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

Mr. Dana V. Syracuse  
Office of General Counsel  
New York State Department of Financial Services  
One State Street, New York, NY 10004  
Tel: [REDACTED]  
Email: dana.syracuse@dfs.ny.gov

Re: Regulation of the Conduct of Virtual Currency Businesses – Addition of Part 200 to Title 23 NYCRR

Dear Mr. Lawsky and Mr. Syracuse:

My name is Scott Nichols and I am founder of Paybits. My business allows employees in any company to be paid in bitcoin. I am a small startup that wishes to do business in New York.

I am writing to comment on your proposed BitLicense regulations issued July 17, 2014.

Before my specific comments, I would like to take a step back and examine exactly what you are trying to regulate.

Bitcoin is an implementation of an innovative solution to a problem that previously remained unsolved: How do you establish trust between parties over an untrusted network? The practical implementation of the solution to this problem is known as the blockchain. The blockchain represents a distributed ledger where all can see transactions and only those who control the private keys can create transactions.

An entry into the distributed public ledger represents an exchange of value, but the value exchanged could be digital property, physical property, a contract, shares of an organization, a token exchangeable for the sovereign currency of a country, or any other number of yet undiscovered and unknown artifacts.

The only approval needed to make an entry into this distributed public ledger is the agreement of the party who controls the private key. This makes the blockchain a digital bear instrument.

The implications of this innovative digital bear instrument has the propensity to alter the world as we know it.

Imagine a world where no taxes are levied to build or maintain roadways. Instead, the roadways could exist as autonomous entities that charge a toll for use. A toll that is recorded in the blockchain. As an autonomous entity in control of the private keys associated with the value received for the use of the roadway, the autonomous entity could manage its own maintenance and expansion based on predefined algorithms.

Imagine a world where individuals collectively agree to contribute funds to create an organization that benefits society, but only if a) there are enough funds contributed; and b) the use of the funds could be transparent and directed only towards the goals of the organization created.

Imagine a world where a trustless, anonymous, irrefutable timestamping mechanism exists to prove ownership of digital or physical property.

Imagine a world where we can trade physical property without the risk of fraud where individuals could make low-trust loans to others, secured by collateral, controlled by the loan payer, but irrefutably pledge to the loan payee on default.

What blockchain innovations await us that have yet to be envisioned?

The above reflection of the world-that-could-be are not a science fiction dream. Instead they are real possibilities made possible by the blockchain. The full potential of the blockchain has yet to be realized, let alone envisioned.

While I endorse and understand the need to protect consumers from unscrupulous proprietors of fraudulent schemes, I would humbly suggest that attempting to place existing monetary shackles onto the blockchain will only serve to a) create an

environment where jurisdictional arbitrage is a reality; and b) dissuade brilliant innovative individuals from contributing to the betterment of our shared society.

It appears to me the proposed regulations are a disproportionate response to the threat posed by digital currencies. Instead, I suggest that New York encourage blockchain innovation by publicly declaring a moratorium on all blockchain (bitcoin) regulation.

My specific comments to the proposed regulations follow.

**Section 200.2 (n) (5)** - The definition of a Virtual Currency Business Activity to include a New York resident that issues digital currency seems misplaced. Does a software developer issue digital currency when they complete the last line of code? Or is it when they share code with another person? Or is it when they place the code into a public repository? What about software that creates digital currency?

The permutation of possibilities for how code is released and how digital currency is created is large.

**Section 200.3 (a)** - This section requires *all* individuals to acquire a BitLicense before operating their business. I propose the appropriate response would be to create a tiered approach to licensing entities based on relevant factors such as revenue or assets. As proposed, you are creating insurmountable barriers to entry for startup businesses. These barriers will drive innovation away from New York.

A better approach would be to allow new businesses to operate under reduced regulation until they have sufficient capitalization (either from investment or revenue) to undertake the full requirements in the regulations.

**Section 200.3 (c)** - The only exemptions provided here are for banks and businesses transacting in digital currency. Please consider expanding these exemptions, including at a minimum the exemptions provided for in the California Financial Code Chapter 2, Section 2010-2011.

**Section 200.8 (b)** - One of the reasons for the excitement surrounding digital currencies is the perceived benefit of unique attributes associated with digital currency when compared to traditional fiat currencies. To develop these attributes into useful products may require holding “profits” in the form of a digital currency. Prohibiting a company from holding an asset that is central to its functioning is a sure way to drive business away from New York.

**Section 200.9 (c)** - On the surface, the prohibition against lending a digital bearer instrument seems to have merit, however, I would suggest there may be legitimate business cases where the “selling, transferring, assigning, lending, hypothecating, pledging, or otherwise using or encumbering assets” has a legitimate value.

It seems overly broad to make such a sweeping prohibition. Why not let the market determine the need to hold or not hold customer assets?

For companies that need to hold 100% of their customer assets the market can insist they prove their reserves.

There is a proposed solution known as proof-of-reserve. This solution does not rely on the customer to trust that the business is in compliance with the regulations, but rather a solution that provides irrefutable proof to the customer that the attestation of the business is true.

From a consumer protection standpoint which is better: A company that says it is in compliance with regulation; Or a company that mathematically proves it holds the reserves it claims?

**Section 200.15 - various** - The anti-money laundering section of the proposed BitLicense requires duplicative compliance for the filing of SARs, and CTRs. These duplicative requirements seem unnecessary in light of the Federal Financial Crimes Enforcement Network.

**Section 200.15 (g) (3)** - This section seems to preclude relationships with Decentralized Autonomous Organizations (DAOs). DAOs represent a tremendous breakthrough in transparency and fairness for companies. It may well be that a DAO owns the roadway in the example offered in the beginning of this letter. Since DAOs will be based on blockchain technology and funded by blockchain technology, it will most likely be blockchain technology companies that have the first interactions with DAOs. Prohibiting interaction with DAOs will surely drive business from New York. However, the creation of the DAO will still take place. You can't put the genie back in the bottle.

**Section 200.16 & 200.17** - While an Information Security Policy, Business Continuity and Disaster Recover or undoubtedly necessary in today's world, I would suggest implementation through regulation is misplaced. Again, why not let the marketplace dictate the appropriate level of demonstrable security?

## **Conclusion**

Financial regulations have never completely protected the consumer and prevented market fraud. From the Spanish Prisoner confidence trick of the 1840's to Bernie Madoff's ponzi scheme of today, fraud has existed because one party has placed trust in another.

However, blockchain technology gives us a glimmer of hope that innovative products can and will be created that establish an environment of "trustless trust."

While digital currency clearly represents the dynamic evolution of industry financial services, regulation reform may not be the best way to guard against financial crises, protect the consumer, and prevent market fraud.

Instead, I would suggest cryptography will provide us with innovative, appropriate and irrefutable solutions to the ills you try and guard against.

Let the market develop, innovate, and thrive. Let us see the results and then determine what course of action we wish to take.

Declare a moratorium on digital currency regulation; Encourage firms to be based in New York; Let the market innovate and protect itself through cryptography.

Sincerely,



Scott K. Nichols  
Paybits LLC