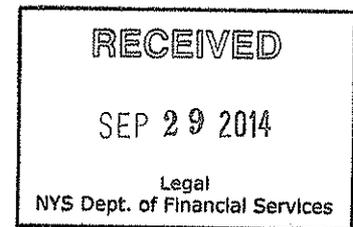


Bitnet

164 Townsend Street #11
San Francisco, CA 94107

22 September 2014

Dana V. Syracuse
DFS Office of the General Counsel
New York State Department of Financial Services
One State Street
New York, NY 10004-1511



Re: **Proposed Regulations regarding Virtual Currency Businesses (DFS-29-14-00015-P)**

Bitnet Technologies Corp ("Bitnet") respectfully submits the following information to the Department of Financial Services ("DFS") for its consideration in refining its proposed framework for licensing virtual currency firms.

We believe that market participants and regulators have common interests in fostering the creation of a virtual currency marketplace that delivers both tangible value and appropriate protections to consumers and other market participants. We welcome the leadership position the DFS has taken in engaging with this important new territory and respect the need to protect consumers and prevent money laundering contained in the proposal. Essential to that effort is creating a regulatory framework that supports, rather than impedes, continued growth and innovation in a rapidly evolving technological ecosystem. At Bitnet, we are deeply committed to promoting responsible business practices in our company and appreciate this opportunity to comment on the proposed licensing framework. We stand ready to provide additional information on the matters discussed below or others relevant to the proposal at your request.

We recognize that regulation has an important role to play in the creation of a vibrant and responsible virtual currency marketplace and submit the following comments for your consideration:

- Bitnet provides a payment platform that processes transactions based on the terms and conditions established by the merchant and accepted by the consumer. As part of this activity, Bitnet neither

maintains direct relationships with individual consumers, nor functions as a virtual currency exchange.

- Consistent with New York's existing exclusions from the scope of money transmission regulation, Bitnet and other firms processing virtual currency payments solely as agents of merchants should be exempt from the licensing framework.
- Given the complexity and novelty of the policy issues involved in this proposal, we request that DFS provide an additional comment period.

I. WHO WE ARE AND HOW BITNET WORKS

a. About Bitnet

Bitnet plans to provide a payment platform that facilitates merchant acceptance of virtual currency as a form of payment and conversion of those funds into U.S. Dollars and other fiat currencies. Merchants will contract with Bitnet to process virtual currency payments, and our service will reduce the costs and risks to merchants of accepting virtual currency payments by providing real-time quotes that convert the cost of a good or service into a virtual currency equivalent and facilitating the conversion of the virtual currency accepted by merchants in such transactions through independent virtual currency exchanges. We will provide recommendations for 'best practices' to our merchant customers on matters such as refund policy for virtual currency transactions, but Bitnet will have no direct relationship with consumers who elect to pay for goods or services with virtual currency, and our business model will not generate revenue from individual consumer relationships.

Our company is headquartered in San Francisco, California with a software development center in Belfast, Northern Ireland and currently employs 26 people. Our executive team features over 130 years of combined experience in the payments sector, including substantial experience with VISA and CyberSource, and we are bringing this deep domain expertise into the virtual currency marketplace for the benefit of our merchant customers and their consumers.

b. Bitnet's Investment in Responsible Business Practices

Our commitment to operating in conformity with applicable regulatory mandates and industry leading practices is reflected in the investments we are making to develop compliant business and operating models. We are working with experts in the field to develop and implement anti-money laundering and compliance programs. For example, we plan to implement a Know Your Customer program that will include all merchants using our services. We are also implementing a real-time monitoring system to track and analyze a multitude of attributes about each transaction to identify any anomalies that could indicate suspicious activity.

c. The Mechanics of a Bitcoin Transaction over Bitnet

A payment transaction via Bitnet occurs in the following sequence:

Payment Request

Step 1: The consumer decides to pay with bitcoin.

Step 2: The merchant's system calls the Bitnet API and provides the order details.

- Step 3: Bitnet receives price quotes in real time from a number of independent virtual currency exchanges.
- Step 4: Bitnet generates and transmits to the merchant an invoice that converts the guaranteed fiat currency price to bitcoin (or other virtual currency equivalent selected by customer).
- Step 5: The consumer is presented with the invoice that expresses the checkout price in an equivalent amount of bitcoin along with a scannable QR code or clickable link to initiate payment from the consumer's wallet.

Payment Transaction

- Step 6: The consumer scans the QR code or clicks the provided link to transfer bitcoin from their wallet to Bitnet.
- Step 7: Bitnet monitors the Bitcoin network for new transactions to be broadcast, propagated, and "confirmed."
- Step 8: Upon confirmation of the transaction, Bitnet immediately trades the bitcoin for fiat currency on a virtual currency exchange.

Settlement and Funding

- Step 9: Each day, the exchange transfers Bitnet's fiat currency trading balance to Bitnet's bank.
- Step 10: Based on its record of the day's transactions, Bitnet instructs the bank to disburse the funds to merchant accounts.
- Step 11: Bitnet's bank transfers the amount of fiat currency owed to merchant accounts.

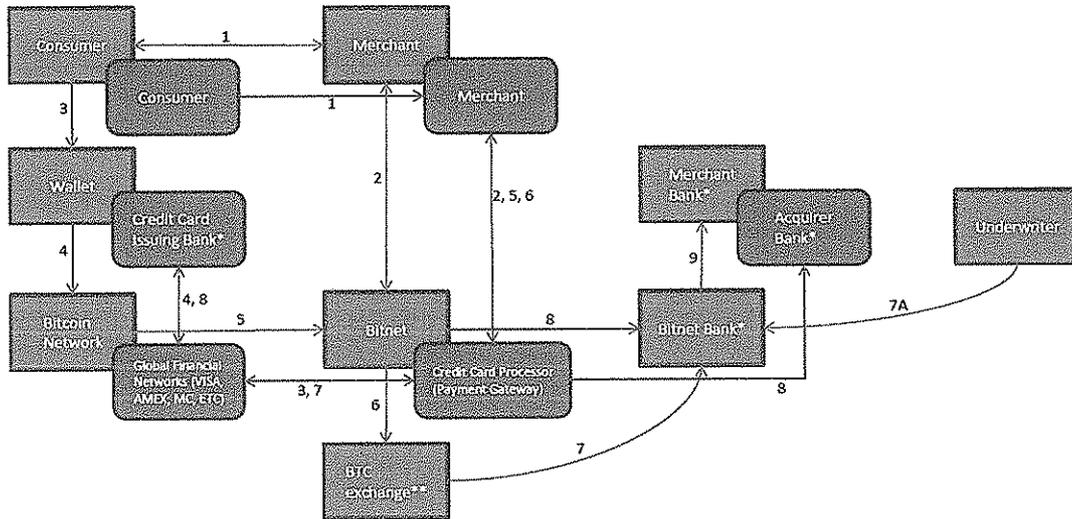
II. BITNET AND OTHER FIRMS PROCESSING PAYMENTS SOLELY AS AGENTS OF MERCHANTS THAT ACCEPT VIRTUAL CURRENCY SHOULD BE EXEMPT FROM THE PROPOSED LICENSING FRAMEWORK.

We believe that the exemption for merchants in the proposed licensing framework (Proposed 200.3[c][1]) should be expanded to include agents of merchants for the following reasons:

- a. The payment processing function that Bitnet provides merchants is fundamentally similar to activities performed by credit card processors.

As set forth more fully above, Bitnet receives virtual currency on behalf of merchants and facilitates the conversion of such virtual currency into fiat currency through independent exchanges. In so doing, Bitnet neither transacts directly with customers, nor engages in conversions of virtual currency. As a result, Bitnet functions in a way that is fundamentally similar to credit card processors, which also process transactions on behalf of merchants by maintaining automated, secure systems that direct consumer payments through regulated financial institutions to the merchant's bank account.

The following diagram shows the flow of transactions using Bitnet and credit cards:



Bitnet

1. The consumer decides to pay with Bitcoin.
2. The merchant calls the Bitnet Api, passing the order details.
3. The consumer is presented with a QR code or clickable link to initiate payment.
4. The consumer uses their wallet to send the BTC to the Bitcoin network.
5. Bitnet monitors the network until the payment is confirmed.
6. Bitnet trades the BTC for fiat currency at the exchange.
7. The BTC Exchange deposits the days trading balance to Bitnet's bank.
 - A. We are insured against exchange failure and can always pay out to merchants.
8. Bitnet instructs the bank to payout to the merchants.
9. Bitnet's bank disburses the monies to the various merchant accounts.

Credit Card Processor (Payment Gateway)

1. The consumer decides to make a purchase from a merchant.
2. The merchant submits an Authorization request transaction for approval.
3. The payment processor passes the request through the associations to the issuing bank and awaits response to be presented to merchant.
4. The Issuing Bank approves or declines the authorization request and puts a hold on cardholder funds – the "Authorization hold".
5. Merchant receives the approved or declined authorization transaction.
6. Merchant submits a Capture transaction.
7. Payment Processor sends batch request for settlement to card scheme.
8. Card Scheme receives settlement payment from issuer and sends settlement payment to acquirer. Acquirer funds merchant account with net proceeds of transaction.

*Regulated by current NY Money Transmitter Laws.
 **Regulated by FinCEN and will be subject to the current proposal.

In either of these payment systems, the processor's role is fundamentally the same: to facilitate transactions on the merchants' behalf.

Notably, credit card processors are not generally required to have a bank or money transmitter license, although credit card acquirers are. By analogy, pure virtual currency payment processors such as Bitnet should not be required to register, although the virtual currency exchanges and banking partners they rely on should be regulated entities. This is consistent with the well-established principle that payments chains typically contain one regulated entity, rather than requiring that all participants in a transaction be subject to the same regulations.

Applying an agency exemption to virtual currency payment processors similar to the one enjoyed by fiat currency payment processors will not result in a material gap in the regulatory framework. As a provider of

payment processing services to merchants on an outsourced basis, Bitnet will maintain relationships with merchants, banking partners, and virtual currency exchanges (which will be licensed under the proposed framework). As a result, Bitnet will be responsible for adhering to various business and regulatory requirements of those counterparties and subject to oversight as a third-party service provider to regulated entities.

- b. Exempting Bitnet and other firms processing payments solely as agents of merchants is consistent with the treatment of comparable fiat currency payment processing activities under current New York law.

New York is among a majority of states nationwide that recognize an exemption from money transmitter licensing requirements for firms processing payments as an agent of merchant-payees:

No person shall engage in the business of selling or issuing checks, or engage in the business of receiving money for transmission or transmitting the same, without a license therefor obtained from the superintendent as provided in this article, nor shall any person engage in such business as an agent, except as an agent of a licensee or as agent of a payee.¹

DFS has interpreted the phrase “agent of a payee” to include merchant’s agents.² Since there is no meaningful risk-based distinction between the activities conducted by a merchant’s agent in the context of processing fiat and virtual currency payment transactions, the exemption for merchants in the proposed licensing framework (Proposed 200.3[c][1]) should also include a specific exemption for agents of merchants to align the regulation of fiat and virtual currency transactions.

- c. Merchants benefit significantly from relying on agents to process virtual currency payments, and those benefits are important to the continued growth and development of the virtual currency ecosystem.

Merchants benefit substantially from relying on firms such as Bitnet to process virtual currency payments. Without Bitnet and other payment processing firms, merchants would have to establish individual accounts at various exchanges and handle individual conversions of virtual currency accepted from consumers. As a result, merchants would face increased exposure to exchange rate volatility and be required to make substantial investments in IT and cyber-security. By contrast, reliance on specialized processing firms like Bitnet guarantees merchants payment for all virtual currency transactions, reduces risks related to chargebacks and fraud, lowers processing fees, and enhances access to customers around the world.

Individually and collectively, these benefits are important to increasing acceptance of virtual currency by merchants in New York and across the globe, a key driver of continued growth in the volume and velocity of virtual currency payments and ultimately of a reduction in the volatility of the overall ecosystem. For New York consumers, expanded access to virtual currency transactions will reduce the costs of purchasing goods and services, and growth in merchant acceptance has the potential to increase the state’s tax revenue. As a result, DFS should take care to evaluate how the costs related to proposed regulation might erode these benefits and craft a regulatory framework that is not broader than necessary.

¹ New York Banking Law, Section 641(1) (emphasis added).

² Interpretative Opinion, Department of Financial Services (July 20, 2007) (last visited on September 12, 2014 at http://www.dfs.ny.gov/legal/interpret_opinion/banking/lo070720b.htm).

- d. The consumer protection and money laundering risks related to the activities of firms like Bitnet that process virtual currency payments are lower than in relation to consumer exchange and hosted wallet services.

Virtual currency transactions that Bitnet processes by definition begin with a customer who already owns virtual currency and is simply looking to use it to transact. Using virtual currency to make purchases reduces each consumer's exposure to the price volatility currently linked to holding virtual currency by reducing the consumer's balance of such currency by the amount of the transaction. Viewed in this context, many of the disclosure and other consumer-oriented provisions of the proposal have little meaningful application to Bitnet's operations.

Bitnet's payment processing also reduces the risks to merchants of transacting in virtual currency. Merchants that use Bitnet to process virtual currency transactions benefit from the ability to convert funds received instantly to fiat currency and from receiving a guaranteed payment amount from Bitnet. Further, Bitnet's merchants will generally know who their customers are (based on, for example, shipping addresses provided), so merchant acceptance has lower AML risks than other parts of the current virtual currency ecosystem.

III. ADDITIONAL OPPORTUNITIES FOR NOTICE AND COMMENT

We recognize the importance of the proposal that DFS has developed, as well as the complexity of the business and regulatory issues involved. Accordingly, we respectfully request that the agency commit to providing stakeholders additional opportunities to provide formal input on subsequent iterations of this proposal.

IV. CONCLUSION

We respectfully request consideration of our comments and suggestions. Should you have questions or require further information about any matter relevant to the proposal, please do not hesitate to contact me at [REDACTED] or by email to [REDACTED]

Sincerely,



John McDonnell

Chief Executive Officer

Bitnet Technologies Corp