October 21, 2014

VIA EMAIL TO DANA.SYRACUSE@DFS.NY.GOV

Mr. Benjamin M. Lawsky
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Mr. Dana V. Syracuse
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Re: Comments on Proposed Rules regarding the Regulation of the Conduct of Virtual Currency Businesses – Addition of Part 200 to Title 23 NYCRR

Dear Mr. Lawsky and Mr. Syracuse:

Ripple Labs, Inc. ("Ripple Labs") submits the following comments in response to the New York Department of Financial Services' ("NYDFS") Proposed Rulemaking on the Regulation of the Conduct of Virtual Currency Businesses reflected in the notice appearing at 36 N.Y. Reg. 14 (July 23, 2014) (the "BitLicense Proposal").

Ripple Labs is the parent company that created and supports the Ripple protocol—an open-source, distributed payment protocol for accounting for financial balances held within and moved between ledgers. The Ripple protocol enables payment in any fiat or virtual currency, including the math-based virtual currency developed by Ripple Labs, XRP.

Ripple Labs appreciates the thoughtful work that NYDFS has put into crafting a new regulatory regime for the virtual currency ecosystem. We believe that developing regulation to apply to the virtual currency space can simultaneously serve the interests of consumers, businesses, and the government.

In that spirit, Ripple Labs wishes to share some concerns about the first draft of the proposed regulations. First as Superintendent Lawsky has acknowledged, the scope of the existing draft is somewhat ambiguous. This ambiguity risks sweeping up businesses that NYDFS either does not want to regulate or already regulates. Second, although certain business activities may raise risks for consumers and others, businesses engaged in virtual currency business activity should not labor under more onerous regulatory burdens than do other licensed entities that present those same or very similar risks.

A. Scope of BitLicense Proposal

The BitLicense Proposal defines "virtual currency" and "business activity" in broad terms. As a result, the existing draft likely sweeps up business activities that NYDFS does not intend to regulate or that it already regulates. Mr. Lawsky has publicly acknowledged the first problem,[1] and we appreciate that NYDFS

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[1] Pete Rizzo, *Ben Lawsky: New York Can't Risk Getting BitCoin Regulation Wrong*, Coin Desk (Aug. 21, 2014, 20:45 BST), http://www.coindesk.com/ben-lawsky-bitcoin-regulation.

intends to revisit the definitions to make sure that software development is not covered. We likewise believe that NYDFS should make sure that its definitions do not inadvertently expose individuals or businesses that seek to trade virtual currencies on their own accounts from whatever definition it ultimately adopts.

As NYDFS revisits the definitions of "virtual currency" and "business activity," we believe that NYDFS should focus on what distinguishes virtual currency from other financial services technologies. In our view, the primary distinction between virtual currency technologies such as BTC and XRP from other value exchange technologies is that BTC and XRP are digital assets that do not create a corresponding liability. This aspect of virtual currency technologies means that businesses that handle virtual currencies on behalf of consumers and others present a new and unique risk profile as compared with other financial services-related businesses.

By the same token, however, all financial services that incorporate virtual currency technologies do not create unique risks. The Ripple Ledger, the BlockChain and other modern settlement technologies have significant advantages over the technologies on which banks, insurance companies and traditional money transmitters rely to move and track money. The definitions that NYDFS ultimately adopts should not dissuade such financial institutions from incorporating these technologies to reduce the risk and speed the movement of money.

Attention to the unique attributes of virtual currency technologies and the manner in which those technologies are implemented should also help to focus the disclosure requirement that is a focus of the existing draft. As drafted, the proposed regulation requires licensees to disclose a laundry list of information to consumers in all circumstances in which a licensee is engaged in covered activity.[2] This disclosure has to potential to cause consumers to "tune out" the specific risks about which NYDFS is particularly concerned (as many do when quickly clicking past a website's terms and conditions). NYDFS instead should focus on the few important risks associated with virtual currency (such as the volatility of virtual currency and the importance of securing passwords) and require BitLicensees to provide specific, clear disclosures addressing these risks.

B. BitLicense Proposal Would Create an Uneven Playing Field

The BitLicense Proposal as written creates an uneven playing field between virtual currency businesses and other financial services entities, in particular licensed money transmitters. Although virtual currencies present issues not contemplated by the current money transmission regulatory scheme, NYDFS should create as much parity as possible between BitLicensees and licensed money transmitters. Imposing stricter licensing requirements on BitLicensees places them at a competitive disadvantage to money transmitters, which will serve only to stifle innovation in the nascent virtual currency space. Mr. Lawsky indicated in a recent speech that, to the extent possible, financial regulation should be "technologically neutral," and that the intent of the BitLicense Proposal is to regulate BitLicensees in a similar manner as other financial companies.[3] We are encouraged by the tone and direction of Mr. Lawsky's comment, and

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[2] BitLicense Proposal § 200.19.
[3] *See* Benjamin M. Lawsky, Superintendent, New York Dep't of Fin. Servs., Excerpts from Prepared Remarks of on Virtual Currency and Bitcoin Regulation at the Benjamin N. Cardozo School of Law, (Oct. 14, 2014), available at: http://www.dfs.ny.gov/about/speeches_testimony/sp141014.htm (hereinafter, "Lawsky Oct. 14 Speech").

we identify the issues below to assist NYDFS in its effort to create regulatory parity between BitLicensees and other financial companies.

1. Relationship between BitLicenses and Money Transmitter Licenses

A starting point is to clarify the relationship between BitLicenses and money transmitter licenses. As drafted, the BitLicense Proposal would require money transmitters engaged in VCBA to obtain a BitLicense in addition to their money transmitter license. At the same time, BitLicensees would be licensed to engage in VCBA only, and not traditional money transmission. Requiring money transmitters and virtual currency businesses to obtain two separate licenses—both of which have largely similar requirements—would serve only to stifle innovation and competition, and may impose nearly insurmountable requirements for smaller companies. Ideally, NYDFS should exempt money transmitters from licensing requirements similar to the exemption already contemplated for entities chartered under the New York Banking Law to conduct exchange services.[4,5] Along the same lines, NYDFS should also clarify that obtaining a BitLicense will satisfy the statutory licensing requirements for money transmission. Mr. Lawsky recently indicated instead that NYDFS will streamline the process where applicants are required to obtain both a money transmitter licenses and a BitLicense, permitting applicants to cross-satisfy the requirements of each license.[6] We believe that combining the application processes for money transmitter licenses and BitLicenses will certainly help alleviate the burden of applying for both licenses, particularly if the application requirements deviate only in the narrow instances that reflect material difference in what is being regulated—virtual currency versus fiat currency.

2. Definitions in Money Transmitter Laws Should Be Carried Forward

NYDFS should carry forward certain definitions contained in the money transmitter laws in order to create a level playing field across businesses engaging in virtual currency and non-virtual currency activity. The money transmitter laws require agents of money transmitters to be bonded and insured. However, agents of licensed money transmitters are themselves exempt from the money transmitter licensing requirement.[7] The BitLicense Proposal takes a different approach, and instead prohibits BitLicensees from conducting VCBA through an unlicensed agent.[8] There is no reason why a money transmitter should be able to utilize an agent while a BitLicensee cannot. NYDFS should permit a BitLicensee to use unlicensed agents, but require that any agent be under written contract and be bonded and insured as under the money transmitter laws.

Similarly, unlike under the money transmitter laws, the BitLicense Proposal does not exempt entities that engage in processing transactions between BitLicensees. The broad definition of VCBA would seem to capture these processing entities. New York's money transmitter laws, however, permit entities to transmit currency between licensed money transmitters without themselves being licensed. There is no reason why NYDFS should require an entity engaged in processing activity between two BitLicenses to obtain its own license. NYDFS should clarify that such activity falls outside the reach the regulation.

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[4] *See* BitLicense Proposal § 200.3(c).
[5] NYDFS should also expand to all chartered banks the existing exemption currently limited to banks charted "to conduct exchange services." *See* BitLicense Proposal § 200.3(c).
[6] *See* Lawsky Oct. 14 Speech.
[7] *See* NY Banking Law §§ 640(10), 648; 3 NYCRR §§ 406.2(l), 406.4.
[8] BitLicense Proposal § 200.3(b).

3. Anti-Money Laundering Program is Overly Burdensome

The BitLicense Proposal's anti-money laundering ("AML") program imposes several requirements not required of money transmitters, and which are not justified and place BitLicensees at a relative disadvantage. Most notably, one specific requirement—to collect the identity and physical address of all parties to a transaction—is not workable under most current virtual currency protocols.

Collecting the Identity and Physical Address of All Parties. The BitLicenses Proposal requires that licensees keep records of all transactions, including "the identity and physical address of the parties involved."[9] Within open network virtual currency protocols, including Ripple, in the common scenario of a one user transferring virtual currency to another user, the only information the transmitting entity needs for the recipient is their public key. And, the user sending the virtual currency may not know anything else about the recipient. In this scenario, the entity transmitting the virtual currency would be engaging in VCBA but would not know the recipient's identity or address and thus be unable to satisfy the BitLicense Proposal's AML program requirements. The problem is that in open networks, a transmitting entity does not have a relationship with all parties to a transaction. Although theoretically there are ways in which the transmitting entity may seek to gather the required information from the recipient, such as by asking the recipient to provide the information, this is not the current practice of most virtual currency protocols. Imposing this reporting burden on the recipient and the BitLicensee (plus any additional added burden of verification) may have the effect of pushing BitLicensees to operate closed or proprietary networks such that all transactions could occur only between a BitLicensee's own users—a move that would drastically restructure this industry and stifle the innovative capabilities of open networks virtual currency protocols.

However, this lack of recipient information is not unique to virtual currency transactions. For example, ACH and SWIFT methods both transfer currency requiring only "key" information from the recipient. Without the need for confirmation of recipient identification for non-virtual currency transfers, it seems hard to argue that there is a policy rationale that should apply only to virtual currency transactions. Nor does the lack of documented harm associated with virtual currencies seem to warrant requiring this heightened level of recipient visibility. And, the fact that many virtual currency technologies, including Ripple, have publicly available ledgers and other methods that make virtual currency transactions *more* traceable than transactions occurring over conventional networks further obviates the need for traditional, or more onerous, reporting requirements.

Reporting Transactions Exceeding $10,000. The BitLicense Proposal's AML program also requires BitLicensees to report transactions exceeding $10,000 in aggregate in any day by a single user.[10] This requirement would be onerous for BitLicensees, and appears to be an arbitrary threshold unlikely to combat money laundering. As virtual currency becomes more widely accepted as a means of payment, we anticipate BitLicensees handling transactions over $10,000 in aggregate for institutional entities on a daily basis. Requiring BitLicensees to submit reports for each such user each day would be onerous, and the reported information would provide little if any value in combating money laundering. Additionally, the $10,000 threshold itself appears arbitrary for identifying suspicious activity. Instead of NYDFS imposing its own requirements on virtual currency business, it is less onerous and more practical for NYDFS to rely on the AML reporting requirements the Bank Secrecy Act ("BSA") imposes on Money Services Businesses ("MSBs"). These requirements apply equally to BitLicencees engaged in VCBA as they do

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[9] BitLicense Proposal § 200.15(d)(1). The proposal elsewhere also requires BitLicensees to keep records of all transactions, including for each transaction "the names … and physical addresses of the parties to the transaction." *Id.* § 200.12(a)(1).
[10] BitLicense Proposal § 200.15(d)(2).

any other MSB engaged in traditional money transmission. Additionally, the fact that virtual currencies are more traceable than cash (because of technologies like publicly available ledgers) should serve to reduce the need to impose more stringent reporting requirements on virtual currency businesses.

Filing Suspicious Activity Reports ("SARs") with NYDFS. The BitLicense Proposal's AML program requires BitLicencees not required to file SARs under the BSA to file them with NYDFS.[11] This creates an inconsistency between BitLicensees and licensed money transmitters. NYDFS requires money transmitters to simply comply with the existing federal regime. It is unclear why BitLicensees should be treated differently. Instead, NYDFS should defer to the federal regime's imposed SAR requirements, and treat virtual currency businesses the same as licensed money transmitters.

Verifying Accountholders Initiating Transactions Exceeding $3,000. The BitLicense Proposal's AML program requirement to verify accountholders initiating transactions over $3,000[12] raises several issues. First, the requirement seems to presuppose a retail interaction between a consumer and a BitLicensee in which the consumer seeks to initiate a single transaction (as opposed to, for example, providing a BitLicensee with instructions to engage in a series of transactions that, over time, will likely exceed $3,000 in aggregate). If this is a presupposition of the BitLicense Proposal, then they should explicitly state that this is the case. Second, this requirement creates an uneven playing field between virtual currency businesses and other financial services entities because it would be unique to virtual currency transactions. For example, a credit card company does not require additional identity verification each time a cardholder makes a purchase exceeding $3,000. Third, the required method for verifying the identity of accountholders is not clear. Would a Licensees simply need to push a pop-up box asking the user: "Please check 'Yes' if you are Mr. Smith"? Or would the user have to re-enter a password or some other personal identifying information? However, in either case, the verification would not provide much value.

4. Cyber Security Requirements Would Be Unique to BitLicensees

The cyber security program requirements[13] would impose a burden on BitLicensees currently not shouldered by licensed money transmitters. While it is entirely appropriate in general for companies engaged in cyber activity to have cyber security programs, NYDFS should not impose upon BitLicensees the requirement to have a cyber security program when money transmitters engaged in cyber activity related to non-virtual currencies have no similar requirement. Doing so has the immediate impact of creating an uneven playing field between BitLicensees and licensed money transmitters. NYDFS should not impose cyber security requirements on BitLicensees without also imposing equal requirements on licensed money transmitters. Moreover, imposing prescriptive cyber security requirements creates a regime that may be much more burdensome than necessary and not rationally related to the risks each individual BitLicensee faces—*e.g.*, such as maintaining audit records for 10 years,[14] enclosing hardware in locked cages,[15] and third-party review of source code (which also potentially introduces additional security risks).[16] NYDFS should instead implement an individualized examination process so that cyber security requirements can be better tailored to each BitLicensee's business.

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[11] BitLicense Proposal § 200.15(d)(3)(ii).
[12] BitLicense Proposal § 200.15(g)(4).
[13] *See* BitLicense Proposal § 200.16.
[14] BitLicense Proposal § 200.16(e)(2)(v).
[15] BitLicense Proposal § 200.16(e)(2)(iii).
[16] BitLicense Proposal § 200.16(e)(3).

5. Certain BitLicense Application Requirements are Too Broad

The BitLicense Proposal imposes application requirements related to fingerprints, photographs, and written policies that are much broader than the application requirements for money transmitter licenses. Existing money transmitters are required to collect this information only from officers, directors, and owners of a significant equity stake in the company, and at that level, these requirements likely contribute to corporate integrity. But there does not appear to be any justification for extending these requirements to all employees of BitLicense applicants.

Additionally, BitLicense applicants must provide a copy of "all written policies and procedures",[17] whereas money transmitter applicants need only provide a limited set of policies. It is also not clear what benefit NYDFS gains in having access to an applicant's entire set of policies and procedures, including those wholly unrelated to VCBA. If anything, applicants should only be required to provide written policies and procedures related to their virtual currency business and relevant to the NYDFS' license determination, such as policies related to anti-fraud, AML, cyber security, privacy and information security, recordkeeping, business continuity and disaster recovery, and complaints.

6. Various Additional Requirements on BitLicensees

The BitLicense Proposal contemplates imposing various other requirements on BitLicensees not currently, or well beyond the current requirements, imposed on licensed money transmitters. These include:

- Requirement to obtain prior written approval for any proposed "material change" to the business[18] (not required of money transmitters);
- Minimum capital requirements[19] (not required of money transmitters);
- Investment restrictions[20] (more onerous than those of money transmitters[21]);
- Requirement to obtain prior written approval for change of control triggered at 10% of a company's equity[22] (instead of at 25% for money transmitters[23]);
- Reports and financial disclosures[24] (more onerous than required of money transmitters[25]); and
- Establishing a written business continuity and disaster recovery plan[26] (not required of money transmitters).

This strict framework—in addition to the examples discussed above—creates disparity between virtual currency businesses and money transmitters. And, in fact, it imposes upon BitLicensees many requirements typically reserved to regulate banking institutions (even though Mr. Lawsky has clarified that banks are subject to separate approval to engage in VCBA and must also abide by BitLicense-specific

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[17] BitLicense Proposal § 200.4(a)(10).
[18] BitLicense Proposal § 200.10.
[19] BitLicense Proposal § 200.8(a).
[20] BitLicense Proposal § 200.8(b).
[21] NY Banking Law § 651.
[22] BitLicense Proposal § 200.11(a)(2).
[23] 3 NYCRR §§ 406.11(b)(1).
[24] BitLicense Proposal § 200.14.
[25] 3 NYCRR §§ 406.10.
[26] BitLicense Proposal § 200.17.

requirements[27]). The nature of virtual currencies provides no reason to justify BitLicensees shouldering these additional burdens. As much as possible, the BitLicense regulatory regime should track that for money transmission.

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We believe the BitLicense Proposal is a strong first step at creating a regulatory framework that will help guide the virtual currency ecosystem, benefitting consumers, businesses, and the government alike. We request that NYDFS consider Ripple Labs' suggestions to improve the initial BitLicense Proposal. NYDFS should revise the definition of VCBA and the list of entities exempted from licensing requirements to ensure that the regulatory regime targets the appropriate conduct and entities. NYDFS should also modify the BitLicense Proposal in order to create greater parity in the regulation of virtual currency businesses and other financial services businesses. Ripple Labs welcomes the opportunity to meet with NYDFS to discuss any of the points in this letter or any of NYDFS' other concerns.

Sincerely,

Chris Larsen
CEO, Ripple Labs, Inc.

[27] *See* Lawsky Oct. 14 Speech.