Hub Culture Response to New York Department of Financial Services Proposed New York Codes, Rules and Regulations Part 200: Virtual Currencies

Comments on DFS-29-14-00015-P

October 20, 2014

Mr. Dana Syracuse
DFS Office of General Counsel
New York State Department of Financial Services
One State Street
New York, NY 10004-1511

CC: Mr. Benjamin Lawsky, Superintendent, New York State Department of Financial Services

Dear Mr. Syracuse:

On behalf of the Hub Culture Group and Ven digital currency ("Ven"), we are writing to share comments regarding the Department's Proposed Rulemaking regarding Regulation of the Conduct of Virtual Currency Businesses – DFS-29-14-00015-P ("BitLicense Rule"), first published in the July 23, 2014 edition of the New York State Register.

Hub Culture is a Bermuda corporation founded in 2006 with principal offices in Hamilton, Bermuda and London, United Kingdom. Hub Culture operates one of the first online social network communities (dating from 2002) with a portfolio of activity including online retail, digital currency, tokenized exchange services, consulting, digital content & messaging, digital identity services and physical real-estate/retail management. Hub Culture is a true Internet innovator, launching the first and only asset backed digital currency, "Ven" in July 2007, with groundbreaking 'world-first' uses in online retail, physical/digital retail, peer-to-peer value exchange, content micro-payments, financial market trading, foreign exchange & commodity pricing and sales, individually owned distributed data ID vaults, and other activities in the realm of digital asset management.

Hub Culture recognizes that the very rapid evolution of digital assets, particularly decentralized, cryptographic currencies, has resulted in growing interest and scrutiny from a diverse range of parties. These stakeholders range from the general public to banks to regulators to governments, as well as asynchronous entities. They are spread worldwide, a function of today's interdependent and connected digital world. They are also very diverse in nature, with areas of priority concern to some that may not be relevant to others.

Hub Culture appreciates that jurisdictions everywhere have an interest in these technologies and a desire to see responsible management of these technologies with respect to rule of law, constitutional rights and consumer protection. In New York, this includes an extra interest and responsibility around the mechanics of financial transactions and the global financial system at large given the state's leadership in the global financial services industry. We therefore thank the New York State Department of Financial Services for taking a lead role in the public policy response to the growth of virtual currency and appreciate the opportunity to submit our views on proposed rules for this nascent, yet conceptually important, industry.

We further echo the comments of the Digital Asset Transfer Authority (DATA) and the Bitcoin Foundation in their representation of general industry perspectives around the BitLicense Rule, and urge the Department to closely consider these statements and the impact that proposed rules would have on the ability of New York to remain a viable leader in the development of next generation financial technologies presented by digital assets development.

Hub Culture requests that the Department echo the U.S. federal approach to these new technologies in that a risk-based approach is helpful in identifying focus areas of activity. In the technology world, less is more. Truly significant value creation for society occurs when technologists are given the space to address and resolve existing needs and inefficiencies. They usually do this through the hand of the market via consumer competition. No player in the digital asset space is 'too big to fail', and that is all for the better.

Concepts and Definitions (200.1,2)

As the earliest player in the cultural transition from "virtual" to "digital" currencies, Hub Culture has had ample time to consider the nomenclature, and would seek to first clarify a small distinction in currency definitions. We appreciate the Department's distinction proposed by the BitLicense Rule section 200.2 that virtual currencies existing exclusively in the online realm as gaming units or closed loop retail units of exchanges are not subject to the BitLicense Rule. This would include Ven. However, it may be beneficial to adjust the definitions such that "digital" currencies refer to the digital units of exchange under proposed guidance, and that "virtual" currencies are left outside that realm.

Despite this assertion, an important consideration should be taken into account: the Internet is making possible the exchange of a multitude of assets which obfuscate the very definition of "currency". As a distributed exchange (and by this we do not mean to confuse the specific block-chain technologies deployed by Bitcoin but instead the technology agnostic distributed Internet, "dI") technology now makes it possible for society to price and exchange a multitude of diverse assets in real time using the Internet. As such, even a closed-loop in-game virtual form of currency, e.g. a bag of apples from a farm, used cars, M&Ms, Target reward points, Bitcoin derived alt-coins, or mileage points from hotels and airlines can easily find a home on secondary exchanges and trading platforms the world over – from eBay to Alibaba to forex trading sites. This is true in the case of Ven, where the issuer does not offer an open loop, but the market includes regulated entities who may offer exchange. We would respectfully submit that unless the Department is prepared to regulate all issuers of value in the economy (i.e. anyone who makes anything), it cannot make sense to include the creator or issuer of a virtual or digital currency or asset as entities subjected to the BitLicense Rule solely on the basis of being an asset creator/issuer. As digital proxies on the Internet come to effectively represent real-world assets, and digital assets find use cases on the Internet and in the real world, their exchange and uses will become ever more mixed. For this reason, we strongly suggest that it is more practical and expedient to focus regulatory activity and licensing around specific entry/exit points in the realm of digital assets: where and when they interact with fiat currency, or when fiat currency is held in reserves as a custodial activity for clients.

While the rationale for this assertion may not yet be obvious, we believe this reality will continue to become more apparent over the coming months and we urge the Department to consider this carefully when evaluating the proposed boundaries of the BitLicense Rule to prevent a situation in which the Rule is essentially obsolete on arrival. Simply buying and selling digital and virtual currencies online, or otherwise, could be considered a "digital asset" purchase or sale, and therefore an activity that falls outside of this purview of 'financial services', especially under certain value amounts (200.2(n)).

Another conceptual definition the Department may wish to consider further involves the imminent rise of distributed autonomous organizations (DAOs) and distributed autonomous corporations (DACs) – an emerging open-source and distributed access technology that allows swarms of individuals to participate in benefits resulting from activities of an organization or company, but with the organizational structures not tied to any individuals or beneficial owners. The ability for technology to 'spin up' such types of DAO/DAC structures will make it difficult for current regulation to capture and enforce guidelines along the old rules, while remaining impossible to prevent. For this and other reasons, the Department may wish to adjust its focus to 'Digital Asset Financial Services' instead of 'currency'.(200.2(g-k)).

Finally, given the wide range of technical innovation in this space, and the public prevalence of Bitcoin as a singular asset rail and currency but not indicative of the entire industry, we urge that the BitLicense Rule favor a more agnostic title without the term "Bit" – popularly associated with this one proprietary technology type – but instead feature a more general Digital Asset Financial Services moniker. The term Bit in the licensing nomenclature implies a favoritism toward only one technology type to the detriment of other existing systems (Ven, Ripple, others). While Bitcoin has received

much of the public attention related to digital assets, the rule promulgated should more fully address the broader class of technologies and assets.

Capital Requirements (200.8)

Hub Culture agrees that companies operating in the digital asset space should be subjected to capital requirements, but we assert that such capital requirements should be proportional to the risk and scope of the company, not industry metrics. In this space, some companies have millions of dollars in venture capital or reserve assets tied to parent companies, while others are building their businesses brick by brick – the good, old-fashioned, American way. Companies should not be penalized or shut out of the market because they are building sustainable business models that involve linear growth, rather than being forced into capital-intensive strategies that would be required by the proposed onerous capital requirements.

Further, we respectfully ask the Department to reconsider the aspects of the Rule that would dictate how private companies can invest retained earnings and profits (200.8.b), especially in the digital assets industry, where the potential for higher returns in the very emerging assets we are building offers the greatest return on investment potential.

The presumably unintended consequence of choking off investment in the very technologies we are building, either from the community or the companies themselves, would be counterproductive to the New York digital asset economy as well as companies that wish to operate in that market. Foreign companies wishing to operate in New York would likely find this aspect of the rule impossible to comply with, because they may not hold assets, reserves, earnings or investments inside the United States. Closing the door to such companies will only hurt New Yorkers and the New York based financial service industry in the long run.

Material Change (200.10) and Change of Control (200.11)

The intersection of technology and innovation are the fertile ground on which digital currencies like Ven are growing. While our currency currently follows very limited pathways for use, it is our hope that a Digital Asset Financial Services License will enable new products and services to emerge using Ven. Already, Hub Culture has enabled a network of Authorities with regulated status to build products and services using the core technology. In such scenarios, it is not possible for the central issuer and technology creator (in this case Hub Culture) to control or anticipate the technological innovations that may come from the market in general.

Moreover, the prohibition of material change to any of the core businesses before they actually emerge implies a kind of precognitive oversight that is inconsistent with democratic capitalism and the founding principles of the United States. We understand that it may become necessary to regulate certain financial service style activities in the realm of digital currency, but we request that the Department and the digital asset communities cross those bridges together when we come to them, not well before their contours and realities are known. No one yet knows what the landscape will look like in the future, and we respectfully contend that it would be imprudent to build roadblocks before the road even exists.

Similarly, the draft requirement to have the Department issue approvals for the business operations of a technology company in this space to operate in areas not involving financial services would be both onerous and deleterious to innovation. This is a fast-paced and highly competitive marketplace, where deals can be done in hours or days, and companies must be free to make the best decisions they can about ownership structures, partnerships, alliances and acquisitions within an appropriate regulatory regime but without the Department dictating the terms, timing and details of these arrangements.

Having to wait up to 120 days for outside approval by the Department would be disastrous for the industry and there is no indication that outsiders from the companies in question are in any position to call the shots on such decisions in the first place. The requirement that all “Material Change” for these businesses be subjected to Department approval puts the industry at odds with its own strategic development, and represents a dangerous precedent for other autocratic

states. We are certain that it is not the intention or wish of the Department to create such a difficult environment for business.

Books and Records (200.12)

Hub Culture is in the fortunate position of operating with a closed loop in which all of its transactions are maintained on a secure ledger available in real time to customers and legally entitled third parties. However, the right to privacy is an important value for our customers and our company, and we believe the record keeping requirements outlined in the draft Rule swing the pendulum too far. The Department may wish to consider that the proposed record keeping requirements are likely to be exceptionally difficult for existing financial institutions, who have legacy architectures that make it impossible for them to maintain these types of records and in this detail. The digital asset industry should not be forced to maintain records that exceed the existing industry norms, which seem to have worked well until now.

While we understand that there are real concerns around anti-money laundering ("AML") "know you customer" ("KYC") and U.S. Department of Treasury/OFAC related issues, we believe certain aspects of the draft Rule are inconsistent with enshrined U.S. Constitutional rights around free speech, movement and basic human rights that include a presumption of innocence until proven guilty and the 4th Amendment's protections against unreasonable searches of private property (which today includes digital property and records) outlined in the U.S. Bill of Rights. There is no need or reason to monitor every transaction in the digital currency ecosystem, let alone for such a long period of time, and the introduction of this unfettered access to the accounts of individuals and companies would be likely to have a chilling effect on the adoption and development of the digital assets industry.

We respectfully request that you consider both the immediate needs of the Department and the sort of situation such state level surveillance precedents would create, not only for generations of future Americans, but for jurisdictions with different values around freedom and human rights, who would use such precedents to curtail the rights of people.

By choosing to take a leadership role in the regulation of these technologies and financial services, the Department also has a responsibility to do so in a manner consistent with the core values of the State of New York, the United States. We believe such surveillance and extra-judicial access to the modern wallets and buying habits of Americans are inconsistent with the founding principles of the U.S., and are not worth the injury that would be caused to these principles particularly when new technologies are emerging that will solve these issues and obviate the need for such an intrusive level of oversight.

In Hub Culture, this data is owned by the individual through our unique technology structures and world-leading legal terms and conditions, which preserves personal data ownership and puts control of this data into the hands of the individual.

As a case in point on industry efforts, we recommend the Department to review the new open-source privacy and identity standards developed with MIT Media Lab through ID3, the Digital Asset Transfer Authority, Hub Culture and other companies, to ensure common core American values are preserved in an era of pervasive digital surveillance:

The Windhover Principles for Digital Identity, Trust, and Data
From ID3.org and MIT Media Lab, issued under MIT License

1. Self-sovereignty of Digital Identity and Personal Data:
Individuals and groups should have control of their digital personal identities and personal data.

Today we communicate, share and transact digitally over the Internet. Individuals who make use of the Internet for these purposes should have control over their digital identities, ensuring individual autonomy, trust in their communications and counter parties, as well as in the integrity of the data they share and transact with.

Individuals, not social networks, governments, or corporations, should control their identity credentials and personal data. Control of one's identity and personal data means that a person should have unfettered access to

their personal data, the ability to verify attributes of their personal identity profile, and the ability to prevent unauthorized public and private access. We support the collaborative open source development of systems that embody these principles and recognize the need to address the requirements of legacy regulatory mechanisms, including by evolving innovative digital technologies to improve privacy, governance, and enforcement.

2. Proportionate Enforcement and Risk-Based Regulation:
Enhancing / improving personal privacy while promoting effective governance and accommodating legitimate auditing and enforcement needs.

We encourage innovation in identity, trust, security, and data technologies and policies, to provide effective methods to address governance and enforcement concerns. Governance includes the concepts of transparency and accountability necessary to protect digital transactions from abuse. We believe these technologies can address public policy interests by enabling appropriate access and verification of identity data. Entities and individuals, acting on the basis of verifiable approvals, including due process and appropriate warrants, should be able to access such data through specific and auditable means. New and evolving digital technologies make it possible to protect an individual's privacy while providing authorized government access to customer identification, due diligence, and transaction monitoring information for legally authorized needs.

3. Ensuring Innovation in Trust and Privacy:
An effective, autonomous identity system reiteratively furthers trust, security, governance, accountability and privacy.

Protecting privacy and fostering trust and governance are foundational Windhover Principles that support a fully functional identity system designed to collect and analyze data in a network in which identities are continuously and independently authenticated. These core principles are intended to foster development of more trustworthy, effective, and resilient products and services to minimize the risks and costs of fraud, money laundering, terrorist financing, and other criminal activity.

4. Open Source Collaboration and Continuous Innovation:
An inclusive, open source methodology to build systems that embody these Principles.

Supporters of the Windhover Principles agree to cooperate to build systems that deliver these requirements and to participate in Living Labs to develop strong and innovative technical product solutions that interoperate to meet these challenges.

Anti-money laundering program 200.15

Hub Culture recognizes the importance of anti-money laundering programs in the digital asset industry with respect to currencies and their interaction with fiat currency. However the application of the rules described in section 200.15 raise questions about proportional risk. As written, the Rule would create a burdensome requirement around both record keeping and transaction reporting that would create a deluge of data that would be impossible to analyze effectively. Micro-transactions, autonomous bot transactions, single click content payments, and many other small value transactions would be at risk under the reporting requirements described, and they present a *de minimis* risk for everyone. They are also, in the case of Ven, a pre-cleared purchase. Monitoring these transactions is akin to first approving a vehicle sale, then monitoring where the vehicle goes and how it is used. We suggest that the oversight should be around purchase, not use, and on aggregate amounts, not daily use.

We request the Department reconsider the requirements around this section in order for them to be in line with the financial services industry at large when connected to the meaningful transaction point, which is the conversion of the digital asset into a fiat currency, not the movement of the digital asset in its native form. It is understandable that similar transaction and record keeping minimums referencing established standards set by OFAC and other previously established guidance should be in place for these conversions, but not for the transfer of the digital asset itself, which has already passed this checkpoint in one form or another at entry or exit.

Similarly, when the purchase of a digital currency is done through traditional financial mechanisms, such as online via credit cards or via traditional bank wires over SWIFT and ACH, the AML/KYC requirements associated with the purchase of the digital asset are covered, and should not require a duplicative effort once in the system. In the same way, once the purchase is made, one could argue that it remains a fundamental right of the asset owner to give, exchange or trade the asset without encumbrance, taking into account existing rules against Specially Designated Nationals that exist beyond 'currency' and into the realm of 'assets' at large via OFAC.

Advertising and Marketing 200.18

As a social network maintaining the ledger and community surrounding Hub Culture and the Ven, the requirements outlined in the Advertising and Marketing section present insurmountable difficulties around communications of services and products related to digital currency, and requires more clarification and/or a lighter approach. In the age of social media, do daily Facebook or Twitter posts, conversations, event flyers, customer conversations, retail offerings in virtual currency, product offerings and other communications constitute free speech or advertising, and in what context do different definitions apply?

We can understand the assertion that the licensing requirements statements appear within the context of some central communication points, such as websites or brochures, but this provision is too vague to be of practical use and endangers the concept of free speech in digital conversation environments, opening a can of worms about the nature of what advertising is and is not. A more practical solution might be to simply publish your own list of approved companies and license holders, which can simply be linked to by the entities on centralized or core materials.

In addition, it is impossible, through 3rd party sites or simple mechanical logistics, to maintain copies of all communications regarding the subject of digital assets in the social environments in which they operate. Please consider reducing this requirement to centralized locations accessible via the web, as opposed to every statement or message that comes from the industry, especially when such messages are often emanating from other jurisdictions and to other audiences, but which may inadvertently cross-pollinate into the New York community via the actions of third parties (such as sharing in social network environments). It is not feasible to be placing such Legends into communications in China, Africa, California or Europe on the off chance they could be seen by customers in New York.

Conclusion

In conclusion, while it seems apparent that Hub Culture and Ven, under their current closed loop retail structures, will be fully able to continue to operate in New York for the foreseeable future, it is Hub Culture's desire to expand operations and build digital asset financial services in New York over the longer term. We appreciate the efforts the Department is making to ensure Ven and other digital assets have a vibrant and secure home in New York, where a wealth of efficiency and productivity benefits can accrue to workers and consumers in New York and beyond. However, we respectfully suggest that as currently written the proposed BitLicense Rule will inadvertently create a major counterweight to efficiency compared to other jurisdictions where Ven and others operate.

Certain business-to-business and financial institutional activities related to Ven may not be able to be created in New York if global competitive advantages in this fast moving industry are to be maintained. In the long term this may limit Ven's scope and present a set of operational realities that are limited given the downstream cost associated with compliance at the level of detail required by the BitLicense proposal in its current form. We respectfully request that the Department consider focusing licensing requirements on the exchange points where 'digital becomes fiat' and ensuring that the emerging digital asset ecosystem can flourish in its native environment without rules so detailed that even the incumbent banking and financial industry could not comply with if faced with the same requirements for their existing services.

Digital assets, whether viewed by the metric of currency or not, need new thinking and market-based approaches to solve the many issues that arise around good governance, exchange capability, reporting and identity control. They also can fit within existing frameworks, and consistent with the level of oversight in the current incumbent system. In their

native format digital assets should be free to exchange, buy and sell without undue impediment – and treated like other assets, which Americans and New Yorkers can freely access, acquire, and build businesses around both in good faith and consistent with core American principles of economic and intellectual freedom.

Thank you again for providing us the opportunity to comment on this important proposal, and we look forward to further discussion as the first round of comments inform the evolution of this nascent industry.

Sincerely,

Stan Stalnaker
Founding Director
Hub Culture and Ven