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CHAMBER OF DIGITAL COMMERCE

August 18, 2014

Superintendent Benjamin M. Lawsky
New York State Department of Financial Services
One State Street
New York, NY 10004-1511

Dear Superintendent Lawsky:

The Chamber of Digital Commerce is a trade association representing the digital currency and digital asset industry. Recently founded on July 19, 2014, its mission is to promote the acceptance and use of digital currencies and assets.

This letter provides comments on your department's (hereinafter, the "NYDFS") Proposed Rulemaking on the Regulation of the Conduct of Virtual Currency Businesses, which was published in the July 23, 2014 issue of the New York Register (hereinafter, the "BitLicense Proposal").

The BitLicense Proposal raises some very serious concerns. If adopted as is, the proposal will require companies with only tenuous connection with New York to obtain a license, impose blunt rules to solve imaginary risks, potentially cripple innovation with prohibitive compliance costs, and possibly severely injure the New York tech sector. Fundamentally, the proposal treats the virtual currency industry as a mature space where the "usuals" and the "long-settled" roam, while the opposite is true. As entrepreneurs race to unlock the potential of virtual currency and the underlying blockchain technology, no one can be sure about the landscape of the industry years into the future and future attendant risks. Forcing a fine-grain

framework at this time would amount to a self-deceiving gesture flung in the face of a fledgling vulnerable industry.

By way of this letter, we urge the NYDFS to (i) reconstruct the definitions of "virtual currency" and "virtual currency business activities" in the proposal to avoid committing an egregious act of regulatory overreach, (ii) include a safe haven provision for start-ups, (iii) make use of existing federal regulatory frameworks when possible, (iv) remove provisions that stymie innovation without apparent justification and (v) make much more extensive efforts to learn from the most highly respected experts in this sector as to what regulations would be beneficial to society and which portend a high likelihood of social and economic damage. While further hearings would very much be in order, a more collegial approach in educating your office would prove of great value. The Chamber would be honored to help facilitate that.

1. The BitLicense Regulation Should Not Apply to Businesses That Store or Transmit Virtual Currency and Do Nothing Else.

Commercial banks and traditional money transmitters are natural choke points for anti-money laundering and counter-financing of terrorism ("AML/CFT") regulators because criminals must rely on financial intermediaries for digital transfer of fiat funds. In contrast, users choose to transmit virtual currency through intermediaries as a matter of convenience, not necessity. Criminals have no need to expose themselves to businesses that offer only virtual currency storage and transmission because these tasks are feasible with personal computers. Regulation of such businesses will be costly and futile, valuable resources of your office will be spent on the monitoring of the least risky group of users. On the other hand,

businesses that offer fiat to virtual currency or virtual currency to virtual currency conversion are far better subjects for AML/CFT regulations because criminals likely have to rely on such businesses to further financial crimes.

Nor does customer protection justify regulation of businesses that merely store and transmit virtual currency. Unlike banks, which act as bookkeepers, businesses that store customers' virtual currency (i.e. wallets) are data custodians. They are not principally different from data storage providers such as Amazon, Apple, DropBox and Google, all of which virtual currency users utilize, and will continue to utilize, for the storage of virtual currency. There is no reason why an online wallet provider should be required to obtain a BitLicense. Amazon, Apple, DropBox and Google do not, nor should they be required to do so. This represents a severe discrepancy and an inequitable provision.

In any case, the market already is addressing the real problems surrounding the protection of customer virtual currency. For example, the new generation of virtual currency businesses is deploying multi-sig addresses, a technology that logically prevents unauthorized access to customer virtual currency. With multi-sig, customers of a wallet provider have no need to trust that the business will comply with legal rules — their virtual currency will remain safe even if the business has been compromised or no longer exists. This market-driven solution is far superior to what regulation can achieve.

Finally, businesses that merely store or transmit virtual currency are often the most creative in the industry because they tend to explore the non-financial uses of the blockchain technology, including secure communication, decentralized file

storage, and self-executing contracts. Onerous regulation, such as that provided by the proposed BitLicense regime, on these businesses runs high risk of stifling this innovation or excluding New York from this significant emerging arena.

We hereby request the NYDFS to exclude businesses that merely store or transmit virtual currency from licensing requirement. Regulation of such businesses tends to be futile and inferior to market solutions, and will transform the NYDFS from a financial regulator to an information censor. That said, the Chamber would not oppose risk disclosure requirements for storage/wallet providers. **The BitLicense Regulation Should Exempt Small Businesses.**

Start-ups are hotbeds for innovation; they often keep larger players on their toes by offering superior products at lower prices. The regulator of a market should avoid building any artificial barrier to entry. Artificial barriers to entry so will deter intelligent minds from developing interest in the market, make existing players complacent and hurt consumers.

Acknowledging the benefits of start-ups for market efficiency and job creation, New York legislature specifically requires New York agencies, including the NYDFS, to accommodate small businesses when proposing rules — the NYDFS is required by Section 202-B of the New York Administrative Procedures Law to utilize "approaches that will accomplish the objectives of applicable statutes while minimizing any adverse economic impact of the rule on small businesses." The New York Financial Services Law further requires the NYDFS to foster the growth of the financial industry in New York through "judicious" regulation.

Unfortunately, the BitLicense Proposal is by no means judicious. The proposal does not adopt graduated compliance requirements or offer phase-in timetables that reflect resources realistically available to small businesses, or exempt small businesses from coverage (subject to reasonable protection of public welfare, much of which can be achieved through prominently published disclaimers).

We hereby request the NYDFS to include in the final BitLicense regulation a small business exemption that waive the licensing requirement for business with total assets below a threshold amount. The NYDFS may consider setting the threshold amount in consultation with recognized experts and industry representatives

The BitLicense Regulation Should Rely on Existing Federal Regulatory Frameworks.

The NYDFS relies on the federal framework for AML/CFT regulation of New York-licensed banks and money transmitters. See Section 116.2 of the General Regulations of Banking Board and Section 416.1 of Superintendent's Regulations. It is puzzling why the department refuses to do the same for virtual currency businesses and chooses instead to create a parallel regime. This is, at best, cumbersome and likely redundant, wasting valuable agency resources.

The AML/CFT regime in the BitLicense Proposal would require virtual currency businesses to report suspicious activity to both FinCEN and the NYDFS. The regime also requires virtual currency businesses to report any virtual currency transaction in excess of $10,000 in value, which FinCEN does not require virtual currency businesses to do. See http://www.fincen.gov/news_room/speech/html/20140318.html. These reporting

requirements will impose significant daily overhead costs on operationally lean virtual currency businesses and generate voluminous submissions, which the department is unlikely to have the staff to review. That outcome cannot be considered judicious.

We hereby request the NYDFS to revise Section 200.15 of the BitLicense Proposal such that the section relies on the FinCEN AML/CFT framework. A state level AML/CFT framework for virtual currency businesses is unnecessary. Relatedly, we also suggest the NYDFS to revise Section 200.19 of the BitLicense Proposal in light of the recent announcement by the Consumer Financial Protection Bureau ("CFPB") that it will work with virtual currency businesses to resolve consumer complaints. The BitLicense regulation should not contain a consumer protection regime that DFS will find extraordinarily burdensome and that overlaps or conflicts with the existing or future regulations of the CFPB.

2. Virtual Currency Businesses Should Have the Freedom to Invest.

The BitLicense Proposal's restriction on virtual currency businesses' investment freedom is unreasonable given the proposal already prohibits licensees to engage in any fractional banking-like behaviors. With full reserve, customers are guaranteed to be made whole even if they rush to withdraw at the same time. There is therefore no justification to dictate how virtual currency businesses should invest their proprietary funds.

We hereby request the NYDFS to strike or substantially limited Section 200.8(b) of the BitLicense Proposal. A virtual currency business should be able to

freely invest its profits if it maintains full reserve of customer properties in the same form and amount as owed to the customers.

3. Virtual Currency Businesses Should Have the Freedom to Innovate.

The virtual currency industry is not a mature commercial space in which participants follow largely settled business models, offering well-understood products and services and observe customary standards. Far from it. Start-ups in the industry must frequently realign business plans in response to rapid technological evolution and changes in consumer demand.

The NYDFS places a shackle on its licensees by requiring them to obtain the department's prior written approval before offering any new product or making any material change to existing products. This can be fatal as BitLicense holders may have to wait in agony as competitors poach their customers with new products and services. Moreover, it is dubious that NYDFS has, or can be expected to develop, the technical and business sophistication to make quick and astute decisions as to product development.

We hereby request the NYDFS to strike or substantially limit Section 200.10 of the BitLicense Proposal to permit virtual currency businesses to innovate as they see fit. If Section 200.10 is adopted without change, the NYDFS will effectively become a phantom managing director of each virtual currency company it regulates. Having a regulator calling the shots in the marketplace, rather than protecting consumers, would cripple any industry and would take NYDFS far outside its competence and appropriate role as regulator.

4. The "Existing Exchange Services" Exemption Discriminates Against Non-New York Persons.

The BitLicense Proposal exempts "[p]ersons that are chartered under the New York Banking Law to conduct exchange services and are approved by the superintendent to engage in virtual currency business activity" from the licensing requirement. Setting aside the fact that "exchange services" is undefined in the BitLicense Proposal, such exemption inequitably, and quite likely unconstitutionally, favors businesses that are chartered by New York over those chartered by other states. The exemption may therefore violate the Privileges and Immunities Clause of the U.S. Constitution.

The exemption also creates an impression of impropriety that it may have been dictated by incumbents of the financial industry. It is, of course, essential for officials to avoid even the appearance of impropriety.

We hereby request the NYDFS to strike Section 200.3(c)(1) of the BitLicense Proposal.

Conclusions

While the NYDFS expects virtual currency businesses to adopt a "risk-based" approach for compliance efforts, it has failed to do the same with this indiscriminate BitLicense Proposal. It is unjustifiable that out-of-state and foreign businesses, which impose minimal risks for New Yorkers should be licensed by new York, and why small virtual currency start-ups should be regulated in substantially the same way as the largest businesses in the industry.

Virtual currency, including Bitcoin, is powered by public ledgers. These transparent, open ledgers log every transaction and trace every move providing an abundance of transactional and balance data that have never before been available in an industry. Similar to how the industry responded to the need for customer asset protection with the elegant multi-sig invention, members of the industry are already addressing some of the same issues that the NYDFS concerns itself with, such as ensuring the solvency and sufficiency of reserve of virtual currency businesses. Their public ledger-empowered solutions will be far more effective and cost efficient than the blunt tools proposed by the NYDFS, which were developed at a time when it was impossible to enable public audits without harming competitive advantages and without the need to trust financial statements released. The NYDFS should allow the industry to self-regulate with these and other superior technological solutions instead of forcing archaic rules that do not work for traditional financial institutions, and will not work for virtual currency businesses.

The NYDFS has first-hand knowledge of jurisdiction shopping. The Department has long competed with the Office of the Comptroller of the Currency and other states for bank charter applicants. Just like banks, virtual currency businesses will forum shop. No rational business will choose the BitLicense jurisdiction if it entails foregoing the rights to innovate and invest, permits the NYDFS to micro-manage its products, and exhausts valuable attention and capital on heavy compliance overhead.

Under such a regime virtual currency businesses are likely to set up screens to deny access from New York and incorporate multifaceted procedures to turn away

New York customers, both upon account opening and as an ongoing task. It does not mean, however, that such businesses are giving up the entire New York market. Conceivably, if the service or products provided by such businesses are valuable, New York residents will find ways to circumvent the screens and misrepresent that they are not from New York. That would be the worst of all outcomes both from the standpoint of the industry and of the regulatory agency.

Thank you for your consideration of these comments. As you know, the Chamber of Digital Commerce has endorsed granting a further extension for comments to allow the industry more time to put forth alternative proposals. We invite you to use this time to meet with us to discuss in depth. The Chamber of Digital Commerce stands ready to answer any questions you may have and to cooperate with you extensively in helping to develop a high quality, high integrity regime that fulfills the NYDFS's legitimate purposes while allowing the high integrity, high quality elements of the virtual currency and virtual asset sector to flourish. Feel free to contact us for further information.

With respect,

Perianne M. Boring
President