propose an amount and provide justification for such proposal regarding a surety bond or trust account. For example, the New York BitLicense provides for a similar approach and does not require a minimum amount of surety bond or trust account.

---

[4] This is similar to the requirements in the New York BitLicense regulatory regime where licensees are required to obtain a surety bond or trust account in an amount that is acceptable to the NYDFS for the protection of the licensee's customers.

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

CCI Response: The amount should be tied to the proportion of business activities covered by DFAL and size of the company, and thus, will vary by applicant.

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?*

CCI Response: Surety bond obligations should be outlined when applications are approved and during annual renewals. Surety bonds should also be capped, which is a standard practice among other regulated financial institutions. To ensure greater transparency for licensees, minimum capital requirements should align with the total shareholder equity construct proposed by the Conference of State Bank Supervisors (CSBS).[5]

Stablecoin approval process (Fin. Code, § 3603)

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?*

CCI Responses to Questions 9.a. & b.: As the Financial Stability Board has highlighted, "stablecoins have the potential to bring efficiencies to payments, and to promote financial

---

[5] *See* Conference of State Bank Supervisors, Model Money Transmission Modernization Act, (Aug. 2021), available at
https://www.csbs.org/sites/default/files/2021-09/CSBS%20Model%20Money%20Transmission%20Modernization%20Act_09.13.21.pdf.

inclusion."[6] Indeed, stablecoins have the potential to reduce costs to merchants and consumers when it comes to payment options, as well as powering the digital assets ecosystem. Stablecoins also have the ability and hold promise for a range of additional use cases including, among others, financial infrastructure improvements, new business models, humanitarian aid[7], and cross-border payments.[8]

Section 3601 and 3603 are separate regulatory frameworks for two different types of stablecoins. Section 3601 governs fiat-backed stablecoins, while 3603 governs other forms of stablecoins such as crypto-collateralized stablecoins. The language "except as provided in Section 3603," designates that stablecoins qualifying under section 3601 shall be treated in a separate manner with separate reserve and capital requirements than stablecoins seeking to retain a license under DFAL under section 3603.

As a general matter, there are at least three primary stablecoin types (fiat-backed, commodity-backed, and algorithmic), and each requires different considerations. CCI would welcome the opportunity to further discuss the types of stablecoins and the various related considerations.

Fiat-backed payment tokens issued by centralized issuers should be backed 1:1 (i.e., market value of the underlying reserve of assets is at least equal to the nominal value of all outstanding units of the stablecoin), secure (e.g., proper cybersecurity and maintenance of the underlying blockchain protocol), audited and have sufficient risk management practices (including, among other things, appropriate redemption policies and procedures). Specifically, the underlying reserves should consist of segregated cash, bank deposits and HQLA, such as short-term US Treasuries. These practices would be consistent with standards developed by other regulatory regimes, including NYDFS, as well as the framework proposed by leading federal legislation.[9]

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

---

[6] Financial Stability Board, *Crypto-assets and Global "Stablecoins"* (last visited Jan 12. 2024), https://www.fsb.org/work-of-the-fsb/financial-innovation-and-structural-change/crypto-assets-and-global-stablecoins/.

[7] *See Crypto and Ukraine – Fundraising at Speed*, Crypto Council for Innovation (Oct. 30, 2023), https://cryptoforinnovation.org/crypto-case-study-ukraine/.

[8] In 2021, California accounted for over one-third of all remittances sent from the U.S. to Mexico. The average cost of sending $200 has hovered around 5 percent, or $10. For the average remittance sender – migrant workers who send around $370 per month in 2-3 installments – these fees add up quickly. Meanwhile, we've seen stablecoins facilitate remittances at a cost of 1 to 3 percent around the world, representing significant savings for those who need it most.

[9] Clarity for Payment Stablecoins Act, H.R. 4766, 118th Cong. (2023), available at https://www.congress.gov/118/meeting/house/116295/documents/BILLS-118-HR4766-M001156-Amdt-3.pdf.

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.*

CCI Responses to Questions 10 & 11: Stablecoin licensing requirements should be based on the different characteristics and underlying mechanics of the particular stablecoin issuance. Not all stablecoins are designed in the same manner, and varying design decisions can affect factors like volatility, liquidity, and accountability.

As detailed above, fiat-backed payment stablecoin should be backed 1:1, be secure, have sufficient risk management practices, have appropriate redemption policies and procedures, and be audited.

California can further lead and distinguish itself from other states by providing clear requirements regarding other types of stablecoins, particularly algorithmic stablecoins. Such requirements can provide both the markets and the digital asset industry with clarity. For example, DFPI can further enable responsible innovation by exercising its discretionary authority to allow for algorithmic stablecoin issuances if certain requirements are met, including, among others, collateralization requirements, proper completion of audits, and adherence to appropriate operational and issuance safeguards. Algorithmic stablecoins, in and of themselves, are not a source of instability; rather, under-collateralization can be the source of instability, along with issuance and operational defects, and this is where DFPI can further lead by providing clear requirements.

It is further appropriate for DFPI to consider whether the stablecoin is listed on the NYDFS' Greenlist; this is particularly so as the NYDFS does have robust requirements focused on many of the areas that CCI has detailed (e.g., reserve requirements, redemption processes, security, etc.). Indeed, to be included on the NYDFS' Greenlist, the stablecoin issuer will have demonstrated a historic record consistent with safety and soundness and the protection of customers, as well as broad marketplace adoption. Passport approval or reciprocity for assets included on the Greenlist would also promote harmonization amongst states with state-licensing frameworks, which can improve efficiency and reduce costs for both regulators and the digital assets industry. Collaboration with other state regulators, like the NYDFS—through acknowledgement of other states' processes and development of reciprocity frameworks—would further regulatory harmonization. However, it is important for DFPI to appropriately tailor this

framework to the unique characteristics of stablecoins and residents of California, which should, in turn, be also afforded proper recognition by other states.

Additional Comments

> *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?*

CCI Response: DFPI staff should keep in mind that the DFAL was drafted with some specific business cases in mind, but the digital financial assets industry is very diverse in terms of business model, size of the company, number of offerings, and relationship to other business models. California should want to see even more new models and innovations come into the industry.

While some businesses were and will continue to be created as digital financial asset businesses, others simply added digital assets into a much larger portfolio of other products and services with their own structures and in some cases oversight. These varying sizes and models should continue to be taken into account as rules are promulgated and applied. As the regulations develop and the industry continues to grow, transparency, clarity, and flexibility are critical in ensuring that the industry continues to flourish responsibly in California.

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

CCI Response: DFPI should consider providing specific rulemaking regarding its processes for ongoing supervision of licensed entities, including its annual assessments criteria and investigations. DFPI should also consider specific rulemaking for algorithmic stablecoin approvals.

DFAL gives DFPI the sole discretion (without providing additional details) to initiate, conduct, and conclude any investigation into any licensee at any time. As a result of the discretion afforded to DFPI, it is unclear how the Department will conduct investigations or examinations. In New York's case, these investigations historically can take years, with very little transparency as to their focus or process, and certain of these investigations ostensibly do not result in any allegation or finding of wrongdoing.

CCI also supports fair and reasonable annual assessments on digital asset licensees, to ensure that California will remain a hub for responsible innovation in the Web3 and digital asset ecosystem. In particular, we urge DFPI to use these assessments to provide for timely review processes, clearly defined timelines regarding such review processes, and early, constructive supervisory feedback to licensees. Any annual assessment charges should also reflect the size of an applicant's business and the potential risks stemming from its unique business model.

DFPI should develop a regulatory framework for algorithmic stablecoins that recognizes the important role of algorithms and digital assets. Over the last two years, the vast majority of

algorithmic stablecoin projects have performed remarkably well, and the exceptional few that did not were significantly under-collateralized and relied on insufficient issuer-generated collateral. We agree that regulation should prevent stablecoin issuers from taking on unreasonable amounts of risk. However, this goal can be achieved without implementing overbroad restrictions to an asset class that is key to other aspects of the blockchain ecosystem, including DeFi, Web3, and other digital asset markets.

<p style="text-align:center">* * *</p>

Thank you again for the opportunity to provide these comments and your consideration of our recommendations. CCI would be pleased to further engage on the comments detailed in this letter and ways to ensure the responsible growth of the digital asset industry in California.

Respectfully,

Sheila Warren
Chief Executive Officer
Crypto Council for Innovation

Ji Hun Kim
General Counsel & Head of Global Policy
Crypto Council for Innovation