

SUMMARY AND COMPARISON

California Legislature—2015-2016 Regular Session

Assembly Bill No. 1326

August 8, 2016 PROPOSED Amendments

http://www.leginfo.ca.gov/pub/15-16/bill/asm/ab_1301-1350/ab_1326_bill_20160808_amended_sen_v94.pdf

- Establishes goals and findings for the statute, and changes the term “Virtual currency” to “Digital currency”
- Requires persons to “enroll” in order to engage in the digital currency business.
 - Enrollment appears to be materially lighter process than obtaining a license. Under statute, DBO is to permit enrollment so long as the applicant, its directors, officers and controlling persons are all of “good character.”
 - This raises question why DBO is still charging \$5k for enrollment - this is a steep fee for smaller companies, and it’s not immediately apparent how that reasonably approximates the cost to DBO of evaluating licensees.
- **No “on-ramp” for startups, as the latest draft of ULC model law includes.**
- **No reciprocity provision for out-of-state licensees who meet certain conditions, as the latest draft of ULC model law includes.**
 - Lack of reciprocity provisions are troublesome as more states implement specific digital currency statutes -- reinforces the balkanized and costly regulatory compliance landscape in digital currency.
- **The proposed statute adds or amends several definitions to specifically relate to digital currency, including: digital currency, digital currency business, E-money, exchanging, fiat currency, issuing, person, program, storing, and transmitting. The proposed statute also maintains many of the same definitions and terms from the earlier version of the bill but renumbers the statute’s section.**
- **“Digital currency business” is the key jurisdictional hook for statute -- requirement to “enroll” applies to persons engaging in digital currency business in CA. So it is a critical term. It covers four activities with respect to digital currency: 1) transmitting, 2) issuing, 3) storing and 4) exchanging. Although there are helpful exclusions, such as for nominal non-financial uses, online games, and affinity programs, there is also unhelpful ambiguity.**
 - In particular, the definition of “storing” suffers from similar flaw as NY BitLicense - it includes concepts of “custody” and “control” of digital currency, but doesn’t define what they mean. The definition of “storing” includes “custody” or “control,” essentially capturing multi-sig wallets. It provides clarifying language for “custody” or “control,” but the use of the word “includes...” indicates that the clarifying language is not limiting, but merely descriptive.
 - In our experience, this vagueness has created significant costs to businesses in determining if they are covered by NY BitLicense.
 - The definition of “storing” is similarly inadequate to address a multi-signature situation. Wallet providers and the concept of control do not cleanly fit within the bill’s definition of “storing” and are not sufficiently addressed elsewhere.
 - As ULC has been persuaded by commenters (at least in the latest draft), including us, these concepts should cover only the unilateral ability to effectuate or prevent disposition of digital currency.
 - The definition of “transmitting” includes “by or through a third party.” The inclusion of the word “through” seems to capture the individual account holders.
 - It is unclear whether the definition of “monetary value” includes digital currency. Page 24 amends Section 2003 to state that “Monetary value does not include any form of value that qualifies as a digital currency under Division 11 (commencing with Section 26000).” This is important because it excludes digital currency

businesses from money the money transmitter licensing requirements. However, on page 25 “monetary value” does not include a carve-out for digital currency.

- The general definitions section, however, also introduces some ambiguity to the definition of the term “monetary value.” In Section 3, the bill’s definition of “monetary value” means a medium of exchange, whether or not redeemable in money. *Monetary value does not include any form of value that qualifies as a digital currency under Division 11 (commencing with Section 2006).*” Section 4 adds identical definitions to the bill, but omits the last phrase (in italics). This begs the question--does digital currency qualify as a trigger for requiring money transmitter licensing?
- **Prior version provided that licensees had to maintain bond or trust account in amount specified by DBO. New version only addresses security issues in context of the “fact gathering” section (26030(a)), where the DBO can ask an enrollee about security arrangements.**
 - No mention of capital/ net worth concepts either. This is an interesting, and potentially favorable, departure from the more prescriptive approaches regarding bonding/security in NY BitLicense (and MT laws in general).
- **Statute expressly allows registered MSBs to comply with BSA regulations (Ch. 5). Although not entirely clear from the statute, the intent of this phrasing appears to suggest that registered MSBs will not face any additional state-level AML requirements so long as they remain in compliance with federal obligations.**
 - This is a notable improvement over NY BitLicense, which imposes additional AML requirements.
- **Changes application and payment/fee requirements. (But requirements are not vastly different from earlier version)**
 - Authorizes the Commissioner to require an enrollee and its agents to submit surveys, investigations, and questionnaires for the purpose of gathering information and to ascertain detailed facts about the enrollee’s business model, capitalization and net worth, and cybersecurity, among other things.
- Also authorizes the Commissioner to require enrollees record-keeping and maintenance.
- **Maintains similar financial, organizational, and auditing reporting to commission.**
 - The bill prescribes fines and penalties for non-compliance with reporting requirements.
 - We remain concerned about the scope of the audit requirement as applied to startups/ small companies in particular -- very impractical to expect those companies to afford formal audited statements in initial years.
 - Underscores need for some kind of “on-ramp” or “transitional” mechanism for startups, as noted above.
- **Requires money transmitter license in addition to enrollment if the person wishes to engage in money transmitter activities and exchange of digital currency. [§ 26014]**
 - NOTE: This requirement seems to defeat the purpose of having a statute specifically designated to regulate digital currency.
- **Requires significantly more disclosures to customers, both during account opening, transacting business, and on receipt materials.**
 - Receipts may be transmitted to the customer electronically and would now be required to contain: the name and contact information of the enrollee, including a telephone number and California mailing address established by the enrollee to answer questions and register complaints; the type, value, date, and precise time of the transaction; the fee charged; the exchange rate, if applicable; a statement of the liability of the enrollee for non-delivery or delayed delivery; and a statement of the refund policy of the enrollee.
 - Notably, there is a requirement to obtain customer’s “acknowledgement” of all disclosures, including new account and per transaction disclosures.

- This could be very burdensome on a per-transaction basis. Along similar lines, per-transaction disclosures should be permitted to be batched at day end.
 - Otherwise could be difficult to manage operationally, especially for small companies.
 - Certain disclosures also seem unmanageable from a substantive standpoint, such as disclosing all “liability” that an enrollee may have to a customer.
 - This is much too broad and vague to result in useful disclosures to customers.
 - **The examination section that was in the prior version has now been removed.**
 - The increase in disclosure requirements, taken with scaling back of specific examination powers, may generally indicate that DBO is not expecting to take a particularly active role in enforcement while the “enrollment” structure is in place.
 - However, there are some lingering references to examination power in specific areas - such as noting that DBO may from “time to time” examine BSA compliance, that enrollees must maintain advertising records for DBO examination, and providing that grounds for disenrollment includes failure to cooperate with an exam.
 - This creates potential ambiguity as to when, and under what circumstances, the DBO does intend to exercise exam authority.
 - **Regulates advertising and marketing.**
 - For instance, the bill would prohibit an enrollee in the program from advertising products, services, and activities without a statutory statement regarding the program and that a government agency has not reviewed the safety or soundness of the business or digital currencies.
 - The bill would require an enrollee to maintain advertising and marketing materials and would prohibit false, misleading, or deceptive representations or omissions.
 - The bill would require an enrollee to make a variety of specified disclosures in English and in any other language spoken by a majority of the enrollee’s customers prior to entering into an initial transaction for, or on behalf of, a customer, when opening an account for a new customer, and prior to each transaction.
 - **Authorizes the commission to engage non-enrolled persons who engage in digital currency exchange in California in enforcement actions. (through cease and desist letters, civil actions up to \$25,000 + attorney’s fees and costs, etc.)**
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Earlier version	Current Version	Notes on changes or Rationale for change?
<p><u>Classification & Goal</u></p> <ul style="list-style-type: none"> The bill would enact the Virtual Currency Act, which prohibits a person from engaging in any virtual currency business in the state unless the person is licensed by the Commissioner of Business Oversight (“CBO”) or is exempt. Repeals Section 107 of the Corporations Code. 	<p><u>Classification & Goals</u></p> <ul style="list-style-type: none"> The bill now would enact the “Digital Currency Business Enrollment Program,” which is administered by the CBO. [Section 5, Division 11, (commencing with Section 26000)] Effective until January 1, 2022. [§ 26050] The bill would prohibit a person from engaging in the digital currency business without enrolling in the program and would prohibit the conduct of digital currency business through an unenrolled agent. Repeals Section 107 of the Corporations Code. “Enable Department of Business Oversight (DBO) to identify all of the businesses providing digital currency services in the state” “Enable businesses to provide digital currency services in the state in a lawful and transparent manner” “Enable the DBO to gather from businesses providing digital currency services any information helpful to determining whether and how the industry should be licensed and regulated in the future” “Ensure that consumers receive appropriate risk disclosures and information about digital currency and digital currency-related services.” 	<ul style="list-style-type: none"> Changes licensing structure to “enrollment” program Adds goals of the bill and findings for need of the bill. Renames the statute.
	<p><u>Findings</u> — adds a series of findings in Section 1(a) including:</p> <ul style="list-style-type: none"> “Digital currency is a new technology that, some predict, will increase the speed and reduce the costs of payment 	<ul style="list-style-type: none"> Trying to establish the need for the updated law.

	<p>transmission;”</p> <ul style="list-style-type: none"> • “Along with digital currency, a new industry has emerged that specializes in providing digital currency-related services” • “It is appropriate for the state to play a role in the development of the new industry, for example by encouraging compliance with law, preventing illicit finance, and ensuring that users receive appropriate risk disclosures;” • “At the same time, it is appropriate for the state to nurture, rather than stifle, these ongoing innovations in payment technology” 	
<p><u>Definitions</u></p> <ul style="list-style-type: none"> • Defines “virtual currency” as “any type of digital unit that is used as a medium of exchange or a form of digitally stored value.” <ul style="list-style-type: none"> ○ Specifically excludes: gaming units, consumer affinity or rewards programs, digital units that can be redeemed for goods, services, or purchases with the issuer or other designated merchants (but cannot be redeemed for fiat currency) • Defines “Virtual currency business” as “maintaining full custody or control of virtual currency in this state on behalf of others.” 	<p><u>Definitions</u></p> <ul style="list-style-type: none"> • Defines “digital currency” as “any digital representation of value that can be digitally traded and is used to facilitate the sale, purchase, and exchange of goods, services, or other digital representations of value, except as specified.” <ul style="list-style-type: none"> ○ Specifically excludes: “fiat currency, e-money, or currency value of which was fixed by its issuer to the value of a fiat currency.” • Defines “digital currency business” as “offering or providing the service of storing, transmitting, exchanging, or issuing digital currency, subject to various exceptions.” <ul style="list-style-type: none"> ○ Specifically excludes: “transmission of digital currency where the transaction is undertaken for nonfinancial purposes and does not involve the transfer of more than a nominal amount of digital currency necessary to complete the transaction,” “online games or gaming platforms that use digital currency that” (A) have no market value outside of those games, (B) cannot be converted into, or redeemed for, fiat or digital currency, and (C) are not redeemable for real-world goods, etc., “customer affinity or rewards programs,” “issuance of a credit card voucher,” “developing, distributing, or servicing digital currency network software,” “contributing software, connectivity, or computing power to a digital currency network,” “providing data storage or cybersecurity services” for an enrollee... • Defines a “person” to include “an individual or other business 	<ul style="list-style-type: none"> • Amendment left most of the definitions in Section 3 (2003) unchanged. • Amendment adds Section 4 to the financial code with a self-repealing date of January 1, 2022, unless later enacted by statute to extend or delete that date. Section 4 includes definitions of the same terms & definitions included in Section three. The definitions are identical, except for: <ul style="list-style-type: none"> ○ The definition of “monetary value” does not include the addition added in the most recent amendment. • Trying to define language specific to digital currency. • “Digital currency business” is the key jurisdictional hook for the bill—requirement to “enroll” applies to persons engaging in digital currency business in California. So it is a critical term. It covers four activities: 1) transmitting, 2) issuing, 3) storing, and 4) exchanging. Although there are helpful exclusions, such as for nominal non-financial uses, online games, and affinity programs, there is also unhelpful ambiguity. <ul style="list-style-type: none"> ○ For instance, the definition of “storing” suffers from similar flaw as NY BitLicense—it includes concepts of “custody” and “control” of digital currency, but doesn’t define what they mean. The definition of “storing” includes “custody” or “control,” essentially capturing multi-sig wallets. It provides clarifying language for “custody” or “control,” but the use of the word “includes . . .” indicates that the clarifying language is not limiting, but

	<p>entities, however organized.”</p> <ul style="list-style-type: none"> • Defines “E-money” to mean “a digital representation of fiat currency used to electronically transfer value denominated in fiat currency.” • Defines “exchanging” with reference to digital currency as “converting or exchanging fiat currency into digital currency, converting or exchanging digital currency into fiat currency, or converting or exchanging one form of digital currency into another form of digital currency.” • Defines “Fiat currency” as “government-issued currency that is designated as legal tender or lawful money, through government decree, regulation, or law, of a government or intergovernmental organization, or by agreement between two or more governments, and customarily refers to paper money and coin and that is circulated, used, and accepted as money.” • Defines “issuing” with reference to digital currency as “creating, introducing into circulation, controlling, and administering digital currency.” • Defines “person” as “individual, partnership, corporation, association, joint stock association, trust, or other business combination or entity, however organized.” • Defines “storing” with reference to digital currency as “to have custody or control of digital currency on behalf of others. For the purposes of this subdivision, custody or control of digital currency includes having access to a customer’s digital currency credentials, the ability to execute a digital currency transaction on behalf of a customer, or the ability to prevent a customer from effecting a desired transaction of digital currency.” • Defines “transmitting” with reference to digital currency as “the transfer of digital currency, by or through a third party, from one person to another person, or from one storage repository of digital currency to another storage repository of digital currency.” • Added to definition of “Monetary value” to now mean “a medium of exchange, whether or not redeemable in money. 	<p>merely descriptive.</p> <ul style="list-style-type: none"> ○ In our experience, this vagueness has created significant costs to businesses in determining if they are covered by NY BitLicense. ○ As ULC has been persuaded by commenters (at least in the latest draft), including us, these concepts should cover only the unilateral ability to effectuate or prevent disposition of digital currency. ○ The definition of “transmitting” includes “by or through a third party.” The inclusion of the word “through” seems to capture the individual account holders. ○ It is unclear whether the definition of “monetary value” includes digital currency. Page 24 amends Section 2003 to state that “Monetary value does not include any form of value that qualifies as a digital currency under Division 11 (commencing with Section 26000).” This is important because it excludes digital currency businesses from money the money transmitter licensing requirements. However, on page 25 “monetary value” does not include a carve-out for digital currency. ○ The definition of storing needs to better address the multi-sig and control situation. The language as written is unclear as to whether it applies to wallet providers.
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	<p><i>Monetary value does not include any form of value that qualifies as a digital currency under Division 11 (commencing with Section 26000)."</i> The second sentence is omitted from Section 4 of the proposed bill, which generates questions as to which definition controls and whether digital currency is considered monetary value.</p>	
<p><u>Enrollment Requirements & Prohibitions</u></p> <ul style="list-style-type: none"> • Required application for license in a form and medium prescribed by commissioner. Application required to state or contain the following (standard MT requirements): <ul style="list-style-type: none"> ○ Legal name, any fictitious names, residential, and any other business address of applicant; ○ Criminal convictions/material litigation of applicant; ○ Description of virtual currency services planned or provided; ○ List of other states where applicant is licensed & licenses; ○ Bankruptcy/receivership information regarding applicant; ○ Sample form of receipt for transactions; ○ Name & address of any bank used for business transactions; ○ Description of the source of money and credit to be used; ○ Date of applicant's incorporation/formation ○ Certificate of good standing; 	<p><u>Enrollment Requirements & Prohibitions</u></p> <ul style="list-style-type: none"> • Requires the person to provide the commissioner specified personal and business information in a form and manner prescribed by the commissioner. Overlapping requirements are highlighted in yellow in column 1. Additional requirements include: <ul style="list-style-type: none"> ○ Website ○ Number of employees of the subject person, titles, and responsibilities ○ Contact person & name/email address ○ Whether person is a money services business subject to the BSA regulations [§ 26036] • Non-refundable fee for enrollment of up to \$5,000, not to exceed "the reasonable costs of enrolling a person in the program." [§ 26040] <ul style="list-style-type: none"> ○ Annual fee of \$2,500 to maintain enrollment. • Requires the person to provide fingerprints. • Standard reporting requirements • Requires enrollee to maintain advertising and marketing materials with a specific statement [§ 26020(a)-(b)] • Requires enrollee to make a variety of specified disclosures in English (and any other language spoken by a majority of enrollee's customers) prior to entering into an initial transaction for a customer, when opening an account for a new customer, and prior to each transaction. [§ 26022] • Requires enrollee to provide a customer receipt containing specified information when accepting digital currency or money. [§ 26024] <ul style="list-style-type: none"> ○ Requires that the English version of the receipt govern disputes over its terms & provides that discrepancies b/t 	<ul style="list-style-type: none"> • Enrollment appears to be materially lighter process than obtaining a license. Under statute, DBO is to permit enrollment so long as the applicant, its directors, officers and controlling persons are all of "good character." • This raises question why DBO is still charging \$5k for enrollment - this is a steep fee for smaller companies, and it's not immediately apparent how that reasonably approximates the cost to DBO of evaluating licensees. • Amendment shortens the list of information required to apply, but requests similar-type information. • No "on-ramp" for startups, as the latest draft of the ULC model law includes. • Adds fingerprints as a requirement, which the commissioner is authorized to turn over to law enforcement. • Increases application fee amount from \$3,500 to \$5,000. • No reciprocity provision for out-of-state licensees who meet certain conditions, as the latest draft of the ULC model law includes. <ul style="list-style-type: none"> ○ The lack of reciprocity provisions are troublesome as more states implement specific digital currency statutes—which reinforces the balkanized and costly regulatory compliance landscape in digital currency. • Significantly increases disclosure requirements to customers and on receipts. <ul style="list-style-type: none"> ○ Notably, there is a requirement to obtain customer's "acknowledgement" of all disclosures, including new account and per transaction disclosures. ○ This could be very burdensome on a per-transaction basis. Along similar lines, per-transaction disclosures

<ul style="list-style-type: none"> ○ Organizational structure description; ○ Criminal and employment history; ○ Most recent SEC (or foreign equivalent) reports (own or parent company); ○ Audited and Unconsolidated financial statements for current fiscal year (and 2 years preceding); ○ Business plan; ○ Application fee: \$3,500 ○ License Renewal fee: \$2,500 (+ \$125/branch) ○ Examiner fee (\$75) ○ Capital determined by commissioner ○ Bond • Standard ongoing reporting requirements • Required licensee to provide customers a receipt containing specific information. 	<p>English and foreign language versions of the receipt be construed against enrollee.</p> <ul style="list-style-type: none"> ○ Prescribes a fine of \$100 for each receipt-provision violation. • Requires enrollee and its officers, agents, and employees to make the enrollee’s accounts, books, correspondence, and other records available upon request and to facilitate the commissioner’s fact-gathering. [§ 26030] • Requires enrollee to provide an audit report containing specified information and prepared pursuant to prescribed standards and an annual report (within 90 days after the end of each fiscal year). [§ 26030(c)] <ul style="list-style-type: none"> ○ Prescribes a fines & penalties for violations & failure to make reports or include required information. • Requires enrollee to file an annual report with the commissioner on or before March 15. [§ 26030(5)(d)] • Requires persons seeking to engage in both money transmission (as defined in Section 2003) and digital currency business to obtain a license under the MT Act and Enroll in the Program. [§ 26014] • Expressly allows registered MSBs to comply with the BSA regulations (Ch. 5). • Prohibits a person from directly or indirectly acquiring control of an enrollee in the program without approval by the commissioner. <ul style="list-style-type: none"> ○ Prescribes a process & fee for approval of acquiring control of an enrollee. ○ Requires an application to acquire control to be under oath. • Prohibits advertising materials from making false, misleading, or deceptive representations or omissions. 	<p>should be permitted to be batched at day-end.</p> <ul style="list-style-type: none"> ○ Otherwise, this could be difficult to manage operationally, especially for small companies. ○ Certain disclosures likewise seem unmanageable from a substantive standpoint, such as disclosing all “liability” that an enrollee may have to a customer. [This is much too broad and vague to result in useful disclosures to customers] • <u>Requires money transmitter license <i>in addition to</i> Enrollment if the person wishes to engage in money transmitter activities and exchange of digital currency.</u> <ul style="list-style-type: none"> ○ NOTE: This requirement seems to defeat the purpose of having a statute specifically designated to regulate digital currency. • Expressly allows registered MSBs to comply with the BSA regulations (Ch. 5). Although not entirely clear from the statute, the intent of this phrasing appears to suggest that registered MSBs will not face any additional state-level AML requirements so long as they will remain in compliance with federal obligations. <ul style="list-style-type: none"> ○ This is a notable improvement over NY BitLicense, which imposes additional AML requirements. • Prior version provided that licensees had to maintain bond or trust account in amount specified by DBO. New version only addresses security issues in context of the “fact gathering” section (26030(a)), where the DBO can ask an enrollee about security arrangements. <ul style="list-style-type: none"> ○ No mention of capital/ net worth concepts either. This is an interesting, and potentially favorable, departure from the more prescriptive approaches regarding bonding/security in NY BitLicense (and MT laws in general). • The bill authorizes the commission to regulate advertising and marketing. <ul style="list-style-type: none"> ○ Prohibits an enrollee in the program from advertising products, services, and activities without a statutory statement regarding the program and that a government agency has not reviewed the safety or soundness of the
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		<p>business or digital currencies.</p> <ul style="list-style-type: none"> ○ Requires an enrollee to maintain advertising materials. ○ Prohibits ads from providing false, misleading, or deceptive representations or omissions. ○ Requires enrollees to make a variety of specified disclosures in English and in any other language spoken by a majority of the enrollee’s customers prior to entering into an initial transaction for, or on behalf of, a customer, when opening an account for a new customer, and prior to each transaction.
	<p><u>Commission Authorization & Requirements</u></p> <ul style="list-style-type: none"> • Authorize commissioner to deliver fingerprints to law enforcement agencies. • Authorize commissioner to require an enrollee (and agents) to submit surveys, investigations, and questionnaires for the purpose of gathering information and to ascertain detailed facts about the enrollee’s business model, capitalization and net worth, and cybersecurity, compliance with BSA, liquidity, investment activity, operational safety, advertising materials, customer complaints and resolution, among other things. [§ 26030(a)] • Authorize commissioner to send cease and desist orders when an unenrolled person is engaging in the digital currency business or violating provisions of the program. [§ 26046] • Authorize commissioner to bring actions (within 4 years after offense) to enjoin acts or practices in violation of the act’s provisions or to enforce provisions. [§ 26046] • Authorize commissioner to include in civil actions claims for ancillary relief (including restitution, disgorgement, on behalf of a person injured, attorneys’ fees and costs, and civil remedies up to \$25,000). [§ 26046] • Authorize commissioner to dis-enroll enrollees for enumerated 	<p>Adds specific authorizations and Requirements for the Commission and Commissioner.</p> <ul style="list-style-type: none"> • The bill authorizes the commissioner to require ongoing reporting/auditing and prescribes fines and penalties for non-compliance with reporting requirements. • We remain concerned about the scope of the audit requirement as applied to startups/small companies in particular—very impractical to expect those companies to afford formal audited statements in initial years. • Underscores need for some kind of “onramp” or “transitional mechanism for start-ups” (as noted above). • The examination section that was in the prior version has now been removed. <ul style="list-style-type: none"> ○ The increase in disclosure requirements, taken with scaling back of specific examination powers, may generally indicate that DBO is not expecting to take a particularly active role in enforcement while the “enrollment” structure is in place. ○ However, there are some lingering references to examination power in specific areas—such as nothing that DBO may from “time to time” examine BSA compliance, that enrollees must maintain advertising

	<p>reasons and after appropriate process. [§ 26048]</p> <ul style="list-style-type: none"> • Limits transparency to public. SEC. 6. (“limitation on the public’s right of access to the meetings of public bodies or the writings of public officials”). • Require commission to permit enrollment in the program, unless it appears to the commissioner that the person (or related parties) are not of good character. • Require commissioner to prepare and make available to the public an annual report on the state of the digital currency business industry by compiling the information received pursuant to these provisions. 	<p>records for DBO examination, and providing that grounds for disenrollment includes failure to cooperate with an exam.</p> <ul style="list-style-type: none"> ○ This creates potential ambiguity as to when, and under what circumstances, the DBO does intend to exercise exam authority.
<p><u>Scope</u></p> <ul style="list-style-type: none"> • Local Program: No 	<p><u>Scope</u></p> <ul style="list-style-type: none"> • Local Program: Yes 	