

Cooley

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On June 1, 2022, the California Department of Financial Protection and Innovation (DFPI) [released an invitation for public comments](#) to inform its development of a comprehensive regulatory approach for digital (or crypto¹) assets. The DFPI's [invitation for comments](#) is one of numerous actions ordered by [California Gov. Gavin Newsom's recent blockchain executive order issued on May 4, 2022](#), which delegated a central role to the DFPI in light of its dual mandate to protect consumers and foster responsible innovation.

As directed by the executive order, the DFPI is seeking comments on how it should approach regulation of crypto assets pursuant to its authority under the California Consumer Financial Protection Law (CCFPL), the state's consumer financial protection law that is modeled after provisions of the federal Dodd-Frank Act. In particular, the invitation for comments asks if rulemaking is necessary to clarify how the CCFPL should apply to crypto assets (e.g., whether crypto meets the definition of a consumer "financial product or service"), as well as persons involved in offering or providing such crypto assets (i.e., "covered persons" or "service providers" under the CCFPL). It also seeks specific input on how the DFPI can advance key regulatory priorities and how the DFPI should conduct a market-monitoring order, which was mandated by the executive order, to inform its future rulemaking. Public comments are due by August 5, 2022.

DFPI's invitation for comments

The invitation for comments includes 16 specific questions under three broad topics, as outlined below.

Regulatory priorities

The invitation for comments requests input on how the DFPI can advance certain key regulatory priorities (including specific actions the DFPI should take) with respect to crypto asset-related financial products and services. These priorities include:

- Better protecting consumers and investors.
- Improving consumer education.
- Ensuring financial stability in the market.
- Addressing climate change.
- Harmonizing the state's regulatory approach with that of federal authorities.
- Working with other state regulators to promote consumer protection and reduce unnecessary burdens.
- Promoting inclusive innovation and equity.
- Making "California the most desirable state for responsible [crypto asset] companies."

CCFPL regulation and supervision

The invitation for comments seeks feedback on whether rulemaking is required or should be adopted under the CCFPL to:

- Require registration of crypto asset-related financial products and services.

- Specify which crypto asset-related financial products and services should be included in the CCFPL’s definition of a “financial product or service.”
- Identify any unlawful, unfair, deceptive, or abusive acts or practices in connection with the offering of crypto asset-related financial products and services.
- Ensure full and accurate disclosure of features of crypto asset-related financial products and services.
- Require the filing of annual or special reports for the DFPI to perform its monitoring and other responsibilities.

Market-monitoring order

The invitation for comments requests input on how the DFPI should conduct the market-monitoring order directed by the executive order – such as the scope of the order (e.g., which companies and products/services should be included), and what information should be collected and made publicly available in aggregate form.

Parties are not limited to providing comments on the specific questions in the invitation for comments. For example, the DFPI indicates that parties may comment on areas for potential rulemaking relating to crypto assets under other laws administered by the DFPI, including the California Money Transmission Act (the MTA)² and the California Financing Law.³

Comments and outlook

Newsom’s blockchain executive order states that California seeks to foster responsible innovation by blockchain (including cryptocurrency) companies in the state and harmonize California’s approach to the regulation of crypto assets with that of the federal government. (For more information on President Joe Biden’s executive order on digital assets, refer to this March 2022 Cooley alert: [Biden Executive Order on Cryptocurrencies and Other Digital Assets Emphasizes Innovation and Regulation](#)). A central objective of Newsom’s executive order is to facilitate the development of a comprehensive regulatory approach for crypto assets that would better protect consumers. Newsom’s executive order and the DFPI’s invitation for comments also indicate that new regulatory guidance and rulemaking regarding crypto assets are likely forthcoming.

The CCFPL, which went into effect last year, provides the DFPI with broad discretion to interpret and implement the law. In particular, it gives the DFPI significant authority to regulate the offering and provision of consumer financial products, and nonexclusive oversight and enforcement authority, under California consumer financial laws and, to the extent permissible, nonexclusive oversight and enforcement authority under federal consumer financial laws.⁴ Among other things, it prohibits covered persons and service providers from engaging in unlawful, unfair, deceptive, or abusive acts or practices.

To date, the DFPI has notably steered clear of regulating activities involving cryptocurrency under the California MTA. In interpretative opinions, the DFPI has consistently stated that it is not currently requiring persons engaged in activities involving virtual currency – including buying, selling, exchanging and holding virtual currency – to be licensed as a money transmitter. This approach has given the industry time to evolve and the DFPI time to evaluate an appropriate regulatory construct. The executive order and invitation for comments, however, suggest that the state is now taking a different tack and may soon be ready to act. So, while it is possible that the DFPI could still decide to regulate at least some digital asset activity under the MTA, persons operating in the digital asset space who are not exempt or do not become exempt (e.g., by obtaining a money transmission license) from regulation under the CCFPL can expect any DFPI rulemaking under the CCFPL to have a direct impact on their operations in California.

The invitation for comments and any resulting regulatory guidance or regulations also are likely to influence the DFPI’s future enforcement activity, especially in light of the executive order’s additional mandate to enforce violations of the CCFPL and other consumer financial laws. However, while the DFPI has to date taken a wait-and-see approach with respect to licensing and

supervisory oversight, this has not precluded enforcement activity in this space. For example, the DFPI has shown no signs of delaying enforcement activity in connection with the offering and selling of products relating to digital assets that constituted securities in California but were not registered, qualified, or permitted for sale in the state as required by California Corporations Code section 25110, as seen in the [BlockFi Lending consent order](#).

Given the precedents in other states, the breadth of the DFPI's questions in the invitation for comments, and its current enforcement activities – especially in light of recent instability, volatility and consumer losses – the DFPI could implement new safety and soundness, registration, and consumer disclosure requirements through regulatory guidance and rulemaking. Thus, the invitation for comments should be closely evaluated by all interested parties, and those who may be impacted by new regulations should consider this a valuable opportunity to inform the scope of the DFPI's long-awaited regulation of digital asset activity.

Notes

1. Newsom's blockchain executive order defines the term "crypto asset" as "a digital asset, which may be a medium of exchange, for which generation or ownership records are supported through a blockchain technology."
2. Cal. Fin. Code § 2000, *et seq.*
3. Cal. Fin. Code § 22000, *et seq.*
4. The CCFPL does not apply to banks and other chartered financial institutions, and entities subject to licensing (e.g., money transmitters, finance lenders and broker-dealers) or certificate requirements by the DFPI, to the extent that such entities are acting under the authority of one of those charters, licenses and certificates. It also does not apply to licensees of any other state agency other than DFPI to the extent that such licensees are acting under the authority of those licenses. (See Cal. Fin. Code § 90002 for the full list of exemptions.)

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