November 18, 2024

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

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

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 (DFPI or the Department) on the proposed application-related rulemaking under the Money Transmitter Law and the Digital Financial Assets Law (DFAL). The Crypto Council for Innovation (CCI) appreciates the Department's continued engagement with stakeholders, including this most recent invitation for comments on draft proposed rules related to the DFAL license application and fees.

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. Our members include many prominent companies founded and headquartered in California.

We believe that constructive partnership between government and business stakeholders is critical to crafting sound policy and regulation that benefits consumers and innovators. As the world's fifth largest economy and a hub for global technology and innovation, California has an important opportunity to position itself as a leader in digital asset and blockchain technology development. Seizing this opportunity will require making significant changes to the DFAL regime. As CCI has previously raised, several urgent, outstanding issues must be addressed to increase clarity for future licensees and address the scope of the legislation in order to maintain California's capacity to foster innovation in this space. While beyond the scope of this proposed rulemaking, we include them briefly here for the Department's continued consideration:

These issues include, DFAL's overly broad scope and imprecise definitions, which could unintentionally capture a wide range of unrelated activity, technology, and individuals into the bill's purview and create operational challenges for both licensees and regulators. Adequate timelines, appropriate exemptions for startups to ensure their ability to grow and innovate in California, reciprocity with similar state regulatory frameworks, and further clarity on approval pathways for stablecoins, including crypto-collateralized stablecoins, are also critical to ensuring California can remain a hub of technological innovation.

With respect to this proposed rulemaking, as California continues to lay the groundwork for implementing the Digital Financial Assets Law (DFAL), we respectfully submit the following recommendations and principles on certain of the key topics outlined in the request for comments.

DFPI Topic: The process and requirements to apply for a license and the requirement for applicants to apply for a license and maintain the license through the Nationwide Multistate Licensing System & Registry ("NMLS")

CCI Comments: CCI appreciates DFPI's efforts to align expectations for the license application and supervisory processes through the Nationwide Multistate Licensing System (NMLS). Many financial institutions have utilized this platform to maintain licenses from regulators across the country. Allowing licensees to use this commonly accepted industry standard for reporting and information delivery will reduce the regulatory burden for compliance teams and examiners. It has also generally been helpful to have a uniform reporting system across most states. We recognize, however, that NMLS was first created over 15 years ago, and that there remain system inefficiencies throughout the platform. We encourage DFPI to work with the Conference of State Bank Supervisors (CSBS) to pursue technical and operational improvements around NMLS infrastructure.

In particular, system inefficiencies, such as outdated processing capabilities and limited flexibility in data reporting, can create delays and operational frustrations for applicants and regulators alike. As the digital asset industry grows and attracts a wide range of stakeholders, the need for a more adaptable and responsive licensing infrastructure has become increasingly urgent.

To that end, CCI encourages DFPI to take a proactive approach in working with CSBS to address these licensing limitations. Exploring opportunities for technical upgrades, such as improved automation features, faster processing times, and enhanced data integration, would streamline the licensing process and increase operational efficiency. Further, investing in operational improvements, such as establishing a dedicated support channel for digital asset-related inquiries within NMLS, could better address industry-specific concerns, making NMLS more user-friendly and reducing potential compliance bottlenecks. In addition, DFPI and CSBS should ensure that all relevant NMLS forms and documentation requirements are appropriately tailored for digital asset firms. General money transmission requirements and reporting forms are often ill-suited to reflect the unique operations of digital asset firms.

DFPI's leadership in this area could motivate other States to follow suit, and potentially collaborate through CSBS on a next-generation licensing infrastructure that not only serves traditional finance but is also optimized for digital assets. By advocating for enhancements to the NMLS platform's technical and operational capabilities, DFPI can make a meaningful impact on regulatory efficiency and foster a regulatory environment better suited to the rapidly evolving digital asset landscape.

With regard to conditional license applications, an Applicant's license or charter number with the New York Department of Financial Services (NYDFS) and the date on which their application in New York was approved should be sufficient to fulfill this requirement. A letter from NYDFS indicating an applicant's good standing will slow the application process without commensurate benefit to consumers. We would instead encourage DFPI to verify this readily available information on NMLS Consumer Access or NYDFS' website.

<u>DFPI Topic</u>: The California-specific documents, fees, and other information that must be filed with NMLS and the timeframes for filing the information

<u>CCI Comments:</u> As a threshold matter, CCI urges DFPI to convene a working group—ideally in partnership with CSBS—to revise standard application forms in a manner that helps to reflect and capture unique characteristics of digital asset businesses. The NMLS system is based on traditional money transmission and lending businesses, not digital assets. It would accordingly benefit applicants and reviewing regulators at DFPI and other state agencies if updated forms were tailored to eliminate friction and ambiguity. Regarding timeframes, applicants should be allowed at least twenty (20) days to submit any and all amendments to their applications as required by DFPI absent a separate extension agreed upon with the DFPI. Allowing applicants thorough time to compile information is essential to ensuring applications are accurate and complete, while mitigating the need for appeal processes. In the event of any change in the executive officers, control persons, and responsible persons named in the application, applicants should have at least thirty (30) days to file an amendment, as changes in key personnel often take additional time to implement. In addition, it is important for the Department to clarify what constitutes a lack of response to any information requested within sixty (60) calendar days of a written notification. For example, there may be circumstances when an applicant responds requesting additional time for specific and legitimate reasons, and we would encourage DFPI to not summarily conclude that an application is dismissed if it has not directly received the information requested.

<u>DFPI Topic</u>: A non-refundable application fee of $20,000 required of applicants

<u>CCI Comments:</u> While CCI appreciates the need for entities to provide an adequate fee to apply for licensure with the DFPI, the proposed application fee of $20,000 is prohibitively expensive (particularly for many, smaller digital financial asset businesses). This is especially the case when the Department will also require separate investigation and annual assessment fees. This excessive application fee amount will serve as a steep barrier to entering California's digital financial asset market, especially for early and mid-stage startups. We respectfully urge DFPI to reduce its application fee to avoid unintentional effects to such smaller digital asset financial businesses. It is also unclear how the Department determined the $20,000 amount, and it may be helpful to provide details and related rationale as to this application fee amount. To that end, CCI would respectfully recommend that the DFPI consider a lower application fee amount. For comparative purposes only, the New York Department of Financial Services (NYDFS) currently requires a $5,000 application fee to apply for licensure to engage in virtual currency business activity in New York.

<u>DFPI Topic</u>: The information required to enable the Commissioner to investigate applicants to determine whether they meet the standards for licensure

<u>CCI Comments:</u> To enhance the effectiveness of any investigation process, CCI recommends that DFPI adopt a tailored, risk-based approach to information requirements. By scaling data requests according to an applicant's size, transaction volume, and consumer-facing activities, DFPI can ensure that its investigations are comprehensive without imposing undue administrative burdens, especially on startups or smaller firms. DFPI should consider tailoring information requirements to (i) the size of the applicant's organization and (ii) 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. As part of this, CCI encourages limiting the scope of information to only what is "necessary and pertinent" for the DFPI to properly assess whether an applicant meets the required standards. For example, DFPI should focus on the information needed to assess an applicant's safety and soundness, including implications for California customers and other users of the proposed product or service. Having an overly broad scope could lead to unintended outcomes, including discouraging applications, particularly since potential applicants will lack certainty as to exactly what types of information may be requested.

<u>DFPI Topic</u>: The processes to challenge information entered in NMLS by the Commissioner; submit and maintain a surety bond; surrender a license; and change information in the license application, information related to digital financial asset transaction kiosks or other business locations, or key personnel.

<u>CCI Comments:</u> CCI supports the ability for licensees to challenge inaccurate or misleading information entered in NMLS, as errors can impact a business's reputation and regulatory standing (and when it comes to the license application process, it could lead to unintentional delays in reviewing and processing). CCI also recommends a tiered bonding requirement that aligns with an applicant's transaction volume or risk profile. Adjusting the bond amount proportionally to each entity's operations would support smaller companies and startups while upholding consumer protections.

The Department should also provide licensees with 90 days to deposit additional security in the event that the licensee receives a notice of a required increase. It is also important for the Department to provide an adequate rationale for such an increase. Licensees must be provided adequate time to raise capital, especially if the capital amount is in the millions of dollars.

As a general matter, CCI respectfully encourages DFPI to bolster its efforts to harmonize 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 Department is adequately resourced to effectively process new applications and supervise registered entities while approving new applications efficiently. As part of this, it is important for any licensing and application process to avoid being prohibitive to smaller and earlier-stage companies.

We appreciate the opportunity to provide these comments as well as your willingness to regularly engage with industry stakeholders. As California forges ahead at the frontier of the digital asset regulatory landscape, CCI stands ready to continue serving as a resource on these important issues.

Respectfully,

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