



ALERT

California Passes Digital Financial Assets Law

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On Oct. 13, 2023, California Governor Gavin Newsom signed AB-39 into law (“Digital Financial Assets Law” or “Law”), which will require persons to obtain a license from the California Department of Financial Protection and Innovation (“DFPI”) to engage in “digital financial asset business activity” on or after July 1, 2025.¹ The Law, which has similarities to New York’s virtual currency regime (i.e., the BitLicense), is expected to have a profound impact on the cryptocurrency industry, which has largely gone unregulated in California.

Governor Newsom – who vetoed a similar bill last year, noting that it was premature to put into place a licensing structure² – backed the Law, specifically emphasizing that it appropriately provides the DFPI with rulemaking authority and an extended implementation period to ensure the “regulatory framework can be thoughtfully tailored to address industry trends and mitigate consumer harm.”³ Governor Newsom also indicated, however, that the “ambiguity of certain terms and the scope of [the Law] will require further refinement in both the regulatory process and in statute,”⁴ which can be addressed during the extended timeline to the Law’s effective date.

Key highlights from the Law include the following:

- Persons engaging in “digital financial asset business activity,” or holding oneself out as being able to engage in such activity, with California residents will be required to obtain a license from the DFPI, unless exempt. “Digital financial asset business activity” includes:
 - Exchanging, transferring or storing a digital financial asset or engaging in digital financial asset administration, whether directly or through an agreement with a digital financial asset control services vendor.
 - Holding electronic precious metals or electronic certificates representing interests in precious metals on behalf of another person or issuing shares or electronic certificates representing interests in precious metals.
 - Exchanging one or more digital representations of value used within one or more online games, game platforms or family of games for either of the following:
 - A digital financial asset offered by or on behalf of the same publisher from which the original digital representation of value was received.

¹ AB-39 Digital Financial Assets Businesses: Regulatory Oversight (2023-2024), available [here](#). Governor Newsom also signed SB-401 into law, which will regulate digital financial asset transaction kiosks. See [here](#).

² See [here](#).

³ See [here](#).

⁴ See *id.*



- Legal tender or bank or credit union credit outside the online game, game platform or family of games offered by or on behalf of the same publisher from which the original digital representation of value was received.
- “Digital financial asset” is defined as “a digital representation of value that is used as a medium of exchange, unit of account, or store of value, and that is not legal tender, whether or not denominated in legal tender,” but excludes certain assets such as securities registered or exempt from registration with the SEC or the DFPI.
- If a person that is not licensed under the Law has engaged, is engaging or is about to engage in digital financial asset business activity with, or on behalf of, a California resident in violation of the Law, the DFPI may assess a civil penalty of up to \$100,000 for each day the person is in violation.
 - Licensees and “covered persons” may be assessed a civil penalty up to \$20,000 for each day the person is in violation of the Law. “Covered persons” are those persons required to obtain a license and such term is intended to be more expansive than the term “licensee.”
- The Law exempts certain persons, including banks; California and national trust companies; persons providing specified computing, network or data storage or security services; registered broker-dealers (to the extent of its operation as such); and merchants that accept as digital financial assets as payment for goods or services (other than digital financial assets).
 - The DFPI also has the discretion to exempt other persons from the Law if the DFPI determines it is in the public interest or the regulation of such person is not necessary for the purposes of the Law.
- The DFPI has the authority to issue conditional licenses, including to New York BitLicensees and New York limited purpose trust companies who have approval to engage in virtual currency business activity under New York law, provided that the BitLicense or authorization was issued or approved no later than Jan. 1, 2023.
- Licensees must maintain capital and liquidity in an amount and form as the DFPI determines is sufficient for the company based on an assessment of, among other things, the company’s business model and risk exposure.
- “Covered persons” will be required to provide customers with certain disclosures, including a schedule of fees, whether the product or service covered by insurance or other guarantee, the irrevocability of transfers and exchanges (and exceptions thereto), and other disclosures similar to the disclosures required by Regulation E for electronic fund transfers (e.g., error resolution, stop payment right).
- With respect to all digital financial assets a covered person “controls” – i.e., has the power to execute unilaterally or prevent indefinitely a transaction – the covered person must hold equal amounts of each type of digital financial asset.
- “Covered exchanges,” prior to listing or offering a digital financial asset that the covered exchange can exchange on behalf of a California resident, must certify that it has complied with specific requirements, including identifying the likelihood that any digital financial asset available to be exchanged through the platform would be deemed a security by federal or California regulators. Such certification shall not be required for any digital financial asset approved for listing on or before



Jan. 1, 2023 by the New York State Department of Financial Services. Penalties for listing or offering a digital financial asset without appropriate certification, or based on material misrepresentations that were made during the certification process, include civil penalties of up to \$20,000 per day the violation has occurred.

- “Covered exchanges” are covered persons that exchange or hold themselves out as being able to exchange a digital financial asset for a California resident.
- Covered persons will be prohibited from exchanging, transferring or storing a stablecoin unless the issuer of the stablecoin: (1) is licensed under the Law (or has an application pending), or is an exempt bank or a California or nationally chartered trust company; and (2) at all times owns eligible securities having an aggregate market value computed in accordance with US generally accepted accounting principles of not less than the aggregate amount of all of its outstanding stablecoins issued or sold. The particular stablecoin must be approved by the DFPI before the covered person engages in exchanging, transferring or storing the stablecoin.
- Licensees must maintain certain policies and procedures, including relating to information security, operational security, business continuity, disaster recovery, anti-fraud, anti-money laundering, compliance with state and federal laws applicable to digital financial asset business activity.
 - Certain of these policies and procedures must also be disclosed to customers.

As the Law does not take effect until July 1, 2025, we expect that there will be opportunities for the industry to provide feedback to the DFPI as it undertakes the rulemaking process. In the interim, companies engaged in cryptocurrency activities in California should carefully review the Law in order to begin evaluating whether their activities could fall under the Law’s scope and, if so, consider developing compliance policies and procedures and preparing to apply for a license as contemplated under the Law. We will continue to monitor developments regarding the Law, including whether there are any opportunities for industry feedback.

Schulte Roth & Zabel’s lawyers are available to assist you in addressing any questions you may have regarding these developments. Please contact the Schulte Roth & Zabel lawyer with whom you usually work, or any of the following attorneys:

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