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Assembly California Legislature



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CHAIR, STREAMLINING SERVICES FOR
VICTIMS OF INTERPERSONAL VIOLENCE

January 11, 2024

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)

To Who It May Concern:

As the author of AB 39, Chapter 792, Statutes of 2023, I appreciate the opportunity to provide comments to the Department of Financial Protection and Innovation (DFPI) regarding the Digital Financial Asset Law (DFAL). My comments are intended to provide insight and context about the legislative intent of provisions highlighted in DFPI's November 20, 2023 Invitation for Comments (Invitation). In these comments, I will not cover every question posed in the Invitation, but I will address the questions that could benefit from additional clarity from the author's office. Furthermore, I align with the comments submitted by AB 39's sponsor, the Consumer Federation of California.

Brief overview of legislative approach

One of AB 39's motivating principles is that financial innovation should not occur at the direct expense of consumers. "Responsible innovation" means innovation guided by reasonable rules that protect consumers from irresponsible actors and untested financial products. AB 39 will achieve this for the digital financial asset industry through a licensing program and tailored consumer protections, resulting in a safer market for consumers and a more sustainable environment for industry.

However, the digital financial asset industry is evolving quickly, and this rapid pace of change requires an empowered regulator that can keep up. For that reason, AB 39 was drafted to grant DFPI significant discretion over certain aspects of the licensing program, including but not limited to fees, application contents, and the availability of certain types of stablecoins in California. This was an intentional decision to ensure the DFAL is durable and remains relevant as the industry changes.

Comments on license application form and related fees

Fees under the DFAL should promote efficient program administration, long-term program viability, and fairness for applicants and licensees. An 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 the DFAL's implementation.

The annual renewal fee established under Financial Code Section 3211, subdivision (c) demonstrates the Legislature's approval of fees that vary by licensee. The annual renewal fee, which will be more critical for long-term program sustainability, will be based on a licensee's business activity in California, as measured by the number of California customers. This fee structure will reflect a licensee's ability to pay and the relative workload a licensee produces for DFPI, a fair way for industry to cover the costs of regulation.

Ideally an application fee would similarly reflect an applicant's ability to pay and the workload associated with processing each application. However, I am concerned that a complex formula, subject to disagreement with the applicant, will slow down the DFAL's initial implementation. In my discussions with industry stakeholders, I have reiterated the need to avoid some of the problems, such as the lack of resources or staffing during the first years of implementation, faced by other states administering digital financial asset programs.

DFPI should consider these dynamics in determining the appropriate application fee.

Comments on stablecoins

The 2022 collapse of the stablecoin TerraUSD was the motivating event for the introduction of AB 39, and the stablecoin chapter in the DFAL is one of the law's most important consumer protections. The DFAL aims to ensure that Californians can redeem their stablecoin at the marketed value while providing a path for innovative new stablecoins to be issued in a way that does not jeopardize consumer safety.

The DFAL creates two distinct ways a stablecoin may be eligible to be exchanged, transferred, or stored by a covered person:

- 1) The stablecoin issuer complies with Section 3601, which among other provisions establishes robust reserve requirements. Specifically, a covered person may not exchange, transfer, or store a stablecoin if the issuer does not own at all times eligible securities, as defined, of not less than the aggregate amount of all outstanding stablecoins issued or sold.
- 2) The stablecoin is approved by the commissioner pursuant to Section 3603. Under this approval process, the commissioner may allow a stablecoin to be exchanged, transferred, or stored by a covered person after the commissioner considers specified factors. One factor is the amount, nature, and quality of assets owned by the stablecoin issuer that may be used to fund redemption requests. Those assets do not need to comply with Section 3601's requirements.

The Invitation suggests that DFPI conflates Sections 3601 and Section 3603 in a way that does not reflect legislative intent. Question #9a states that any stablecoin approved under Section 3603 must also comply with Section 3601's asset requirements, possibly also implying that any stablecoin compliant with Section 3601 must be separately approved by the commissioner pursuant to Section 3603. This is unnecessary. Section 3603 is an alternative path for a stablecoin whose issuer does not comply with Section 3601 to be exchanged, transferred, or stored. Specifically, Section 3601, subdivision (a) begins with, "Except as provided in 3603..." This clause states that the 3601 requirements apply to any stablecoin except for a stablecoin approved under Section 3603. DFPI retains flexibility in how it carries out the Section 3603 approval process, so long as the listed factors are considered and consumer safety remains a motivating principal behind DFPI's decision-making.

As an illustrative example, it is possible under Section 3603 for the commissioner to approve a stablecoin collateralized by other digital financial assets. Under Section 3601, such a stablecoin would be prohibited because digital financial assets are not included in the definition of “eligible securities.” However, DFPI may determine, after evaluating the factors listed in Section 3603, that such a stablecoin is appropriate to be traded in California, and DFPI may impose limitations and conditions on that approval.

Conclusion

Thank you for considering these comments. I look forward to working with DFPI to ensure successful implementation of this important new program. Please do not hesitate to contact my staff if you would like to discuss these comments.

Sincerely,

TIMOTHY S. GRAYSON
Assemblymember, 15th District

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