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By email only

DFS Office of General Counsel – Dana V. Syracuse
NYS Department of Financial Services
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New York, NY 10004

Email: dana.syracuse@dfs.ny.gov

**Re: NY Proposed Regulation of Virtual Currency Transactions – Proposed Title 23:
Part 200 -Regulation Should be Proportionate to Whom and What is Regulated.**

Ladies and Gentlemen:

I am writing to you to comment upon New York’s proposed regulation of virtual currency transactions, Proposed Title 23; Part 200. You will find the background of the writer, of my firm and certain articles on financial regulation and virtual currency legal issues at MushkinLaw.com.

I agree that some regulation of certain virtual currency dealers and certain virtual currency transactions is appropriate. The infamous Mt. Gox bankruptcy and the Silk Road fiasco make it clear that some regulation of dealers and transactions in virtual currencies will act as a deterrent to simple default in the best case scenario and to fraud in the worst case scenario. Indeed, the posting of notice by those licensed by the Department that they are licensed by you will act as a badge of integrity much like that of banks stating that they are members of the FDIC.

I have no problem with requiring those who are required to register make full disclosure of (a) who they are, and (b) that they maintain the minimum finances adequate to carry on their particular licensed business. On the other hand, I think that §200.2(n) goes well beyond what is necessary to protect the State’s financial markets. As proposed, Part 200 would require licensing of people in whom the Department should have no little interest since they do not handle other people’s money. For instance, I see no need for New York to regulate businesses which merely buy and sell virtual currencies for their own account. In addition the regulation should be proportionate to the business to be conducted as are other regulations administered by the Department.

Involving New York

§200.2(n) states: “*Virtual Currency Business Activity* means the conduct of any one of the following types of activities involving New York or a New York Resident” (emphasis added.) “Involving New York” is breathtaking in scope. No doubt it is limited by the subparagraphs that follow, but it still takes in the world.

How far does the proposed regulation intend to reach with this language? In the banking world, in *Licci v. Lebanese Canadian Bank*, 20 N.Y.3d 327, 960 N.Y.S.2d 695, 984 N.E.2d 893 (2012) New York’s highest court ruled the New York court had jurisdiction over Lebanese Canadian Bank sued by U.S., Canadian, and Israeli citizens resident in Israel who were victims of Hezbollah rocket attacks. The claim was that the bank assisted Hezbollah by “facilitating international money transactions” by using its New York correspondent bank to transfer money to Hezbollah agents. This approach could be applied to virtual currency. The *Licci* case was a tort case, brought as a “transaction” under CPLR 302(a)(1). The New York bank was allegedly used to “facilitat[e]” the transaction. It is one thing to protect the integrity of New York licensees by allowing private individuals to use its courts to obtain restitution and quite another to require licensing of people who are in effect just passing through. See *Daimler AG v. Bauman*, 571 U.S. 746, 134 S.Ct. 746 (2014). I submit that the phrase “involving New York” is just trouble. It may present Constitutional issues which should be avoided. See Seigel N.Y. Practice, 5th Ed. 2014 Supp. §82-88

§200.2(n)(1) requires licensing of people engaged in “activities” “involving New York” who are: “receiving Virtual Currency for transmission or transmitting the same” There is no limitation on this language. It could be interpreted as covering everyone who owns a bitcoin. It is well accepted that anybody who receives fiat currency – as we all do – intends to transmit that currency to somebody else. People do not buy virtual currency just to hold it; they buy it as an investment or to use as a currency. In the securities world, the assumption is that the person who buys securities is doing so to resell it. In that realm what is regulated is not just the buying or selling but the procedures and quantities so transmitted. I submit §200.2(n) (1) ought to be eliminated.

There are other areas of §200.2(n) which will be controversial. For instance, what does “retail” mean in “Performing retail conversion services” in §200.2(n)(4). “Retail” is defined in dictionaries as the sale of small quantities. §200.15(g)(4) requires each “Licensee ...verif[y] ... accountholders initiating transactions having a value greater than \$3,000.” A “conversion [of less than] ... \$10,000 in one day, by one Person” need not be reported. 200.15(g)(1). Which of those phrases defines a retail transaction? Or is it some other unstated dollar amount?

Exempting Private Entrepreneurs

§200.3(c) should provide an exemption for private entrepreneurs. Such an exemption would exempt from registration any “Person” which is capitalized solely with the money (fiat or virtual) of the owners of the enterprise, its officers, and directors. Call them virtual currency hedge funds or virtual currency exchange traded funds. Most importantly for purposes of the

virtual currency markets they will not be any kind of agent (or fiduciary) using other people's money and therefore should not be subject to virtual currency dealer registration.

They may or may not have to register with the SEC, the Attorney General, or the CFTC. See the Winklevoss Bitcoin Trust SEC registration (in progress). Their investment advisors may also have to register with the Attorney General, SEC, or CFTC. But those are not areas which virtual currency regulation should cover. Depending on the size and frequency of transactions, they may or may not have an effect the price or volume of trades in the virtual currency market. Virtual currency dealers of that size may become subject to U.S. Treasury, Federal Reserve and other federal regulators. In the foreseeable future I submit that the amount of virtual currency known to be in circulation is so small that the State of New York should certainly not be concerned with disruption of this tiny financial market.

Certain transactions would still have to be reported and books kept but the investment and disclosure requirements might be eased. As noted. I note again that certain transactions "involving New York" are covered only if they are "retail". I cannot determine what that word means in this investment oriented context.

Compliance Provisions - One size should not fit all.

200.7 Compliance, 200.8 Capital Requirements, 200.9 Custody and Protection of Customer Assets, and many following provisions establish a system of regulation which is unnecessary for some virtual currency Person[s]. The New York banking regulations provide regulatory schemes proportionate to the licensee's activity. Full service banks with street branches, are heavily regulated in contrast to mere money exchanges, money transmitters, or check cashing services.¹ I suspect that virtual currency exchanges which only exchange virtual currency for fiat currency and vice versa, and only transmit it to a wallet or other location designated by the customer only hold currency, virtual or fiat, for at most overnight. Part 200 should provide for proportionate minimal regulation.

The Introducing Dealer and Clearing Dealer

I suggest that the regulations establish an introducing dealer and clearing dealer licensee similar to those available for brokers in the securities industry. In that scenario the introducing broker is typically a small broker perhaps working out of his home or a store front in a small community. He "introduces" his customer to the "clearing" house. The clearing house oversees and assures the introducing broker (and the regulators) of compliance with all the "back office" requirements including financial stability. One use of this vehicle would be for the legally fastidious virtual currency dealer in Smalltown, SomeState, USA, to be an introducing dealer operating through a licensed clearing dealer. The introducing dealer would have the comfort of being a licensee at small cost for the few transactions he might make. One incentive for that Person would be being "required" to advertise he was licensed by New York

¹ Of course, full service banks will probably apply to be exempt under 200.3(c)(1).

Of course the introducing dealer would be primarily responsible for knowing his customer, and for having adequate finances to execute the orders he placed. Of course such virtual currency dealers would have to keep records and comply with the many existing anti-money laundering laws. And he would have to make a deposit with the clearing house so that when clearing house accepts his customer or executes a transaction, it knows the deal is covered by the introducing dealer's finances on hand to the extent required by the rules, and the particular transaction characteristics. The clearing house would get a piece of the action for its oversight and execution of the transactions. The introducing broker keeps his independence. The clearing dealer's responsibility for the conduct of an "employee" is limited. I submit that many of the introducing dealer's customer will be people with small accounts executing "retail" trades which are exempt under §200.15(g)(4) and §200.15(g)(1).

Very truly yours,

A handwritten signature in cursive script that reads "Martin Mushkin".

Martin Mushkin