
SENATE COMMITTEE ON PUBLIC SAFETY

Senator Aisha Wahab, Chair

2023 - 2024 Regular

Bill No: AB 76 **Hearing Date:** July 11, 2023
Author: Davies
Version: May 25, 2023
Urgency: No **Fiscal:** Yes
Consultant: MK

Subject: *Money laundering: blockchain technology*

HISTORY

Source: CA Conference of Bar Associations

Prior Legislation: None relevant

Support: California District Attorneys Association; California State Sheriffs Association; Los Angeles County District Attorney's Office; Los Angeles County Sheriff's Department; Peace Officers Research Association of California (PORAC)

Opposition: None known

Assembly Floor Vote: 80 - 0

PURPOSE

The purpose of this bill is to expand anti-money laundering statutes to cover virtual assets using blockchain technology.

Existing federal law prohibits a person, in part, from conducting certain financial transactions knowing that the property contains proceeds of unlawful activity if they did so to facilitate such unlawful activity or to disguise the illicit origins of the proceeds. (18 U.S.C. § 1956 (a)(1)(A)(i) & (a)(1)(B)(i).)

Existing federal law prohibits a person, in part, from conducting certain financial transactions involving property represented by law enforcement to be derived from illicit activity, as specified. (18 U.S.C. § 1956 (a)(3)(A) & (a)(3)(B).)

Existing federal law defines, a “financial transaction,” in part, as a transaction which in any way or degree affects interstate or foreign commerce, or involves the movement of funds by wire or any other means. (18 U.S.C. § 1956 (c)(4).)

Existing federal law defines “specified unlawful activity,” as certain racketeering offenses, certain offenses related to controlled substances, certain extraditable offenses, among other things. (18 U.S.C. § 1956 (c)(7).)

Existing law prohibits a person from conducting, through a financial institution, one or more transactions of specified amounts of monetary instruments over certain periods of time, in order

to facilitate criminal activity or knowing that the monetary instruments are derived from criminal activity. (Penal Code § 186.10 (a).)

Existing law defines a “financial institution” to include, when located or doing business in this state, a national bank, state bank, savings and loan association, foreign bank, brokers or dealers in registerable securities, businesses dealing with money orders, investment bankers, insurers, gold or other specified mineral dealers, pawnbrokers, persons involved in transferring titles of real estate and certain other properties, and specified gambling establishments, among other things. (Penal Code § 186.9 (b).)

Existing law defines “monetary instrument” as, among other things, any currency or coin, bank check, cashier’s check, money order, stock, investment security, gold and other specified minerals. Excludes personal checks under certain circumstances. (Penal Code § 186.9 (d).)

Existing law defines “criminal activity” as a criminal offense punishable by death, state prison, imprisonment in county jail pursuant to criminal justice realignment, or an offense committed in another jurisdiction punishable by death or a term of imprisonment exceeding one year. (Penal Code § 186.9.)

Existing law states that money laundering is punishable by as an alternate misdemeanor or as a felony under realignment, unless the transaction exceeds certain amounts, in which case additional terms of imprisonment will be imposed. (Penal Code § 186.10 (c).)

Existing law prohibits a person from possessing money or negotiable instruments exceeding a specified amount, knowing that the moneys are the result of illicit controlled substance-related activity. (Health & Saf. Code § 11370.6)

Existing law prohibits a person from engaging in a specified type of transaction involving proceeds known to derive from certain controlled substance-related violations, with the intent to disguise the source of the proceeds. (Health & Saf. Code, § 11370.9.)

This bill expands the prohibition on money laundering to cover digital assets that use blockchain technology.

This bill defines “digital asset” as any asset that is purely digital or is a digital representation of a physical asset.

This bill defines “blockchain technology” as a “distributed digital ledger of cryptographically signed transactions grouped into blocks, where each block is cryptographically linked to the previous one after validation and undergoing a consensus decision.”

This bill makes technical, non-substantive updates.

COMMENTS

1. Need for This Bill

According to the author:

California is a leader in consumer protection and ensuring our laws reflect the growing and innovative technology used for day-to-day transactions. This technology has continued to evolve to now include cryptocurrency. AB 76 is a

common-sense measure to strengthen our state’s money laundering statutes and close the current loophole that permits the laundering of assets using cryptocurrency. It should also be noted that as we have seen a rise in drug trafficking, nefarious organizations are using this type of currency to escape detection and continue their illegal activities in the underground markets. California law must evolve to keep up with the digital operating methods of financial criminal organizations.

2. Money Laundering and the Rise of Virtual Assets

Most individuals generally think money laundering refers to the process by which criminals try to disguise illegally-gained financial assets in a manner such that the assets appear to come from a legal source. However, California’s anti-money laundering laws prohibit more than just trying to conceal the nature of ill-begotten assets. (Penal Code § 186.10 (a).) State laws prohibit certain transactions simply if a person knew the assets were derived from criminal activity or if they conducted the transaction with the intent to facilitate a criminal activity. (*Id.*) Currently, state law specifies that US and foreign currency, checks, money orders, gold, emeralds, stocks, investment security, and other types of financial assets are “monetary instruments” and prohibits a person from laundering those items. (Penal Code § 186.9 (d).) This bill would include digital assets, as defined, into California’s anti-money laundering statutes.

The author and supporters believe this update is needed because over the past few years, virtual assets such as bitcoin and non-fungible tokens (NFTs) have risen in use for both legitimate and illegitimate purposes. The rise of virtual assets in general has left governments playing catch-up to try and regulate this new technology. (Department of Treasury. *National Money Laundering Risk Assessment*. (Feb. 2022) (hereafter *ML Risk Assessment*) <https://home.treasury.gov/system/files/136/2022-National-Money-Laundering-Risk-Assessment.pdf> [as of Feb. 7, 2022] at pg. 40-41.) Although the use of virtual assets for money laundering remains far below traditional methods in volume, law enforcement agencies in the U.S. have recently detected an increase in virtual assets being used to pay for online drugs or to launder proceeds of drug trafficking, fraud, and cybercrime, among other offenses. (*ML Risk Assessment* at 41.) For example, the US Government Accountability Office (GAO) found that 15 of the 27 online commercial sex marketplaces they examined accepted virtual currencies. (GAO. *As Virtual Currency Use in Human and Drug Trafficking Increases, So Do the Challenges for Federal Law Enforcement*. (Feb. 24, 2022) <https://www.gao.gov/blog/virtual-currency-use-human-and-drug-trafficking-increases-so-do-challenges-federal-law-enforcement> [as of Feb. 9, 2023].)

One of the first issues in discussing virtual assets is conceptually understanding and using the appropriate terminology. A virtual asset can include bitcoin and similar digital coins, which are regarded as “cryptocurrency” and are generally defined as a digital asset/unit within a system, which is cryptographically sent from one blockchain network user to another by using digital signatures. (U.S. Dept. of Commerce National Institute of Standards and Technology (NIST) *Glossary: Cryptocurrency*. <https://csrc.nist.gov/glossary/term/cryptocurrency> [as of Feb. 7, 2023].) Most cryptocurrencies rely on a “blockchain” to conduct their transactions. (LA Times. *A beginner’s guide to cryptocurrency*. (Dec. 24, 2021) (hereafter *Crypto Beginner’s Guide*) <https://www.latimes.com/business/technology/story/2021-12-24/a-beginners-guide-to-cryptocurrency> [as of Feb. 8, 2023].) A blockchain is essentially a network of computers that store and update permanent digital records of every transaction on the network. (*Id.*) Blockchain uses cryptography, a mathematical technique that turns information into unbreakable codes, to

ensure bitcoins are not spent more than once and allow for the computers on the network to keep identical and immutable records. (*Id.*) That being said, the future of cryptocurrency may not always be tied to the blockchain system, alternative cryptocurrencies using Directed Acyclic Graphs or Cloud services are already in existence. (TechTarget. *6 alternatives to blockchain for businesses to consider.* (May 25, 2021) <https://www.techtarget.com/searchcio/feature/6-alternatives-to-blockchain-for-businesses-to-consider> [as of Feb. 6, 2023].)

Although cryptocurrencies are the most prominent of virtual assets, a virtual asset can also, although not always, include an “NFT.” (*FATF Update* at pg. 24; US Internal Revenue Service. *Digital Assets.* <https://www.irs.gov/businesses/small-businesses-self-employed/digital-assets#:~:text=A%20digital%20asset%20that%20has,to%20as%20convertible%20virtual%20currency>. [as of Feb. 7, 2023].) An NFT is generally defined as a virtual asset that is unique, rather than interchangeable, and in practice is used as a collectible, however, its classification can vary depending on the circumstances of its use. (*Id.*)

As such, a “digital” asset has been defined in various ways depending on the government or agency involved, but one of the most prevalent definitions is, “a digital representation of value that can be digitally traded, or transferred, and can be used for payment or investment purposes... [not including] digital representations of fiat currencies...” (*FATF Update* at 109.) This bill would expand California’s money laundering statutes to cover instances where criminals conduct transactions using digital assets based on blockchain technology, if they knew that the digital assets are derived from the proceeds of criminal activity or if they intended to facilitate a criminal activity.

3. Argument in Support

The Los Angeles District Attorney’s Office supports this bill stating:

AB 76 would modernize California’s money laundering statutes to cover instances where criminals conduct transactions using virtual assets based on blockchain technology, if they knew that the virtual assets are derived from the proceeds of criminal activity or if they intended to facilitate a criminal activity. AB 76 would also update California’s money laundering statute to cover a transaction that uses virtual assets to go through a financial institution, and so would cover P2P transactions.

Given the rise of illegal cryptocurrency transactions that can bypass the traditional scrutiny of more traditional financial institutions, it is important that California’s money laundering statutes be updated to take this new technology into account. It is estimated that last year there was over \$20 billion in criminal cryptocurrency transactions. Given this rise there is no legal or policy reason not to close the loophole in existing law that allows criminal activity to take place. Why should California’s money laundering statute cover government-backed currencies, checks, money order, and certain kinds of transferable assets, such as precious metals, gems, and securities but not include digital assets, like cryptocurrencies and NFTs?

Because AB 76 closes loopholes in our money laundering statutes our Office is pleased to support AB 76.