

Assessment of Public Comments for Newly Proposed 23 NYCRR 102

The New York State Department of Financial Services (“Department” or “DFS”) received 4 public comments on proposed revised rule 23 NYCRR 102 (“Part 102”).

The Department has considered every comment received and will not make any changes to Part 102. This Assessment provides an overview of the comments received and the reasons requested revisions were not made. The Department is adopting 23 NYCRR Part 102 as originally proposed.

Comment: All four commenters state that the complexity of digital asset platforms and the number of digital assets offered by a licensee should have a direct correlation to the assessment of examination costs and, they assert, the proposed rule’s assessment computation fails to adequately account for the complexities of different cryptocurrency business models. In particular, they claim, using total outstanding liability and transaction volume as a proxy for the complexity of the virtual currency industry is not sufficiently specific because companies with similar liability and transaction volumes may offer a significantly different array of products and services that may require different levels of supervisory resources. Further, some commenters asserted that using the total value of virtual currency held on behalf of all customers for the past year rather than just funds held for New York customers is not an accurate measure for allocating the costs of the Department’s supervision.

Response: The Department understands that virtual currency business models may vary significantly and will likely continue to do so as the industry evolves and innovates. Given the variety of existing business models,

and the fact that the industry is growing and developing, it is impossible to establish an assessment mechanism that captures all the possible variations. In preparing the proposed regulation, the Department conducted an extensive analysis of its supervisory and regulatory costs and staffing models, both historical and projected, to identify the most effective method of allocating the Department's cost of regulating the industry in line with the resources required to regulate licensees. When it promulgated 23 NYCRR 102, the Department concluded that the proposed data points are the most effective proxies for assessing the agency resources required to effectively regulate a licensee. The Department continues to believe that the proposal reflects the most effective way to allocate the costs of regulating virtual currency licensees. Notably, while the commenters criticize the methodology proposed in 23 NYCRR 102, they do not propose an alternative methodology.

Part 102 uses total custodial funds, not just New York customer funds, because the Department concluded that total custodial funds are the better metric to assess the amount of oversight required by the Department to ensure that an entity is operating in compliance with the requirements of 23 NYCRR 500. As stewards of others' assets, virtual currency entities play an important role in the financial system and, therefore, a comprehensive and safe regulatory framework is vital to protecting customers and preserving trust. Total custodial funds, however, is not the only metric used by proposed Part 102. In particular, to align the assessment with actual New York activity, Part 102 uses the number of New York transactions as a key metric for allocating the assessment of the Department's costs.

Comment: Three commenters objected to the proposed rule's methodology of distributing Transaction Basis and Custody Basis supervisory hours among three tiers. Specifically, the proposed rule classifies licensees as small, medium, and large depending on certain metrics as a proxy for the complexity of the business model of each licensee and uses that classification to assess supervisory resources needed (5%, 15%, and 30% respectively)

for each tier. For example, commenters stated, while it may turn out that “large” licensees, as measured by Transaction Basis, will account for 30% of actual supervisory hours, the proposed rule does not explain the mechanism to verify those assumptions. In addition, commenters argue that the three tiers are not sufficient to adequately differentiate among similarly situated licensees.

Response: Extensive binominal distribution analyses were performed based on the Transaction Basis and Custody Basis, relative to the number of entities and the determination of the associated tiers. DFS will review the assigned tier ranges annually to ensure adequate binominal distribution based on the preceding year’s business activity (average quarterly total custodial assets and annual number of New York virtual currency transactions), of the associated operating costs, as well as reasonableness of the estimated time commitments for each tier. Distributing supervisory hours by tiering the size of a licensed entity has long been used in the Department’s assessments of banking entities. Details on the use of supervisory hours is available on the Department’s website in publicly posted quarterly calculations for other industries regulated by the Department.

Comment: One commenter objected to the allocation of the Regulatory Component to virtual currency licensees without any differentiation based on the proportion of activity in New York akin to the proportion of Industry Financial Basis used for other industries regulated by the Department. The commenter noted that given the variability in size of businesses, this would disadvantage small entities and should be charged proportionally like other elements in the proposed calculations.

Response: While significant portions of the proposed assessment calculation accounts for the size of the entity and the volume of their transactions, the regulatory component represents the baseline cost of examining

licensees. As all licensees are subject to examination, the cost was spread evenly. The variable cost of regulating larger, more complex entities is captured in the supervisory component.

Comment: Two commenters recommended transparency requirements to the proposed rule, including adding a provision that requires the Department to publish an annual report detailing the amounts of assessments levied against each licensee and the corresponding percentage of assessments paid by each licensee. This would allow licensees to understand how much of the financial burden they are being asked to shoulder each year. Public disclosure of regulated entities' regular assessments would promote greater transparency.

Response: The Department is committed to transparency and already posts assessment calculations for all licensed entities online for entities subject to assessments on a quarterly basis on the Department's website. The Department plans to post similar materials for virtual currency assessments in the near future. Further the Department's full budget is publicly available at the New York State Division of Budget website. Further amendments are not needed.

While the public is entitled to know the aggregate revenues received by the Department as a result of the assessment, the Department will not publicize transactional volume or assets managed by individual companies as such disclosure could cause licensees commercial harm. The Department routinely protects such information from public disclosure.

Comment: Two commenters recommended an appeals review process wherein licensees can challenge or otherwise seek input from DFS on assessed fees.

Response: The Department is committed to transparency with its licensees and has historically answered questions regarding their assessments or provided further explanation to licensees when requested. New York State law provides an existing process to challenge agency determinations through the New York State Civil Practice Law and Rules Article 78. Adding an additional internal procedure for administrative appeal is not necessary and would be unduly burdensome.

Comment: An industry trade association expressed concern about the special assessments provision in Section 102.6. It points out that the Department initiates investigations in its sole discretion and conducts them with minimal transparency. Any special assessment arising from such an investigation could create unpredictable costs for a licensee. This commenter requests a methodology for periodic disclosure and review of such costs during an investigation and a way to challenge the hours worked or fees charged for any special assessment.

Response: The Department included a special assessments provision in Part 102 because Financial Services Law Section 206 already provides for assessment of special examinations. The language used in Part 102 is identical to the language used in 23 NYCRR Part 101, applicable to banking organizations and their affiliates. Virtual currency businesses subject to the Banking Law are already subject to this provision in 23 NYCRR 101.

Comment: One commenter recommended process changes to the way the Department reviews and processes virtual currency license applications.

Response: This comment bears no relationship to how the Department calculates or bills assessments of virtual current companies and is not germane to the Proposed Rule.