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Testimony of the Department of Commerce and Consumer Affairs

**Before the
House Committee on Consumer Protection and Commerce
Thursday, February 9, 2023
2:00 p.m.
Conference Room 329**

**On the following measure:
H.B. 1261, RELATING TO SPECIAL PURPOSE DIGITAL CURRENCY LICENSURE**

Chair Nakashima and Members of the Committee:

My name is Iris Ikeda and I am the Commissioner of Financial Institutions, Department of Commerce and Consumer Affairs (“Department”). The Department supports this bill with amendments.

The purpose of this bill is to establish a program for the licensure, regulation, and oversight of digital currency companies. Appropriates moneys.

Digital currency has grown in popularity and acceptance in this state, nationwide, and globally. There is, however, little regulation of the industry. The regulation that is available to states is through their money transmission laws, which do not adequately supervise companies and do not provide consumer protection.

Through the research conducted by the DFI and the Hawaii Technology Development Corporation (HTDC) in the Digital Currency Innovation Lab (DCIL), DFI learned that the current regulatory scheme of the money transmitter laws do not comport with the activities conducted by digital currency companies. The research

provided the catalyst for DFI to establish a new licensing scheme for the digital currency industry. This bill provides a new regulatory framework for digital currency companies.

If enacted, it will be the first license of its kind. Other states are taking different approaches with this industry, chartering as a bank with 100% back of fiat currency, chartering as a trust company, licensing as a money transmitter. Hawaii is the only state to specifically research activities on digital currency companies can craft a law for the industry. DFI realizes that this industry is still evolving and the provisions of the bill are somewhat generalized to attempt to be nimble with its supervision as the companies innovate.

The recent failures of digital currency companies like BlockFi, Three Arrows Capital, Voyager Digital, Celsius Network, and FTX to name a few, have illustrated the volatility of the units, how quickly a company can fail, and how consumers were left with nothing at the failure. Some of the companies in the DCIL were affected by the failures of those companies, but because of the structure of our oversight in the DCIL, few customers were hurt.

The three strongest aspects of the licensure law:

- (1) Provides licensing requirements consistent with our other industries,
- (2) Provides minimum regulatory policies like Anti-Money Laundering policy to identify illicit behavior, cybersecurity as activity is only over the internet, and privacy policies to protect consumers; and
- (3) Requires companies to maintain a strong financial standing, including holding permissible investments (liquid investments to cover units held).

The digital currency companies continue to innovate and DFI continues to meet with various stakeholders (Digital Currency Innovation Lab participants, industry association, consumers, state and federal regulators, and companies who transaction in digital currency).

DFI requests amendments to the bill to provide a more nimble supervision of the companies as the industry evolves. In addition, the DFI requests three permanent examiners to establish and implement the purposes of the special purpose digital

currency license. Attached is Appendix A, with the Department's proposed amendments.

The Department requests that this bill continue to move through the process as the Department is committed to providing a licensure scheme that will provide appropriate consumer protection while allowing companies to flourish.

Thank you for the opportunity to testify on this bill.

Appendix A

Add definition of "**Control**" means ownership of, or the power to vote, twenty—five per cent or more of the outstanding voting securities of a licensee or controlling person. For purposes of determining the percentage of a licensee controlled by any person, there shall be aggregated with the controlling person's interest the interest of any other person controlled by the person, or by any spouse, parent, or child of the person.

Add definition of "**Control person**" means an individual who directly or indirectly exercises control over a licensee or applicant.

Page 3, line 17, delete "digital units of exchange". Add "any type of digital representation of value"

Page 4, line 4, delete "Digital Units". Add "digital representations of value"

Page 17, line 2 should read "Federal Bureau of Investigation or [~~and~~] any governmental"

Page 40, line 16: insert: "Records, **Tangible** net worth requirement"

Page 41, line 14 -15 delete reference to "United States Postal Service" (may be a foreign address)

Page 43, line 15: change seven years to five years (industry request)

Page 43, line 18-19 – delete the words "hard copy"

Explanation – all advertising is conducted through the internet. DFI's examinations are also conducted through the internet.

Page 43, line 20 – change "script" to "transcript"

Explanation – typo

Page 60, line 4-5 delete "and has returned the original license issued." No paper license is issued.

Page 61 line 9: Add "investigation". Should read as follows: "make any investigation or examination authorized by this chapter; or"

Page 81, line 14 – delete "implement the licensing program established by this Act."

Add "establish and hire three full—time equivalent (3.0 FTE) permanent examiners, without regard to chapter 76, Hawaii Revised Statutes, to carry out the purposes of the special purpose digital currency license program established by section 2 of this Act; provided that the positions may be added to the position count for the division of financial institutions of the department of commerce and consumer affairs.

The sums appropriated shall be expended by the department of commerce and consumer affairs for the purposes of this part.

Explanation – to allow DFI to hire three FTEs to implement the licensing program.



Written Statement of
Len Higashi
Executive Director
Hawaii Technology Development Corporation
before the
HOUSE COMMITTEE ON CONSUMER PROTECTION & COMMERCE
Thursday, February 9, 2023
2:00 p.m.
Conference Room 329 and Videoconference

In consideration of
HB1261
RELATING TO SPECIAL PURPOSE DIGITAL CURRENCY LICENSURE.

Chair Nakashima, Vice Chair Sayama and Members of the Committee.

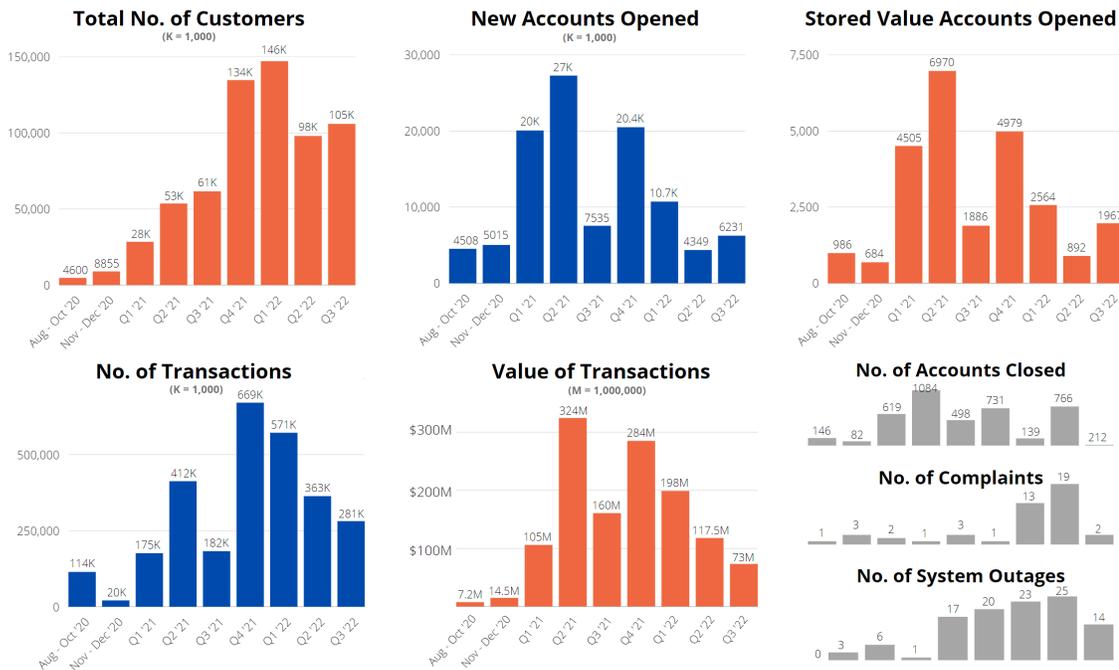
The Hawai'i Technology Development Corporation (HTDC) **supports** HB1261 that establishes a program for the licensure, regulation, and oversight of digital currency companies.

HTDC supports initiatives aimed at accelerating the adoption of new technologies. HTDC has partnered with the DCCA Division of Financial Institutions on a pilot project for digital currency which initiated in 2020 and has been extended to June 30, 2024. The goals of the program are to:

- * Create economic opportunities for Hawaii through early adoption of digital currency
- * Offer consumer protection by providing guidance to issuers of digital currency
- * Provide data to shape legislation supporting digital currency activities

There are currently 11 digital currency companies in the program. Data shows over 105,000 Hawai'i based customers currently participating with hundreds of millions of dollars transacted each quarter. HTDC has hosted 13 educational webinars on various topics, two roundtables with local financial institutions and crypto investors, formed an advisory group of local domain experts in crypto, and facilitated two pilot projects exploring the economic benefits of crypto for fundraising and Non-Fungible Tokens (NFT) for selling art. HTDC received 45 complaints from general Hawai'i based consumers during the span of the program. A summary chart of the data collected is provided below and can also be found on our website at

<https://www.htdc.org/digital-currency-innovation-lab/>

DIGITAL CURRENCY INNOVATION LAB


In 2022, the crypto currency market experienced major volatility due to the collapse of FTX Trading, Ltd., the 2nd largest crypto exchange in the world. The collapse underscored the need for government regulation for consumer protection. While the federal government works on creating uniform laws for the country, the bill offers Hawai'i residents some consumer protection through disclosures and some business safeguards. HTDC's interest and advocacy in crypto revolve around new, novel uses that leverage crypto such as Non-Fungible Tokens (NFT). HTDC supports this bill and defers to the Division of Financial Institutions on the technical aspects of the bill.

Thank you for the opportunity to offer these comments.



Feb. 9, 2023

2 p.m.

Conference Room 329 and Videoconference

To: House Committee on Commerce and Consumer Protection

Rep. Mark M. Nakashima, Chair

Rep. Jackson D. Sayama, Vice Chair

From: Grassroot Institute of Hawaii

Ted Kefalas, Director of Strategic Campaigns

RE: SB1261 — RELATING TO SPECIAL PURPOSE DIGITAL CURRENCY LICENSURE

Comments Only

Dear Chair and Committee Members:

The Grassroot Institute of Hawaii would like to offer its comments on [HB1261](#), an 80-page tome that would establish a program for the licensure, regulation and oversight of digital currency companies.

In general, this bill is a response to the proliferation of cryptocurrencies worldwide, and seeks to impose a wide array of regulations on cryptocurrency businesses operating in Hawaii.

One of the main problems with HB1261 is the vast and nearly unlimited powers over the cryptocurrency market it gives to the commissioner of the Division of Financial Institutions. Nearly every regulation in the bill has a caveat that would allow the commissioner to rewrite the law according to his or her will, which could centralize too much power in the hands of the commissioner and burden cryptocurrency companies with a high level of regulatory uncertainty.

Crypto companies would not be the only ones facing regulatory uncertainty, should this bill become law, however. Federal law and regulations governing cryptocurrencies are unclear and constantly in flux. For example, the Board of Governors of the Federal Reserve issued new rules on Feb. 6 that directed how cryptocurrencies could be used in the U.S. banking system.¹

¹ Alexandra Kelley, "[Federal Reserve Issues New Restrictions on Crypto Banking](#)," Nextgov, Feb. 7, 2023.

Ironically, this bill could itself create significant uncertainty for the commissioner too, as he or she attempts to implement it without contradicting federal rules. Meanwhile, the combination of state and federal uncertainty would serve to chill the cryptocurrency market in Hawaii, harming both operators and consumers.

The division's regulatory sandbox, on the other hand, provides crypto businesses with some degree of certainty. Extending the sandbox while waiting on clearer federal guidance might be the best bet.

However, should this bill move forward, Part II, Section 2, Subsection 9 should be retained. It provides that the proposed regulation would not apply to:

(9) Non-custodial digital currency business activity by a person using a digital currency:

(A) Acknowledged as legal tender by the United States or a government recognized by the United States; or

(B) That has been determined to not be a security by a United States regulatory agency;

This language would give cryptocurrencies an avenue to become recognized at the federal level and give the DFI commissioner a standard for determining which cryptocurrencies should be exempt from this licensure regime.

Thank you for the opportunity to submit our comments.

Sincerely,

Ted Kefalas
Director of Strategic Campaigns
Grassroot Institute of Hawaii



COMMENTS ONLY TESTIMONY OF
HB 1261: RELATING TO SPECIAL PURPOSE DIGITAL CURRENCY LICENSE

Rep. Mark M. Nakashima, Chair
Rep. Jackson D. Sayama, Vice Chair

House Committee On Consumer Protection & Commerce
329 Via Videoconference

Wednesday, February 9, 2023 at 2:00 PM

Dear Chair Nakashima and members of the Committee:

Chamber of Progress, a tech industry coalition promoting technology's progressive future, writes to provide comments on HB 1261, which establishes a program for the licensure, regulation, and oversight of digital currency companies.

Chamber of Progress supports public policies at the federal and state level that seek to build a fairer, more inclusive country in which all Americans benefit from technological leaps. We support the establishment of clear and transparent markets for consumers, so that companies can make decisions on product choice to the best of their abilities.

Consumers Deserve Transparency in the Digital Asset Marketplace

The past year was a turning point for the digital asset industry, as bad actors like FTX, Terra/Luna and a handful of others exited the marketplace due to fraud, bankruptcy and improper business models. It is clear after these major collapses this industry needs thoughtful regulation that gives companies clear rules of the road and gives consumers more confidence.

The licensure program that HB 1261 establishes will create the appropriate recordkeeping, risk mitigation and anti-money laundering (AML) standards for consumers to feel protected when transacting on the blockchain. This bill also includes important provisions that address current challenges in the industry around disclosures, customer deposits, and adequate reserves in the case of a bank run. With the majority of consumers storing their digital assets on exchanges¹, sections §14(c),(e) are imperative to safeguard digital assets from misappropriation or theft.

Hawai'i's Digital Asset Sandbox Allows For Responsible Innovation

We commend Hawai'i for establishing a regulatory sandbox in partnership with the Hawai'i Tech Development Corporation (HTDC)² to work with digital asset companies on establishing the best practices for full licensure in the state. HB 1261 would allow on-ramping of sandbox participants into full licensure, which is an innovative model that should be the standard for all states.

While we support the extension of the sandbox to 2024³, we suggest it remain indefinitely. Due to the emergence of new products and services in the digital assets space, it would be in Hawai'i's best interest to explore this new technology in a collaborative space with an on-ramp to licensure. Additionally, the sandbox could be structured to become an incubator for up-and-coming digital asset companies that have a net worth of less than \$500,000. The continued existence of the sandbox will ensure responsible innovation and keep digital asset companies stateside.

In addition to our recommendation above, we propose the following:

Clarify the definition of material change in §11(e)(2)

To provide certainty for companies creating new products and services, the "material change to information" should define a materiality threshold to include a product or service that would significantly alter the business model of the original license application. The material change should exclude product upgrades or innovative features of existing products and services approved in the license.

¹<https://www.binance.com/en/blog/all/binance-research-releases-first-ever-global-report-on-crypto-user-motivations-behaviors-and-preferences-421499824684901545>

² <https://www.htdc.org/digital-currency-innovation-lab/>

³<https://cca.hawaii.gov/blog/news-release-11-companies-continue-in-the-state-of-hawaiis-digital-currency-innovation-lab/>

We thank the authors for their leadership in establishing regulatory rules of the road and setting a precedent for thoughtful crypto policy. Cryptocurrency and other digital assets will benefit from regulatory clarity seeking to stimulate innovation and increase workforce development in blockchain technology.

Respectfully,

A handwritten signature in black ink, appearing to read 'JE', is positioned below the word 'Respectfully,'.

Janay Eyo
Director of Financial Policy
Chamber of Progress

HB-1261

Submitted on: 2/7/2023 1:53:36 PM

Testimony for CPC on 2/9/2023 2:00:00 PM

Submitted By	Organization	Testifier Position	Testify
Ryan Kawailani Ozawa	Individual	Support	Written Testimony Only

Comments:

As this bill continues the important and tireless work of Commissioner Iris Ikeda of the DFI to carefully and safely introduce cryptocurrency exchange activities in Hawaii—legislation that inexplicably died in conference committee last session—I support **HB1261**. Cryptocurrency will not go away, and while it is not a guaranteed investment vehicle (few things are), Hawaii residents should have the freedom to explore this emerging tech. With the requirements established by this bill, the people of Hawaii can have greater confidence in the soundness of licensed entities and adopt the level of risk they're willing to accept.

HB-1261

Submitted on: 2/6/2023 5:30:26 PM

Testimony for CPC on 2/9/2023 2:00:00 PM

Submitted By	Organization	Testifier Position	Testify
Victor K. Ramos	Individual	Support	Written Testimony Only

Comments:

SUPPORT: This is inevitable.