



March 27, 2015

VIA EMAIL—VCRRegComments@dfs.ny.gov
[REDACTED]

Benjamin M. Lawsky
Superintendent
Dana Syracuse
Office of the General Counsel
New York State Department of Financial Services
One State St.
New York, NY 10004

**RE: Comments of the Electronic Frontier Foundation to the New York State
Department of Financial Services on the Revised BitLicense Regulatory Framework**

Dear Superintendent Lawsky and General Counsel Syracuse:

The Electronic Frontier Foundation (“EFF”) submits these comments in response to the New York State Department of Financial Services’ (“NYDFS”) revised BitLicense regulatory framework, DFS-29-14-00015-RP,¹ as a supplement to the comments submitted by EFF pursuant to the initial BitLicense proposal.²

As a preliminary matter, implementing digital currency regulations now will only serve to stifle innovation. Digital currency is an industry in its infancy. And although NYDFS’s goals in proposing a regulatory framework for digital currencies—protecting consumers and rooting out illegal activity—are laudable, it is simply too soon to begin regulating virtual currencies. We do not know, as a practical matter, what the use of virtual currencies will look like ten years from now. We therefore do not know what regulation is actually needed—and what regulation will be effective—to achieve NYDFS’s stated goals. We also do not know what other services unique to virtual currencies might arise, such as free and independent third-party guarantors for contracts or deals, and whether such services will as a practical matter have the resources to meet the proposed recordkeeping obligations. Because of the concern over stifling innovation, any regulations adopted now should include a mandate that any recordkeeping burdens and restrictions imposed be reconsidered every two years to assess whether they can be cut back.

¹ 2015-08 N.Y. St. Reg. 17 (Feb. 25, 2015), http://www.dfs.ny.gov/legal/regulations/revised_vc_regulation.pdf.

² See Comments of Electronic Frontier Foundation, Internet Archive, and reddit to the New York State Department of Financial Services on BitLicense: The Proposed Virtual Currency Regulatory Framework (Oct. 21, 2014) <https://www.eff.org/files/2014/10/21/bitlicense-comments-eff-ia-reddit-hofmann-cover.pdf>.

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We do, however, recognize and applaud NYDFS's efforts to improve the original BitLicense proposal. Most significantly, through explicitly providing that "[t]he development and dissemination of software in and of itself does not constitute Virtual Currency Business," NYDFS has taken a great step toward ensuring that its BitLicense regulations will not stifle innovation in the digital currency space.

But NYDFS must make additional changes to the revised regulatory framework to more fully protect privacy, free expression, and innovation, and to ensure that the proposed regulations do not undermine the unique civil liberties benefits digital currencies can offer. Indeed, as we noted in our earlier comments, one of the most promising features of digital currency is its potential as a privacy-enhancing technology, since all transactions are linked to pseudonymous public keys rather than real-world identities. The revised BitLicense proposal—like the initial proposal—would eviscerate this feature by compromising the privacy of average consumers as well as small business owners and entrepreneurs.

(1) The revised BitLicense proposal's recordkeeping requirements are unduly burdensome and create a massive consumer privacy risk.

The revised BitLicense proposal would require licensees to keep detailed records of all transactions they perform for seven years "in a condition that will allow [NYDPS] to determine whether the Licensee is complying with all applicable laws, rules and regulations."³ The proposal mandates that such records include, for each transaction: (a) the amount, date, and precise time of the transaction, and any payment instructions; (b) the total amount of fees and charges received and paid to, by, or on behalf of the Licensee; and (c) the names, account numbers, and physical addresses of (i) the party or parties to the transaction that are customers or accountholders of the Licensee, and (ii) to the extent practicable, any other parties to the transaction.⁴

While we appreciate NYDFS's attempt to decrease the burden imposed by its initial regulations through requiring that licensees maintain records on counterparties only "to the extent practicable," the revised BitLicense proposal would still dramatically expand the recordkeeping requirements of state and federal anti-money laundering regulations, such as FinCEN (which, for example, requires collection of data regarding counterparties only if the data is received during the course of the transaction). As we stated in our initial comments, forcing companies to maintain detailed records about every transaction, no matter how mundane or insignificant, is burdensome and unnecessary and will stifle innovation. Furthermore, the phrase "to the extent practicable" is vague—leaving licensees unsure of the efforts they must undertake to collect data about counterparties.

Of even more concern are the privacy issues raised by requiring that every transaction be linked to names and physical addresses of the parties (and then maintained for seven years). Not

³ Section 200.12(a).

⁴ Section 200.12(a)(1).

only does this undermine pseudonymity, but it also creates a massive consumer privacy risk should malicious actors ever get access to those records. The public nature of the blockchain makes the privacy risk of long-term record storage far greater for digital currency-related businesses than equivalent recordkeeping for more traditional businesses.

EFF believes it is important that NYDFS ensure that the privacy-enhancing potential of digital currency works in favor of consumers—not against them. We recommend that NYDFS impose recordkeeping requirements no greater than those already imposed by state and federal anti-money laundering regulations.

(2) The revised BitLicense proposal’s ban on identity obfuscation threatens user privacy.

The revised BitLicense proposal—like the initial proposal—provides that “No Licensee shall engage in, facilitate, or knowingly allow the transfer or transmission of Virtual Currency when such action will obfuscate or conceal the identity of an individual customer or counterparty.”⁵ This ban on identity obfuscation has profound implications for Bitcoin-like systems that have pseudonymity built into them by design. As mentioned, one of the benefits of Bitcoin and similar currencies is that they offer the potential for pseudonymous transactions because the blockchain does not directly link a transaction to the parties’ name. But the revised regulations would nullify this hallmark of digital currency protocols—along with the privacy protection pseudonymity provides—by forbidding licensees to allow any non-personally identifiable transactions. Indeed, although the BitLicense proposal states that “[n]othing in this Section . . . shall be construed to require a Licensee to make available to the general public the fact or nature of the movement of Virtual Currency by individual customers or counterparties,”⁶ this is not enough to ensure privacy of transaction details. Because transactions on the blockchain are transparent by nature—and because there are various techniques to link personal identities to Bitcoin pseudonyms—users of digital currency may choose to use identity obfuscation to safeguard the privacy of their online transactions. Any regulations the NYDFS adopts should give users breathing room to take extra steps to protect the privacy of their transaction details, not take it away.

Furthermore, identity obfuscation is not clearly defined. Many commonplace Bitcoin practices, such as generating new change addresses with every transaction, could be interpreted as identity obfuscation. A ban on obfuscation generally is thus not only unwarranted, but it will also cause great confusion and uncertainty.

EFF recommends that NYDFS remove the ban on identify obfuscation and thereby allow users to keep personal and sensitive transaction details private.

⁵ Section 200.15(g).

⁶ *Id.*

(3) NYDFS is moving far too quickly to enact a BitLicense proposal.

Lastly, NYDFS is moving far too quickly to enact a BitLicense proposal. NYDFS provided for a mere 30-day period for public comment on its revised BitLicense regulatory framework, as compared to the 90-day period provided on the initial proposal.⁷ This is simply not enough time for the public to comment on the unprecedented issue of digital currency regulation. To ensure that any regulatory framework is adopted with prudence, rather than haste, NYDFS must slowdown its process and allow more time for public comment on its revised BitLicense proposal—either by extending the deadline for public comment or by providing for a second public comment period on the revised BitLicense proposal.

Sincerely,



Rainey Reitman
Director of Activism
Electronic Frontier Foundation



Jamie Williams
Frank Stanton Legal Fellow
Electronic Frontier Foundation

⁷ See Announcement of Revised BitLicense Regulatory Framework, http://www.dfs.ny.gov/legal/regulations/rev_bit_license_reg_framework.htm.