



October 21, 2014

VIA COURIER

Office of General Counsel
Attn: Dana V. Syracuse
New York State Department of Financial Services
One State Street
New York, NY 10004

Re: Proposed Regulation of Virtual Currency

Dear Mr. Syracuse:

We are writing in response to the request for comments on the “BitLicense” regulation proposed by the New York Department of Financial Services. I.D. No. DFS-29-14-00015-P N.Y. St. Reg. (July 23, 2014) (the “Proposed Regulations”). We commend the careful and thoughtful approach the DFS has taken to regulation of Virtual Currency, including the extension of the comment period to double its original length. We support the Department’s goal of promulgating regulations that will ensure that virtual currencies are properly regulated, and we recognize that this emerging technology comes with risks. At the same time, we seek to ensure that the final regulations are appropriately targeted and do not impose duplicative, unclear, or unnecessarily burdensome requirements that could inadvertently stifle important innovations. We therefore request clarification regarding the application of the Proposed Regulations to (i) rewards programs and (ii) certain entities that are already subject to licensing and regulation.

I. Exclusion for Affinity or Rewards Programs

The definition of Virtual Currency contained in proposed Section 200.2(m) provides an exclusion for affinity or rewards programs:

Virtual Currency shall not be construed to include . . . digital units that are used exclusively as part of a customer affinity or rewards program, and can be applied solely as payment for purchases with the issuer and/or other

designated merchants, but cannot be converted into, or redeemed for, Fiat Currency.

We agree with the Department's position, reflected in this definition, that "customer affinity or rewards program[s]" should not be regulated as Virtual Currency and we suggest modifications to the proposed regulations to help ensure that such programs are not covered by the final regulation. In particular, our suggested changes are intended to clarify the intent of the clause at the end of this exclusion, which states that affinity or rewards programs would be regulated as Virtual Currency if they can "be converted into, or redeemed for, Fiat Currency." "Fiat Currency" is defined in Section 200.2(d) as "government-issued currency that is designated as legal tender in its country of issuance through government decree, regulation, or law."

We are concerned that this "Fiat Currency" clause in the affinity/rewards exclusion is unclear. If this clause were "broadly construed" (as suggested by other language in the definition of Virtual Currency), it could inadvertently sweep rewards programs back into the regulation as Virtual Currency. To avoid this outcome -- which we do not believe the Department intends -- we respectfully recommend that the language be modified as provided below.

Virtual Currency means any type of digital unit that is used as a medium of exchange and acts as a substitute for Fiat Currency but does not have the status of Fiat Currency in the United States. ~~a form of digitally stored value or that is incorporated into payment system technology.~~ Virtual Currency shall be broadly construed to include digital units of exchange that (i) have a centralized repository or administrator; (ii) are decentralized and have no centralized repository or administrator; or (iii) may be created or obtained by computing or manufacturing effort. Virtual Currency shall not be construed to include digital units that are used solely within online gaming platforms with no market or application outside of those gaming platforms, nor shall Virtual Currency be construed to include digital units that are used exclusively as part of a customer affinity or rewards program; and can be ~~applied solely as payment redeemed for goods, services, discounts or purchases with the issuer and/or other designated merchants~~ or redeemed for digital units in another customer affinity or rewards program, but cannot be directly converted into, or directly redeemed for, Fiat Currency or forms of Virtual Currency described herein;

Fiat Currency means government-issued currency that is designated as legal tender through government decree, regulation, or law and refers exclusively to paper money and coin that circulate as cash.¹

The principal purpose of our revisions is to make clear that most affinity or rewards programs will not be covered by the final BitLicense regulations. Like the Department, we believe that affinity/rewards programs should not be regulated as Virtual Currency, but recognize that the Department may wish to cover a program if it provides for rewards to be converted into “true” forms of Virtual Currency, such as Bitcoin. We do not believe that our suggested revisions to accomplish this goal would make the definition “circular” because affinity/rewards program units do not share the characteristics of true Virtual Currencies: they are not used as a medium of exchange and do not act as a substitute for Fiat Currency. Because rewards units are not Virtual Currencies, only those units that can be converted into true Virtual Currencies will be covered by the regulations pursuant to our proposed revised definition.

Additionally, we have suggested revisions to the language regarding “digitally stored value” in the proposed definition of Virtual Currency because this language may be read to include prepaid access products, such as gift cards and pre-paid cards. These products are subject to regulations (at both the State and Federal levels) and including them in the final BitLicense regulations will not have a meaningful impact on the products’ safety. Instead, it will only likely create confusion and regulatory burden.

The rest of our suggested modifications are intended to incorporate into the description of affinity/rewards programs the type of language that is typically used to describe such programs. For that reason, we suggest use of terms such as “redeemed” and “discount,” and we also suggest a more descriptive list of the types of redemption options typically found in such programs. Additionally, we propose adding the concept that only those points that are directly convertible into Fiat Currency or other Virtual Currency be covered, as affinity/rewards programs can provide redemption options that may resemble an indirect conversion into Fiat Currency, such rewards in the form of “cash back” or statement credits.

¹ See 31 CFR § 103.11(h) (defines “currency” as coin and paper money of the United States or of any other country that is designated as legal tender and that circulates and is customarily used and accepted as a medium of exchange in the country of issuance); *see also* FFIEC, FinCen Form 104 (defines “currency” as coin and paper money of the United States or any other country, which is circulated and customarily used and accepted as money).

Along similar lines, if DFS also wishes to regulate as Virtual Currency any affinity/rewards programs that can be converted into physical dollar bills or coins, we would recommend clarifying that the definition of "Fiat Currency" for this purpose only includes physical dollar bills and coins.

II. Application to Already Regulated Institutions

Proposed section 200.3 contains an exemption for "persons that are chartered under the New York Banking Law to conduct exchange services" who obtain approval of the DFS. The Department issued an order on March 11, 2014, which provides for firms to seek such approval. There is no general exemption, however, for banks or bank holding companies, which are already heavily regulated at both the federal and state levels. Applying the Proposed Regulations to banks and bank holding companies will provide little to no additional safety and soundness or anti-money laundering precautions. We respectfully request that banks and bank holding companies either be exempt entirely from the final BitLicense regulations or be provided a procedure under which to apply to the Department for such an exemption.

Similarly, there is no exemption for New York State licensed and regulated money transmitters. We understand that the Department may wish for currently licensed money transmitters to obtain a separate approval to engage in Virtual Currency activities. However, we respectfully request that the Proposed section 200.3(c)(1) be revised to include an exemption for licensed money transmitters from application requirements that are duplicative of those already required for licensing as a money transmitter, as duplicative requirements do not serve any additional policy purpose. We discuss below examples of substantial duplication of such requirements and propose ways the Department should clarify in the regulations when compliance with the regulations that currently apply to licensed money transmitters is sufficient.

Information Submitted in connection with Obtaining a License. Section 200.4 lists information required to be submitted in order to obtain a license to engage in Virtual Currency Business Activities.² The information listed in Section 200.4 mirrors the information that must be submitted as part of a money transmitter license application. To avoid wasteful duplication, licensed money transmitters should be required to submit

² Such information includes affiliates and relationships (§ 200.4(a)(2)); information about officers and directors (§ 200.4(a)(3)); background reports on officers and principals (§ 200.4(a)(4)); fingerprints and portraits (§ 200.4(a)(5)); organization charts (§ 200.4(a)(6)); written policies and procedures (§ 200.4(a)(10)); affidavit of legal proceedings (§ 200.4(a)(11)); and insurance policies (§ 200.4(a)(12)).

information again only to the extent that there are material differences from prior submissions related to Virtual Currency issues.

Examinations. Section 200.13 provides for periodic examinations. If a licensed money transmitter were to engage in Virtual Currency Business Activities, it may rely to some extent on the same personnel, systems and platforms for both activities. Because a licensed money transmitter may be examined at any time the Department deems necessary or advisable,³ it could be subject to examination under both regimes, which would be inefficient and costly. For example, Section 200.8 subjects Licensees to capital assessments, in addition to the capital assessments required of licensed money transmitters. We respectfully ask the Department to include in the final BitLicense regulations that examinations of the same entity operating under both sets of regulations will be coordinated, so that, for example, a single capital assessment could be conducted to assure that any resulting requirements are consistent across both regimes.

Reports and Financial Disclosures. Section 200.14 requires Licensees to submit quarterly and annual financial statements to the Department. Because these statements are also required to be submitted by licensed money transmitters, we propose that the Department clarify in the final BitLicense regulations that only one set of statements is required to the extent that the statements include the Virtual Currency Business Activities.

Change in Control. Section 200.11 requires Licensees to obtain the prior written approval of the Department in the event of a transaction resulting in a change of control of the Licensee. There is a similar approval requirement, along with a reporting requirement, placed on change of control transactions involving licensed money transmitters.⁴ We suggest a clarification in the final BitLicense regulations that only the existing change-in-control regulatory framework apply in the event of such a transaction involving a company that is licensed both as a money transmitter and to engage in Virtual Currency Business Activities.

Anti-Money Laundering. Section 200.15 obligates Licensees to establish, maintain and enforce an anti-money laundering compliance program with specified components, and also imposes specific reporting requirements. Licensed money transmitters in New York are required to have an anti-money laundering program that

³ See Chapter III Superintendent's Regulations, Part 406 – Money Transmitters, § 406.7.

⁴ See N.Y. Banking Law § 652-a; Chapter III Superintendent's Regulations, Subchapter B Non-Banking Organizations, Part 406 – Money Transmitters, § 406.11.

complies with applicable federal laws and regulations, and compliance with applicable federal requirements is deemed to constitute compliance with New York requirements. We respectfully encourage the Department adopt the same approach with respect to Licensees to avoid duplicative or unnecessarily burdensome regulation. We share the Department's objective to deter the improper use of virtual currencies, and believe that this objective can be achieved most effectively by reference to existing State and Federal rules.

Cyber Security. Section 200.16 obligates Licensees to institute a cyber security program with specified components. Regulating cyber security programs at the State level could potentially result in 50 different cyber security regimes, compliance with which would be burdensome and lead to confusion. In addition, for federally regulated financial institutions, these State regulations could potentially conflict with the existing cyber security regulations that help to protect the U.S. banking industry. Moreover, static prescriptive regulations may cause considerable problems in a dynamic and rapidly changing threat environment. We therefore respectfully recommend that, for entities that are not already subject to the security provisions of the Gramm Leach Bliley Act and regulation by a federal banking regulator (which entities should be exempt from this Section), the Department take the more adaptable approach of conducting cyber security audits as part of the examination process to ensure that Licensees are employing best practices. The Department's examination procedure and expectations should refer to an appropriate basis for evaluating a Licensee's cyber security program, such as the US Department of Commerce's National Institute of Standards and Technology (NIST) 800 Series, a family of publications that cover cyber security best practices across multiple dimensions.

Books and Records. Section 200.12(a) requires Licensees to retain books and records for a period of at least ten years. This retention term is much longer, and thus much more burdensome, than other State and Federal record retention requirements,⁵ and we are not aware of any reason requiring a particularly long period here. Therefore, we respectfully request the Department reduce the retention term to three years, which is a comparable term for other licensees.⁶

Non-Completed Transactions. Section 200.12(c) requires that Licensees retain records of "non-completed" accounts or "transactions" for at least five years. We request

⁵ See, e.g., 31 C.F.R. § 103.15(c) (requiring five year record-retention under the Bank Secrecy Act).

⁶ See 3 N.Y.C.R.R. § 406.9(b) (requiring three year record-retention for NY money transmitters).

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the Department to clarify that this requirement is intended to capture abandoned property (as defined in the Abandoned Property Law) concerns and thus would not apply to situations that do not result in abandoned Virtual Currency, as, for example, when a consumer logs on to begin a transaction, but is interrupted and never completes it.

We thank the Department for its consideration of our comments. If you have any questions, please feel free to contact me directly at [REDACTED], or my partner David A. Luigs at [REDACTED].

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Eric Dinallo". The signature is fluid and cursive, with the first name "Eric" and the last name "Dinallo" clearly distinguishable.

Eric R. Dinallo