itBit USA LLC
Charles Cascarilla, Chief Executive Officer
140 E. 45th Street, 17th Floor
New York, NY 10007

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Superintendent Benjamin M. Lawsky
New York State Department of Financial Services
One State Street
New York, NY 10004

Re: Comments on Proposed BitLicense Regulatory Framework for Virtual Currency Firms

Dear Superintendent Lawsky:

itBit USA LLC ("itBit") appreciates the opportunity to comment on the New York State Department of Financial Services' ("DFS") proposed BitLicense regulatory framework for persons conducting defined Virtual Currency Business Activity[1] (the "BitLicense Framework"), which was published in the New York State Register on July 23, 2014. itBit commends DFS for a thoughtful and thorough BitLicense Framework that seeks to provide a sound foundation for consumer protection, market stability and innovation in the development of virtual currencies. In particular, itBit appreciates the spirit of cooperation and openness that Superintendent of Financial Services Benjamin M. Lawsky ("Superintendent") and DFS have demonstrated in working to consider the interests of entrepreneurs, businesses, and consumers to find the right balance for the BitLicense Framework. As discussed below, itBit supports the BitLicense Framework and suggests certain revisions and enhancements to assure that it will accomplish the goals announced by the Superintendent upon the release of the BitLicense Framework.

itBit Pte. Ltd, an affiliate of itBit, operates a leading bitcoin exchange in Singapore. As an innovator in the development of sound practices for the operation of bitcoin exchanges, itBit and its affiliate have a strong interest in the safety and soundness, market stability and competitiveness concerns that DFS has sought to address in the BitLicense

[1] This term, as well as any other capitalized terms used but not otherwise defined in this comment letter, refer to defined terms in § 200.2 of the BitLicense Framework.

Framework. As the Superintendent noted in announcing the proposed BitLicense Framework, the DFS proposal seeks

> to strike an appropriate balance that helps protect consumers and root out illegal activity – without stifling beneficial innovation. Setting up common sense rules of the road is vital to the long-term future of the virtual currency industry, as well as the safety and soundness of customer assets.[2]

It is in this spirit that itBit offers the following comments and seeks to continue to work with DFS to accomplish these goals identified by the Superintendent.

I. Background

Virtual currencies, particularly bitcoin, have been the subject of widespread public commentary and some controversy as well as regulatory scrutiny in recent years. Some highly publicized failures and potentially illegal activity have focused attention on virtual currencies and have highlighted the need for a sound regulatory framework for virtual currencies. This is particularly true for the system of Bitcoin, which is designed to operate without any central administrator.

In contrast to legal tender or fiat currency, Bitcoin is 'simply' a distributed ledger – through the 'blockchain' – stored on computers that records all transactions involving a particular bitcoin. Significantly, while it can be used to record the transmission of value, it can also record virtually any other type of information or record. More generally, the open source and irreversible properties of the blockchain can create a powerful safeguard against fraud, theft, money laundering and other illicit activities by providing a durable and transparent record of the transaction at issue so long as effective and appropriate identification and security procedures are in place.

These characteristics present opportunities for development of the protocol beyond the transmission of value. The Bitcoin blockchain offers opportunities to address major problems in security, transaction verification, and documentation for a wide variety of commercial interactions and transactions. For example, the multi-signature technology using multiple private keys associated with a defined public key provides heightened security and may facilitate a number of transaction types that require agreement between multiple entities or individuals in a group, such as escrow, mediation, or shared financial management transactions. Additionally, the blockchain can allow for so-called time-locked transactions, such as wills and trusts, where bitcoins would be disbursed on a pre-programmed schedule to specified recipients. Over the longer horizon, the blockchain can also be leveraged for "smart" contracts that could provide customers with a stronger and more reliable system of legal documentation for mortgages, leases and purchase contracts, for instance.

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[2] Press Release, "NY DFS Releases Proposed BitLicense Regulatory Framework for Virtual Currency Firms," July 17, 2014.

However, these development opportunities also pose challenges to designing a regulatory framework that focuses on financial interactions that may require regulatory oversight to protect consumers and prevent abuses, while not stifling the potential for innovation through the open source protocol underlying the blockchain. Given past events, balanced regulation is essential for virtual currencies to achieve their potential and to operate in a sound and trustworthy manner.

II. Current Regulatory Environment

Several federal and state regulators have been evaluating virtual currency developments to determine whether there is a statutory basis for regulation and whether new regulation is warranted. The Federal Trade Commission, Securities and Exchange Commission, Commodity Futures Trading Commission, and the Consumer Financial Protection Bureau ("CFPB") have all begun some review.

Among the key federal regulatory responses to bitcoin, and of particular relevance to the BitLicense Framework's definitional scope and anti-money laundering ("AML") provisions, was the March 18, 2013 Guidance by the U.S. Department of the Treasury's Financial Crimes Enforcement Network ("FinCEN"). This Guidance ruled that "exchangers" and "administrators" of virtual currency were money transmitters and, as a result, money services businesses ("MSBs") and subject to all of FinCEN's registration, reporting, and recordkeeping requirements applicable to MSBs. The Guidance defined "exchangers" as businesses that exchanged virtual currency for legal tender or other virtual currency. "Administrators" were defined as those who issued or redeemed virtual currency. By contrast, users of virtual currency are not MSBs and not subject to FinCEN's MSB regulations. This Guidance provided important definitions around who would be required to comply with FinCEN's regulations, but it left many issues unresolved as well.[3]

A number of states have applied existing money transmitter licensing requirements to firms engaged in virtual currency transactions on behalf of institutions and/or individual consumers. Although DFS is creating a standalone regulation for virtual currency through the BitLicense Framework, it has nonetheless modeled many provisions of the BitLicense Framework on analogous provisions in New York's money transmitter law, the New York Transmitters of Money Act ("NYTMA").[4] To illustrate, the BitLicense Framework has applied the NYTMA's requirements to post surety bonds, undergo periodic safety and soundness examinations, comply with applicable AML laws, and maintain certain books and records in its regulation of Virtual Currency Business Activities, with adaptations and expansions for some of

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[3] FinCEN, Application of FinCEN's Regulations to Persons Administering, Exchanging, or Using Virtual Currencies (March 18, 2013), http://www.fincen.gov/statutes_regs/guidance/html/FIN-2013-G001.html. FinCEN subsequently published rulings addressing some of those unresolved issues, including ruling that virtual currency "mining" "solely for the user's own purposes" such as purchasing goods or services did not make the person a money transmitter. FinCEN, FinCEN Publishes Two Rulings on Virtual Currency Miners and Investors (Jan. 30, 2014), http://www.fincen.gov/news_room/nr/pdf/20140130.pdf.

[4] New York regulates money transmitter businesses broadly consistent with the multi-state Uniform Money Services Act, and requires anyone selling or issuing checks, or engaging in the business of receiving money for transmission or transmitting money to obtain a license from DFS.

the requirements. The proposed BitLicense Framework has adapted many of the NYTMA requirements to the virtual currency context, as recently noted by the Superintendent, in recognition of the similarities and differences between "traditional" money transmission and Virtual Currency Business Activity.[5] itBit recommends that in those areas where the NYTMA serves as a baseline for provisions in the BitLicense Framework, careful consideration be given as to whether Virtual Currency Business Activity requires more or less regulation than fiat currency money transmission activities as well as whether the activity being conducted is principally a transfer of value or the documentation of another transaction. As a governing principle, itBit would urge DFS to eliminate or minimize the differences between the BitLicense Framework and the NYTMA on analogous points, so as to prevent competitive disparities between fiat and virtual money transmission from arising. In those areas where the activity is principally using the transfer of virtual currency for documentation or other non-financial purposes, itBit recommends that DFS consider limiting regulation to that necessary for transparency to promote innovation and development of these non-monetary uses.

The BitLicense Framework is the product of a year-long inquiry by the Superintendent and DFS, which included extensive public hearings and public comments. The Superintendent has been actively reviewing consumer and other issues in a wide variety of virtual currency operations. For example, on March 11, 2014, the Superintendent separately issued an order inviting applications and proposals for the establishment of virtual currency exchanges in New York. While the BitLicense Framework expressly notes that it is not applicable to a New York regulated exchange, the proposed framework provides a vital regulatory approach that will affect the future of all virtual currency-related businesses in New York and beyond. itBit greatly appreciates the engagement of the Superintendent and DFS in exercising leadership to develop this approach through engagement with interested parties.

III. Comments

1. Summary of Comments

itBit supports the BitLicense Framework and believes it can be enhanced through some revisions that will better help the regulations accomplish the goals announced by the Superintendent upon the release of the BitLicense Framework. In summary, itBit suggests the following areas where the BitLicense Framework can be improved to provide the needed regulatory environment that protects the security of virtual currency operations, protects consumers, and promotes innovation.

First, itBit recommends that the BitLicense Framework be tailored to respond to the risks posed by particular Virtual Currency Business Activity. As a result, itBit suggests that DFS consider limiting the applicability of certain requirements to those conducting more than a *de minimis* volume of transactions and apply a tiered approach, as suggested by the

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[5] Excerpts from Superintendent Lawsky's Remarks on Virtual Currency and Bitcoin Regulation in New York City, October 14, 2014, http://www.dfs.ny.gov/about/speeches_testimony/sp141014.htm.

Superintendent in his recent speech, to other activities that may not require all of the elements of the BitLicense Framework.[6]

Second, itBit suggests that the definitions of Virtual Currency Business Activity and Virtual Currency should be revised to more narrowly focus the BitLicense Framework on financial transactions on behalf of customers. This is particularly important given the great potential provided by Bitcoin and the blockchain for innovative documentation and other uses where the transmission of value is not central to the use. itBit also makes additional suggestions to tailor the regulations more closely to the announced goals of the BitLicense Framework.

Third, itBit offers a number of additional suggested revisions to specific elements of the BitLicense Framework designed principally to tailor the regulations to the risks posed by different types of Virtual Currency Business Activity. For example, itBit suggests greater flexibility for permissible investments and adoption of a risk-focused capital approach based on the types of activities in which the business engages. Similarly, to promote continued innovation in virtual currency uses, itBit would recommend replacing the pre-approval requirement with a notice requirement that would provide DFS with an opportunity to review and object to products that it determined were unsafe or presented other problems. itBit also recommends, as noted above, a tiered approach to specific elements of the BitLicense Framework such as the recordkeeping, examination and reporting requirements. A further streamlining of requirements for AML to match those applied by federal regulators may assist Licensees in meeting these important requirements. Finally, itBit strongly supports the consumer protections included in the BitLicense Framework, but recommends some modifications to the disclosure requirements that will enhance compliance and improve the effectiveness of the disclosures for consumers.

2. General Comment Regarding Applicability of BitLicense Framework

The BitLicense Framework would apply to all persons engaging in Virtual Currency Business Activity irrespective of the volume of such business activity or the different risks that may arise from some Virtual Currency Business Activity and not others. While itBit understands that this straightforward approach is beneficial in certain ways, notably by minimizing the number and complexity of rules to be followed, it may be appropriate to consider whether limitations upon the applicability of certain requirements, such as examination and recordkeeping, to persons engaging in Virtual Currency Business Activity over a *de minimis* volume may be appropriate. Similarly, certain Virtual Currency Business Activity, such as holding but not transacting for others, may not require the same capital and liquidity requirements as those business activities that focus on transmitting fiat currency or virtual currency on behalf of customers. Where the proposed BitLicense Framework requirement may be derived from the analogous requirements of the NYTMA, as described in more detail below, it may be appropriate to tailor such requirements to the subset of Virtual Currency Business Activity that is more akin to money transmission compared to other activities.

Accordingly, itBit generally recommends, as noted in a number of specific contexts below, that DFS consider instituting a tiered approach to the BitLicense Framework,

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[6] See id.

including *de minimis* exemptions or risk-based adjustments for small bitcoin businesses and out-of-state bitcoin businesses with limited activity in New York, where appropriate. These exemptions or adjustments could take various forms. itBit suggests that some requirements, such as those for capital, liquidity, disclosure, examinations, and recordkeeping, may appropriately be tailored more specifically based on transaction volume or the risk that DFS seeks to avoid.

3. Definitions of "Virtual Currency Business Activity" and "Virtual Currency"

In several important respects, the definitions of Virtual Currency Business Activity and Virtual Currency may have a broader scope than is necessary to address the issues identified by DFS as underlying its regulatory goals. In addition, in some areas further clarification of the definitions may help market participants by providing more guidance about business activities encompassed by the BitLicense Framework.

The BitLicense Framework broadly defines Virtual Currency Business Activity as:

> [T]he conduct of any one of the following types of activities involving New York or a New York Resident:
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> (1) receiving Virtual Currency for transmission or transmitting the same;
> (2) securing, storing, or maintaining custody or control of Virtual Currency on behalf of others;
> (3) buying and selling Virtual Currency as a customer business;
> (4) performing retail conversion services, including the conversion or exchange of Fiat Currency or other value into Virtual Currency, the conversion or exchange of Virtual Currency into Fiat Currency or other value, or the conversion or exchange of one form of Virtual Currency into another form of Virtual Currency; or
> (5) controlling, administering, or issuing a Virtual Currency.[7]

The proposed BitLicense Framework specifically exempts from the licensing requirement (1) persons that are chartered under the New York Banking Law to conduct exchange services and are approved by the Superintendent to engage in Virtual Currency Business Activity; and (2) merchants and consumers that utilize Virtual Currency solely for the purchase or sale of goods or services.[8]

Virtual Currency is also broadly defined in the BitLicense Framework, and includes "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."[9] However, the definition of Virtual Currency expressly excludes digital units "used solely within online gaming platforms with no market or

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7 BitLicense Framework, § 200.2(n).
8 BitLicense Framework, § 200.3(c).
9 BitLicense Framework, § 200.2(m).

application outside of those gaming platforms" or "used exclusively as part of a customer affinity or rewards program, and can be applied as solely as payment."[10]

a. Distinctions may be appropriate between virtual currency financial transactions and non-financial uses of the blockchain.

Although Bitcoin-related value creation and transfer currently are the principal uses of the blockchain, there are many non-financial uses of the blockchain that are either currently in development or on the near horizon. As explained above, the Bitcoin blockchain has many uses that focus on its qualities as a public ledger rather than the transmission of value, which may include (but are not limited to) products related to escrow, wills, trusts as well as "smart" contracts for mortgages and leases.

These innovations, should they come to fruition, may require the transfer of bitcoins as a means of recording approvals or incorporating certain information to the blockchain. However, such transfers would be merely incidental to the principal purpose for which the blockchain would be used – enforcing contracts, recording property ownership, and so forth. It may be appropriate to regulate these innovative ledger functions in some way, but it may not be optimal to regulate them as purely financial transactions. However, these functions would not come within either of the exemptions from licensing provided in Section 200.3(c). itBit therefore recommends that DFS broaden the "purchase or sale of goods and services" carve-out in Section 200.3(c)(2) to exempt activity from the definition of Virtual Currency Business Activity where the principal or predominant purpose of the activity relates to a non-financial use of the blockchain, such as for documentation or recordkeeping, and in which any transfer of bitcoins is incidental (e.g., as nominal consideration) to that principal or predominant use.[11]

Additionally or alternatively, an exemption for these non-financial uses of the virtual currency could be achieved through the definition on Virtual Currency. To the extent that other forms of virtual currency (i.e., other than Bitcoin) are dedicated solely to non-financial uses such as effectuating contractual arrangements or property transfers, such virtual currencies would not appear to come within the very limited exclusions for online gaming or rewards program units in the Virtual Currency definition. Thus, itBit would also recommend as an additional or alternative clarification broadening the exclusion in the Virtual Currency definition to provide that virtual currencies with, or the use of a virtual currency for, principally or predominantly a non-financial purpose (or a similar formulation) are not covered by the licensing requirement. At a minimum, however, itBit would urge DFS to include an additional clause in the Virtual Currency exclusion to make clear that the enumerated types of units (i.e., online gaming

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[10] Id.

[11] itBit greatly appreciates the Superintendent's recognition of these issues in his October 14 comments. itBit supports regulatory approaches that recognize that the financial and many other aspects of the BitLicense Framework may not appropriately apply to such uses of Bitcoin where the transmission of value is not the primary purpose of the transaction. Although FinCEN's Guidance does not set forth a "non-financial" carve out to the scope of covered virtual currency activities, the Guidance is clearly centered on financial transfers and does not reflect a focus on non-financial uses of Bitcoin. However, given the broader regulatory goals identified by DFS in the BitLicense Framework, a distinction between those transactions principally designed to transfer value and those principally designed to use the blockchain as a recordkeeping tool may be appropriate.

platforms, customer affinity and rewards programs) are illustrative only and not meant to create negative implications regarding the coverage of other putative virtual currencies.

b. Consideration should be given to refining the scope of "activities involving New York or a New York resident".

To provide clarity to non-New York based market participants in their attempt to determine if their contacts with New York would constitute Virtual Currency Business Activity, itBit suggests that DFS specify the intended breadth of "activities involving New York or a New York resident." A useful reference point would be the NYTMA and DFS's 2011 interpretive letter on the NYTMA's extraterritorial reach.[12] By leveraging an established, known regulatory framework in this manner, DFS could mitigate uncertainty for non-New York based market participants. To the extent DFS anticipates any material differences in how broadly it would apply the BitLicense Framework extraterritorially as compared to the NYTMA, it would be helpful to provide an illustrative list of any such differences.

At the same time, as noted above, itBit would urge DFS to consider the regulatory environment for relationships between future New York-based Bitcoin exchanges and potential exchange customers. Specifically, there could be a risk that non-New York bitcoin entities based in other jurisdictions could decide that their actual or projected volume of business with New York residents is too small to justify the costs of obtaining a BitLicense. This could yield at least several negative consequences.

First, it could reduce the attractiveness of New York for Virtual Currency Business Activity generally, thus allowing other states a competitive advantage at least in the critical near term period as the market grows and matures. To address this concern, itBit suggests that DFS consider instituting a *de minimis* exemption for non-New York entities, keyed to a notional amount of bitcoins transacted over a specified timeframe.

Second, New York-based Bitcoin exchanges potentially could lose trading and ancillary business from transactions involving non-New York based traders who would arguably be captured by the BitLicense Framework (e.g., by transacting on behalf of customers).[13] As a general matter, subjecting such traders to licensing requirements when transacting on a fully-licensed and regulated New York Bitcoin exchange should be unnecessary, given that the exchange will already be required to fulfill the stringent regulatory obligations with respect to the transaction. itBit therefore recommends that DFS adopt a generally-applicable exemption from the BitLicense requirement for exchange customers that conduct New York-related Virtual

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[12] DFS Industry Letter, Money Transmitters with No Physical Presence in New York (Mar. 31, 2011).

[13] This concern would apply to non-New York based traders transacting with a New York-based trader on the exchange. Based on itBit's reading of the draft BitLicense Framework, and assuming DFS were to apply the BitLicense Framework with the same extraterritorial reach as the NYTMA, it appears that trades between two non-New York based traders on a New York Bitcoin exchange (who have no connection to New York other than transacting on the exchange) would not subject either of the traders to the licensing requirement. itBit would ask DFS to clarify this in its next iteration of the draft BitLicense Framework. Additionally, as discussed in more detail below, itBit assumes that the BitLicense requirement would apply only to traders transacting on behalf of customers (as opposed to proprietary traders) in any event.

Currency Business Activity exclusively through a regulated New York exchange or for persons who engage in New York-related Virtual Currency Business Activity through a regulated New York exchange.

If DFS determines not to adopt these suggestions, itBit requests that it provide either further definition of the scope of New York's regulation of customers of New York exchanges and similar types of businesses in the final BitLicense Framework or in follow-up guidance. Clarity on the application of these regulations will be very important to fostering the development of New York as a center for virtual currency businesses.

c. The coverage of "[r]eceiving Virtual Currency for transmission or transmitting the same" should be limited to activity on behalf of customers, consistent with the BitLicense press release.

As described in the press release announcing the proposal of the BitLicense Framework, DFS stated in relevant part that subpart (1) would cover "[r]eceiving or transmitting [V]irtual [C]urrency on behalf of consumers." Unfortunately, the corresponding regulatory language in the draft BitLicense Framework covers "receiving Virtual Currency for transmission or transmitting the same", but does not limit the coverage of the definition to such activity on behalf of customers.[14] Furthermore, itBit suggests that DFS define the scope of the term "customer" for purposes of the Virtual Currency Business Activity definitions to eliminate any ambiguity as to what activities are covered.[15] For instance, while it is clear that "customer" is intended to exclude personal use, it could be unclear whether certain proprietary or affiliate transactions could be considered "customer" business.

d. Consideration should be given to limiting the coverage of "securing, storing, holding or maintaining custody or control of Virtual Currency on behalf of others" in subpart (2) to "control of Virtual Currency on behalf of others.

The current definition of Virtual Currency Business Activity may encompass activities, such as management of investments that include bitcoin, which are adequately regulated through the regulation of other financial activities and do not require separate regulation under the BitLicense Framework. For the sake of clarity, it may be preferable to limit this component of the definition of Virtual Currency Business Activity to activities related to transactions conducted in Bitcoin on behalf of others and exclude activities that simply involve holding, for investment or other purposes, bitcoins on behalf of others.

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[14] Although the current language appears to track a provision in the NYTMA, see N.Y. Banking Law § 641, itBit believes that the "on behalf of customers" limitation is critical in the virtual currency context. While the formulation in the NYTMA may have been interpreted as if it included "on behalf of customers," itBit suggests that greater clarification through including the specific language would greatly improve clarity.

[15] Please note that the same point applies to the use of "customer business" in subpart (3) of Virtual Currency Business Activity.

e. The scope of "performing retail conversion services" in subpart (4) of Virtual Currency Business Activity should be defined with specificity.

With respect to "retail conversion services" in subpart (4) of Virtual Currency Business Activity, itBit suggests that DFS provide a definition of "retail" to provide greater market certainty as to what kinds of activities would be captured in that definition. Although the illustrative list in the current subpart (4) makes clear that conversions between Fiat Currency and Virtual Currency (as well as between forms of Virtual Currency) are covered, it is not entirely clear whether the term "retail" implies any limits on the method or customer of the conversion service. Additionally, it is unclear whether, and to what extent, bitcoin ATM operations would be encompassed by this definition.

4. Capital and Investment Requirements

itBit generally endorses the factors listed in Section 200.8 for capital and investment requirements, but respectfully submits that certain investment limitations should be narrowed and that capital and liquidity requirements should be subject to an activity-based risk adjustment, as described below.

a. Investment limitations on retained earnings and profits should be removed.

Licensees already would be required, under proposed Sections 200.9(b) and (c), to maintain full, unencumbered reserves for all Virtual Currency liabilities (in the specific type of Virtual Currency owed), so additional restrictions on a Licensee's retained earnings and profits may not be necessary in the ordinary course. This is especially true when considering that many bitcoin companies hold such amounts in a combination of fiat currency and virtual currency and desire to invest such assets to grow their businesses. Removing these additional restrictions, moreover, would be generally consistent with the approach taken in the NYTMA with respect to fiat money transmitters.[16]

b. Capital requirements should be calibrated to activity risk.

With respect to capital requirements, itBit would urge DFS to incorporate a risk-based approach where capital requirements may vary based on the particular activities that the regulated entity undertakes. On one end of the spectrum, virtual currency businesses that conduct predominantly transmission services clearly need to have high liquidity and be fully capitalized. However, this "one size fits all" approach may be overly broad as applied to certain other virtual currency businesses, such as those involving investment management or lending,

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[16] See N.Y. Banking Law § 651 (providing, with respect to regulated money transmitters, that each "licensee shall at all times maintain permissible investments having (i) a market value, computed in accordance with generally accepted accounting principles, at least equal to the aggregate of the amount of all its outstanding payment instruments and all its outstanding traveler's checks or (ii) a net carrying value, computed in accordance with generally accepted accounting principles, at least equal to the aggregate of the amount of all its outstanding payment instruments and all its outstanding traveler's checks so long as the market value of such permissible investments is at least eighty per centum of the net carrying value.")

where lower capital and liquidity standards could allow for greater investment and growth without creating any material increase in risk to New York.

5. Custody and Protection of Customer Assets

Consideration should be given to refining the custody requirements to provide greater clarity on customer instructions.

In Section 200.9(c), it is stated that a Licensee is prohibited from "selling, transferring, 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." At least with respect to "selling" or "transferring" Virtual Currency, it is logically implied that a customer's consent or instruction would override this prohibition. However, it is not clear whether this implication would necessarily apply to the remaining prohibitions on lending, hypothecating, pledging or otherwise using or encumbering assets. itBit suggests that DFS clarify this possible ambiguity in Section 200.9(c).

Additionally, along the same lines as comment 2(d) above regarding "control" in the Virtual Currency Business Activity definition, itBit suggests that the phrase "secures, stores, holds, or maintains custody or control of Virtual Currency" in Section 200.9(b) (and the analogous language in Section 200.9(c)) be truncated to "maintains control of Virtual Currency" to more narrowly address the regulatory concerns posed in the multi-signature context.

6. Material Changes in Business

Consideration should be given to replacing the pre-approval requirement for introducing new products with a notice requirement.

The proposed regulations governing material changes in business in the BitLicense Framework, at Section 200.10, reflect DFS's understandable concern with ensuring that new products are not introduced that pose an unacceptable risk to New York. However, given the pace of innovation in the virtual currency field, the pre-approval requirement could constrain innovation and potentially place Licensees at a significant disadvantage to competitors based in other jurisdictions. While there could be products introduced in virtual currency businesses that pose significant consumer protection risks, itBit suggests that concerns over such products could be adequately addressed by requiring notice and providing DFS with an opportunity to object to the new product. Although the NYTMA and its implementing regulations address a more developed marketplace, it is relevant that neither the NYTMA nor the regulations impose a pre-approval requirement.

itBit therefore submits that DFS's desired balance between safety and soundness on the one hand, and promoting innovation on the other, may be better served by requiring that Licensees simply notify DFS before introducing a new product. At a minimum, DFS should consider instituting a relatively short time limit on the pre-approval process, perhaps 30 days, to mitigate the potential of indeterminate delays and competitive harm to Licensees. One approach to providing more flexibility for new products if DFS determines that it wishes to retain the pre-

approval process would be to provide "no action" letters in response to new products that provide substantial benefits but may raise issues requiring further study. The CFPB has recently announced a similar approach.[17]

7. Recordkeeping, Examinations and Reporting

As a general matter, itBit supports the recordkeeping, examination and reporting requirements that the BitLicense Framework would impose. However, as explained below, there are several important ways in which it may be possible to narrow the requirements to match corresponding requirements under federal law and the NYTMA or for some Licensees to reflect the size and risk profile of the regulated entity.

a. The recordkeeping requirement should be tailored to analogous NYTMA and federal Bank Secrecy Act ("BSA") standards and limited to the Licensee's records related to Virtual Currency Business Activity.

To comply with the BitLicense Framework, each Licensee, for a period of ten years, must maintain and make available for review upon DFS's request accurate, extensive, and detailed records for each transaction, including the "names, account numbers, and physical addresses of the parties to the transaction," as provided in Section 200.12. itBit suggests that DFS consider several changes to these requirements.

First, given that the BSA rules impose only a five year recordkeeping requirement,[18] itBit would request that DFS consider adopting a parallel timeframe to those comparable standards.[19]

Second, because of its unique open network feature, Bitcoin does not need to have, and generally does not have, a relationship with all parties for the transaction to occur. Accordingly, the requirement in Section 200.12 to collect the "names, account numbers, and physical addresses of the parties to the transaction" is, for all practical purposes, impossible in the context of decentralized virtual currency. Virtual currency businesses based on an open network would be forced to either not participate and forego a BitLicense, or operate on a closed network where they maintain a business relationship with everyone capable of participating in the transaction. In light of this conflict, itBit requests that DFS revise the recordkeeping requirement to reach no further than what is required by the BSA for entities subject to the BSA, or a risk-focused standard based on the potential financial and consumer risks modeled closely on the BSA standards for those entities not currently subject to the BSA.

Further, Section 200.12(b) requires each Licensee to provide DFS "immediate access to all facilities, books, records, or other information maintained by the Licensee or its Affiliates, wherever located" upon request. This requirement is similar to that for licensed

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17 See 79 Fed. Reg. 62118 (Oct. 16, 2014).

18 31 C.F.R. §1010.430(d).

19 See Federal Financial Institutions Examination Council, BSA/AML Examination Manual, Appendix P (citing 31 C.F.R. § 103), https://www.ffiec.gov/bsa_aml_infobase/pages_manual/OLM_116.htm.

money transmitters in New York under the NYTMA. However, the BitLicense Framework requirement would benefit from a parallel clarification so that a Licensee would be only required to provide access to documents "relating to its money transmission instruments."[20] Similarly, DFS should consider confining its access to internal records to documents and records related to the Licensee's Virtual Currency Business Activity, so as to more appropriately tailor such access to the relevant regulatory concern.

Finally, Section 200.12(b) explicitly extends DFS's right to access the facilities, books, and internal records of the Licensee to the Licensee's affiliates on an "immediate" basis. If left as written, the Licensee's entire corporate family is potentially subject to extensive and immediate review by DFS, regardless whether the separate members are not processing transactions related to a Virtual Currency Business Activity or assisting the Licensee with such activities. Although itBit recognizes DFS's important regulatory interest in robust investigatory powers, it respectfully suggests that these interests could be achieved with a more tailored provision that is limited to the affiliate's interaction with the Licensee regarding Virtual Currency Business Activity.

b. Out-of-state examination powers should be limited to matters relating to Virtual Currency Business Activity.

Section 200.13 provides DFS the authority to examine each Licensee not less than once every two years, which itBit believes is a reasonable timeframe. Moreover, the proposed rule's topical scope – to determine the Licensee's financial condition, the safety and soundness of its business practices, the policies of its management, and its compliance with applicable laws and regulations, as specified in Sections 200.13(a)(1) through (4) – is generally appropriate for the goals of the BitLicense Framework. There is a catchall provision in Section 200.13(a)(5) that gives DFS the power to review the Licensee's activities outside of New York if the Superintendent determines that these activities "may affect the Licensee's business involving New York or New York Residents." It may be helpful to clarify that this authority extends only to those business matters involving Virtual Currency Business Activity.

c. A de minimis exemption from the audited financial reporting requirement should be considered.

itBit generally supports the quarterly and annual financial disclosure requirements in Section 200.14 as applied to most Licensees, as it will assist DFS in remaining informed of each Licensee's financial condition.

However, itBit would recommend that DFS consider aligning the required content of the quarterly and annual disclosure requirements with the NYTMA, which requires "a balance sheet, a profit and loss statement, and a statement of retained earnings."[21] The additional requirements set forth in the BitLicense Framework, notably regarding financial projections and strategic business plans, off-balance sheet items, account charts and permissible investments for

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[20] 3 New York Codes, Rules, and Regulations § 406.9(c).

[21] 3 New York Codes, Rules, and Regulations § 406.10(b).

quarterly reports (under Sections 200.14(a)(3)-(6)) as well as management's certification of compliance with various laws and regulations for annual reports (under Sections 200.14(b)(1) and (2)), are not required of fiat money transmitters and it is unclear why they would be needed in the virtual currency context. Should DFS nonetheless decide to include these additional requirements, itBit would request that DFS consider applying them only to entities that exceed a certain activity threshold so as to minimize the compliance burden for smaller entities.

Similarly, the expense of preparing an annual audited statement under Section 200.14(b) may be prohibitive for smaller entities. The marginal regulatory benefit of having audited statements from such entities likely would not justify the cost of preparation, given the minimal risk those entities would pose to New York. itBit therefore suggests that DFS allow entities below a certain activity threshold to submit unaudited financial statements in satisfaction of Section 200.14(b).

8. Anti-Money Laundering

The AML requirements should generally be coordinated with federal BSA standards.

The BitLicense Framework's proposed AML compliance requirements set forth in Section 200.15 are largely consistent with the federal BSA regulations applicable to MSBs. However, the BitLicense Framework goes beyond the BSA requirements in several ways that may not warrant the additional compliance obligations for Licensees.

The BitLicense Framework, like the BSA, requires regulated businesses to develop and maintain an AML program that includes policies and procedures to prevent money laundering, to designate a compliance officer responsible for the program, and to ensure ongoing employee training and independent review. itBit believes that this is the correct approach for DFS to take with respect to AML compliance programs, given the potential for virtual currencies to be used in money laundering schemes and due to the fact that the comparable BSA regulations applicable to MSBs would cover many of the entities that would need to obtain a BitLicense. Likewise, the AML reporting obligations proposed in the BitLicense Framework are generally comparable to requirements under the BSA regulations with respect to the type of transaction information businesses are required to record and retain and the transaction reports and suspicious activity reports ("SARs") that Licensees are required to submit to regulators.

However, unlike MSBs, Licensees must report transactions that exceed $10,000 in one day by a single person and notify DFS within 24 hours, record and retain records of the name and address of the parties to the transaction, the transaction amount and execution date and a description of the transaction for all transactions involving the transmission of virtual currency. In contrast, the BSA rules require nonbank financial institutions to only retain such information for transactions amounting to at least $3,000.[22] While it is important to ensure that suspicious transactions are identified and that appropriate records of such transactions are retained, it may

[22] BitLicense Framework, §§ 200.15(d)(1) and (2). Compare 31 C.F.R. § 103.29(a).

be appropriate to consider modifying these requirements to include a monetary value cut-off consistent with that provided under the BSA.

Under the NYTMA, by contrast, New York fiat money transmitters need only certify their compliance with the BSA rules, and it is unclear why virtual currency would necessitate the additional AML requirements noted above.[23] Thus, itBit recommends that DFS consider adopting a parallel approach to the NYTMA and generally align the AML requirements for Licensees with the federal BSA standard. With regard to Licensees that do not qualify as MSBs, itBit recommends that DFS consider whether BSA equivalents should be uniformly applied to such Licensees, or if differentiated requirements or exemptions would be more appropriate. In this regard, for example, the BitLicense Framework currently imposes a SAR requirement for Licensees that would not be subject to the federal SAR requirements. If DFS wishes to retain this requirement, itBit recommends that DFS provide a safe harbor and confidentiality protections within the final BitLicense Framework.

Over the longer term, itBit observes that the open-source, universally accessible, and irreversible nature of the blockchain will provide more robust structural protections against money laundering than fiat systems generally offer, which may reduce the need for AML regulations as virtual currency infrastructures mature.

9. Consumer Protection

a. Allowing standard, succinct risk disclosures at the opening of accounts or initial transactions should be considered to improve effectiveness.

Given the novelty of virtual currencies, itBit supports the BitLicense Framework requirement that Licensees provide their customers with a disclosure of material risks, as set forth in Section 200.19(a). However, as currently phrased, this requirement would appear to require substantial elaboration on the "minimum" ten factors enumerated in Section 200.19(a). This undertaking, which is not required of fiat money transmitters in New York, would likely result in Licensees providing lengthy and complicated disclosures that may be difficult for the average retail customer to interpret. Rather, itBit suggests that a standard disclosure that clearly and succinctly explains the ten enumerated factors in Section 200.19 would be optimal for most customers – possibly with a link to DFS's website for more details on the risks inherent in any particular factor. A standard set of disclosures may provide the optimal approach to ensure that reasonable disclosures are made available to customers.

b. A disclosure requirement regarding potential liability of the Licensee under "any applicable federal or state laws, rules, or regulations" may be difficult for Licensees to implement and for customers to use effectively.

Section 200.19(b)(3) provides that a Licensee must disclose its liability "to the customer under any applicable federal or state laws, rules, or regulations." If this requirement

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[23] 3 New York Codes, Rules, and Regulations § 416.

mandates identifying all specific federal and state laws that could be applicable and providing relevant disclosures of obligations under those laws, then this would be a complex undertaking, particularly considering that the regulatory framework for virtual currencies is still largely undeveloped. As a result, it may prove particularly difficult to comply and require continual revision and conjecture on the part of Licensees, which could lead to more complex disclosures that may be hard for customers to use effectively. Thus, itBit recommends that DFS consider clarifying or removing this requirement.

Furthermore, and for the same reasons discussed in context of the material risks requirement above, itBit would recommend that the general terms and conditions requirement apply only to account opening disclosures and upon any substantial change to the disclosed terms and conditions thereafter (possibly with, for ease of reference, links in a transaction receipt to the existing terms and conditions on the Licensee's website).

c. Consideration should be given to modifying the requirement to acknowledge disclosures.

Section 200.19(d) requires that customers acknowledge receipt of all disclosures required in the section. This would impose a significant compliance burden if required for all transactions that would fall especially hard on small Licensees that do not have large compliance staffs to monitor and follow-up on whether the disclosures for each transaction are received. itBit respectfully submits that such acknowledgments are unnecessary given the underlying requirement in Section 200.19(a) that each Licensee make disclosures "in clear, conspicuous, and legible writing in the English language and in any other predominant language spoken by the customers of the Licensee." itBit therefore recommends that the acknowledgment of disclosure requirement be limited to account opening disclosures.

d. Should the DFS disagree with the recommendations in comments 9(a) through (c) above, it should nonetheless consider a de minimis exemption from per-transaction disclosure requirements under Section 200.19(a) and (b) and from per-disclosure acknowledgment requirements under Section 200.19(d).

Although itBit believes that the recommendations in comments 9(a) through (c) above should be applied to all Licensees, it suggests, at a minimum, that DFS consider exempting entities with minimal bitcoin activity in New York from the per-transaction disclosure requirements of Sections 200.19(a), (b) and the per-disclosure acknowledgment requirements of Section 200.19(d). As discussed above, itBit respectfully submits that these requirements, due to their resource-intensive nature, would likely create high barriers of entry into the virtual currency business sector without corresponding safety and soundness benefits to New York.

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itBit appreciates DFS's consideration of the points addressed in this comment letter. Please do not hesitate to contact the undersigned with any questions or comments. As noted in the introduction, itBit supports the BitLicense Framework and offers these suggestions in the spirit of helping to accomplish the goals announced by the Superintendent upon the release of the BitLicense Framework.

itBit USA LLC

Charles Cascarilla

Charles Cascarilla, Chief Executive Officer by MHK

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