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

Dear Ms. Syracuse:

I appreciate the opportunity to comment on the proposed regulations relating to virtual currency recently published in the July 23, 2014 edition of the New York State Register on behalf of my client, an entity involved in a Bitcoin trading platform. I was Georgia's principal securities regulator for over eight years and, previously and subsequently, an attorney in private practice representing a variety of firms and individuals active in various areas of financial services and products. While issues relating to virtual currency regulation are certainly different in some respects from those facing other financial industries and instruments, I believe that there are enough similarities that issues and regulatory responses and experience in other areas can be constructive.

My comments fall in three basic areas:

1. The "one-size-fits-all" regulatory approach to the virtual currency industry;

2. Lack of specificity, clarity and over breadth concerning certain licensing and operational requirements; and

3. Jurisdictional issues.

"One-Size-Fits-All" - Rather than differentiating among different types of business models within the virtual currency industry, the regulation establishes a single license for any business engaging in "virtual currency activity." Under the Section 200.2 of the proposal, the definition of "virtual currency activity" covers a wide range of activities, including its creation (Section 200.2(n)(5)), safeguarding it for owners (Section

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200.2(n)(2)), selling it (Section 200.2(n)(3)), facilitating its transfer to third parties (Section 200.2(n)(1)) and converting it to and from traditional currencies (section 200.2(n)(4)).

The proposal creates a single license for all of these business models and activities. Under regulatory schemes in other areas of financial services, greater differentiation appears. For example, securities issuers, exchanges, broker-dealers and investment advisers all perform disparate functions within that sector of the industry and are, therefore, subject to rules tailored to their particular areas. The regulation of participants in the commodities industry has even more variations of regulated entity, licensing requirements and operating requirements. Registration and operational considerations among various classes of participants in the virtual currency arena should be no less distinct.

The regulation would seek to regulate, for example, creators of virtual currency. Presumably, that would include Bitcoin "mining" which, while it can be conducted independently, is also conducted through a number of entities created for that purpose and which "borrow" computing capacity for the purpose of performing the extensive calculations necessary to "mine" the virtual currency. The "miners" pay the "mining company" for the right to purchase a share of the Bitcoins as they are mined.

Harnessing vast computing capacity to be directed toward creating virtual currency requires distinctly different technology from, for example, operating a business which facilitates the exchange of virtual currency with other currencies on an anonymous basis.

Similarly, regulating an entity which exists for the purpose of transmitting value between different individuals raises significantly different issues than would be the case for an entity which conducts exchange transactions for individuals, but in a manner which prevents directed transmission of value to third parties. Addressing money-laundering concerns, for example, might be a primary driver of regulations for the former, which issues relating to account integrity might be more important for the latter.

In almost every situation, the imposition of regulations on an industry participant either imposes direct or indirect costs on that participant, or imposes a barrier to entry. The costs and barriers, and therefore the regulations, should be tailored to the nature of the business to be conducted by a potential registrant. A meat-packing plant and a food truck selling ice cream, while both in the food business, present many widely disparate regulatory concerns, despite some overlap.

Lack of Specificity, Clarity and Over Breadth - Several provision of the proposed regulation would impose substantial standards and requirements upon virtual currency businesses without specifying any detail about those factors, are unclear or overbroad. Of specific concern are the following:

a. Section 200.2(n)(3) and (4) - The meaning and differentiation of these sections is unclear from the text of the proposal. I respectfully suggest that the "buying and selling" of virtual currency "as a customer business" in subsection (3) appears to be identical to activity which would be included within the conversion or exchange provisions of subsection (4). I recommend clarifying the provisions of these two subsections if a different meaning is intended.

a. Section 200.4(4) - This provision requires the application to include a "background report prepared by an independent investigatory agency acceptable to the superintendent" for each individual playing a significant role for an applicant. The provision does not specify the topics to be covered by a report nor which "independent investigatory agenc[ies]" would be acceptable. Many financial services industry regulatory schemes require a criminal background search to be conducted using an applicant's fingerprints (as required by Section 200.4(a)(5), yet it appears this proposal requires more for virtual currency industry. If the Department wishes additional background information to be obtained for an applicant, I respectfully suggest that it should specify the types of information it seeks, and the qualifications of the agency which must prepare it, before asking applicants to undergo the cost of purchasing independent reports which may, in the end, be insufficient due to either their content or their provider.

b. Section 200.5 - This provision requires "an initial application fee, in an amount prescribed by the superintendent..." However, the proposal does not provide guidance as to the amount of the fee, when it is to be determined, or whether it may change during the course of the application process.

c. Section 200.6(a) - The proposal provides that "upon demonstration by the applicant of its ability to comply with the provisions of this part, the superintendent shall investigate the financial condition and responsibility, financial and business experience, and character and general fitness of the applicant." Then, the superintendent will determine whether he believes the "applicant's business will be conducted honestly, fairly, equitably, carefully, and efficiently." It is unclear how, prior to the commencement of the superintendent's investigation, can the applicant "demonstrate its ability to comply with the rule's provisions." More significantly, the proposal does not specify the standards by which the applicant's fitness is to be judged. For example, will there be a non-insolvency or minimum net worth qualification? Is there to be a specific experience qualification? Will there be any requirement that an applicant demonstrate competencies in matters relating to virtual currencies, as opposed to finance in general?

Vagueness of required qualifications and, therefore, of the bases upon which an application might be denied, are problematic for applicants. First, many may be dissuaded from applying simply because they are unable to determine what is required. Others may apply and be denied for failing to meet unknown criteria which, if published, would have either dissuaded an application or prompted the applicants to take actions to meet the criteria before incurring the time and expense of submitting an application preordained for denial. It is respectfully suggested that this part of the proposal include a greater degree of specificity about the required qualifications of applicants for the various types of participation within the virtual currency industry.

d. Section 200.6(b) - While the proposal requires an application to be approved or denied with ninety days, the proposal does not provide the manner in which a denial would be communicated to applicants. Unlike the case with issued licenses, it appears that an application denial does not provide an opportunity for a hearing like that provided in Section 200.6(d) for licensees subject to suspension or revocation. Furthermore, the proposal appears not to contain a provision requiring the department to provide a reason for a denial, or an opportunity to correct any application deficiencies.

e. Section 200.8(a) - Licensees are required by this provision to maintain "capital" in an amount that the "superintendent determines is sufficient to ensure the financial integrity of the Licensee and its ongoing operations," and sets out a non-inclusive list of factors which will be considered in determining that sufficiency. The provision is extremely problematic. First, it fails to define the amount of required capital, and precisely how that amount is to be calculated. Second, it does not describe when that capital determination will be made, and whether and how often the required capital amount might be changed. Any industry participant, or potential participant, would have great difficulty evaluating whether and when to apply for a license if it cannot know the amount of operating capital it will be required to maintain or have at the outset. In establishing capital rules for its members, the SEC and FINRA have a clear set of requirements so that firms - depending upon their business model - can calculate precisely their required level of capital. The Commodities Futures Trading Commission provides for a similar approach. I respectfully recommend that the Department use those approaches as model for its capital requirement, carefully considering capital amounts which are appropriate for various industry participation types without creating unnecessary barriers to entry.

f. Section 200.9(a) - This provision requires virtual currency businesses to maintain a "bond or trust account" in "such form and amount as is acceptable to the superintendent..." Again, the vagueness of this provision renders decision making difficult. Without specifying the amount of the required bond or "trust account," it will be impossible for an applicant to obtain it. Also, the proposal does not specify the factors which would determine whether a trust account would be required, or whether a bond would be acceptable. Additionally, it is unclear whether the bond or trust account would change over time, and, if so, the manner and timing in which such a change would be communicated and how it would be determined.

g. Section 200.11(a)(2) - Understandably, the Department's proposal seeks to require that a change on control of a licensee requires an application process similar to a new application, so that a change of control cannot be used as a subterfuge to what otherwise would be a new application process. Unfortunately, the definition of "control" in Section 200.11(a)(2) is overbroad. Many companies in the virtual currency industry are small, privately held entities. If such a company had three shareholders, two of whom owned 10% of the company's interests, and the remaining shareholder owned 80%, clearly the 80% shareholder controls every aspect of the company's business. Nevertheless, a change in one of the 10% owners, for any reason, would require a new application under the proposal. It is respectfully recommended that the definition of "control" be reconsidered to more specifically address true changes of control as opposed to an arbitrary ownership percentage applicable to all situations, and provide for a more limited notice amendment procedure when other ownership changes occur.

h. Section 200.12 - The requirement that books and records be maintained for a period of ten years seems overly lengthy. Securities brokerage firms are required under SEC Rules 17a-3 and 17a-4 under the Securities Exchange Act of 1934 for either three or six years depending upon the nature of the record, and SEC registered investment advisory firms generally have a five-year record retention requirement under Rule 204-2(e) of the Investment Advisers Act of 1940. Practically speaking, rarely, if ever, firms called upon to produce records older than that, and it is respectfully recommended that the require requirement be shortened to no more than the six-year maximum required of securities firms.

i. Section 200.14 - Following on the recommendation that the Department consider differentiating among the various types of virtual currency businesses, I believe the implementation of this provision, in particular, would benefit from more differentiation. As written, the proposal allows the Superintendent latitude to prescribe the information required to be reported; presumably that would allow differentiation among various types of business models within the virtual currency space. Specifically, it is noted that quarterly reporting for certain business types might be unnecessary, and that requiring quarterly updates to financial projections and strategic business plans may produce no significant information. While collecting information from registrants can be an important part of the regulatory oversight process, it is suggested that collecting too much information too frequently can burden not only the registrants, but also the administrative staff of regulators who are assigned the task of receiving, logging and storing it - not to mention reviewing it.

j. Section 200.16 - Obviously, it is critical that any business engaged in handling virtual currencies in any manner, and for any reason, must have stringent cyber-security processes and procedures in place. In subsections (c) and (f), the proposal requires licensees to "employ" personnel to act as a Chief Information officer and otherwise as cyber-security personnel. I respectfully recommend that the Department modify the proposal to allow these functions to be performed by independent contractors, rather than employees. In many cases, a business, especially a small business, will be better served by retaining an independent firm specialized in security matters than by recruiting and hiring an employee. An independent firm's level of expertise may be higher than a potential employee's, and its personnel may be more skilled in the numerous issues which may present themselves. Moreover, the heightened degree of independence itself may produce more robust identification of security issues is any are discovered. I therefore recommend clarifying the proposal to allow these functions to be performed by either independent contractors or employees.

k. Section 200.18 - While it is relatively easy to maintain copies of static printed, audio and video advertisements, maintaining copies of web-based advertising may be more difficult because of the dynamic nature of such advertising. Websites may have frequent updates in the normal course of business, as various updates and edits are made. In addition, websites often literally change constantly. For example, a home page of a company handling Bitcoin transactions may have a constantly changing presentation of Bitcoin value. Similarly, websites may have frequently updated, or even scrolling, feeds of news items. Preserving screenshots of each iteration of these types of webpages would require massive amounts of data storage capability, not to mention sophisticated data capture technology. We encourage the Department, in its requirement that advertising materials be retained, to provide a mechanism which will allow retention of copies of examples of website pages, rather than each version of pages containing constantly changing material.

Jurisdictional Issues - In 1996, Congress passed the National Securities Markets Improvement Act ("NSMIA"), which significantly altered the regulatory structure of the securities industry in the United States. The act eliminated state regulatory authority from many operational aspects of securities businesses and securities markets, recognizing that the continuation of a multitude of differing, and sometimes contradictory, state law requires was hindering the operation of a national industry. By and large, the drafters of NSMIA recognized that most securities brokerage firms and markets operate in many or all states, and requiring those participants to comply with dozens of state laws, as well as federal law, was extraordinarily burdensome and counterproductive. The States' anti-fraud enforcement authority over firms operating within their respective states was preserved, as was basic licensing authority, but most broker-dealer operational requirements were reserved for the Securities and Exchange Commission and the national securities self-regulatory agency, now called the Financial Industry Regulatory Authority (FINRA).

Since the passage of NSMIA, states have remained vital and significant members of the regulatory structure of the securities industry. They have been able to focus what are typically limited resources on matters most affecting consumers, while leaving most structural issues, of firms but also of markets, to be governed under federal regulatory authority.

In addition, in 2010's Dodd-Frank Act, which further refined the securities industry regulatory scheme, Congress bifurcated and expanded state regulatory authority of investment advisers by reserving to the states authority over those advisers with less than $100 million dollars under management. This approach recognizes that those relatively small firms typically operate in at most a few states and, often, in only one, so that it makes sense to allow states to be their primary regulator and for the federal government to regulate larger firms. Furthermore, the regulatory scheme recognizes a greater degree of responsibility for those firms' "home state" regulators in some instances.

As of now, of course there is no federal or widespread uniform regulatory structure for virtual currencies, although some regulators have indicated that it is being considered. So, in that respect, virtual currency regulation is in a similar posture to securities regulation in the latter part of the 19th Century, prior to federal regulation and in the early stages of state regulation. Nevertheless, less than fifty years passed from the passage of the first "Blue Sky" law to the adoption of the federal Securities Acts of 1933 and 1934. In the modern financial environment in which all transactions may be truly global, I suggest that the Department, if it chooses to be among the first, if not the first, jurisdiction to enact a broad scope regulatory scheme, do so with a view that it may well be challenged and then supplanted by federal regulation in the near future - probably well before the passage of fifty years. Or, perhaps as an alternative, the Department could include other states in the process as they formulate regulations, so that the finished product represents approach with input and approval from other states and thus less likely to be contradicted by other states and, then, inevitably, replaced by yet a different regulatory structure imposed upon the industry through federal preemption.

The risks and costs of duplicative regulation should also be considered. The needs for consistency and uniformity are paramount when various regulators are engaged in the same space. It may be, as various federal regulators adopt approaches which would include regulation of participants in various aspects of the virtual currency space, that regulatory schemes will emerge that present conflicting, or at least burdensome, requirements for those participants.

Moreover, entities registered as a commodities dealer under the CFTC, or a broker-dealer under FINRA, are already subject to regulations as stringent as, or even more stringent than, as those contemplated in the proposal. By adding an exemption for those firms from the licensure requirements of Section 200.3(c) of the proposal, those firms would be automatically excluded from the possibility of being subject to duplicative and possibly conflicting regulations.

Some industry members may prefer that the industry continue without regulatory strictures, but that approach brings uncertainty, and uncertainty breeds fits and starts that might be avoided with a fair, thorough, differentiated approach to regulation of this new industry.

Thank you for the opportunity to comment.

Very truly yours,

Robert D. Terry