



May 12, 2015

The Honorable Matt Dababneh  
State Capitol  
P.O. Box 942849  
Sacramento, CA 94249-0045

Dear Chairman Dababneh:

The California Assembly has made laudable progress refining AB 1326, legislation that will protect virtual currency consumers and promote innovation. Language describing capital requirements has been made more flexible, and language describing qualifying virtual currency business activities has been simplified to omit the over-inclusive term “securing.” We thank you and your staff for taking a conscientious approach to this law-making.

The amended bill, however, may still be interpreted to mandate licensure from actors who do not pose a consumer financial risk and who, nonetheless, create innovative and promising products using virtual currency technology.

Just as California’s money transmission law does not cover all businesses that touch money (*i.e.* it is tailored to cover only the third-party transmitters of money and omit businesses who deal with money in a non-custodial or incidental manner), California’s virtual currency licensing law should not cover every businesses that touches virtual currency (*i.e.* it should be tailored to mandate licensure *only from those who are in the business of having control and custody of a customer’s virtual currency*). It should protect consumers specifically from those parties that assume a position of trust.<sup>1</sup>

Such a tailored approach is particularly important for virtual currency because these technologies can also be used to streamline and improve many consumer services that are not financial. At root, virtual currency technology is robust and secure bookkeeping software, and therefore it can

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<sup>1</sup> In its policy statement on state virtual currency regulation, the Conference of State Bank Supervisors has specified that the normative case for consumer protection regulation of digital currencies is based on “trust.” Conference of State Bank Supervisors, *CSBS Policy on State Virtual Currency Regulation 2* (Dec. 2014) available at

<http://www.csbs.org/regulatory/ep/Documents/CSBS%20Policy%20on%20State%20Virtual%20Currency%20Regulation%20--%20Dec.%2016%202014.pdf> (“[T]ransmitting, exchanging, and/or holding of value on behalf of another . . . place the activity provider in a position of trust. This position of trust is the basis for most financial services laws and regulations, and should be applied regardless of the medium of value.”).

be an ideal tool for digital identity, document notarization, bookkeeping, and other services the bear only an ancillary relationship to currency—if there is any relationship at all.<sup>2</sup>

A tailored approach is also important because virtual currency businesses may be in the business of securing funds but may remain incapable of losing those funds and abusing consumer trust.

The Assembly should celebrate these innovative, low-risk, and non-financial uses of virtual currency and be a leader in promoting their development. Accordingly, the definition of *Virtual Currency Business* in AB 1326 should exclude innovative companies that do not pose a consumer risk or offer financial services.

The Assembly should consider the following simple revision to draw these distinctions.

***First, omit the words “storing” and “holding” from the definition. These metaphorical terms for use of virtual currency are confusing and may lend themselves to over-inclusive interpretations.***

***Second, define “custody or control of virtual currency” as “having the ability to unilaterally execute or prevent a Virtual Currency transaction.”***

***Third, exempt a category of “non-qualifying activities” from licensure. Language should be added to the bill specifying:***

***In no event shall any of the following activities, in and of themselves, be interpreted as Virtual Currency Business:***

- 1. developing, distributing, or servicing software;***
- 2. contributing software, connectivity, or computing power to a virtual currency network;***
- 3. providing data storage or security services to a licensed virtual currency business; or***
- 4. engaging in otherwise qualifying activities undertaken for non-financial purposes, or that do not involve more than a nominal amount of Virtual Currency.***

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<sup>2</sup> For example, the digital identity service Onename.io uses a blockchain and nominal transactions with virtual currency in order to create indellable records of identification credentials. Even if these transactions do involve currency, they would never be useful for actually storing or sending money. See Muneeb Ali & Ryan Shea, Comments to the New York Department of Financial Services on the Proposed Virtual Currency Regulatory Framework, available at [http://www.dfs.ny.gov/legal/vcrf\\_0500/20141022%20VC%20Proposed%20Reg%20Comment%20245%20-%20OneName.pdf](http://www.dfs.ny.gov/legal/vcrf_0500/20141022%20VC%20Proposed%20Reg%20Comment%20245%20-%20OneName.pdf)

Providing an explicit definition of “custody or control” gives certainty to innovators, which will enable them to plan and experiment without the risk of unforeseen legal liabilities. It also clearly announces to consumers that any business with the *ability* to lose their financial holdings, or mispend them, *will always be licensed* in California. It is also easily justiciable, simplifying the jobs of regulators and judges: a question regarding who must be licensed avoids metaphorical inquiries into whether the business “holds” or “stores” virtual currency and, instead, can be answered simply by asking whether the business is *able* to execute or prevent a financial transaction without the individual’s knowledge and participation—hence “unilaterally”.

Explicit carve outs, from an exemption for non-qualifying activities, protect companies that do not pose a consumer risk or do not offer a consumer financial service from unforeseen legal liability. For example, a cloud storage provider like Amazon or Dropbox does not need to become licensed in order to continue offering services that could be used in tangential relation to digital currency. Similarly, an online identity service should not need to become licensed merely because they use nominal amounts of virtual currency in order to create indelible records of customer information. Finally, a software developer merely releasing computer code should not need a license in order to publish his discoveries and tools, itself a constitutionally-protected speech-act.

By refining the statute’s definitions in this manner, the Assembly would be creating an invaluable environment for innovation and improved consumer services, an environment with legal certainty and consumer protections unmatched by other states or countries.

This definitional refinement is the single most meaningful and innovation-enhancing adjustment that the Assembly can make to AB 1326. Additionally, however, one smaller modification may be fruitful.

The section on consumer disclosure includes a passage regarding unconfirmed transactions. This language is only applicable to Bitcoin and some Bitcoin-derived virtual currencies (*i.e.* those that use blockchains to record transactions). Such language would not be applicable to other virtual currencies that are devised with alternative transaction processing mechanisms. The disclosure requirement may prove more effective if it was less technologically specific. To that end, the language chosen by the New York Department of Financial Services is a useful guide. The NYDFS mandates disclosure of all “material risks” and lists ten specific disclosures that must be made.<sup>3</sup>

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<sup>3</sup> See New York Department of State Department of Financial Services, PROPOSED NEW YORK CODES, RULES AND REGULATIONS TITLE 23. DEPARTMENT OF FINANCIAL SERVICES CHAPTER 1. REGULATIONS OF THE SUPERINTENDENT OF FINANCIAL SERVICES PART 200. VIRTUAL CURRENCIES at (Jan. 2015) *available at* [http://www.dfs.ny.gov/legal/regulations/revised\\_vc\\_regulation.pdf](http://www.dfs.ny.gov/legal/regulations/revised_vc_regulation.pdf).

Thank you for your time, and please do not hesitate to contact us for further clarification on these points or other questions.

Sincerely,

A handwritten signature in black ink, consisting of a stylized 'J' and 'B' intertwined.

Jerry Brito  
Executive Director