



March 27, 2015

Office of the General Counsel  
New York State Department of Financial Services  
One State Street, New York, NY 10004

Re: Regulation of the Conduct of Virtual Currency  
Businesses – Addition of Part 200 to Title 23 NYCRR

Ladies and Gentlemen:

The undersigned members of the bitcoin industry (collectively, the “**Industry Working Group**”) respectfully submit the following comments on the revised Regulation of the Conduct of Virtual Currency Businesses (the “**BitLicense Proposal**”) published by the New York State Department of Financial Services (the “**NYDFS**”) on February 25, 2015.

The Industry Working Group very much appreciates that the NYDFS has taken the time — and made the effort — to solicit and review the numerous comment letters submitted previously. We believe the BitLicense Proposal is much improved as a result. We are delighted to see revisions addressing most, if not all, of the areas of most concern. For example, the inclusion of a *conditional license* will encourage new entrants to the ecosystem. Also, numerous time periods and objective standards have been relaxed or otherwise modified to make them more manageable from an operational perspective. We thank the NYDFS for meeting with us (on multiple occasions) and for the staff’s hard work and openness in addressing our concerns, evidenced by what we view as a thoughtful second draft.

In the last year, the Bitcoin industry has grown — and grown up — in many important ways. Companies have hired experienced management teams and advisors with deep financial services experience, raised hundreds of millions of dollars, and built highly professional compliance programs. New products and enterprises abound. Just in the last week, the Digital Currency Group announced the Bitcoin Investment Trust, which allows investors to purchase securities representing interests in bitcoins with the blessing of the SEC.

Notwithstanding all this investment and effort (including by members of the Industry Working Group), the ultimate success of Bitcoin as a currency is far from secure. The implications of the blockchain and other core technology underlying Bitcoin are as yet unknown. And Bitcoin firms in the financial services space, while stronger than a year ago, remain vulnerable to much larger competitors and a very uncertain regulatory landscape.

As such, we believe that regulation of the industry should strike an appropriate balance between the worthy consumer protection and anti-money laundering goals that underpin the BitLicense Proposal and encouraging innovation that has the potential to make financial services better for millions of New York residents - and billions of people around the globe - who do not have adequate access to affordable payments services.

The regulatory and legal landscape associated with Bitcoin and digital currencies is still fraught with uncertainty. This uncertainty makes it harder for Bitcoin businesses and their investors to deliver on the huge public policy potential of Bitcoin and blockchain technologies more generally. We believe the NYDFS may be in a unique position to serve as a model for others and bring about greater certainty to the regulatory landscape.

In its current form, while significantly improved from the previous draft, we believe the BitLicense Proposal still contains measures that impose disproportionate burdens on Bitcoin firms that will hinder

positive innovation. This is worrisome given the potential for other jurisdictions to emulate the NYDFS and the fact that many Bitcoin businesses have a presence in New York. As such, we believe the BitLicense Proposal should be revised in a few key areas.

Members of the Industry Working Group may also submit individual letters and the subjects covered herein are by no means intended to be comprehensive. The areas of coverage in this letter are as follows:

- Section 200.2(q)(2) - clarification regarding the definition of “custody”
- Section 200.3 - clarification regarding relevance of money transmitter licensing
- Section 200.4(c) - Superintendent discretion to grant a conditional license
- Section 200.10 - consent required in connection with new products
- Section 200.11(a) - consent required in connection with financing events
- Section 200.15 - duplication of federal regulatory requirements
- Section 200.19 - consumer protection provisions

We have ordered our comments to correspond with the sequence of the sections in the BitLicense Proposal and not in order of importance.

**Please provide clarification on the meaning of “storing, holding, or maintaining custody or control of Virtual Currency on behalf of others”:**

The Industry Working Group seeks a clearer definition of Section 200.2(q)(2), which states that Virtual Currency Business Activity means the conduct of “storing, holding, or maintaining custody or control of Virtual Currency on behalf of others.”

Does the NYDFS consider self-hosted bitcoin wallet providers to be “storing, holding or maintaining custody or control of Virtual Currency on behalf of others”? As background, self-hosted wallet providers (such as Blockchain, Pheeva, Breadwallet) offer software applications that enable owners to be their own custodians of bitcoins. Self-hosted wallet providers do not have access to owner’s private keys and consequently, do not have custody or control of the owner’s bitcoins. This, in turn, reduces the risk of loss created by third-party custodians becoming insolvent, or absconding or losing consumer funds (or in this case, bitcoin) — some of the primary drivers for the policy behind licensing third-party custodians in the first place. Depending on the specific wallet features provided, self-hosted wallet providers may “hold” or “store” encrypted backups of the owner’s private keys but this is not equivalent to “custody” or “control” as only the owners can un-encrypt the keys to spend or move bitcoins. Owners using self-hosted wallets therefore must take sole responsibility for safeguarding their private keys, which they often do by backing up the private keys to prevent loss in the event a wallet is compromised (e.g., a smartphone is lost or damaged or the downloaded software application becomes dysfunctional).

The NYDFS has stated that “[t]he development and dissemination of software in and of itself does not constitute Virtual Currency Business Activity” which would suggest that self-hosted wallet providers would be outside the scope of the proposed regulations. However, by covering providers who “store” or “hold” Virtual Currency on behalf of others without any granulation around access to those funds (i.e., encrypted storage versus unencrypted, fully accessible storage), the NYDFS may technically cover self-hosted wallet providers while indicating an intention to exclude them. The industry would welcome explicit clarification that self-hosted wallet software providers fall outside of the scope of the BitLicense.

Would hosted bitcoin wallet providers that utilize multi-signature be considered to be “storing, holding or maintaining custody or control of Virtual Currency on behalf of others”? Such hosted bitcoin wallets allow customers to track and manage their bitcoins by relinquishing private keys to the hosted bitcoin wallet provider. In essence, customers in this case are instructing the hosted bitcoin wallet provider to initiate the spending or movement of bitcoins. However, with the introduction of multi-sig in January 2012 through Bitcoin Improvement Proposal 16, hosted wallet providers may now not have full custody or power to spend or move bitcoins. Multi-sig is designed to require M signatures from a total of N keys, or M-of-N keys (such as 2 of 3, where the hosted wallet provider is only one of the 3 signatories)

in order to complete a transaction. In light of this innovation, which is rapidly becoming a commonplace functionality for hosted (as well as self-hosted) wallets, the industry requests the NYDFS exempt from regulation those hosted multi-signature wallet providers that do not hold sufficient signatures to complete a transaction.

**Clarification on whether obtaining a BitLicense would satisfy a licensee's obligation to also obtain an MTL:**

Many Bitcoin businesses have a US dollar — or other fiat currency — component as well as a Bitcoin component. As written, the proposed rule would seem to require that these businesses, which also engage in traditional money transmission, would need to acquire *both* a money transmission license and BitLicense. We believe dual licensing places undue operational, administrative, and cost burdens on businesses, while not conferring additional safety for the public. What value results from requiring double licensing, especially as the BitLicense standards are in many cases higher than the equivalent money transmitter standards?

We note that there will be entities that engage in Virtual Currency Business Activity which do not engage in money transmission. This is because they either do not have a conventional U.S. dollar stored value product or exchange-like USD settlement facility; or because their business does not touch fiat money. Those entities could still be licensed under the BitLicense, and it would be the only license they are required to obtain. But if an entity has an overlapping business activity, wherein they do have such a mix of fiat and virtual currency products, they would already be regulated as a money transmitter. In that case, the proposed rule should exempt such businesses.

**Superintendent discretion to grant a conditional license:**

Along with the overwhelming majority of the digital currency community, we welcome the inclusion of a conditional license in the most recent BitLicense Proposal. A startup onramp has the power to catalyze the growth of an already rapidly growing and transformative industry. In these early days, when this industry is still defining itself, this sort of enabling provision is critical. We deeply appreciate the NYDFS' willingness to consider innovative approaches with the potential to support positive innovation.

Nonetheless, the onramp as it now exists will only reach its potential if the NYDFS can provide more specifics about how it will operate. The weakness of the conditional license is in its vagueness. Under the current provisions, a business may be granted a license to operate even if it does not meet certain licensure requirements, but the Superintendent may revoke that license at any time. Such a business might be required to satisfy certain conditions, or it might not. For the onramp to reach its undoubted potential, the industry needs a clear framework that the NYDFS will apply.

One of the most consistent themes presented to the NYDFS in the testimony it heard over a year ago was that "regulatory certainty" would be a boon to the industry, and "regulatory uncertainty" would be its bane. The conditional license, in its current state, is simply too vague to grant meaningful certainty. To the contrary, it leaves early startups in the same place they were before the conditional license: unsure of whether they will qualify for a license to operate in New York (or, for that matter, uncertain about what they need to do to maintain that license).

There is a solution, and it does not lie in divining some set of magic-bullet metrics for which businesses would qualify for a conditional license and which would not. Indeed, the NYDFS has no doubt searched for this set of metrics, and found that no such magic bullets exist. Instead, the NYDFS should recast the conditional license as an initial registration requirement for startups conducting low volumes of Virtual Currency Business Activity with New York Residents.

On this model, any business conducting any Virtual Currency Business Activity at all in New York would be required to register with the NYDFS — much like they register with FinCEN — and satisfy all of the reporting and anti-money laundering requirements of the final BitLicense. Additionally, they would make regular, detailed reports of their Virtual Currency Business Activity volume to NYDFS. This would ensure that New York would know what businesses are servicing its residents, and could adequately

guard against money laundering. Also, while transaction volumes remain low and limited largely to enthusiasts, young businesses would be spared onerous prudential obligations that would likely be of limited real-world, dollars-and-cents benefit to the public. Once transaction volumes trip a certain threshold, though, full BitLicense obligations kick in, and, after a short grace period, an application for a Section 200.3 license must be made.

The benefits of a volume-based onramp are myriad. Setting predefined volume triggers for licensure retains the conditional license's elasticity while discarding its vagueness. Requiring regular reporting expands the NYDFS' understanding and oversight of a young industry as it grows and its risks evolve. Relieving young businesses (with relatively little volume and few customers) of onerous regulatory obligations properly calibrates the significant burdens on businesses to the limited risk to consumers. We urge the NYDFS to consider this approach.

**The BitLicense Proposal should not require prior approval for product updates:**

The BitLicense Proposal imposes a wide range of requirements over key business decisions. Most saliently, it requires both notice and prior written approval for "any plan or proposal to introduce or offer a new product, service, or activity, or to make a material change to an existing product, service, or activity, involving New York or New York residents." The digital currency industry and technology is evolving rapidly. We believe this provision could negatively impact business decisions and the ability to effectively bring new products and services to the market for consumers in a timely manner. Absent a time limit, it is unclear how long it would take the NYDFS to act on a notice of a new product or material change in services. Also, it would seem that this rule would thrust NYDFS into an ungainly role – as the arbiter of which companies can introduce which products, and when.

We suggest that this provision be eliminated or that NYDFS consider having a *notice-only* provision (without requiring prior approval), or a notice provision paired with a short fuse review period (a week), to provide NYDFS ample time to request additional information prior to implementation, if the product update posed an unacceptable risk to New York residents. The NYDFS should also provide additional clarity on what is considered a "material change" and the criteria used to determine this definition to avoid confusion in the marketplace and the reporting burdens on Licensees.

**The BitLicense Proposal will impair venture capital fundraising:**

The revisions made to Section 200.11(a) of the BitLicense Proposal, providing some clarity around the meaning of "control" and elsewhere, are certainly welcomed. We believe the control threshold of 10% is still far too low and does not reflect regulatory consensus on the meaning of control nor a practical application of such a meaning. As a result, Section 200.11(a) would restrict a licensee from engaging in a standard venture capital financing transaction without first obtaining the prior written consent of the Superintendent. We recognize the interest of the NYDFS in reviewing and consenting to true change of control transactions, especially since a stock purchase could be used to circumvent scrutiny in the context of a merger. That said, the inability of a company to obtain ordinary course financing where no change of control exists could be detrimental to a business and thus the breadth of Section 200.11(a) is unjustified. We seek modifications to the provision to exempt transactions that do not arise to a true change of control.

In general, "control" can be defined in a number of ways but it typically denotes the ability to exert a controlling influence at the stockholder or board level via a majority stake, or, in some cases, a plurality blocking right. We propose revising the requirement to provide for a minimum 25% threshold and ability to control the majority of the board of directors. A 25% control threshold would be in line with similar thresholds utilized in the context of banking regulations and otherwise. We note that the NYDFS would become aware of lesser changes to a licensee's board of directors and beneficial owners through the ongoing reporting required elsewhere in the BitLicense Proposal.

**The BitLicense Proposal unnecessarily duplicates federal anti-money laundering (AML) obligations:**

Current Federal rules require virtual currency exchanges (among others) to register as Money Service Businesses (MSBs) and establish risk-based Anti-Money Laundering (AML) programs in accordance with federal law. The BitLicense Proposal includes new, unprecedented state level AML reporting and recordkeeping requirements.

The BitLicense Proposal requires licensees to: (i) collect the identity and physical address of any parties to a virtual currency transaction, (ii) file state-mandated activity reporting on a 24-hour deadline (which has no equivalent in any other sector the NYDFS regulates), and (iii) verify the identity of any customer who establishes an account, among many other requirements. While the Department includes language noting that (i) and (iii) can be applied “to the extent practicable” we believe this language remains too vague and imposes a higher standard than that applied to traditional money transmitters. These requirements would appear to eliminate opportunities to establish a reasonable risk-based approach to AML programs. The result would indiscriminately force all New York citizens who wish to use virtual currency businesses to be punished, vis-à-vis aggressive personal disclosure and verification procedures that the rest of the nation wouldn’t be subject to.

Notably, these recordkeeping and verification requirements are not supported by the underlying Bitcoin Protocol. The draft rule would almost certainly force businesses to operate closed, proprietary virtual currency networks. This would eliminate the greatest features of the Bitcoin protocol - and the larger internet that underlies it, global open access and ability to transmit money without having to use natural monopolies or oligopolies such as the card networks that drive up transaction costs.

If each state were to follow New York’s approach, businesses would be forced to modify their AML programs to meet the specific requirements and reporting obligations of individual states, districts and territories - potentially resulting in the need to create over 50 different sets of standards to operate a business in the United States (one for each applicable state/territory and the federal standard from FinCEN). This is not only untenable from an operational perspective, it will also put a nascent industry at a major competitive disadvantage with traditional financial institutions that only have to follow federal law..

New York’s approach of requiring transaction reporting for certain digital currency transactions imposes a particularly high burden on the relatively small firms in the industry, especially if one extrapolates the approach and imagines firms having to comply with more than 50 (potentially inconsistent) state, district and territory reporting requirements. FinCEN has focused significant time and resources in providing thoughtful guidance on Bitcoin and, more generally, the national AML framework is both effective and efficient. It would be far clearer and cleaner to allow those standards to remain at the federal level, which still afford the NYDFS authority to examine digital currency businesses against federal BSA/AML standards as it has proven so effective at with the other types of institutions it oversees.

**The BitLicense Proposal’s requirement of disclosure of material risks, general terms and conditions, the terms of transactions in both the English language and in any other predominant language spoken by the customers of the licensee is unduly burdensome:**

As currently written, Licensees must determine the predominant language spoken by each of its customers and ensure that material risk (200.19(a)), general terms and conditions (200.19(b)), and terms of transactions (200.19(c)) disclosures are translated into each of those languages during the account-opening process.

NYDFS should strike the requirement to translate disclosures in these three sections to “any other predominant language spoken by the customers of the Licensee” because the requirement is vague and places an undue burden on the licensee in time and resources.

To the extent that NYDFS would require such translation, NYDFS might instead consider the approach taken by the Consumer Financial Protection Bureau (CFPB) in its guidance on 12 CFR Part 1005(g) with regard to foreign language disclosures as applied to remittance transfers. CFPB requires that disclosures be made in each of the foreign languages principally used by the provider to advertise,

solicit, or market services at the office in which a customer conducts a transaction or asserts an error. This approach would create a determinative obligation.

In addition, where a Licensee can determine the predominant languages spoken across its aggregate customer base, there already exists a strong incentive for Licensee to advertise in and otherwise create a user experience translated into those languages. The CFPB's approach strikes a fair balance by requiring the Licensee to translate into foreign languages predominantly spoken by the customer bases of which Licensee is sufficiently aware and already incentivized to actively promote its products and services.

**The BitLicense Proposal's requirement that each licensee furnish customers with a written disclosure of the terms and conditions "prior to each transaction in Virtual Currency" is overly broad and burdensome:**

During the account-opening process, Licensees should rightly be required to provide customers with a full disclosure of terms and conditions, and it is prudent to ensure their receipt by requiring acknowledgement. Such disclosures should also be readily available to customers throughout the term of the relationship.

However, 200.19(c) requires Licensees to disclose "terms and conditions of the transaction" prior to each transaction. Does this mean that a full set of routine disclosures must be repeated again and again prior to each transaction? What customer would pay attention? What customer would put up with this? As currently written, the proposed rule is not only unduly onerous, but vague, suggesting that a Licensee must disclose *all terms and conditions* which might conceivably apply, and not those terms that are specific to a particular kind of transaction, risk profile or value.

NYDFS should strike the continuous acknowledgement requirement because it is unlikely to improve the customer's comprehension of the disclosures in the context of an established relationship, and places an undue emphasis on the "riskiness" of the transaction by suggesting that the customer must be repeatedly reminded of his or her rights and the allocation of liabilities. If the recurring acknowledgement requirement should stand, then NYDFS should tailor the continuous acknowledgements to address the risk profiles of the particular financial service provided by Licensee, or limit these disclosures to those itemized in Section 200.19(c)(1)-(5).

Virtual currency businesses have the potential to provide cost-effective alternatives to a wide range of financial services traditionally provided by non-virtual currency money transmitters and banks, without necessarily introducing a higher risk profile--services including remittance, bill payment, foreign exchange, merchant processing. However, the continuous acknowledgement requirement is only applied to Virtual Currency businesses, which creates an unfair disadvantage in their ability to provide a frictionless and user-friendly customer experience, and it does not provide a tangible benefit to customers.

As an industry, we strongly support the need to provide clear risk disclosure to consumers. However, long experience shows that consumers simply ignore overly lengthy disclosure documents. By requiring all digital currency firms to disclose a minimum of 10 material risks specified by the NYDFS as well as all other material risks, the NYDFS risks inadvertently encouraging long, legalistic disclosures that almost no consumers will read. We therefore encourage the NYDFS to reduce the degree of specificity in proposed disclosures and instead adopt a principles-based approach that requires the industry to provide clear and conspicuous risk disclosures.

**The BitLicense Proposal's requirement that licensees furnish customers with receipts is duplicative in application:**

Section 200.19(e) requires all Licensees to provide a receipt after each transaction, without exception. We prefer that firms instead *offer* to provide a receipt, while ensuring that an enduring record

of the transaction is available to the customer. And while the receipt requirement is sound with respect to many transactions, such as remittances, and bill payments, it should not be required in all transactions.

For example—where Bitcoin merchant processors provide payment processing services for customers on behalf of merchants, a receipt for the processing of a payment should not be required in addition to the receipt which the merchant provides for the payment of goods or services. In addition, exchanges typically provide their customers with an account history listing all transactions. It makes little sense to require that a separate receipt be delivered at the time of the transaction, especially if the customer does not want it, or is not able to receive it at that time. The Proposed BitLicense should be modified to include exceptions where traditional receipts would otherwise be provided in connection with a transaction.

\* \* \* \*

Thank you for your office's efforts to date with respect to the BitLicense Proposal. We believe that the proportionate regulation will be a boon to the Bitcoin and digital currency industries. New York is in a unique position to take a position of leadership on this subject and we believe making the amendments to the BitLicense Proposal suggested in this letter will create a proportionate framework that will facilitate innovation while protecting consumers and deterring money laundering. We are happy to assist in any way we can to help achieve the best outcome for all parties in this regard.

Sincerely,



Johnny Reinsch  
SVP, Legal & Strategy, Xapo



John Collins  
Head of Government Affairs,  
Coinbase



Tim Byun  
Chief Compliance Officer, Bitpay



Roseanne Lazer  
Legal and Compliance Officer,  
CoinX



Marco Santori  
Chairman, Regulatory Affairs  
Cmt., The Bitcoin Foundation



George Frost  
Chief Legal Officer, Bitstamp



John Beccia  
General Counsel & Chief  
Compliance Officer, Circle



Patrick Murck  
Executive Director, The Bitcoin  
Foundation



Scott Benson  
Director, Regulatory Compliance,  
Bitnet

s/ Juan Llanos

Juan Llanos  
Chief Transparency and  
Compliance Officer, Bitreserve