



STATE OF CALIFORNIA
FAIR POLITICAL PRACTICES COMMISSION
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TITLE 2. FAIR POLITICAL PRACTICES COMMISSION

NOTICE IS HEREBY GIVEN that the Fair Political Practices Commission (the Commission), under the authority vested in it under the Political Reform Act (the Act)¹ by Section 83112 of the Government Code, proposes to adopt, amend, or repeal regulations in Title 2, Division 6 of the California Code of Regulations. The Commission will consider the proposed regulations at a public hearing on or after **May 16, 2024**, at the offices of the Fair Political Practices Commission, 1102 Q Street, Suite 3050, Sacramento, California, commencing at approximately **10:00 a.m.** Written comments should be received at the Commission offices no later than **5:00 p.m.** on **May 15, 2024**.

BACKGROUND/OVERVIEW:

Proposed amendments to Regulation 18237 and 18421.2 would clarify reporting requirements for cryptocurrency holdings. Regulation 18237 clarifies that cryptocurrency does not fall under the definition of “investment” for purposes of the Act and therefore need not be reported on statements of economic interests. Regulation 18421.2 would clarify that cryptocurrency campaign contributions should be reported as monetary contributions rather than “in-kind” or nonmonetary contributions because after the contribution goes through a payment processor, as required by the Regulation, the funds are received in U.S. dollars.

Currency (also referred to as “real” currency) as defined by federal regulations is “the coin and paper money of the United States or of any other country that is designated as legal tender and that circulates and is customarily used and accepted as a medium of exchange in the country of issuance.”² In contrast to real currency, “virtual” currency is a medium of exchange that operates like a currency in some environments, but does not have all the attributes of real currency. Virtual currency includes cryptocurrencies, such as Bitcoin. In particular, virtual currency does not have legal tender status in any jurisdiction, is not backed by a governmental body, and is entirely digital.³ Cryptocurrency is a digital, encrypted, and decentralized medium of exchange. There is no central authority that manages and maintains the value of a cryptocurrency. Instead, these tasks are broadly distributed among cryptocurrency’s users via the internet.⁴

Cryptocurrency can be exchanged in two ways; either directly, person to person, as a “peer to peer” transaction, or through an intermediary such as a cryptocurrency exchange or payment processor. A cryptocurrency exchange is a platform on which you can buy and sell cryptocurrency. Exchanges can be used to trade one crypto for or to buy cryptocurrencies using regular currency, like the U.S. Dollar. Exchanges reflect current market prices of the cryptocurrencies they offer.

¹ The Political Reform Act is contained in Government Code Sections 81000 through 91014. All statutory references are to the Government Code, unless otherwise indicated. The regulations of the Fair Political Practices Commission are contained in Sections 18110 through 18997 of Title 2 of the California Code of Regulations. All regulatory references are to Title 2, Division 6 of the California Code of Regulations, unless otherwise indicated.

² 31 CFR § 1010.100(m).

³ Department of the Treasury, Financial Crimes Enforcement Network, FIN-2013-G001

⁴ <https://www.forbes.com/advisor/investing/cryptocurrency/what-is-cryptocurrency/>

Exchanges can also be used to convert cryptocurrencies back into the U.S. Dollar or another currency on an exchange, to leave as cash within an account or withdraw to a user's regular bank account.⁵

A cryptocurrency payment gateway is a payment processor for digital currencies, similar to a payment processor for a credit card.⁶ Cryptocurrency gateways enable clients to accept digital payments and receive real 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. (*Ibid.*) 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. (*Ibid.*)

Most of payment gateway services are required to implement some degree of know-your-customer ("KYC") rules, therefore linking a real-world identity to addresses and transactions. KYC rules are a procedure for verifying a customer's identity. This is standard practice for financial institutions and financial service businesses, including banks, stockbrokers, and is now applicable to cryptocurrency exchanges.⁷ Customers typically need to provide during the KYC process: date of birth, Social Security number, and physical address. In addition, exchanges and payment processors also generally ask for a photo of valid government-issued identification, such as a driver's license, state ID, or a passport. (*Ibid.*) After a user provides the requested information, the exchange or payment processor will use that to verify the user's true identity.

Cryptocurrency holdings are highly volatile and unlike investments in stocks or bonds, cryptocurrency markets are unregulated and engage in short-term speculative trading.⁸ When a person purchases cryptocurrency they are not buying a security or ownership interest in a business. In this way, holdings of cryptocurrency are more similar to holdings of gold or foreign currency than investments in stocks or bonds.

Regulation 18237

Under the Act, an "investment" is: "any financial interest in or security issued by a business entity, including, but not limited to, common stock, preferred stock, rights, warrants, options, debt instruments, and any partnership or other ownership interest owned...by the public official...if the business entity... has an interest in real property in the jurisdiction, or does business or plans to do business in the jurisdiction, or has done business within the jurisdiction at any time during the two years prior to the time any statement or other action is required under this title." (Section 82034.) Section 82005 defines a business entity as "any organization or enterprise operated for profit, including but not limited to a proprietorship, partnership, firm, business trust, joint venture, syndicate, corporation or association."

⁵ <https://time.com/nextadvisor/investing/cryptocurrency/what-are-cryptocurrency-exchanges/>

⁶ <https://www.investopedia.com/tech/bitcoin-payment-services-introduction/>

⁷ See <https://www.investopedia.com/terms/k/knowyourclient.asp>

⁸ <https://www.fca.org.uk/investsmart/investing-crypto>

One of the main draws for purchasers of cryptocurrency is that the system is decentralized, placing the task of managing and maintaining the system on users, not a centralized authority, there is not one centralized “business entity” through which to purchase the cryptocurrency. When a person purchases cryptocurrency, they are not buying a security in a business, or an ownership interest, they are essentially making an exchange of one type of currency to another that is less stable and subject to constant changes in value. For that reason, staff believes that cryptocurrency is more akin to investing in gold, which is volatile and an exchange from currency to an asset that fluctuates constantly, and like gold, would not be an investment under the Act. If cryptocurrency is not an investment, then it need not be reported on statements of economic interests because it does not fall under any other reportable category.

Regulation 18421.2

Under the Act, a contribution is “a payment, a forgiveness of a loan, a payment of a loan by a third party, or an enforceable promise to make a payment, except to the extent that full and adequate consideration is received or if it is clear from the surrounding circumstances that the payment is not made for political purposes.” (Section 82015.) Contributions include tickets to events, the granting of a discount or rebate not provided to the public, and payments for personal services that benefit the candidate. (*Ibid.*) Contributions can be both monetary, as simple as a payment, and nonmonetary, like a discount or personal service.

As Regulation 18421.2 currently stands, if a contributor wishes to contribute cryptocurrency, they must send the payment through a payment processor that employs KYC procedures. As a result of this requirement, when the contribution is ultimately received by the candidate or committee it is received in U.S. dollars. However, Regulation 18421.2 currently requires the contribution be reported as nonmonetary. It has become apparent to staff that, in practice, these contributions act more as a monetary contribution than an in-kind or nonmonetary contribution because the committee or candidate receives a monetary sum after the conversion through a payment processor. Under the Regulation there is never a circumstance where the candidate or committee would receive a contribution that is an amount of cryptocurrency, like Bitcoin. Because the contribution comes to the candidate or committee through a processor and is received in U.S. dollars, staff believes it is more accurate to report these contributions as monetary contributions.

REGULATORY ACTION: Amend 2 Cal. Code Regs. Sections 18237 and 18421.2

Commission staff proposes amended Regulation 18237 and 18421.2 for adoption. Proposed amendments to Regulation 18237 are intended to make clear that cryptocurrency holdings are not considered investments under the Act. Proposed amendments to Regulation 18421.2 are intended to make clear that cryptocurrency campaign contributions should be reported as monetary contributions.

SCOPE: The Commission may adopt the language noticed herein, or it may choose new language to implement its decisions concerning the issue identified above or any related issue.

FISCAL IMPACT STATEMENT:

<u>Fiscal Impact on Local Government.</u>	None.
<u>Fiscal Impact on State Government.</u>	None.
<u>Fiscal Impact on Federal Funding of State Programs.</u>	None.

AUTHORITY: Section 83112 provides that the Fair Political Practices Commission may adopt, amend, and rescind rules and regulations to carry out the purposes and provisions of the Act.

REFERENCE: Government Code sections 82015, 82034 82025, 84211 and 84306.

CONTACT: Any inquiries should be made to Valerie Nuding, Fair Political Practices Commission, 1102 Q St., Suite 3050, Sacramento, CA 95811; email: vnuding@fppc.ca.gov; telephone (916) 322-5660; or 1-866-ASK-FPPC. Proposed regulatory language can be accessed at <http://www.fppc.ca.gov/the-law/fppc-regulations/proposed-regulations-and-notices.html>.