



January 12, 2024

Via Electronic Submission

Regulations@DFPI.CA.Gov

Mary Tomé
Senior Counsel for the Commissioner
Department of Financial Protection and Innovation
2101 Arena Boulevard
Sacramento, CA 95834

Re: Invitation for Comments on Proposed Application-Related Rulemaking Under the Digital Financial Assets Law (PRO-02-23)

Ms. Tomé:

Payward, Inc., d/b/a/ Kraken (“Kraken”) welcomes the opportunity to submit a response to the State of California Department of Financial Protection and Innovation’s (“DFPI”) Invitation for Comments (“IFC”)¹ on the proposed application-related rulemaking under the Digital Financial Assets Law (“DFAL”).²

Founded in San Francisco in 2011, Kraken is one of the world’s oldest and largest digital asset trading platforms. Since then, we have steadily grown into a diversified digital asset business serving over 10 million customers around the world. We strive to offer the most secure and transparent execution platform, deepest liquidity, and best user experience in our markets.

In the United States, Kraken maintains registration as a Money Services Business with FinCEN³ and, through one of its US subsidiaries, holds multiple money transmitter licenses. Separately, Kraken Financial is supervised by the Wyoming Division of Banking under a Special Purpose Depository Institution charter.⁴ Additionally, Kraken holds licenses and registrations in the United Kingdom, European Union, Canada, and Australia, as well as in other developed and emerging markets.

Customer protection is core to Kraken’s culture and operating model. We are consistently named one of the most secure places to buy and sell crypto due to our robust security protocols.⁵ We are proud of our twelve-year track record of offering California consumers a platform to safely access evolving digital asset technology designed to create a fairer, more inclusive financial system.

Kraken is committed to supporting policy makers both in the United States and abroad to implement effective domestic rules and a coherent international regulatory framework for digital asset markets. As other major jurisdictions advance fit-for-purpose rules to regulate digital assets, we welcome efforts by the California government to provide clear and effective rules that will allow innovative digital asset

¹ <https://dfpi.ca.gov/wp-content/uploads/sites/337/2023/11/DFAL-Invitation-for-Comments-11-20-2023.pdf>

² <https://legiscan.com/CA/text/AB39/id/2834136>

³ Payward Ventures, Inc., MSB Registration No. 31000239561651

⁴ Payward Financial, Inc., Charter No. 269

⁵ <https://www.csoonline.com/article/570667/us-cso50-2022-awards-showcase-world-class-security-strategies.html>

technology to grow in the United States, while ensuring adequate consumer protections are in place to protect California residents.

Given the legislature's intent to refine the statute during the 2024 legislative session and the subsequent July 1, 2025 effective date, we urge the DFPI to publish a well-defined implementation plan to ensure a thoughtful and productive rulemaking process.

Please find our responses to specific questions below. We appreciate the opportunity to provide feedback on this important issue and look forward to working with the DFPI as it works to implement the DFAL.

Sincerely,

The Kraken Team

Responses:

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

1. *Section 3203 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 information listed in the law is sufficient and conforms with standard money transmission laws, closely aligning with the requirements in section 2032(b) of the California Financial Code’s Money Transmission Act.⁶

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?*

Rulemaking should clarify that the application fee is a flat fee, regardless of the applicant’s size, as this is standard practice.⁷ The five thousand dollar (\$5,000) application fee employed by section 2032(a) of the California’s Money Transmission Act is an appropriate fee for the DFAL application.⁸

We recommend the application fee cover the cost of DFPI’s investigation. It is not common practice to include an additional investigatory fee on top of the application fee. New York’s “BitLicense” regulation assigns a five thousand dollar (\$5,000) application fee “to cover the cost of processing the application, reviewing application materials, and *investigating the financial condition and responsibility, financial and business experience, and character and general fitness of the applicant.*”⁹ To the extent that an additional investigatory fee is still required, we recommend the DFPI implement a cap on reasonable costs or a definite hourly fee for the investigation of the application.

- 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.*

The DFPI should follow standard practice for state money transmission laws and implement a flat fee for all applicants engaged in exchanging, transferring, or storing digital financial assets such as Kraken.¹⁰

⁶CA Financial Code § 2032(b)

⁷<https://faisalkhan.com/solutions/licensing/money-transmitter-license-mtl/summary-table-for-us-states-money-transmitter-license-with-costs/>

⁸ CA Financial Code § 2032(a)

⁹ 23 N.Y.C.R.R § 200.5

¹⁰<https://faisalkhan.com/solutions/licensing/money-transmitter-license-mtl/summary-table-for-us-states-money-transmitter-license-with-costs/>

II. 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 section 3207?*

While there are a range of factors that can reasonably be considered by the DFPI in determining the dollar amount, the principal factor should be the licensee's average daily outstanding obligations attributable to digital financial business activity in California, consistent with Section 2037(e) of California Money Transmission Act.¹¹

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

Again, to ensure alignment with the companion money transmission licensing framework, we recommend a two hundred fifty thousand dollar (\$250,000) minimum surety bond requirement, which reflects Section 2037(e) of the California Money Transmission Act.¹² We also recommend implementing a reasonable maximum amount, similar to section 10.02 of the Model Money Transmission Act.¹³

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

Surety bond or trust account amounts should vary depending on the type of activity and the risk it presents, subject to a reasonable maximum amount, similar to section 10.02 of the Model Money Transmission Act.¹⁴

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

Surety bonds or trust accounts are designed to serve as a backstop in the event of a shortfall or other incident that compromises the licensee's ability to fulfill its obligations to customers. As a result, in order to promote public confidence in licensees, we view it as important that surety bonds or trust accounts amounts remain in full force notwithstanding adherence to specific activity requirements set forth under the DFAL.

III. Capital (Fin. Code, § 3207, subd. (b) & (c))

7. *Section 3207 requires a licensee to maintain capital "in an amount and form as [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 sufficient, or are additional factors needed and if so, what should those potential additional factors be and why?*

Yes, the factors detailed in section 3207 are satisfactory.

¹¹ CA Financial Code § 2037(e)

¹² Id.

¹³ Model Money Transmission Act § 10.02

¹⁴ Id.

The DFPI should also consider allowing for reciprocity if the licensee is holding capital in connection with another state’s virtual asset licensing program or money transmitter license (i.e., if the licensee is holding “X” percent of capital in connection with its money transmitter license in another state, then the DFPI should consider allowing the licensee to also apply that to the DFAL capital requirements).

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

As discussed in Question 5, capital minimums should vary depending on the type of activity and the risk it presents.

IV. 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?*

We agree with the legislature’s intent to capture Kraken’s trading platform in the DFAL. However, we strongly encourage the DFPI to consider our affiliated entity, Kraken Financial, for exemption from licensure under section 3103(b) of the Financial Code, given Kraken Financial’s constructive qualification under the statute and its ability to custody assets on behalf of California consumers in the safest way possible.

Financial Code section 3103(b) exempts from licensure, among other entities, “a commercial bank or industrial bank, the deposits of which are insured by the Federal Deposit Insurance Corporation or its successor,” and goes on to say that “the commissioner may, by regulation or order...exempt from all or part of this division any person or transaction, or class of persons or transactions, if the commissioner finds such action to be in the public interest and that the regulation of such persons or transactions is not necessary for the purposes of this division.”

In 2020, Kraken Financial obtained a charter from the State of Wyoming to operate a special purpose depository institution (“SPDI”). Kraken Financial is a “fully-reserved bank that receive[s] deposits and conduct[s] other activity incidental to the business of banking, including custody, asset servicing, fiduciary asset management, and related activities.”¹⁵ Kraken Financial is a ‘bank’ under both Wyoming law¹⁶ and federal law.¹⁷ While a subsidiary of Kraken, the SPDI is structured and required to be operated as an independent entity. This includes its own Board of Directors and separate executive management. Additionally, Kraken Financial is subject to regular safety and soundness examinations.

Kraken Financial is prohibited from making loans with consumer deposits and must at all times have 100% of customer deposits backed by unencumbered liquid assets. Therefore, Kraken Financial and other SPDIs are not required to obtain FDIC insurance because SPDIs can *insure*

¹⁵ <https://wyomingbankingdivision.wyo.gov/banks-and-trust-companies/special-purpose-depository-institutions>

¹⁶ 11 Wyo. Stat. § 13-1-101(a)(i).

¹⁷ 12 U.S.C. § 1813(a)(1), (2) (“The term “State bank” means any bank, banking association, trust company, savings bank, industrial bank . . . , or other banking institution which—(A) is engaged in the business of receiving deposits, other than trust funds (as defined in this section); and (B) is incorporated under the laws of any State or which is operating under the Code of Law for the District of Columbia”); 12 U.S.C. §§ 221, 248a, 321, 461(b)(1)(A)(i); 12 U.S.C. § 1831a(j)(4); 15 U.S.C. §§ 78c(a)(6); 15 U.S.C. § 80a-2(a)(5); 15 U.S.C. § 80b-2(a)(2); 26 U.S.C. § 581.

*all deposits, at all times, and in amounts over \$250,000.*¹⁸ As such, Kraken Financial should be granted the same exemption applied to FDIC insured banks.

We encourage the DFPI to consider these factors when assessing SPDIs, including Kraken Financial, given the robust protections such institutions can provide California consumers in safeguarding their assets.

We welcome the opportunity to discuss this subject, and others, in further detail.

¹⁸ <https://wyomingbankingdivision.wyo.gov/banks-and-trust-companies/special-purpose-depository-institutions>; This “full reserve” requirement, if it had applied to Silicon Valley Bank and Signature Bank, may have prevented the failure of those banks. *See, e.g.*, James Lee and David Wessel, *What did the Fed do after Silicon Valley Bank and Signature Bank failed?* March 22, 2023, available at <https://www.brookings.edu/2023/03/22/what-did-the-fed-do-after-silicon-valley-bank-and-signature-bank-failed/> (explaining that banks that only keep a fraction of customer deposits on reserve may not have enough cash on hand to satisfy withdrawals if all customers withdraw at once, which can lead to a bank run, which can cause a bank to have to sell its assets quickly, at a loss.)