

# Strevus

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September 5, 2014

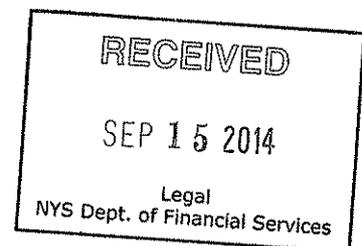
Superintendent Benjamin M. Lawsky  
cc: Dana V. Syracuse, Office of General Counsel  
New York State Department of Financial Services  
One State Street  
New York, NY 10004-1511

RE: Comment on BitLicense Proposal

Strevus, Inc. is a Delaware corporation with offices in New York City and San Francisco ("Strevus" or "we"). In accordance with Section 202 of the New York State Administrative Procedure Act and the public comment submission procedures specified in the Rulemaking Notice, 36 N.Y. Reg. 14 (July 23, 2014), Strevus hereby respectfully submits its comments on the Regulation of the Conduct of Virtual Currency Businesses proposed by the New York State Department of Financial Services ("DFS") on July 23, 2014 (the "BitLicense Proposal"). Section references are to the BitLicense Proposal unless otherwise noted.

We limit our comments to those matters about which we have specific competence -- regulatory compliance, specifically to the anti-money laundering, Know Your Customer, fraud and terror financing provisions referenced in the BitLicense Proposal. Our silence with respect to other aspects of the BitLicense Proposal should not be construed as either implied endorsement or criticism of the remaining provisions contained therein.

DFS asserts in its statement of needs and benefits published in the BitLicense Proposal's State Administrative Procedure Act filing that "Extensive research and analysis by the Department of Financial Services ... has made clear the need for a new and comprehensive set of regulations that address the novel aspects and risks of virtual currency." NYS Register/July 23, 2014, Proposed Rule Making, Regulation of the Conduct of Virtual Currency Businesses, available at <http://docs.dos.ny.gov/info/register/2014/july23/pdf/rulemaking.pdf> ("DFS Proposed Rule Making"). DFS's argument for not "simply apply[ing] existing money transmission regulations" is that new guidelines could have the benefit of being "tailored to the unique characteristics of virtual currencies" and, by implication, that the existing money transmitter licensing framework do not and cannot



serve that purpose.<sup>1</sup>See DFS, Notice of Intent to Hold Hearing on Virtual Currencies, Nov. 14, 2013, available at <http://www.dfs.ny.gov/about/press2013/virtual-currency-131114.pdf>. Thus, Strevus submits that in order to apply its own logic, and to effectuate its own policy intent, the DFS BitLicense Proposal should neither be more burdensome than the Money Transmitter law (and, derivatively, the Federal AML laws to which it requires money transmitter licensees to adhere), nor should it depart from either of these regulatory frameworks unless it can be demonstrated that such departure is necessary to support identified unique characteristics of virtual currencies.

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<sup>1</sup> In any event, the DFS should clarify the role the NY Money Transmitter law should play in regulation of virtual currency businesses moving forward. Strevus submits that DFS has to date delivered conflicting messages on whether virtual currency businesses are now, or in the future should be, regulated by the NY Money Transmitter law. On the one hand, it could be argued that DFS does not believe virtual currency businesses are covered under existing NY Money Transmitter Law. In support of this assertion, the DFS admitted in the “Needs and Benefits” analysis accompanying the BitLicense Proposal that “[e]xisting laws and regulations do not cover proposed or current virtual currency business activity.” DFS Proposed Rule Making, available at <http://docs.dos.ny.gov/info/register/2014/july23/pdf/rulemaking.pdf>. This belief may be further supported by the fact that the BitLicense Proposal draws legal authority exclusively from the New York Financial Services Law, and not from the New York Banking Law in which the money transmitter provisions (Article XIII-B) lie. On the other hand, DFS intimates that virtual currency businesses currently operating in New York are likely unlawfully operating a money transmitter business without a license. See DFS Notice of Inquiry on Virtual Currencies, Aug. 12, 2013, available at <http://www.dfs.ny.gov/about/press2013/memo1308121.pdf>. Continued lack of clarity here will not serve the DFS’s interest in promoting innovation in virtual currency, so we would request that DFS clarify that the BitLicense Proposal is indeed a framework that will be in lieu of, and not in addition to, the money transmitter licensing requirement. As we interpret the BitLicense Proposal, nothing in it either expressly or implicitly eliminates the need to obtain a separate money transmitter license, especially if a virtual currency business also handles fiat cash flow.

**1. To promote innovation in the digital currency ecosystem, the BitLicense Proposal should be no more burdensome than the New York State Money Transmitter Law nor the Federal AML laws.**

a. In the following specific instances, the BitLicense Proposal is more burdensome than the NY Money Transmitter Law.

- i. Books and records. Section 200.12 states in pertinent part as follows: "Each Licensee shall, in connection with its Virtual Currency Business Activity, make, keep, and preserve all of its books and records in their original form or native format for a period of at least ten years from the date of their creation [.]" (emphasis supplied.) Subsection (b)(2)(i) of New York Money Transmitter law section 416.1 (Anti-Money Laundering Programs) provides as follows: "Each Licensee properly files reports, and creates and retains records, in accordance with applicable requirements of 31 CFR Part 103 [.]" Subparagraph (d) of 31 CFR 103.38 (Nature of records and retention period) states, "All records that are required to be retained by this part shall be retained for a period of five years." (emphasis supplied.) Accordingly, Strevus requests that the DFS reduce its retention period to 5 years to be fully consistent with New York State's Money Transmitter law and the federal Bank Secrecy Act record retention provisions.
- ii. AML program. Section 416.1 of New York's Money Transmitter law sets forth the requirements for each money transmitter licensee to implement an anti-money laundering (AML) program. That AML program obligation requires only that each Licensee "demonstrate an anti-money laundering program that complies with applicable federal anti-money laundering laws ... and regulations promulgated [thereunder]." In no other section of New York's money transmitter law, regulations, guidelines or application is the federal AML obligation broadened or modified to achieve a unique State AML framework. The same cannot be said for the BitLicense proposal. Following is a non-exhaustive list of areas in which the BitLicense

proposal exceeds federal AML requirements: reporting of transactions in excess of US\$10,000 in one day and its 24 hour notification requirement (Sec. 200.15(d)(2); a suspicious activity reporting requirement that exceeds federal requirements by additional reporting about, among other things, tax evasion (Sec. 200.15(d)(3); the requirement to file State-based SARS where no Federal requirement is present (Sec. 200.15(d)(3)(ii); and, as previously discussed, the requirement to identify all parties to a transaction (Sec. 200.15(d)(1)). Strevus submits that the policy objectives of the DFS are not served by establishing separate, parallel paths for AML compliance and introduction of a new State-specific AML regime.

- b. In the following specific instance, the BitLicense Proposal is more burdensome than Federal AML law.
  - i. EDD on foreign entities. Strevus interprets the BitLicense Proposal to incorrectly apply Federal Anti-Money Laundering practices and procedures in connection with enhanced due diligence (EDD). Section 200.15(g)(2) appears to impose mandatory EDD on all non-US persons. If that is in fact the DFS's intent, that result is inconsistent with the recommendations set forth in the Bank Secrecy Act Anti-Money Laundering Examination Manual published by the Federal Financial Institutions Examination Council ("FFIEC Manual"), [http://www.ffiec.gov/bsa\\_aml\\_infobase/documents/bsa\\_aml\\_man\\_2010.pdf](http://www.ffiec.gov/bsa_aml_infobase/documents/bsa_aml_man_2010.pdf) which do not categorically impose EDD procedures on the basis of geographic location or "foreign entity" status. To be sure, identifying geographic locations that may pose a higher risk is an essential component to a BSA/AML compliance program, but "... geographic risk alone does not necessarily determine a customer's or transaction's risk level, either positively or negatively." FFIEC Manual at 25. The FFIEC Manual further notes, "Higher-risk geographic locations can be either international or domestic." See FFIEC Manual at 26. Accordingly, Strevus requests that Section 200.15 (g)(2) be redrafted to make clear that while EDD

procedures should be in place for all Licensees, the determination as to whether to impose EDD on a specific entity should be made on a case by case basis, not be limited to geographic jurisdiction analysis alone, but also involve a review of the customer's business activity, ownership structure, anticipated or actual volume, and types of transactions.

**2. To promote innovation in the digital currency ecosystem, the BitLicense regulatory framework should avoid deviating from NY's Money Transmitter Law or Federal AML laws when doing so frustrates the DFS's objective to support identified unique characteristics of virtual currencies.**

- a. **Physical addresses of all parties.** Subparagraph (d)(1) of Section 200.15 (Anti-Money Laundering Program) requires that licensees as part of their AML program keep records of all transactions, including "the identity and physical address of the parties involved[.]" As noted by Mercatus Comments at 7, it is not possible to comply with this "address from all parties" requirement and at the same time honor the DFS's guiding objective of implementing regulations "tailored specifically to the unique characteristics of virtual currencies" because this regulatory obligation would nullify a central advantage of digital currencies – their open network. This regulatory objective, however, could be partially addressed by simply including language currently contained in the BitLicense Proposal's Customer Identification Program. Section 200.15(g) provides with respect to new account opening, that each Licensee must, at a minimum, verify the customer's identity, to the extent reasonable and practicable[.]" (emphasis supplied.) Identifying, to the extent reasonable and practicable, the identity and physical address of the parties involved in the transaction would ensure Licensees commit in good faith to achieve this regulatory objective, but not take such further steps to ensure compliance as would eliminate the open network and thereby sacrifice the DFS's goal of preserving the unique characteristics of virtual currencies.
- b. **Obfuscation of identities.** Section 200.15 (f) provides that "No Licensee shall engage in, facilitate, or knowingly allow the transfer or transmission of Virtual Currency when such action will obfuscate the identity of

an individual customer or counterparty.” Intentional identity obfuscation is of course a key characteristic of criminal schemes involving digital currency, and we assume DFS had intended to address only this practice in the drafting of this provision. We further assume it was not DFS’s intent to regulate a limitation on the financial right to privacy of digital currency users. Yet, as written, the proposal appears to achieve precisely this unintended result. It can be potentially difficult to maintain anonymity with digital currency because one of its chief characteristics is that every transaction is publicly logged and anyone can see the flow of Bitcoins from address to address. As some commentators have noted, “Alone, this information can't identify anyone because the addresses are just random numbers.

However, if *any* of the addresses in a transaction's past or future can be tied to an actual identity, it might be possible to work from that point and guess who may own all of the other addresses. This identity information might come from network analysis, surveillance, or just Googling the address.” See “Anonymity”, available at <https://en.bitcoin.it/wiki/Anonymity> See also <https://bitcointalk.org/index.php?topic=241.0> for a discussion of attacks and proposed responses including use of external mixing services. To be sure, using a new address for each transaction would certainly frustrate identification of the user, but if one should want to take additional steps to prevent identification and maintain one’s financial privacy, those steps, under our interpretation of Section 200.15 (f), would be considered unlawful. Therefore, as written, Section 200.15(f) is overbroad, and could frustrate the unique privacy preserving characteristics of digital currency and dampen innovation. It may be that simply restating Section 200.15(f) as follows would better achieve DFS’s objective: “No licensee shall engage in, facilitate, or knowingly allow the transfer or transmission of Virtual Currency when such action will *unlawfully* obfuscate the identity of an individual customer or counterparty.” (emphasis supplied.)

- c. SARs. Section 200.15(d)(3)(i) provides that Suspicious Activity Reports (SARs) must be filed in accordance with federal law. However, filing SARs in a virtual currency environment will be frustrated by the unique characteristics of digital currency: (1) lack of effective and material metrics and established usage patterns for

monitoring for a nascent asset class represented by digital currencies; and (2) the semi-anonymous nature of digital currency addresses, which make it very difficult to clearly identify the beneficiaries or senders. For these and other reasons, we request that the DFS offer further guidance about how SAR reporting can be practically achieved in a digital currency framework.

3. **To promote innovation in the digital currency ecosystem, and ensure a continued, vibrant New York-based digital currency community, DFS should consider implementation of well-established regulatory tools such as minimum thresholds, transition periods and safe harbors.** We appreciate DFS's desire to promote innovation in the digital currency arena. We further appreciate that that innovation goal must be balanced with an equally important consumer protection interest. So, the question must be asked: How can a digital currency regulatory body enable small seed or venture-backed startups to innovate under a compliance regime that is admittedly daunting? Or, for that matter, major financial institutions and multinational businesses with an AML compliance budget far beyond the entire capitalization of these startups. In this instance, public policy objectives might require market incentives. A well-worn approach adopted by US federal regulators in other circumstances has been to utilize safe harbors and similar tools to promote important policy objectives.<sup>2</sup> Accordingly, we agree with the suggestion offered by Mercatus Comments at 10-11 and others – that is, to amend the BitLicense Proposal's Exemption section (Sec. 200.3 (c)) to include a Safe Harbor against claims of BitLicense proposal violation where the Safe Harbored Licensee (1) can demonstrate its revenues fell below a minimum financial or deposits-on hand threshold, (2) can commit to register with FINCEN and fully comply with its AML and KYC requirements, and (3) has not been the subject of any consumer complaints.

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<sup>2</sup> See, e.g., Children's Online Privacy Protection Act, 15 U.S.C. 6503 and COPPA Rule, Part 312.11, 78 Fed. Reg. 12, (Jan. 7, 2013)(enables industry groups to be bound by self-regulatory guidelines regarding web-based child privacy laws); US-EU Safe Harbor Framework, available at [http://www.export.gov/safeharbor/eu/eg\\_main\\_018493.asp](http://www.export.gov/safeharbor/eu/eg_main_018493.asp) (enables US companies to self-certify compliance with EU Data Protection laws); and Digital Millennium Copyright Act, 17 U.S.C. 512 (shields online service providers from acts of direct copyright infringement).

**Conclusion.** The BitLicense proposal has historic importance as it represents the first significant attempt at rulemaking around digital currency. Strevus appreciates the opportunity to provide comments. The DFS's stated objective to "balance both allowing new technologies to flourish, while also working to ensure that consumers and our country's national security remain protected" can be achieved in our view if DFS takes care to implement no regulations more burdensome than New York's Money Transmitter law nor the Federal AML laws; preserves and protects those unique aspects of digital currency; and offers an appropriate safe harbor to ensure the continued viability of the digital currency industry.

A handwritten signature in black ink, appearing to read 'John Bliss', is written over a solid horizontal line.

John Bliss, Esq.  
Chief Compliance Officer  
Strevus, Inc.

September 15, 2014