



October 19, 2014

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

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

Dear Mr. Syracuse,

This comment letter is submitted on behalf of CoinX, Inc. ("CoinX") in response to NYDFS' proposed BitLicense rule in the notice appearing at 2014-15 N.Y. St. Reg. 14. CoinX is a Delaware corporation, incorporated in May 2013, with its principal office in Atlanta, Georgia. CoinX operates a virtual currency exchange platform whose primary purpose is to facilitate the trade of virtual currency for fiat currency for a wide array of customers—both individual and institutional.

It is our firm belief that the money transmitter ("MT") licensing framework—including both its federal and state components—is both broad enough in scope and sufficiently tailored to permit NYDFS to "strike an appropriate balance that helps protect the consumers and root out illegal activity—without stifling beneficial innovation".

We are concerned that the BitLicense framework mostly mirrors the pre-existing MT licensing framework. However, in most instances where it deviates, the provisions are vague and present administrative burdens that do not provide a corresponding consumer protection benefit or oversight advantage to NYDFS. Where such new provisions lack clarity and are driven by a lack of familiarity with the true risk profiles of virtual currency businesses, these new rules merely serve to stifle innovation and impede healthy business.

Since FinCEN's March 2013 guidance, CoinX has been steadily working through the process of developing a compliance program that meets the requirements for MTs. CoinX has engaged in healthy discussions with nearly every state regulatory authority in order to work through the questions raised in applying the MT framework to the virtual currency exchange business model.

Every concern that NYDFS seeks to address with the BitLicense rules has been raised during CoinX's application process in other states. During in-depth exploratory conversations with state regulators, CoinX has been able to provide insight into the specific risks present to its model. In many cases, regulators found the MT licensing framework sufficient to deal with the

risks presented. In some cases, regulators created a set of conditions that CoinX would be required to meet in order to become licensed.

Rather than imposing a blanket and heavy-handed BitLicense framework which is not specifically tailored to true risk, we would encourage NYDFS to take this more flexible approach in using the broad authority already afforded by MT statutes and rules to explore virtual currency businesses on a case by case basis and apply risk-based requirements accordingly. In the alternative, please accept the below comments to specific provisions in the Proposed Rule.

We thank the NYDFS for the opportunity to comment on the BitLicense framework, and we hope that the comment process provides NYDFS with insight into how the framework might be improved.

Section 200.1 Introduction

“This Part contains regulations relating to the conduct of business involving Virtual Currency, as defined herein...”

We seek clarification as to whether businesses that transmit virtual currency *as well as* fiat currency would be fully licensed to do business if they comply with the BitLicense framework. The BitLicense framework confers authority to Licensees to engage only in “Virtual Currency Business Activity” as defined in 200.2(n). In addition, the definition of “Transmission” in 200.2(l) is limited to the transfer of Virtual Currency.

The absence of language addressing the transmission of fiat currency suggests that NYDFS may envision that virtual currency businesses that also transmit fiat currency will be required to acquire a MT License as well as a BitLicense.

The MT License and BitLicense requirements are often redundant or in conflict. Unless NYDFS streamlines and provides clarification, an impacted virtual currency business would be saddled with the impossible task of divining a coherent regulatory framework as applied to its particular business model. This kind of uncertainty would impede healthy business, negatively affect the consumer, and present enormous administrative difficulties for NYDFS.

Section 200.3 License

(b) Unlicensed agents prohibited.

Under the proposed BitLicense rules, virtual currency businesses are prohibited from taking on authorized agents. We understand that NYDFS perceives the agent model to present additional risk, but we believe that NYDFS can control for such risks by evaluating each Licensee’s proposal for an agency relationship on a case-by-case basis, as with MTs.

When structured appropriately—such that the relationship is well-defined, the Licensee retains control over the conduct of the business, transactions are processed through the licensee’s platform, funds are not commingled and held in trust for benefit of Licensee, as well as any other appropriate guidelines—then CoinX believes that agent relationships can play a role in the healthy expansion of business which is beneficial to consumers.

Section 200.4 Application

200.4(5)—All individuals employed by the applicant must provide a set of fingerprints and two portrait-style photographs.

We understand that NYDFS seeks to closely monitor the identities of those employees who have managerial responsibility, control over customer funds or access to sensitive customer data. However, it is not beneficial to do the same for employees who are tasked only with improving the design and layout of the website, or lower-level administrative tasks. This requirement as applied to every employee in the company is costly, time-consuming, and may not represent any advantage to NYDFS in monitoring actual risk within the business.

Section 200.7 Compliance

200.7(b)—Each Licensee shall designate a qualified individual or individuals responsible for coordinating and monitoring compliance.

We seek clarification on the term “qualified individual” in this context. In the context of the MTL application, a “qualified individual” would have three years experience in performing compliance for a MT or a bank consistent with the proposed activities of the applicant, in addition to relevant training. It would be helpful to know the criterion that NYDFS might use to determine whether a compliance officer is “qualified” in the context of the BitLicense.

Section 200.8 Capital Requirements

200.8(a)—Each Licensee shall maintain at all times such capital as the superintendent determines is sufficient to ensure the financial integrity of the Licensee and its ongoing operations.

We understand that NYDFS seeks to set a minimum capital requirement tailored to each virtual currency business model that enables it to operate safely, while also allocating resources effectively for growth and development. However, it is difficult for an emerging business in a rapidly developing industry to provide reliable financial projections. Because of this, an analysis based on a number of projected figures may not be practically helpful to NYDFS in appropriately setting the minimum capital requirement.

Similar to the model for MTs, we suggest that NYDFS determine a baseline figure pegged which, in addition to a surety bond, compliance with permissible investments, and a restriction on the use and encumbrance of customer assets, should be sufficient to support financial soundness.

Additionally, a balance should be struck across all of the mechanisms available to NYDFS such that the convergence of financial requirements does not negatively impact the ability of virtual currency businesses to survive.

200.8(b) Each Licensee shall be permitted to invest its retained earnings and profits in only...high-quality, investment-grade permissible investments...

This restriction is too broad. The requirement for virtual currency business to invest ALL of its retained earnings and profits in the defined permissible investments is not tailored to any reasonable risk profile. This leaves virtual currency businesses without any ability to decide how to invest its own earnings and profits—even when their investment may have little to no impact on ability to meet financial obligations.

In the context of money transmission, the requirement to maintain permissible investments is often pegged against the licensee's outstanding money transmission liability. Pegging against outstanding money transmission liability provides for a minimum requirement with the goal of protecting consumers from loss or financial instability, while also permitting the company to invest additional profits and earnings as it sees fit.

Section 200.9 Custody and protection of customer assets

Section 200.9(a) Each Licensee shall maintain a bond or trust account in United States dollars for the benefit of its customers in such form and amount as is acceptable to the superintendent for the protection of the Licensee's customers.

As with minimum capital requirements, we suggest that NYDFS determine a baseline bond or trust account figure that does not tend impede survival or stifle healthy growth. Again, a balance should be struck across all of the mechanisms available to NYDFS such that the convergence of all these requirements does not negatively impact the ability of virtual currency businesses to properly allocate resources for development.

Section 200.9(b) Each Licensee is prohibited from selling, transferring, assigning, lending, hypothecating, pledging, or otherwise using or encumbering assets, including Virtual Currency, held, stored, or maintained by, or under the custody or control of, such Licensee on behalf of another Person.

We understand that customer assets are held on behalf of customers, and must be maintained securely such that they are readily available for dispersion. While a restriction on encumbrance may address the liquidity or security of customer assets, a restriction on any type of transfer or use of assets may restrict virtual currency businesses from devising systemic improvements which may actually serve to better protect assets and more effectively manage risk.

Section 200.10 Material change to business.

Section 200.10 (a)-(c)

We understand that NYDFS seeks to restrict Licensees from deviating significantly from the approved business model. However, the requirement of prior approval significantly reduces the ability of virtual currency businesses to respond to market changes, or make timely and necessary modifications to its operations to accommodate consumer needs.

In addition, this requirement is drafted ambiguously. For licensees, the definition of "material change" does not provide a clear margin of discretion wherein the virtual currency

business could safely assume that the approval provision is not triggered. This amounts to a scenario in which the virtual currency business would not be able to make even minor business development decisions without triggering the obligation to draft a full write-up including a description of the change, a “detailed” description of the business operations, compliance policies, and the impact on the overall business. This would present a significant burden in both time and resources on staff (and exorbitant costs for businesses which may choose to utilize outside legal counsel).

As with the MT model, NYDFS should require virtual currency businesses to provide notice within a certain time frame *after* revisions are made to the business model. The receipt of such notice will provide NYDFS with a context wherein it may better evaluate the appropriateness of a more detailed write-up and provide specification on the type of analysis it wishes to see.

Section 200.12 Books and records.

200.12(a) Each Licensee shall... make, keep, and preserve all of its books and records in their original form or native file format for a period of at least ten years from the date of their creation...

We understand that NYDFS needs cooperation from Licensees to preserve the record for the benefit of customers. However, a systematic baseline requirement of ten years far exceeds any other recordkeeping timeline promulgated for MTs—or any similarly situated financial services company—by any state or federal authority. For example, most states require MTs to keep books and records from 3-5 years and the Bank Secrecy Act requires books and records to be kept for five years. NYDFS has essentially doubled this length of time, without providing insight into on how this might reasonably assist the NYDFS to protect consumers. This ten-year requirement is imposed without limitation on all the types of records listed, without exception and without any assessment of the value this might add in preserving the record.

In addition, NYDFS requires “immediate access” to all facilities, books, and records. This may be an unreasonably stringent timeliness requirement, particularly when books and records may need to be assembled or delivered from a location which is not conveniently located near NYDFS offices, and where a delay of a matter of days will not inhibit the quality of the investigation or deteriorate the quality of the data.

Section 200.14 Reports and financial disclosures

200.14(a) Each Licensee shall submit quarterly financial statements...containing without limitation: (1) a statement of the financial condition of the Licensee, including a complete balance sheet, income statement, profit and loss statement, statement of retained earnings, statement of net liquid assets, statement of net worth, statement of cash flows, and statement of change in ownership equity; (2) a statement demonstrating compliance with any financial requirements...(3) financial projections and strategic business plans, (4) a list of all off-balance sheet items, (5) a chart of accounts, including a description of each account; and (6) a report of permissible investments by the Licensee...

The BitLicense quarterly reporting requirements are more burdensome than any other states' requirements for *annual* reporting from MTs. This requirement seems particularly insensitive to the time and resource burden this reporting would impose on company staff when completed every three months. Furthermore, such quarterly reports would require projections and an updated business plan in addition to write-ups requesting prior approval for material changes. This is redundant information, the processing of which creates additional work burden on the NYDFS staff with no effective gains in oversight.

We also seek clarification on what is meant by "a chart of accounts, including a description of each account." Does NYDFS seek an itemized list of every customer account currently maintained by the business, in addition to a description of the account? If so—such a requirement is very burdensome. In order to get a sense of the types of customers served by the Licensee, NYDFS could potentially require a high-level summary. However, even this would be far outside the scope of the quarterly report currently required from MTs.

As NYDFS is already aware—each state has different deadlines and information requirements for quarterly, supplemental, annual, and other reports. NYDFS has not yet joined efforts with other states to use the NMLS system, a platform that greatly enhances MTs' ability to manage multiple states' reporting requirements. A more uniform reporting platform enables regulatory authorities to have more visibility and control while also greatly reducing the administrative burden on companies with multiple licenses. This new BitLicense framework is a significant and discouraging move away from balancing the burden imposed on businesses with effective regulatory oversight.

Section 200.15 Anti-money laundering program

In general, the federal money laundering requirements imposed by the Bank Secrecy Act, the USA Patriot Act, and FinCEN guidance provide a comprehensive framework which both effectively and fairly applies AML program development, transaction monitoring, reporting, and recordkeeping requirements across all money services businesses, including virtual currency businesses.

The federal requirements already impose a high burden on MSBs, and may be prohibitive requirements for most virtual currency startups. However, there is at least some clarity and common understanding of the federal requirements. We are concerned that the NYDFS AML rules seem to emphasize pre-existing requirements with vaguely redundant language which may conflict with our understanding of federal AML obligations. These rules may not necessarily enhance NYDFS ability to provide AML oversight and in fact impose greater (or conflicting) administrative burden and introduce unnecessary confusion to an already very demanding and comprehensive AML framework.

For clarity, where NYDFS makes reference to obligations already imposed by federal requirements, and seeks to underline those requirements—NYDFS should specifically reference the relevant United States Code or Federal Regulation, instead of summarizing it.

As an example, 200.15(i) states "Each Licensee shall have in place appropriate policies and procedures to block or reject specific or impermissible transactions that violate federal or state laws, rules, or regulations." It seems the intent behind this provision is to underline an

obligation to comply with all pre-existing federal or state requirements. However, the vague language also introduces the possibility that Licensees must take a specific action to “block” or “reject” transactions which are “impermissible”, even when they may run afoul of a state rule that may instead suggest other corrective action—such as enhanced due diligence. There is also a detailed BSA framework for assessing whether and how to go about blocking or rejecting certain transactions, but the BSA does not impose a blanket requirement to “block” or “reject” any transaction that violates any federal or state law, rule, or regulation. More specificity and clarity is needed. Otherwise, this kind of vague language should be eliminated.

200.15(d)(2) Reports on transactions.

If NYDFS requires a report triggered at the aggregate \$10,000 per Person per day, we would urge NYDFS to make such reporting requirements consistent with the pre-existing BSA requirements for filing a CTR. Namely—we would ask that the time period for filing the report be extended to at least *15 days* after the date of the transaction.

In addition, we would ask that NYDFS to refrain from creating an entirely new reporting methodology or processing platform. Ideally, NYDFS would coordinate directly with FinCEN to obtain the information about reports already filed with FinCEN. At most—this requirement should be fulfilled by a duplicate filing with NYDFS for any relevant CTRs already required to be filed via the BSA E-filing system.

200.16 Cyber security program; Section 200.17 Business continuity and disaster recovery

We believe that some kind of cybersecurity and disaster recovery framework is appropriate. However, the same kinds of risks addressed by these rules are present for both virtual currency businesses and any other regulated MSBs which operate on electronic systems. Therefore, NYDFS should impose this same framework to all scenarios in which it fairly applies—rather than singling out virtual currency businesses for such regulation.

The scope and function of electronic systems will vary widely, so it is important for cyber security requirements to be attuned to the risks presented by each business model. Thus, NYDFS should require businesses operating electronic systems to develop risk-based programs which are consistent with some broad standards that coincide with industry best practices. For example, the 200.16(e)(3) source code review requirement is a very onerous and resource-intensive requirement which might be more suitable only for larger, more established entities. Even then, it may be more appropriate to have such source code reviews performed internally by qualified personnel.

Section 200.18 Advertising and Marketing

We would ask NYDFS to provide clarification on the frequency with which advertisements must be recorded, and the required retention period. Particularly in the early development stages for startup virtual currency businesses, minor changes in graphics, text, or user interface may occur frequently as a website is being built and updated in response to

customer feedback. Would the Licensee need to provide a screenshot for every posted change? It might be helpful to peg record-keeping requirements to material updates.

We also seek further clarification on whether a business pitch to a potential institutional business partner in a non-public setting qualifies as an advertising or marketing material which would require maintaining an audio or video record.

Section 200.19 Customer protection

200.19(c) Disclosures of the terms of transactions.

CoinX already furnishes customers with a set of terms and conditions which largely conform to the requirements set forth in this section. However—it is excessive to require the acknowledgement of the terms and conditions prior to *each* transaction. Such a requirement would actually do a disservice to the customer, as it is very unlikely that the customer will read the terms and conditions before each transaction and therefore would be less likely to notice any changes.

Rather, NYDFS might require that customers acknowledge and ‘accept’ the terms and conditions by clicking through during the account-opening process. In addition, consumers may be alerted to material changes to the terms and conditions with a clear and conspicuous posting on the website, or a notice communicated via their designated email address.

With respect to the requirement that written disclosures be provided “in any other predominant language spoken by the customers of the Licensee”—NYDFS should more closely track the logic behind CFPB’s Remittance Transfer Rule guidance regarding language on written disclosures. More specifically, CFPB requires that disclosures must be made in any foreign languages principally used to advertise, solicit, or market remittance transfer services at an office in which the sender conducts a transfer or asserts an error.

200.19(d) Acknowledgement of disclosures.

NYDFS requires that customers acknowledge the receipt of disclosures prior to each transaction. Again, we would request that these pre-transaction disclosures be limited to the specific terms of the transaction (or track the logic of prepayment disclosures required by the CFPB in its Remittance Transfer Rule guidance). Then, the consumer can provide acknowledgement by clicking through to confirm the terms of the transaction.

Section 200.20 Complaints

200.20(c)

NYDFS’ ability to provide oversight would be compromised by the administrative burden posed by a submission of the complaint policies and procedures whenever “any” change is made. The reporting requirement should rather be pegged to “material” change.

The complaint policy sets up procedural processes as a first line to handle consumer complaints. If such complaints go unresolved—they will almost certainly be reported directly to NYDFS by the consumer, who is provided with NYDFS contact information in the terms and conditions and presented conspicuously on a separate page of the website which discloses the



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Licensee's status as a NYDFS-licensed entity. Thus, the timeline of seven days should be extended to at least 30 days, as a longer timeline would not substantially affect the rights of the consumer, or the licensed entity's liability with respect to consumers and transactions.

Thank you again for your efforts in drafting sensible regulations and the opportunity to comment on the BitLicense Proposed Rules. While it is our hope that NYDFS reconsiders the creation of the new BitLicense framework for virtual currency businesses, we would look forward to additional opportunities to provide feedback as they arise in the future.

Sincerely,

A handwritten signature in black ink, appearing to read "Roseanne Lazer". The signature is fluid and cursive.

Roseanne Lazer
Legal and Compliance Officer