



STATE OF CALIFORNIA
FAIR POLITICAL PRACTICES COMMISSION
1102 Q Street • Suite 3000 • Sacramento, CA 95811
(916) 322-5660 • Fax (916) 322-0886

To: Chair Miadich, Commissioners Baker, Wilson, and Wood

From: Dave Bainbridge, General Counsel, Zachary W. Norton, Senior Counsel

Subject: Adoption of Proposed New Regulation 18421.2, Cryptocurrency Contributions

Date: July 11, 2022

Executive Summary

At the Commission's May meeting, staff presented research providing an overview of cryptocurrency, the traceability of cryptocurrency transactions, and the approaches that other jurisdictions have taken concerning campaign contributions in cryptocurrency. This included proposed options for amendment to the existing prohibition on cryptocurrency contributions. After receiving direction from the Commission, staff presents the proposed repeal of the existing regulation prohibiting cryptocurrency contributions, and the adoption of a new regulation, which would permit a person to make, and a committee to solicit, a contribution in cryptocurrency as an in-kind contribution through a payment processor.

Background/Overview

Law

Under the Political Reform Act ("Act")¹ "a contribution" is any payment made for political purposes without full and adequate consideration. (Section 82015.) The Act's definition of "contribution" also includes "in-kind" or nonmonetary contributions. Nonmonetary or in-kind contributions are items other than money, such as goods and services, provided free of charge to a candidate or committee, or at a discount from the fair market value not provided in the regular course of business to members of the public. (Section 82015(c).) The Act also imposes contribution limits on candidates for elected office and their controlled committees that vary depending on the particular office for which the candidate is running. (See generally chapter 5, article 3 of the Act.) Similarly, the Act prohibits contributions from certain sources, including foreign principals and lobbyists and prohibits anonymous contributions of \$100 or more from any source. (Sections 84304, 85320, and 85702.)

Additionally, Section 85201 provides that all contributions or loans made to a candidate, or the candidate's controlled committee, shall be deposited into a single campaign bank account. This is typically, referred to as the "one-bank account" rule.

¹ The Political Reform Act is contained in Government Code sections 81000 through 91014. All further statutory references are to the Government Code. The regulations of the Fair Political Practices Commission are contained in sections 18110 through 18997 of Title 2 of the California Code of Regulations.

Currently, Commission regulations prohibit contributions via cryptocurrency. In 2018, the Commission voted to prohibit the making and receipt of cryptocurrency contributions with the adoption of Regulation 18215.4.² In adopting the current regulation, the Commission expressed concerns about the traceability of cryptocurrency and how, as a result, cryptocurrency might be utilized to circumvent contribution limits and prohibitions on contributions by foreign principals.

Nine states, including California, prohibit cryptocurrency contributions. Twelve states, as well as the District of Columbia, expressly allow cryptocurrency contributions in some form. Some of these states treat cryptocurrency in the same manner as a cash contribution.

Staff provided relevant background regarding cryptocurrency and the cryptocurrency marketplace in its memorandum to the Commission, dated May 9, 2022, for the prenotice discussion. At the May Commission meeting, the Commission instructed staff to draft a version of the proposed regulation that allowed cryptocurrency contributions made through a payment processor, which converts cryptocurrency to U.S. dollars before transferring the amount of the contribution to the committee. These include specific requirements for the use of a U.S. based processor, and a requirement for instantaneous conversion of the cryptocurrency to U.S. dollars upon the making of the contribution. Staff has further refined the proposed regulation language consistent with this direction.

Payment Processors

Cryptocurrency payment processors facilitate transactions in digital currencies, similar to payment processors for credit card transactions. Cryptocurrency payment processors enable clients to accept digital payments and receive fiat currency immediately in exchange. They pay the client an amount equal to the digital currency's fair market value at the time of the transaction, and the cryptocurrency payment service instantly converts the payment into the currency of the client's choice, such as U.S. dollars. The money is added to that account with the payment processor and is deposited to the client's designated bank account in intervals decided on in the client's service contract. The client does not need a cryptocurrency wallet, and does not need to handle any cryptocurrency conversions when using a payment processor. Payment processors also implement some degree of know-your-customer ("KYC") protocol, therefore verifying the real-world identity of the customer making the payment in the transaction.

Regulation of Money Services Businesses and KYC Requirements Under Federal Law

The federal Anti-Money Laundering Act of 2020 codified prior Financial Crimes Enforcement Network ("FinCEN")³ guidance by making all transactions in "value that substitutes for currency" subject to reporting requirements and money transmitter registration

² Regulation 18215.4 states "[n]o contribution may be made or received in cryptocurrency."

³ FinCEN is a bureau of the United States Department of the Treasury that collects and analyzes information about financial transactions in order to combat domestic and international money laundering, terrorist financing, and safeguard the financial system from illicit use.

under the Bank Secrecy Act (“BSA”). The underlying requirements for KYC protocol are derived from this regulatory framework.

FinCEN’s regulations define the term “money transmitter” to include a “person that provides money transmission services,” or “any other person engaged in the transfer of funds.”⁴ Money transmission involves the acceptance and transmission of value that substitutes for currency by any means, transactions denominated in cryptocurrency are subject to FinCEN regulations.⁵ A money services business (“MSB”) is “a person wherever located” operating directly, or through an agent, agency, branch, or office, who functions as, among other things, a “money transmitter.”⁶ In general, cryptocurrency payment processing service providers will be money transmitters, and qualify as MSBs under the BSA, regardless of whether they accept and transmit the same type of cryptocurrency, or they accept one type of value (such as cryptocurrency) and transmit another (such as fiat currency). A transmittal of funds of \$3,000 or more (or its equivalent in cryptocurrency) may trigger certain requirements on a money transmitter or payment processor.⁷

The BSA and its implementing regulations require MSBs to develop, implement, and maintain an effective written anti-money laundering program that is reasonably designed to prevent the money transmitter from being used to facilitate money laundering and the financing of terrorist activities. The program must, at a minimum, include policies, procedures and internal controls reasonably designed to assure ongoing compliance, including verifying customer identification filing reports, creating and retaining records, and responding to law enforcement requests. Additionally, any business engaged in money transmission must register with FinCEN within 180 days of starting to engage in money transmission.⁸

The purpose of KYC rules required under this regulatory scheme are to reduce fraud by having businesses collect and verify data about customers. Traditional financial institutions use these measures when new clients open accounts. These measures include requests for identity data — such as driver’s licenses, SSNs, and other financial statements — verification, and the storage of this data to ensure compliance. These protections are also essential to guard against potential campaign money laundering.

Proposed New Regulation 18421.2.

Under this proposal, cryptocurrency contributions may be made in any amount not exceeding any applicable contribution limit. This regulation would require cryptocurrency contributions to be facilitated by a third-party, U.S. based, FinCEN registered, payment processor, which must take appropriate steps to verify the identity of the contributor, collect required contributor information, and immediately convert the contributions to U.S. dollars at the prevailing rate of exchange upon receipt and transfer the funds to the campaign bank account.

⁴ 31 CFR § 1010.100(ff)(5).

⁵ <https://www.fincen.gov/sites/default/files/2019-05/FinCEN%20Guidance%20CVC%20FINAL%20508.pdf>

⁶ 31 CFR § 1010.100(ff).

⁷ 31 C.F.R. § 1010.410(f).

⁸ 31 CFR § 1022.380.

Requiring committees to use a payment processor that collects the name, address, occupation, and employer of each contributor at the time the contribution is made and transmit this information to the committees within 24 hours of the time the contribution is made will help to ensure the true identity of the contributor is disclosed, and that committees are in possession of contributor information so that this information may be fully and truthfully disclosed in a timely manner. A committee may not accept any contributions from a contributor where the payment processor has not verified the identity of the contributor and provided the required contributor information to the committee.

This regulation would also make clear that the amount of the contribution is the fair market value of the cryptocurrency at the time the payment processor obtains possession of the contribution, as well as require that the cryptocurrency be converted to U.S. dollars upon receipt by the processor at the prevailing rate of exchange and that the funds be deposited into the committee's campaign bank account within two business days of receipt.

This regulation also specifies that for purposes of reporting cryptocurrency contributions, the contribution amount is the fair market value of the cryptocurrency at the time the payment processor obtains possession of the contribution, any charge incurred, or discount received, in the payment collection process must be reported in the same manner as credit card transactions.

This is consistent with the "one bank account rule," which generally requires all contributions to be deposited in, and all expenditures must be made from, a single designated campaign bank account. Requiring cryptocurrency contributions to be made through a third-party payment processor, the use of KYC protocol, and not allowing committees to hold cryptocurrency or maintain a wallet, alleviates some traceability concerns helping to ensure that campaign expenditures are "fully and truthfully disclosed" and that "adequate enforcement mechanisms" exist to verify that expenditures are properly reported.⁹

Education and Outreach

Staff will undertake efforts at education and outreach to ensure the public is aware of this change upon the adoption of this regulation. This will include providing a copy of Regulation 18421.2 to all people who have signed up for the Commission's Newly Adopted, Amended or Repealed Regulations mailing list, posting Regulation 18421.2 on the FPPC website on the new regulations page, and updating informational material on the website.

Attachments

Regulation 18215.5 (Repeal)
Proposed Regulation 18421.2

⁹ Section 81002.