

Payments Pros – The Payments Law Podcast**Understanding the DFPI's Proposed Rules: A Deep Dive Into California's Digital Financial Assets Law – Crossover With *The Crypto Exchange Podcast*****Speakers: Keith Barnett, Ethan Ostroff, Alex Barrage, and Carlin McCrory****Date Aired: December 17, 2024****Keith Barnett:**

Welcome to another episode of [Payments Pros](#), a Troutman Pepper podcast, focusing on the highly regulated and ever-evolving payment processing industry. This podcast features insights from members of our fintech and payments practice, as well as guest commentary from business leaders and regulatory experts in the payments industry. My name is Keith Barnett, one of the hosts of the podcast.

Before we jump into today's episode, let me remind you to visit and subscribe to our blog, TroutmanPepperFinancialServices.com. Don't forget to check out our other podcasts on troutman.com/podcasts. We have episodes that focus on trends that drive enforcement activity, digital assets, consumer financial services, and more. Make sure to subscribe to hear the latest episodes.

Today, I'm joined by my colleagues, Ethan Ostroff, Alex Barrage, and Carlin McCrory for a special crossover episode. We will be discussing the California DFPI's proposed rulemaking to implement the state's new cryptocurrency licensing regime under the Digital Financial Assets Law, including licensure exemptions, required disclosures, conditional licensing, digital assets, kiosk requirements, and its place within the broader state payments framework. This episode will also air on our *Crypto Exchange Podcast*. Ethan, Alex, and Carlin, thank you for joining me today.

Alex Barrage:

Thank you for having me.

Carlin McCrory:

Thanks, Keith.

Ethan Ostroff:

Yeah. Good to be with you, as always.

Keith Barnett:

All right. Let's get started. I'll start off with asking questions to Ethan and Alex. Do you all want to provide the audience with a brief overview of the Digital Financial Assets Law? Why don't we start with Ethan?

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Ethan Ostroff:

Yeah. I guess, just by way of background, right, just set the stage. California adopted actually two virtual currency regulatory bills into law. On the one hand, the California Digital Financial Assets Law or DFAL, which is essentially a broad licensing oversight and enforcement framework applicable to digital asset activity. Then also, sign to the law, the digital Financial Asset Transactions Kiosks Bill, which we'll be talking about a little bit as well today. That was back in October of 2023 that Governor Newsom signed those bills into law.

Then fast forward almost a year, at the end of September of 2024 and the governor signed another bill, which did a few things. Number one, it extended the licensure deadlines under DFAL a year. Extended it from July 1st, 2025 to July 1st, 2026. Effectively, entities have another additional year to obtain licensure, or theoretically, to obtain some exemption. Also, that assembly bill 1934 that was signed into law just a few months ago made some changes to the DFAL in addition to maintaining customer financial records. Licensed digital asset companies must also now maintain monthly DFAL compliance records and also, adds in some clarifications to the DFAL stablecoin specific provisions.

Going backwards in time, if you will, right, before these new laws were enacted and prior to them coming into force, and there was a part of the Digital Financial Asset Transactions Kiosk Bill that came into force as of January of 2024 concerning transaction limits. Prior to that, there was really no applicable law specific to digital assets, including, for example, in the Money Transmitter Laws of California, right? Although, you had ideas of fraud and other consumer protection provisions that could potentially be applicable to digital asset companies in California, there were no affirmative regulatory requirements. There was no specific to California licensing, or compliance, or safety and soundness, or consumer disclosure thresholds for companies to operate in California. That's all going to significantly change over the next approximately 13 months, where I think at a high level, you're going to see California joining New York as having the two most comprehensive digital asset frameworks on either the federal, or the state level. I guess, maybe, just Alex, your thoughts, generally high level about these new laws?

Alex Barrage:

Sure. Thank you, Ethan. I think that's a really helpful springboard. DFAL was enacted in November of last year. We've been living with it for just over a year. It is very similar to the licensing regime. We have studied in New York for many years, and maybe going back, I don't know, seven years, eight years, that's a bit licensed that many of us are familiar with. I think Louisiana might also have a framework to regulate digital assets. It's probably not as in the spotlight as New York's, because New York's, I think, the oldest.

Yeah, agree. This is now joining a hokodra of states that are focused on virtual currency specific frameworks. You think the interesting thing about DFAL, and I agree with your point about licensure is that before DFAL, I think many clients in virtual currency space have been relying on different opinion letters in terms of operating and serving the California market and California consumers. Now with DFAL, these providers do have a licensing requirement, and that includes a broad array of players, everyone from exchanges, wallet providers, etc.

I think the reprieve on the additional time was greatly appreciated by the market. I think that they're – based on my review of the – well, there were probably 17, or 18 common letters from

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different corners of the crypto industry. I think one of the things that's interesting and unique about DFAL is that it does allow for a certain harmonization with New York's bill licensing process. I think that was following some of the comments that came in on the original bills. I think at a high level, it is going to cover quite an array of digital financial asset business activity, whether you're exchanging, or transferring, or storing digital assets. It does have a pretty robust enforcement mechanism to it, giving the DFPI pretty extensive enforcement authority that I think they have flexed and continue to flex across their work at the state level.

I also think that similar to other licensing regimes, there are some exemptions in it that are entirely sensible, exemptions for banks and trust companies and other entities. A lot of the DFAL, I think, should be very similar to people who have studied the BitLicense regime. Without getting into too much detail, there are a number of stablecoin specific provisions, as you mentioned, Ethan, on different types of conduct requirements on licensees and service providers. For example, security and capital and holding, surety bonds and being beholden to the DFPI in terms of details of the form and the amount of that. Some of these provisions to me are very reminiscent of how we advise clients on BitLicense reuse.

Good to see another state making progress on these frameworks. I think that overall, that's a positive step. Of course, we still have a pretty fragmented system across the states. Unfortunately, for better or for worse, that's been one of the criticisms from the federal regulators here who don't really have much of a framework at all. That's a really interesting tension and maybe we can touch on that a little bit later.

Ethan Ostroff:

Alex, really interesting comments. I guess, two things. Number one, first, the name of your dog who is joining us on the podcast as well today, right? Is what?

Alex Barrage:

McDuff.

Ethan Ostroff:

McDuff. There we go. McDuff is now part of the podcast crew as well. I thought interesting looking forward perspective, right, is that if there really is all this perceived momentum on Capitol Hill to a comprehensive federal framework, applicable to digital assets, right, query whether or not that includes any type of preemption of state laws and whether or not you could have a law passed by Congress and signed by the president before any of these DFAL rules go into force, because now we're talking about a pretty extensive time period until January of 2026 before any of this stuff becomes operable. I just throw that out there as an interesting aside of what may be to come, right?

I thought it was also interesting that the DFPI has now gone through two separate sets of proposals and requests for comments. One of which just closed, I think, maybe about two or three weeks ago in middle of November. And just curious if you had any thoughts about that rulemaking process and when we might expect to get some rules.

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Alex Barrage:

I think you are right that there is some will at the federal level to have a broader framework around crypto. That's in and of itself a pretty broad statement, because there have been multiple attempts of trying to regulate stablecoins. There have been various attempts to repeal SAB 121. There have been in this current administration, different attempts to try and do that and there are different theories about whether you should have a stablecoin specific bill, or a payments bill, or a much broader infrastructure type bill. I don't know what that right answer is. But what I do know, what I have thought a lot about is with respect to the federalism question, the role of the federal government versus the states on payments, my view is that currently, we are very polarized in that discussion where you have federal government, Biden administration officials arguing for a full preemption model and then you have the states through the CSBS saying, we've been regulating issuers forever and we're the laboratories of innovation and why do we need a federal payments framework?

It's very polarizing. I'm interested in finding the connective tissue there, because I don't think either position will ultimately prevail, especially if we're looking at these issues from a bipartisan lens, which in my view, we ought to be. I'm interested in finding the version of federalism, it's called cooperative federalism, or marble cake federalism. It's this idea that the role of our federal and state governments are swirled like a marble cake. We should be thinking about hard problems from the perspective of sharing those hard problems and working together on them.

I think there is a role for, let's say, a state chartered DFAL entity with a license. Maybe that entity wants a master account. Well, if that entity wants a master account, they would have to apply to the Fed that that would have to be a viable path. Today, there really is no path for a stablecoin insurer to have that. But let's say there was. Well, then the tradeoff there is that you would have the federal government, maybe it's the RCC in the Fed or some combination. Monitoring and supervising and regulating that entity, the federal level. Maybe you could still have a role for a state-chartered entity. Maybe the state regulator focuses on consumer protection, or something else that is specifically delineated.

That's just one example where we should have some version of what we have in banking, which is dual banking, dual supervision, sometimes it overlaps. Why couldn't we imagine a similar system for payments? For entities that should choose which regulator they want depending on whether they want to scale, whether they want to offer a more limited, or a much broader set of financial services, whether they want access to the payment rails. I'm really interested in thinking through the tradeoffs with any one of those options, but not only having a state charter, or only having a federal charter. Because I just think there's so much friction and turf wars already that that feels like a non-starter to me.

Ethan Ostroff:

No, those are very interesting points. I mean, to me, I in my head think about the payments use case as its own bucket, right? That fits into the discussion you're having about having a master account, having access to the payment rails, right? Then there are so many other use cases for digital assets that fall outside of that payments use case. In my mind, I find it hard to believe that they're really going to pull these different use cases apart in the sense of having a federal law that's just for stablecoins, as opposed to being something part of a bigger, broader,

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comprehensive regime. It's going to be very interesting, I think, to watch, especially in the first Congress under the new president starting in January.

Alex Barrage:

I would say, as a general observation, reading some of the comments and the proposals out of the states is there is a theme of harmonization that comes out across the different responses, which is, we understand your need to regulate, please, can you not have conflicting requirements across your different regimes? Relisting through New York DFS is a good example of that, where California essentially recognizes that as a way to comply, so that you don't duplicate very similar processes, or had different standards. You have a relatively same playing field.

Regardless of the specific proposals that I have seen, I do think that that theme is super important, especially, if ultimately, we have a system where you have effectively the replica of dual banking. You don't want to build an opportunities for arbitrage, either across the different states, or between the states and the federal government. Ideally, you want something that is relatively homogeneous across each of those different systems. I don't know if others have seen that comment in their work, but it's definitely something that has jumped out.

Ethan Ostroff:

Yeah, it's interesting. One of the things that struck me is, and I don't know if you know, like how many entities have a BitLicense, right? It's not that many, right?

Alex Barrage:

It's probably less than 24.

Ethan Ostroff:

Those incumbents, if you will, have a leg up to operate under California's new regulatory regime once it goes into effect, right? I mean, they effectively have a moat that helps them, as opposed to their competitors. I've been curious and perhaps something worth tracking to see if companies are going to New York now to try to get a BitLicense for purposes of being compliant with California's new regulatory regime once it goes into effect, right? If that's the path to operating in both and having approval to operate in both as quickly as possible. Just something, I think, to think about and for our readers to consider if that's something worth keeping in the back of your mind as you're thinking about forward-looking and complying with a new regime in California.

Alex Barrage:

I wonder if it's any faster. It may not be.

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Ethan Ostroff:

It may not be, but it seems like, there's an avenue to be ready for when these rules come into place by going through the path that exists and has existed in New York, as opposed to waiting for the opportunity to start applying for licensure in California whenever that may open up, right?

Carlin McCrory:

I wanted to talk briefly about money transmission, because we know that some states have decided to regulate digital assets under their money transmission statutes. With this DFAL law, they're expressly excluding any money transmission associated with what is quoted as digital financial asset business activity, which is defined within the law. I won't go into the nitty-gritty specifics and read it to everyone. It's generally exchanging, transferring, or storing any digital financial asset. That activity will be excluded from money transmission licensure, which I think is important.

Ethan Ostroff:

Is that in the law, or is that in the proposed rules the proposed rule subpoena?

Carlin McCrory:

The proposed regs.

Ethan Ostroff:

Right. The proposed regs are thinking about that exemption, right? But that's not codified in the law. That's, I mean, to me, a big deal as to whether or not that actually gets into the final rules.

Carlin McCrory:

Oh, yeah. I agree that it would be. At present, though, I don't think California's money transmission laws encompass digital assets. Keith, you can correct me if I'm wrong, though.

Keith Barnett:

No, that's right. I mean, this proposal was actually consistent with all of the no-action letters that California has issued, saying that it does not regulate digital assets under its money transmitter law. That is primarily because California defines money as actual legal tender that is issued by a government. As we all know, typical cryptos are not issued by a government.

Ethan Ostroff:

Right. This exemption is really, in my mind, just taking something that industry participants know about through no-action letters and really formally putting it into the rule, right? Saying, what's already understood by the industry to be the operative guidance.

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Keith Barnett:

At least in California, yes. As Carlin mentioned, other states, though, expressly include digital assets crypto within their money transmitter laws for the purposes of payments. Carlin, did you have anything to add?

Carlin McCrory:

The other thing I wanted to note is this generally looks like some of the other requirements we've seen in federal laws when it comes to disclosures. Things that are required to be provided on the front end would be something like a schedule of fees and charges, whether the products are insured. Similar to REG-E, whether a licensee is liable for unauthorized, mistaken, or accidental transfers. A lot of this, it appears that they're pulling from other regs and things that we've seen. It's not completely outside of what we're seeing within the industry as the norm.

While we're on the topic of licensure, I want to note that the DFAL license does not replace any other licenses required under California law. Companies need to be sure if they're engaging in other sorts of activity that require a license in California, that they still need to have that license, except for this possibility of money transmission activities being excluded.

Keith Barnett:

Alex, turning it back to you, can you discuss how this law fits within the larger state framework?

Alex Barrage:

The default framework fits in within the other two state frameworks that we're aware of. That's the New York and the Louisiana frameworks. Louisiana gets less attention, I think, in regards to New York. On the one hand, it seems early for states to be doing these types of enactments. At the same time, the New York bill license has been around since 2014. We've been living with it for the better part of 10 years. It's certainly a reflection of the growth in the market in crypto. It's also, I think, an acknowledgement that states, or continuing to legislate and to try and, in each of their different ways, come up with a system that is uniform. The extent to which that has been completely successful, however, is up for question.

I think that, again, the California framework is reminiscent of other frameworks that we've seen and the extent to which more states can borrow from frameworks that crypto entities are familiar with, the more compliance costs will be reduced. We'll see if more states follow in the path of New York, Louisiana and California. I expect that they will, but of course, it might depend on where crypto falls within their broader money transmission regimes and other related policies. I'd wonder, do we expect more states to be doing what these three states have done already? Any thoughts on what's to come?

Ethan Ostroff:

I think it's a really interesting question to see if states are going to spend time and political capital being active right now, at least in the next year in this space. Or, if they're going to wait and see what happens, if anything, on the hill. I can imagine a lot of state legislators thinking that they have other things they'd rather prioritize while they see if the federal government is

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going to actually do anything in this space. At the same time, it seems like, if these regulations in California actually go into effect and you have these two states with behemoth economies, where you have these entities being licensed and functioning appropriately within the law, then perhaps, it becomes easier for other states in a couple of years to adopt very similar laws and do licensures through the MLLS, and it becomes another relatively seamless process.

Keith Barnett:

Well, I mean, I think part of the reason why California enacted this is because in the past, they had said, at least from the payments perspective, that money transmission is not digital assets, right? If you are engaging any type of crypto exchange, or anything like that, as long as it's both cryptocurrencies on both ends, that they're not going to regulate it. Other states on the other hand, have expressly regulated, or decided to regulate cryptocurrencies within their money transmitter statute. Those states may not follow this, because they already have a regime in place within their money transmitter laws.

Then secondly, you also got to keep in mind that CSPS put out the MTMA several years ago that many states have adopted portions of it, at least, if not whole cloth. There's an optional virtual currency part of that, right? Those states might elect to adopt the MTMA with the virtual currency piece baked into that. Those are just a couple of things to keep in mind. Turning it back to Carlin, do you want to discuss the requirements for digital asset kiosks?

Carlin McCrory:

Notably, there are various states that companies have to comply with for kiosks. The first was actually at the beginning of this year, where a kiosk operator has to provide the department with a list of all kiosk locations, where they operate within the state, and they also have to provide a customer with a receipt with specific information on transactions. Additionally, which I think we're going to hear from Ethan in a little bit on this point, they can't dispense, or accept more than \$1,000 in a day to or from a customer via kiosks.

Then beginning in January 1 of 2025, so this upcoming January, kiosk operators must provide pre-transaction disclosures to customers. They're also prohibited from collecting, in any single transaction, the greater of \$5, or 15% of the US dollar equivalent of the digital financial assets involved in the transaction.

Then lastly, these same kiosk operators will now need to comply with the licensing requirements that are slated to begin on July 1st of 26. Ethan, do you want to talk a little bit about a lawsuit regarding that \$1,000 daily cap?

Ethan Ostroff:

Interestingly enough, there was a lawsuit filed by the Alliance for the Fair Access to Cryptocurrency Terminals, and challenging the \$1,000 per customer per day crypto kiosk was raw limit as unreasonable and exceeding the legislature's authority. The Superior Court for Los Angeles rejected their argument and found that the cap on the daily transactions was a reasonable method for limiting fraud.

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Keith Barnett:

All right. Well, Ethan, Alex and Carlin, thank you for joining us today, and thank you to our audience for listening to today's episode. Do not forget to visit our blog, [TroutmanPepperFinancialServices.com](https://www.troutmanpepper.com), and subscribe so you can get the latest updates. Please be sure to also subscribe to this podcast via Apple Podcast, Google Play, Stitcher, or whatever platform you use. We look forward to the next time.

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