



To:

Department of Financial Protection
and Innovation, Legal Division
Attn: Sandra Navarro
Regulations Coordinator
2101 Arena Boulevard
Sacramento, CA 95834

Date:

Aug. 5, 2022

**Re: Invitation for Comments on Crypto-Asset
Related Financial Products and Services Under the
California Consumer Financial Protection Law**

Coinbase Global, Inc. welcomes the opportunity to comment on the Department of Financial Protection and Innovation's ("DFPI") invitation for comments on crypto-asset related financial products and services under the California Consumer Financial Protection Law.

California has a special opportunity to welcome crypto innovation, and establish a regulatory environment that strengthens the already robust community of crypto users, innovators, and businesses in the state. To that end, we have framed our comments in ways that we hope are of most use to DFPI's work. We begin by providing an overview of the innovative potential of crypto, as well as sharing some thoughts on the foundation that DFPI should consider working from when regulating crypto. We also address some, high-level consumer protection principles that DFPI should consider.

As for specific comments on the questions asked, we stress two points. The first is that definitional clarity is critical to effective regulation, and that DFPI should carefully examine what crypto assets it considers to be financial products or services. Second, and relatedly, we urge DFPI to carefully consider whether those persons who offer/provide such products and services should be required to register with DFPI. Our answers to these questions are informed by core legal and financial principles, and by the goal of aligning California's approach with that of federal regulators and other states.

We appreciate your thoughtful efforts to develop a regulatory framework for crypto assets, and we look forward to continued engagement.

Sincerely,

Faryar Shirzad
Chief Policy Officer
Coinbase Global, Inc.



Introduction to Coinbase:

Coinbase plays an integral role in the global cryptoeconomy as the largest and only publicly-traded crypto exchange in the United States. Coinbase was founded in 2012 as an easy and trusted place to buy and sell Bitcoin. Since then, Coinbase has helped fuel the development of an entire industry with thousands of different blockchains, tokens, and projects. Today, we offer much more than Bitcoin trading, enabling millions of individuals, businesses, and developers in over 100 countries to easily and securely invest, spend, save, earn, and use crypto. We currently make 210 assets available for trading and 341 assets available for custody on our platform, all of which undergo rigorous legal, compliance, and security review before being added to the platform. We have also invested in more than 300 teams and projects in recent years through Coinbase Ventures, building everything from layer 1 protocols, Web 3.0 infrastructure, centralized on-ramps, decentralized finance, NFTs, metaverse technologies, to developer tooling and more.

Our mission is to increase economic freedom in the world. To do that, we have worked to build a company that is the most trusted, secure, and compliant onramp to the cryptoeconomy. Our early focus on regulatory compliance, consumer protection, and innovation has helped drive growth in both our products and services and our consumer base. We are a leading provider of end-to-end financial infrastructure and technology for the cryptoeconomy. Coinbase Global, Inc. (COIN) is a public company registered with the SEC and began trading on the Nasdaq in April 2021. Our primary operating company, Coinbase, Inc., and our affiliates (collectively, "Coinbase") make up one of the largest digital asset financial infrastructure platforms in the world, including our exchange for digital assets.

We believe that crypto can and will be based on the following three pillars, which recognize crypto as:

1. **New financial system.** Crypto is opening up a new financial system. This means creating digital tools and services that enable people to engage in financial transactions, such as extending or receiving credit, using payment instruments, and settling payment obligations, all in a safe, compliant way. Decentralized finance, smart contracts, and other new technologies will drive innovation and exponentially expand opportunities to improve our financial system in the U.S. and globally.

2. App platform. Crypto and blockchain technologies will provide the next app platform. Fundamental to crypto is the decentralization of ownership, which gives individuals the opportunity to develop new financial and non-financial applications, like non-fungible tokens (NFTs). Coinbase is building tools that both enable individuals, institutions, and app developers to plug into the existing crypto infrastructure to create new products, as well as benefit from the distribution and use of these products. By supporting both the development of and access to these new applications, Coinbase can help fuel the development of Web 3.0.
3. Investment. We want to empower everybody to achieve economic freedom through investing in and using crypto. At Coinbase, we believe we can enable customers to buy, sell, and hold crypto in a safe, informed, and compliant way. The world of crypto has expanded far beyond Bitcoin to include assets with diverse use cases and characteristics, and we are working to give consumers the tools they need to make informed decisions.

California and Crypto – Recognizing the Potential for Innovation:

We agree with the principles set forth in California Executive Order N-9-22. We applaud Governor Newsom for recognizing that crypto and blockchain technology is laying the foundation for a new generation of innovation, spurring a new rise in entrepreneurialism, and benefitting California's thriving tech economy. Such recognition is paramount to crafting an appropriate regulatory regime.

The cryptoeconomy is a fair, accessible, efficient, and transparent system that leverages crypto assets built on blockchain technology to transfer value or ownership. Digital asset trading platforms like Coinbase have emerged to meet the demand from users in California and around the world for access to innovative crypto assets and products. Crypto is no longer simply buying, holding, selling, and speculating on Bitcoin; the use cases for these assets are many and the list is growing. It is imperative that the U.S., including individual states, adopt policies that promote responsible innovation. Doing so supports a number of principles that are recognized as important in Executive Order N-9-22 and by California state policy generally, including:

- Access. Anyone, anywhere with an internet connection can directly access crypto networks. Access is not limited by education, race, geography, age, or any other personal characteristic. This increased access furthers California's stated goals of advancing equity and inclusivity.
- Enhanced transparency. Distributed ledgers are simultaneously hosted across multiple systems with no central authority. Recording a transaction requires consensus in accordance with the distributed ledger's technology: for example,

via a computationally intensive cryptographic problem (*i.e.*, “proof of work”) or validation by the community of digital asset owners (*i.e.*, “proof of stake”). The distributed nature of this validation process and accessibility of the ledger provides enhanced transparency, as well as a readily accessible means of auditing past transactions.

- *Increased resiliency.* Because distributed ledgers are simultaneously hosted across multiple systems, they are highly resistant to corruption and cyberattacks. For example, the blockchain underlying Bitcoin has operated for more than a decade without a cyber incident. More generally, an effective attack on a widely used and decentralized blockchain would require extraordinary resources and intense coordination that we have not yet seen. System failures of well established blockchain protocols are extremely unlikely.
- *Efficiency.* Crypto enables real-time processing that is available 24/7/365, which reduces counterparty risk and the risk of transaction delays or failures to clear transactions. It also reduces transaction costs when sending, receiving, and holding digital assets.
- *Creator control.* Crypto can empower a new generation of creators who own their content and maintain life-time monetization of it. For instance, crypto is increasingly enabling artists and other creators to release their product directly to consumers and receive credit for their creation beyond its initial sale.

Protecting Crypto Consumers in California Starts with a Consistent Foundation:

The Department of Financial Innovation (“DFPI”) has the important job of balancing both the benefits of crypto – and the ways in which crypto technology can be a force in California’s economy – with thoughtful regulation that will protect crypto users. With this balance in mind, we would like to specifically answer questions #11, #12, and #13, related to registration, how crypto asset-related financial products are defined, and fraud, respectively. Note we address question #12 first, because definitional clarity is a critical and necessary foundation for effective regulation.

We encourage the DFPI to adopt definitions and standards that closely align with the practices and guidance of the federal government. This will further the DFPI’s stated goal of creating consistency with the federal government, as well as with other states that follow the same approach of following federal guidance. Specifically, in order to help ensure that DFPI’s approach provides clarity and consistency to crypto operators in California, we suggest that DFPI model certain key terms and requirements after those used by the Consumer Financial Protection Bureau (“CFPB”) and other relevant federal agencies. Because these terms have had extensive use and application in federal

matters, and because they have general applicability throughout the United States, the adoption of these terms will provide innovators in California a clearer roadmap for meeting their regulatory obligations.

The Invitation for Comments poses the following at Question 12:

Financial Code section 90005, subdivision (k)(12) of the CCFPL states that “financial product or service” includes “offering another financial product or service as may be defined by the department, by regulation,” subject to certain criteria. Are regulations needed to specify crypto asset-related financial products and services that should be included in the definition of a “financial product or service” subject to CCFPL authority?

We suggest that the DFPI clarify by regulation which crypto assets, if any, fall within the scope of being financial products or services. The California Consumer Finance Protection Law (“CCFPL”) requires its definitions to be “interpreted consistently with the Consumer Financial Protection Act of 2010,”¹ which is the federal statute that the CFPB administers. In 2016, the CFPB issued a rule on creating consumer protections for prepaid accounts under Regulation E, which implements the Electronic Fund Transfer Act.² As part of that rulemaking, the CFPB considered whether to regulate virtual currency products and services under this final rule, but ultimately declined to subject virtual currencies to Regulation E.³ It stated that staff continued to analyze whether it should and could regulate virtual currencies.⁴ The Bureau has not, five years later, concluded virtual currencies are financial products subject to its jurisdiction.

We thus encourage the DFPI to carefully consider which crypto assets and categories of assets, if any, it believes are financial products, and to provide the necessary analysis to reach any conclusion that the Department reaches under the CCFPL.

We expect that the DFPI’s legal analysis will show that many crypto assets are not financial products – e.g., cash, an ownership interest in an entity, or a contract that calls for the delivery of a financial instrument.⁵ Such financial products require a chain of contractual obligations that ends with the delivery of cash or an ownership interest in an

¹ California Consumer Finance Protection Law § 90005(p).

² Prepaid Accounts Under the Electronic Fund Transfer Act (Regulation E) and the Truth In Lending Act (Regulation Z), 81 FR 83934 (Nov. 22, 2016).

³ *Id.* at 83953, 83978-79.

⁴ *Id.* at 83978-79.

⁵ Accounting Standards Codification Master Glossary, “financial instrument.”

entity.⁶ Some crypto assets, such as stablecoins redeemable for fiat currency, are clearly financial instruments that meet this definition. But most crypto assets do not pay a dividend or interest, and their intrinsic value is based solely on their perceived utility. These assets, which include Bitcoin, Ether, and many utility tokens, are not financial instruments.

If the DFPI determines that certain crypto assets are financial products, it should set forth an easily applied test for crypto developers to use when determining whether the chain of necessary contractual obligations is present. That test should include a presumption that a crypto asset will not be considered a financial product or service unless a qualifying definition is met, such as would be the case with a stablecoin being redeemable for fiat currency or a crypto asset expressly containing an ownership interest in an off-platform entity. In the absence of such a qualifying feature, the regulations should make clear that a crypto asset is not considered to be a financial product or service, thereby giving innovators and others certainty and predictability that is critical for a well-functioning regulatory regime.

The Invitation for Comments further asks the following at Question 11:

Financial Code section 90009, subdivision (a) of the CCFPL authorizes the DFPI to “prescribe rules regarding registration requirements applicable to a covered person engaged in the business of offering or providing a consumer financial product or service.” Are regulations needed to require registration of crypto asset-related financial products and services with the DFPI under Financial Code section 90009, subdivision (a) of the CCFPL?

a. What factors should be considered in determining whether the offer or provision of a crypto asset-related financial product or service should trigger registration?

We do not believe that additional registration requirements are necessary here. Incorporating the definitions discussed above, in response to Question 12, will make clear that most crypto assets are not financial products or services. If any product is determined to be a financial product or service, the Department should then determine whether it is the type of financial product or service that is already required to register under an existing regime. In many cases, those assets will already be required to register with the state under existing registration requirements, thus making additional registration requirements redundant.

For example, those crypto assets that are considered to be financial products because they result in an ownership interest in an entity could be considered securities under the Securities Act of 1933, the Securities Exchange Act of 1934, and California’s Corporate

⁶ *Id.*

Securities Law of 1968. Any such crypto assets that are securities would thus be required to register with the Securities and Exchange Commission and/or with DFPI, pursuant to securities law.

Similarly, some crypto assets that are considered to be a financial product or service because they represent a claim against an issuer for cash could fall within California's definition of money transmission, thus subjecting their issuers to registration as a money services business. In California, money transmission means any of the following: "(1) Selling or issuing payment instruments. (2) Selling or issuing stored value. (3) Receiving money for transmission."⁷ The DFPI has previously issued several facts and circumstances specific letters to platforms, exchanges, and other digital asset service providers, exempting the entities from registration as a money transmitter.⁸ But it has not provided clear guidance as to whether any cryptocurrencies, such as stablecoins, are covered under the California Money Transmission Act ("MTA"). DFPI should make clear whether issuers of crypto assets that are designed to represent cash and are redeemable for cash, such as fiat-backed stablecoins, are required to register with the state as a money services business.

Before it considers enacting a new registration regime that applies to all crypto asset-related financial products or services, the DFPI should first make clear when registration is necessary under existing regimes, including the MTA and relevant securities laws. If the majority of crypto asset-related financial products and services are found to be covered under an existing registration regime, enacting a new regime would prove unnecessary, and would impose a burden on crypto that is significantly greater than the value it provides to consumers.

Finally, the Invitation for Comment asks the following at Question 13:

Financial Code section 90009, subdivision (c) of the CCFPL authorizes the DFPI to "prescribe rules applicable to any covered person or service provider identifying as unlawful, unfair, deceptive, or abusive acts or practices in connection with any transaction with a consumer for a consumer financial product or service, or the offering of a

⁷ California Money Transmission Act § 2003(q).

⁸ See, e.g., DFPI Letter, "Digital Asset Trading Platform Services," March, 23, 2022; <https://dfpi.ca.gov/2022/03/29/digital-asset-trading-platform-services/>; DFPI Letter, "Purchase and Sale of Digital Assets; Payment Processing Services," December 6, 2021; <https://dfpi.ca.gov/2022/03/21/purchase-and-sale-of-digital-assets-payment-processing-services/>; DFPI Letter, "Cryptocurrency Escrow Accounts and Exchanges," July 28, 2020; <https://dfpi.ca.gov/2020/08/04/cryptocurrency-escrow-accounts-and-exchanges/>.

consumer financial product or service.” Are regulations needed to identify any unlawful, unfair, deceptive, or abusive acts or practices in connection with the offering of crypto asset-related financial products and services?

DFPI should enact regulations to identify unlawful, unfair, deceptive, or abusive acts/practices (UDAAP) in connection with the offering of crypto asset-related financial products and services. Preventing such acts and practices is at the cornerstone of consumer-protection law, as recognized at the federal level by the Dodd-Frank Wall Street Reform and Consumer Protection Act, the mission of the CFPB, and California’s own Unfair Competition Law.

DFPI should define the scope of “unlawful, unfair, deceptive, or abusive acts or practices” that concern crypto asset-related financial products or services in a way that is appropriately tailored to target the most meaningful threats to consumers, while also recognizing that the crypto-economy can be volatile. DFPI should be careful to not remove a consumer’s responsibility for decision-making when purchasing or transferring a crypto-asset related financial product or service. Rather, DFPI should tailor its regulations to eliminate from crypto asset-related financial products and services:

- Activities or practices that cause, or are likely to cause, substantial harm to consumers;
- Where the injury is not reasonably avoidable by consumers; and
- Where the injury is not outweighed by countervailing benefits to consumers or to competition.⁹

By rooting its foundational definitions in terms that are well-understood by the crypto community and applied broadly throughout the United States, the DFPI will position California’s crypto economy to flourish, while simultaneously positioning itself to protect the state’s consumers that are most at risk of harm.

The Best Regulation for Californians Will Right-Size Consumer Protection Principles with Crypto and Its Promise for Innovation:

DFPI knows consumer protection. While the current iteration of the agency was only created in 2020, California has a long history of protecting consumers using its consumer protection laws. Creating the appropriate regulatory framework for crypto will require the DFPI to apply the fundamentals of consumer protection to the ever-evolving crypto

⁹ See *generally* Dodd-Frank Act, Title X, Subtitle C, Sec. 1036; PL 111-203 (July 21, 2010). The principles of “unfair” and “deceptive” practices in the Dodd-Frank Act, as applied by the CFPB, are also similar to those under Sec. 5 of the Federal Trade Commission Act.

landscape in a way that is fit for purpose. To do this, Coinbase suggests focusing on the following:

Promotional Activities and Required Disclosures:

Recommendation - Persons who offer or provide crypto asset-related financial products or services should:

- Provide accurate information, that is not false or misleading, in any promotional activity disclosures;
- Provide accurate information regarding material risks; and
- Clearly and conspicuously disclose their fees.

Explanation - The basic principles of providing clear, accurate information (that is not false or misleading), and acting honestly and fairly, help establish a baseline standard to evaluate promotional activities disclosures. These guiding principles should underpin any disclosure regime in order to help promoters evaluate whether they have provided the consumer with all the material information needed in order for the consumer to make an informed decision. The SEC, for example, has recently reiterated the importance of not providing false and misleading information on financial risks to consumers.¹⁰ Most recently, Voyager came under scrutiny regarding its misleading claims to consumers on their deposit accounts.¹¹

It is also important to establish a standard of providing accurate information regarding any material risks. Existing asymmetric information hurts consumers and is harmful to the industry as a whole. In particular, DFPI should encourage a level playing field by requiring continuous updates of any material risks associated with the promoted activity.

Lastly, there should be clear and conspicuous disclosure regarding fees associated with the service. Fees should be accurate and disclosed prior to consummation of a transaction. As Web 3.0 protocols become more decentralized and participants govern various aspects of the protocol, including fee structures, a clear disclosure regime helps put the community on notice that fees should be disclosed before a user elects to move forward with a transaction.

¹⁰ See *generally* BlockFi Agrees to Pay \$100 Million in Penalties and Pursue Registration of its Crypto Lending Product, U.S. Securities and Exchange Commission (February 22, 2022) on BlockFi providing false and misleading information on its website regarding the level of risk in its loan portfolio and lending activity.

¹¹ See US Fed, FDIC accuse Voyager Digital of 'false and misleading' insurance claims, The Block (July 28, 2022).

Customer Service:

Recommendation - Persons who offer or provide crypto asset-related financial products or services should provide a way for customers to contact that person, or a designated representative, and normally receive a response within 3 business days. However, DFPI should also apply a facts and circumstances test when reviewing compliance with this rule, to allow for leniency in certain circumstances, such as when a young start-up does not meet these guidelines.

Explanation: DFPI should encourage effective and transparent procedures for customer services and ensure that complaints received from clients are handled in a timely manner. Further, DFPI should encourage complaints by customers to be handled in a timely manner.

Correctly handling inquiries and complaints is important to protecting consumers, managing risk, and identifying pain points. Effective customer service can help to resolve issues early and prevent them from snowballing into larger ones. DFPI should acknowledge the importance of these customer service principles and encourage crypto companies to improve by handling them appropriately.

However, when encouraging these sound customer service principles, DFPI must always remember that the goal of any customer service policy or action should be to provide a clear channel of communication between the customer and relevant crypto company. While the crypto economy includes some well-established, large companies that are able to devote significant resources to customer service, it also includes many early-stage start-up companies that are not able to staff departments focused on customer service or internal investigations. Some such companies may not yet have a dedicated legal counsel for responding to consumer or regulatory complaints. Thus, any framework from DFPI should be flexible to allow companies that are still in early stages to develop, while simultaneously ensuring that consumers have a path toward receiving customer support and complaint resolution. If DFPI grounds its guidance on the principle of accessibility, it should reach the right balance of these important interests.

Appropriate Risk Mitigation Standards:

Recommendation - DFPI should apply a standards based approach when adopting any risk management standards, and not an asset based approach.

Explanation: DFPI should work to ensure that crypto financial products and services satisfy risk mitigation standards. As DFPI develops its approach to oversight over platforms that support crypto assets that are financial products, we would suggest that the DFPI use a standards-based rather than asset-based approach. Specifically, there is a model of oversight pursuant to which platforms are required to seek per asset regulatory approval. This asset-based model has the effect of interposing the regulator

between issuers and the public, forcing the regulator to act as a gatekeeper for individual offerings. We believe that a standards-based approach modeled on consumer protection principles will strike the right balance between ensuring robust and dynamic competition for financial products and the need to protect consumers.

This approach should understand the nuances surrounding crypto and blockchain technology. For example, blockchain based-ledgers, which are used to transfer most crypto assets, are immutable. Anyone can download the ledger and see the entire history of every transaction that has ever occurred on a given blockchain, and once a given transaction has occurred, it cannot be undone. Thus, if a consumer makes an erroneous transaction, that transaction can not be undone. A number of other features regarding crypto, its use of public/private keys, and blockchain technology make it different from traditional finance transactions. DFPI should seek to understand these technological features that relate to crypto and blockchain, and make any regulation it carries out consistent with those features.

Conclusion - Regulation Should Be Mindful of the Future:

Web 3.0 ultimately represents a paradigm shift in how we all interact with the internet. That shift will unleash unprecedented innovation and economic freedom, but in order to release that freedom, regulators must acknowledge that Web 3.0 cannot fit entirely into pre-existing boxes. The first iteration of the internet, or Web 1.0, was static content (e.g. a website describing a company's goods and services). In the era of Web 2.0, social media and mobile companies enabled users to interact with internet content in a dynamic way. Web 3.0 is the next evolution, driven by crypto and blockchain technology. Crypto combines content, payments, and identity on decentralized platforms controlled by individual consumers, in order to further a number of different use cases:

- **In social media, digital assets will change governance.** Digital assets will give users the ability to vote on future policies like content moderation, store their own content, and exercise data rights.
- **In content creation, digital assets will provide transparency and monetization to creators and consumers.** Currently, content creators cannot track engagement and share in revenue without relying on an aggregator. Digital tokens allow any creator – not just major labels or studios – to issue, track, and earn from their content.
- **In payments, digital assets will provide accessibility.** With current solutions, users pay high transaction costs, limiting the flow of value through the digital economy. With digital assets, users have the ability to transfer value at lower cost over distributed networks in the form of tokens.

- **In gaming, digital assets will allow for custody and portability.** With current solutions, users cannot store or transfer digital goods/experiences to other users or different gaming services. In Web 3.0, users can buy and sell digital goods with other users as tokens, or transfer them between different services.
- **In supply chain, digital assets solve the problem of contractor transparency.** Current supply chain efforts rely on disparate systems to identify and track contractors, including subcontractors and country of origin. This is acute in the military. In Web 3.0, the military and key suppliers can transact directly with digital assets that represent trusted credentials and are tracked on an immutable blockchain.
- **In cloud services, digital assets can help solve the problem of pooling.** Current cloud service solutions involve building centralized infrastructure at scale that is costly, and may be vulnerable or unreliable. In a digital asset ecosystem, tokens can reward suppliers who pool underutilized storage or computing capacity as part of a decentralized cloud service, and track their contributions.
- **In business, decentralized autonomous organizations (DAOs) will reinvent how people work.** For example, a global talent pool could use a DAO to work on their own time and receive ownership stakes in the networks in which they choose to participate. While early service DAOs are crypto focused, one can envision a future in which a ride hailing app is replaced by a DAO that pairs drivers with riders, while paying drivers an ownership stake in the network (though it will be while before DAOs integrated beyond the purely digital realm).

The needs of crypto consumers are evolving: On average, 54% of Coinbase's monthly transacting customers engaged in activities beyond buying and selling crypto, including the use of stablecoins and other tokens as payment methods. Blockchain technology and crypto are paving the way to Web 3.0, which is a more fair, accessible, efficient, and transparent system to transfer value and ownership. We are encouraged by Governor Newsom's recognition of these benefits in Executive Order N-9-22. If California is to lead in these areas, the DFPI should develop a regulatory framework that both protects consumers and allows for future innovation. This can best be accomplished by creating a regime that is appropriately tailored to the nascent crypto industry and the unique technology it encompasses.