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Via Email

New York State Department of Financial Services
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Re: BitLicense Hearing Jan 28-29, 2014

I. Introduction

Coinbase, Inc. (Coinbase) appreciates the opportunity to participate in the NYS DFS Bitcoin Hearing on January 28 and 29, 2014. Per your request in advance of that meeting, below are responses to the introductory set of questions posed via email.

II. Responses to Questions

1) The feasibility of the Department issuing a 'BitLicense' specific to virtual currency transactions.

Coinbase supports the issuance of a BitLicense: we believe it will help protect consumers and lend credibility to the digital currency industry. In doing so, it's important clearly define who needs a license and what is required of the licensee. Some reasons this is particularly challenging in the Bitcoin world are:

- by nature the Bitcoin protocol is designed to be a peer to peer system whereby users can transact with each other without any intermediary, similar to meeting someone in person and handing them cash. Thus, requiring a license in order to conduct Bitcoin to Bitcoin transfers would not be feasible.
- Bitcoin can be mined; some users receiving Bitcoin (and at times holding large quantity of Bitcoin) may be miners and thus, are not acquiring Bitcoin from another

party. While it could be possible to require miners to register, many of these miners reside in global markets outside the U.S.

We respectfully request that the Department clarify what activities would be covered by the BitLicense versus a money transmitter license and if any entities holding a BitLicense may also be required to obtain a money transmission license under any circumstances. While we hope that the BitLicense would supersede the need for a money transmission license, we request that should both be required then at a minimum the process for obtaining the corollary is streamlined and does not create unnecessary burden on the applicant.

2) What specific types of virtual currency transactions and activities should require regulation?

There are two services we believe are the most appropriate for regulation, which in many cases may go hand in hand:

- Storing of digital currency on behalf of other parties, particularly if the entity that is storing such Bitcoin has taken hold of the private keys controlling access. In this instance the entity storing the funds should be required to ensure that tight security controls are in place to keep the Bitcoin (private keys) safe. By extension, companies who facilitate the buying and selling of Bitcoin, if they hold the Bitcoin of someone else for some period of time, should be required to obtain a license.
- As in current money transmitter statutes, a service with stored value account of fiat currency component (ex: United States dollars) then used to conduct digital currency transactions should be required to obtain a license.

Further to this point, in FinCEN's March 18, 2013 Virtual Currency Guidance it was stated that "A user of virtual currency is not an MSB under FinCEN's regulations and therefore is not subject to MSB registration, reporting, and recordkeeping regulations. " The nature of the bitcoin protocols allows for peer to peer transactions to occur without the involvement of any 3rd party. Thus, in considering creation of a BitLicense it is important to ensure that regulation does not become incumbent upon the general population and that it does not disincentivise the use of 3rd party services, who can provide tremendous value to consumers in facilitating and securing Bitcoin transactions.

3) Should entities that are regulated be required to follow specifically tailored anti-money laundering guidelines?

Entities who are regulated under a BitLicense should fall within FinCEN's definition of an MSB and thus, should be required to comply with anti-money laundering guidelines. In the digital currency space, we believe AML controls should focus on the purchase and sale of bitcoin, when "placement" and "integration" stages of money laundering occur.

4) Should entities that are regulated be required to follow specifically tailored consumer protection guidelines?

Bitcoin operates very similarly to cash in that:

- It can be transferred between parties with no intermediary.
- It is "irreversible" from a technology perspective; funds cannot be pulled back once they have been sent.

Any 3rd party holding the private keys to consumer's Bitcoin should be required to have reasonable security in place to prevent loss. Outside of that, we believe there will be a number of developments in the area of consumer protections over the coming years such as rating systems, consumer reporting capabilities, dispute resolution systems, etc. and that the best approach is to let the market further develop before imposing specific procedures on this topic.

5) Should entities that are regulated be required to follow specifically tailored regulatory examination requirements?

It is reasonable to require regulatory oversight in the form of an examination, and we recommend that both the examination guidelines and process be standardized across States and offered on a joint State (or Federal) basis.

6) The benefits and drawbacks of using virtual currency from a retail perspective.

It's important to separate the ecommerce (remote payment) space from the point of sale (proximity payment) space when talking about retail payments.

In the online space, there are significant benefits for merchants accepting Bitcoin:

- Fees. Bitcoin was created to optimize Internet payments: it is a fast, inexpensive, secure way to transact. The result for merchants and consumers is that because the number of "middle men" is significantly reduced, Bitcoin payments can be processed at a much lower cost, in the range of 1% or less, whereas a traditional card payment would typically cost 2x to 5x times greater. The cost of processing payments for

Internet merchants is often a large expense; Bitcoin has the capability of reducing this expense and offering merchants the ability to pass along such savings to the consumer.

- Fraud. Bitcoin payments are typically done via a “push” method, whereby the consumer is sending the payment to the merchant, as opposed to the merchant initiating the payment by drawing funds from the consumer’s account or billing their credit card. In order to make a Bitcoin payment, one must have access to the private key associated with the Bitcoin. At Coinbase, we have had a significant focus on securing these private keys such that 97%+ of the Bitcoin we hold for customers never touches the internet and thus, would be extremely difficult to compromise. For these reasons, unauthorized payment transactions, the most common type of fraud on the Internet, are and we believe will continue to be much lower in the Bitcoin world.
- Global acceptance. Accepting payments globally is large, complex challenge for any merchant. Bitcoin helps merchants expand their global footprint without complexities of foreign exchange.
- Unbiased. Any person or entity, whether banked or unbanked, can hold bitcoin.
- Public transaction ledger. Bitcoin transactions are recorded in a “block chain” and each is verified by the bitcoin mining community. The block chain provides valuable information on the source of funds and will play an integral role in law enforcement’s ability to prosecute cases for bad actors.

Drawbacks of bitcoin include :

- Fluctuations in Bitcoin exchange rates. This is a problem we believe will be dampened and largely solved over time.
- Consumer education and awareness: consumers are not yet trained in how to think about payments in a Bitcoin denomination, how to keep their private keys safe and how payments must be made with caution similar to that used when paying in cash.

We expect the above drawbacks will decrease over time, as the price of Bitcoin stabilizes and becomes more mainstream. Nevertheless, the Coinbase service has been designed to help mitigate these risks by simplifying the consumer experience and by allowing merchants to continue to price and be paid for goods in a fiat currency denomination.

The same pros and cons exist in the proximity payments space, though they are less pronounced.

7) Pricing, volatility and security of the virtual currency market from an investor perspective?

The fluctuating price in Bitcoin has created an opportunity for investors, and many of the people holding Bitcoin today are doing so because they believe there is potential for the price to rise in the future. Of course, with the volatility in price comes risk and any investment made in Bitcoin should be done only after careful consideration and research on the part of the investor.

We continue to think there will be volatility in the price during the near term, though as the number of bitcoins in circulation increases we would expect the price volatility to decrease.

With respect to security, any investor holding Bitcoin should understand their options on how to keep their bitcoin secure, and any party holding Bitcoin on behalf of another party should be held to security standards to prevent loss.

8) The future expectations and anticipated developments of the virtual currency market from an investor and retail perspective.

We believe that over time the benefits of having a payment option with less friction and lower fees will allow new types of businesses and a more competitive marketplace to develop which will in the end benefit consumers.

III. Closing Remarks

We thank you very much for the opportunity to participate in the NY DFS BitLicense Hearing. We believe issuance of a BitLicense could help legitimize digital currency as a payment method and ensure payment processors, wallet holders and other bitcoin related companies are operating under a standard set of rules. In that vein, we are supportive of issuing a BitLicense that is tailored to the digital currency space, and are happy to participate in any future discussions on this topic.

Respectfully submitted,

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