

March 27, 2015  
Benjamin M. Lawsky  
Superintendent of Financial Services  
New York State Department of Financial Services  
One State Street  
New York, NY 10004-1511

via email to [VCRegComments@dfs.ny.gov](mailto:VCRegComments@dfs.ny.gov)

**Re: Public Comments by Epiphyte Corporation on NYDFS Revised Proposed Regulations: Title 23, Chapter I, Part 200: Virtual Currencies (“Bitlicense” Regulations)**

Dear Superintendent Lawsky:

Epiphyte Corporation (“Epiphyte”) respectfully submits the following comments on Revised Proposed Regulations: Title 23, Chapter I, Part 200: Virtual Currencies (“Bitlicense” Regulations). Epiphyte appreciates the opportunity to comment upon the issues raised in the Revised Proposed Regulations.

**Epiphyte**

Epiphyte provides financial institutions with the software, documentation, analysis and deep subject matter expertise required to identify the optimal integration and use cases for distributed ledger technology. Epiphyte helps its customers identify low risk, high impact business cases and minimize the need to change workflows to take advantage of the technology. By leveraging our offering, our clients are better positioned for increased financial flows and asset creation as a result of a beneficial integration with crypto-financial networks.

**Balanced and Proportionate Regulation**

We welcome all regulatory frameworks which strike an appropriate balance between consumer protection and innovation. The New York State Department of Financial Services (DFS) and Superintendent Ben Lawsky should be commended in appreciating that the existing regulatory framework is insufficient to deal with cryptocurrencies as an emergent property of distributed ledger technology, the most disruptive technology of recent times.

However, the revised proposed framework or “BitLicense” regulations (DFS-29-14-00015-P, “Regulation of the conduct of virtual currency businesses”), even in its current form, is overly broad and places unnecessarily onerous requirements on businesses who operate in the cryptofinance space.

There must be sufficient flexibility for banking and financial services technologies, which represent an evolution and do not readily fit within existing statutory, regulatory, and/or supervisory regimes, to be exploited in the marketplace while at the same time ensuring:

- a. consumer protection,
- b. market stability, and
- c. law enforcement.

While we appreciate Superintendent's Lawsky's comments that the technology underlying virtual currencies is quite powerful which if harnessed in the right way can improve the financial system, we are extremely concerned that the approach taken will lead to heavy handed regulation and risks damaging the sector. Additionally, there remains a lot of unresolved concerns even with the Revised Proposed Regulations.

It is against this background that we took a decision to headquarter in London, which has adopted a more liberal and supportive stance on crypto-finance and offers an environment that truly stimulates innovation in the financial technology ('fintech') sector. In August 2014, the UK government announced a major programme of work looking into the benefits and risks associated with digital currencies and underlying technology, with a particular focus on the question of regulation. In November 2014, the UK government published a call for information to gather views and evidence on these questions. Due to clear potential advantages of digital currencies such as micro-payments and cross-border transactions and the nascent state of the technology, the UK government indicates there should be "proportionate regulation at this time"<sup>1</sup>. We share this view.

Our concerns about the DFS Revised Proposed Framework are as follows:

### **"Virtual Currency Business Activity" is Overly Broad**

By section 200.3, no person can engage in any "Virtual Currency Business Activity" without a license. The current definition includes anyone who engages in "controlling, administering, or issuing a Virtual Currency".

It is very encouraging that the Revised Proposed Regulations generally exclude from the licensing requirement software development on the basis that "development and dissemination of software in and of itself does not constitute Virtual Currency Business Activity".<sup>2</sup>

However, the definition in current form would appear to place a disproportionate burden on innovators and the industry. Requiring licensing of anyone who creates a digital currency or protocol would stifle innovation. There is no need for consumer protection against creators of

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<sup>1</sup> [Digital currencies: response to the call for evidence](#), 18 March 2015 at para. 2.26

<sup>2</sup> NYDFS Revised Proposed Regulations: Title 23, Chapter I, Part 200: Virtual Currencies, § 200.3(q)

new digital currencies or creators of new protocols who should be expressly excluded from the licensing requirement. The Revised Proposed Regulations, like all regulations, should ultimately serve the consuming public, not preclude them from the benefits of innovation by unduly burdening creators during early days. Since the draft regulations proposed in 2014, we have seen many new developments in the space with potential benefits, such as sidechains, which enables bitcoins and other ledger assets to be transferred between multiple blockchains.<sup>3</sup>

The overly broad definition currently proposed will stifle innovation unless appropriately refined.

### **Requirements According to Activity Type**

Not all crypto currency businesses are the same. Lumping all business in the space together and imposing one set of regulatory requirements, as appears to be the case, will create an unfortunate entry barrier and stifle innovation. We suggest an approach similar to that taken by the Conference State Bank Supervisors in their December 16, 2014 Policy Statement and proposal for activities-based regulation. Such activities should center around custodianship of digital assets rather than a technology based approach.

Those who facilitate the trade or exchange of digital assets, including digital currencies, should not be held to the same standard or same requirements as though who facilitate transactions but not take custody of digital assets. To this end, an understanding is required of what constitutes custodianship consistent with the properties of Distributed Ledger Technology. Software wallet providers do not control digital currencies managed by their software. Where software wallets such as Blockchain<sup>4</sup> use a model by which the digital currency hosted can never be accessed by that wallet provider, they should not be considered custodians. In such cases the service provider has unencrypted access to the keys necessary to transmit the currency. Moreover, there is the technological innovation of multisignature wallets, whereby multiple signatures from keys generated and held by multiple people are required to conduct a transaction. Holding a key may not mean access to the digital currency but may mean that if the owner lost one of his two keys, he could ask the holder of the third key to sign a transaction to move value into his wallet. In this way, the third party key holder is involved in custody of the digital currency but never takes custody of it.

### **Startups & Compliance Costs**

With respect to the resultant costs of implementing policies to remain in compliance with the BitLicense Regulations, it was previously stated that “creative solutions” were being considered

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<sup>3</sup> Back et al, “Enabling Blockchain Innovations with Pegged Sidechains”. 2014. Available at <http://www.blockstream.com/sidechains.pdf>

<sup>4</sup>Available at [www.Blockchain.info](http://www.Blockchain.info)

by the DFS. Superintendent Lawsky's public comments that startups should be allowed to startup and should not be truck-crushed by compliance rules were encouraging. Yet, respectfully, the conditional license which may be issued under the Revised Proposed Regulations is not enough as an equitable solution can to startups. We suggest that there should be a de minimis threshold exception, so that small amounts of virtual currency transactions (for example, under \$500 and accounts under \$3,000) would not trigger licensing requirements OR a safe harbor exemption that allows startups and small companies a fair chance at staying afloat without the burdensome compliance costs during the first 2 years of their life. Without a "Startup Onramp," or a period of time during which new companies are not subject to exempted from licensing requirements, will be unduly burdensome on and will stifle innovators and creators in the space.

## **Conclusion**

The advent of Distributed Ledger Technology can be compared to the invention and commercialization of the internet itself. In hindsight, we can see that the benefits provided far outweighed the disadvantages but in the early days we could not have imagined the extent of its utility and global usage. Regulatory efforts can be central to the evolution of the banking and finance sector and exploitation of Distributed Ledger Technology.

There are many opportunities to explore a number of different applications for the Distributed Ledger Technology to the financial services sector. We expect to see this technology underpin the creation of new financial services and products in addition to reducing, and in some cases eliminating, inefficiencies that exist in transaction processing. However, since it is still early days, without a proportionate and balanced regulatory approach, new models, products, services and ventures will fail to emerge to the disservice of the consuming public.

We hope our comments are helpful and we would be happy to engage further with the NYDFS and stakeholders in this respect.

Sincerely,



Epiphyte Corporation