January 12, 2024

ripple

Commissioner Clothilde Hewlett
Department of Financial Protection and Innovation
Attn: Legal Division
2101 Arena Boulevard
Sacramento, CA 95834
Email: regulations@dfpi.ca.gov

Dear Commissioner Clothilde Hewlett:

Ripple Labs Inc. (Ripple) welcomes the opportunity to provide comments to the California Department of Financial Protection and Innovation (DFPI) regarding the promulgating of rulemaking for the licensure process as directed by the Digital Financial Assets Law (DFAL).

Introduction

Ripple is the leading provider of crypto solutions for business. We are an enterprise business-to-business financial services technology company that utilizes blockchain technology to enable our customers to move funds around the world. Ripple is faster, more transparent, and more cost-effective than traditional financial services. Additionally, Ripple and its clients – global financial institutions, international corporations, and national governments –are all entities that adhere to the strongest compliance controls designed to prevent financial crimes and keep consumers safe.

Headquartered in the heart of San Francisco, Ripple is firmly rooted in the belief that California, recognized globally as the cradle of Silicon Valley innovation, possesses a deep understanding of both the vast potential and the complexities associated with the digital asset domain. California, already celebrated as a worldwide epicenter for cutting-edge technological advancements, nurturing exceptional talent, and fostering groundbreaking business innovations, is ideally positioned to ascend as a premier destination within the United States for the burgeoning digital asset sector. This can be achieved by establishing a regulatory environment that is straightforward, transparent, and founded on sound principles. Such a framework would not only safeguard consumer interests but also create a fertile ground for the industry to thrive and expand, thereby catalyzing investment and business growth in the digital asset arena.

What is Ripple

Using blockchain technology, Ripple allows financial institutions to process payments instantly, reliably, cost-effectively, and with end-to-end visibility anywhere in the world. Our customers are financial institutions and enterprises that want tools to effect faster and less costly cross-border payments, as well as eliminate the uncertainty and risks that have been historically involved in moving money across borders by using traditional interbank messaging. All this is done in compliance with Anti-Money Laundering (AML) regulations.

Some customers, in addition to deploying Ripple's "blockchain" solution (RippleNet), leverage a digital asset known as XRP. Just as Bitcoin is the native asset to the open-source Bitcoin ledger, and Ether is the native asset to the open-source Ethereum ledger, XRP is the native asset to the open-source XRP Ledger. XRP, given its unique design, can serve as a near instantaneous bridge between fiat currencies (or any two representations of value), further reducing the friction and costs for financial institutions and enterprises to transact across multiple global markets.

Although Ripple utilizes XRP and the XRP Ledger in certain product offerings, XRP is independent of Ripple. The XRP Ledger is decentralized, based on open-source software, and operates on what is known as a "consensus" protocol. While there are well over a hundred known use cases for XRP and the XRP Ledger, Ripple leverages XRP for use in its product suite because of XRP's suitability for cross-border payments. Key characteristics of XRP include speed, scalability, energy efficiency, and cost efficiency, all of which benefit our clients and help reduce friction in the market for cross-border payments.

With this overview, Ripple respectfully submits the following response comments set forth in the Invitation in the attached Appendix.

Sincerely,

Lauren Belive
Head of US Public Policy and Government
Ripple Labs Inc.

Appendix

License Application Form and Fees

(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?

Ripple has no additional information to include at this time.

(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.

The costs of DFPI's investigations, which applicants are required to cover, should be aligned with the costs of investigations DFPI undertakes for money transmitter license applications. Given that the information being investigated is similar in both instances, the costs of both investigations should likewise be similar.

Ripple believes the costs and fees should be fixed and knowable prior to the application being published. DFPI should publicly disclose this information and any changes should be announced with enough notice for applicants to take necessary action.

Surety Bond or Trust Account

(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)?

Dollar amounts of surety bonds or trust accounts should be determined by factors relevant to the size of the business activity. This includes transaction volumes and assets under management.

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

Ripple has no additional information to include at this time.

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

Yes, surety bond or trust account amounts should vary based on the type of activity requiring licensure. Licensed activities can vary by risk, and surety bond or trust account amounts should be reflective of the type and size of risk of that activity. Applicants offering services such as trading, custody, or stablecoin issuance are examples of different activities with different risk profiles. A surety bond or trust account amount should correspond with a type of activity based on the risks associated with that activity.

(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?

If an applicant proves to have ownership of the asset, the applicant should not need separate, additional financial accounts. Specific activity requirements in the DFAL should impact surety bond or trust account amounts based on the volume of activity or size of assets under management. However, surety bond or trust account amounts should also factor in the size of assets being held by the applicant.

<u>Surety Bond or Trust Account</u>

(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?

All the factors listed are reasonable to Ripple.

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

Yes. See Ripple's response to Question (5) above.

<u>Stablecoin Approval Process</u>

(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)?

Ripple acknowledges and supports the existing regulatory framework as delineated under Financial Code sections 3603 and 3601, which meticulously govern the approval and operation of stablecoins. The current approach, which necessitates that the issuer of a stablecoin maintains eligible securities as defined in Financial Code section 2082, with a market value at least equal to the amount of all outstanding stablecoins, is a well-considered strategy ensuring financial stability and consumer protection.

b. Regarding the amount and nature of assets, is there particular information that the DFPI should consider?

In terms of the amount and nature of assets, under Financial Code section 3601, subdivision (a)(2), it is mandated that the reserve amount held by the issuer be no less than 100% of the outstanding stablecoins. For the DFPI, this means focusing on:

- Verification of Reserve Ratio: Ensuring that the issuer maintains a 1:1 ratio at all times, with eligible securities' market value equating to or exceeding the total amount of issued stablecoins.
- Daily Monitoring: Implementing systems to monitor the reserve ratio on a daily basis, to ensure ongoing compliance with the 100% reserve requirement.
- Stress Testing: Conducting regular stress tests to see how the reserve would behave under various adverse market conditions.

- Audit and Reporting: Regular auditing and transparent reporting of the reserve status to maintain public and regulatory confidence in the issuer's ability to meet its obligations.
- Interest Rate and Maturity Risk: Understanding how changes in interest rates and the maturity of assets can impact the overall value of the reserves.

By focusing on these areas, the DFPI can ensure that the issuers not only comply with the letter of the law but also maintain the spirit of stability and consumer protection intended by these regulations.

(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?

Ripple has no additional information to include at this time.

(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?

When evaluating a stablecoin under Financial Code section 3603, subdivision (b)(2)(F), the DFPI should give significant consideration to the issuer's other liabilities. It is preferable that these liabilities are minimal and do not pose a risk to the assets reserved for the stablecoin business. This cautious approach ensures that the issuer's obligations do not compromise the stability and reliability of the stablecoin.

b. What "other factors" should the DFPI consider?

DFPI should consider whether the issuer is licensed in other jurisdictions and explore the potential for reciprocity or conditional licensure in California if an issuer holds a license in another jurisdiction that has similar requirements to those in California. This would encourage issuers to seek securing a license in California without duplicating application efforts unnecessarily.

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.

In considering the listing of a stablecoin on the "Greenlist," the DFPI should recognize the utility of such a list while also acknowledging its limitations. The Greenlist represents a selection of digital assets generally approved for trading in New York, but it's important to note that it does not encompass all viable or trustworthy digital assets.

The emphasis should be placed more on companies establishing and rigorously adhering to appropriate policies and procedures for token approval. This approach ensures a high standard of diligence and integrity in the approval process. While the Greenlist can serve as a reference, it should not be the sole determinant in the decision-making process.

California could conduct its own independent analysis rather than solely relying on the assessments or approvals of other state regulators. This independent evaluation ensures that decisions are tailored to the specific economic and regulatory context of California, and it upholds the state's responsibility to protect its consumers and markets with its own informed and autonomous judgments. This approach aligns with the state's commitment to fostering a secure, robust, and dynamic digital asset market.

(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?**

Ripple has no additional information to include at this time.

> **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)?**

Implementing a requirement for all issuers to certify compliance with standards akin to those outlined for covered exchanges under Financial Code section 3505, subdivision (a), is a commendable idea, especially if it is specifically adapted for stablecoin issuers. This tailored approach would ensure that the unique characteristics and risks associated with stablecoin issuance are adequately addressed, thereby enhancing the overall regulatory framework.

Additionally, it is worth considering the expansion of the exemption provided under section 3505(a)(2), which currently applies to digital assets approved by the New York

Department of Financial Services (NYDFS). Expanding this exemption to include other reputable jurisdictions, such as Wyoming, could foster a more inclusive and diversified regulatory environment. This expansion would acknowledge the robust regulatory standards of other jurisdictions while promoting a harmonized approach to digital asset regulation. It could help to facilitate broader market participation and innovation.

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?

When proposing regulations related to the DFAL license application, licensure requirements, or stablecoin approval, the DFPI should consider the practicality of timeframes stipulated in section 3207(a)(4). The current 30-day period may not be sufficient for crypto companies to implement necessary changes or increases in coverage, as these processes could take several weeks or even months. This timeframe should be re-evaluated to better align with the operational realities of cryptocurrency companies.

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

In contemplating future rulemaking actions related to the administration of the Digital Financial Assets Law (DFAL), the DFPI should consider several key areas to address emerging challenges and opportunities in the rapidly evolving digital financial assets space:

- **Environmental Considerations:** Given the increasing awareness of the environmental footprint of digital asset operations, such as cryptocurrency mining, the DFPI has the opportunity to pioneer regulations that emphasize and incentivize carbon-neutral blockchain practices. By focusing on sustainability and promoting operations with a reduced carbon footprint, these regulations could pave the way for more environmentally responsible blockchain technologies. This approach not only addresses ecological concerns but also highlights the potential benefits of adopting carbon-neutral practices in the blockchain sector, setting a standard for eco-friendly innovation in the digital asset realm.

- **Education and Awareness Programs:** Implementing initiatives to educate both consumers and businesses about digital financial assets, their risks, and benefits

could be beneficial. This helps in creating an informed user base and a more transparent market.

- **Adaptation to Technological Advancements:** The DFPI should continuously update its regulations to keep pace with technological innovations in digital finance. This includes accommodating new types of digital assets and transaction methods, ensuring that regulatory frameworks remain relevant and effective.

Each of these areas addresses specific aspects of digital financial asset management and aims to create a balanced environment where innovation is encouraged, but consumer protection and market integrity are not compromised. These considerations are essential for adapting the DFAL to future challenges and opportunities in the digital finance sector.