

Statement of

ADRIENNE A. HARRIS

**SUPERINTENDENT
NEW YORK STATE DEPARTMENT OF FINANCIAL SERVICES**

before the

**STANDING COMMITTEE ON CONSUMER AFFAIRS AND PROTECTION
AND
STANDING COMMITTEE ON BANKS**

NEW YORK STATE ASSEMBLY

MAY 25, 2023

Good afternoon, Chair Rozic, Chair Hunter, Ranking Member Mikulin, Ranking Member Curran, members of the Assembly Standing Committee on Consumer Affairs and Protection, and members of the Assembly Standing Committee on Banks. My name is Adrienne A. Harris, and I am the Superintendent of the New York State Department of Financial Services. Thank you for inviting me to today's hearing.

The New York Department of Financial Services (the "Department" or "DFS") has in place the most comprehensive virtual currency regulation in the United States. DFS's virtual currency regulatory framework has been in place since 2015, and is built on the model of full-scope banking supervision (including, *e.g.*, capitalization requirements, transaction monitoring and reporting obligations, and consumer protection requirements), but designed for the unique considerations of the industry. It is DFS's priority to protect New York consumers, keep virtual currency entities safe and sound, and hold bad actors to account.

I want to take a moment to thank Chair Rozic, Chair Hunter, and the rest of the legislature for your continued support of DFS's virtual currency regulatory framework. I am grateful for the assessment authority that the Governor and you and your colleagues in the Legislature granted in last year's Budget. This past month, we finalized the regulation and issued assessments to DFS licensees.¹ Your support has been critical as we continue to build on the progress made over the past year and a half, cementing the Department as the leading global prudential regulator for virtual currency business activity.

Upon my arrival at the Department in September 2021, I recognized the evolving risks virtual currency activity can pose to consumers and the U.S. financial system and began work to strengthen our oversight. Since I joined, we have added almost 50 professionals to the Virtual Currency Unit, including seasoned experts specializing in Bank Secrecy Act/Anti-Money

¹ See [Virtual Currency: Annual Assessment Charges - BitLicense | Department of Financial Services \(ny.gov\)](#)

Laundering laws and regulations, accounting oversight, financial crimes, data governance, cybersecurity, and more.

Given the Department's leading and longstanding approach to regulating the space, I testified in front of the House Financial Services Committee just last month as federal legislators contemplate a national framework for regulating stablecoins.² Numerous federal legislators – on both sides of the aisle and from myriad points on the ideological spectrum – as well as foreign regulators, have cited DFS's framework as the gold standard, recognizing the important role that DFS plays in regulating such a fast-moving industry. State prudential regulators can act more nimbly than federal counterparts to respond to industry developments and support responsible innovation given their ability to modernize regulations more quickly and leverage their more immediate understanding of consumer needs. I look forward to sharing with you some key features of the DFS framework here today.

The Department has a wide range of tools to regulate the virtual currency industry, including licensing, supervision, and examination. DFS also has the authority to take enforcement action against a company when we find that it is not in compliance with laws and regulations. But comprehensive regulation which protects markets, entities, and consumers does not work exclusively through enforcement.

Beginning with the application process, DFS's framework allows for responsible innovation with guardrails tailored to the specific risks that virtual currency creates. Unlike states that license virtual currency entities only as money transmitters, DFS has two distinct licensing and chartering regimes for entities engaging primarily in virtual currency activities—the BitLicense and the limited purpose trust company (LPTC) charter.

² [Hearing Entitled: Understanding Stablecoins' Role in Payments and the Need for Legislation | Financial Services Committee \(house.gov\)](#)

The BitLicense regulation³, which was enacted in 2015 under the New York Financial Services Law, requires companies to pass DFS’s rigorous licensing standards to engage in any “virtual currency business activity.”⁴ Importantly, DFS developed the BitLicense through a long and deliberate public process, including extensive stakeholder engagement and the review of over 1,200 public comments from across the globe.⁵ Since then, our regulatory framework has allowed the Department to respond quickly to the fast-moving industry, issuing guidance letters⁶ and updating supervisory agreements to ensure consumers are protected and institutions remain safe and sound.

LPTCs⁷ engaged in virtual currency business activity in New York are chartered under the New York Banking Law and also are required to comply with the substantive provisions of the BitLicense Regulation.⁸ LPTCs have additional powers and therefore additional supervisory expectations arising under the Banking Law. Specifically, an LPTC may act as a fiduciary, while a BitLicensee does not have fiduciary powers.⁹

³ 23 NYCRR § 200.

⁴ Specifically, 23 NYCRR § 200.2(q) defines “virtual currency business activity” to mean any one of the following activities involving New York or a New York resident: a) receiving virtual currency for transmission or transmitting virtual currency; b) storing, holding or maintaining virtual currency or control over virtual currency on behalf of others; c) buying and selling virtual currency as a customer business d) performing exchange services as a customer business; or e) controlling, administering or issuing a virtual currency.

⁵ On March 11, 2014, DFS issued a public order considering proposals and applications to conduct virtual currency activity in New York. Four months later, DFS released its first proposal for the BitLicense regime for public comment. After two rounds of public comment, DFS published the final BitLicense rules in June 2015, approving the first BitLicense application for Circle Internet Financial on September 22, 2015.

⁶ See [Industry Letters | Department of Financial Services \(ny.gov\), which includes guidance on the prevention of market manipulation, coin listing requirements, use of blockchain analytics, USD-backed stablecoin issuance, banking activity, protocol changes, and consumer protections in the event of an insolvency.](#)

⁷ All references to LPTC entities in this testimony are to those LPTC entities engaged in virtual currency business activity (described above), unless otherwise noted. While the Department also regulates and supervises LPTCs that engage in traditional trust activities only (“traditional LPTCs”), those entities have not been approved to engage in activities related to virtual currency and so are not subject to the virtual-currency-specific requirements described in this testimony.

⁸ See e.g., DFS press releases issued on October 5, 2015, and March 11, 2014, available at https://www.dfs.ny.gov/reports_and_publications/press_releases/pr1510051 and https://www.dfs.ny.gov/system/files/documents/2020/04/ea140311_proposals_vc_exchanges.pdf.

⁹ New York’s LPTCs are chartered and regulated under the NYBL, pursuant to which they possess the same general powers as banks, with the exception that LPTCs are permitted only to accept deposits and make loans that arise directly from the exercise of their fiduciary powers. In addition, LPTCs are empowered under the NYBL to provide custody and related services in a fiduciary capacity. (See NYBL § 100.)

Approval for a license or charter requires that companies meet the standards of DFS's comprehensive assessment of controls regarding financial crimes, cybersecurity, capitalization, financial/accounting, character and fitness of controlling parties, operational risk, consumer disclosures, anti-fraud measures, and more.¹⁰

Many entities have applied for but not received a DFS license because they failed to meet those rigorous standards. Of note, FTX made public that they had a charter application pending in with DFS. The approval requirements that DFS maintains are designed to catch the issues on display with FTX, which prevents actors that fail to meet these standards from operating within New York. And the same is true for other now defunct virtual currency entities such as Voyager and Celsius.

Once an entity is approved to be licensed or chartered, DFS creates a detailed supervisory agreement that is tailored to the specific risks presented by the company's business model. Licensed and chartered entities also are subject to ongoing supervision and are regularly examined for compliance with broadly applicable virtual currency regulations and other rules, as well as with their supervisory agreements. Supervisory agreements are updated on an as-needed basis to take account of changing business models, market conditions, or other relevant considerations. Licensed companies also must get approval from the Department for any material changes of business, including for any and all new product offerings and stablecoin issuance.¹¹

DFS also regularly issues guidance to regulated entities to make transparent more specific regulatory expectations and guardrails.¹² During my tenure, the Department has issued guidance to regulated virtual currency entities on the use of blockchain analytics tools; issuance of U.S.

¹⁰ 23 NYCRR § 200.4

¹¹ 23 NYCRR § 200.10.

¹² See [Industry Letters | Department of Financial Services \(ny.gov\)](#).

dollar-backed stablecoins; and consumer protections in light of an insolvency. In such a fast-moving industry, the ability to issue guidance and update regulations allows the Department to address market changes, consumer needs, and federal laws in a timely manner.

The Department examines our virtual currency entities, including to assess that the institutions have virtual currency-specific controls in place to protect consumers that are appropriately tailored to the risks presented by the entity's business model. The Department supplements such examinations through proactive supervision. Through this work, staff evaluate each entity against regulatory requirements and bespoke supervisory agreements. Upon identification of supervisory gaps or deficiencies, the Department can require remedial actions¹³ to swiftly address issues. For example, in February of this year, the Department was the first regulator in the world to address Binance, ordering Paxos to cease minting Paxos-issued BUSD, ameliorating risks before consumers were harmed. After DFS took this supervisory action, federal and foreign regulators quickly followed in our footsteps.

Since I joined the Department, we have strengthened oversight by acquiring technologies, onboarding specialized experts, and enhancing training to support more real-time supervisory awareness of our entities. For example, the Department now has a trained team in place who can review wallet addresses and transaction hashes associated with DFS-regulated entities and their counterparties to identify potential illicit finance activity.

If through our supervision we find that a regulated entity is not in compliance with our rules, our supervisory team can quickly refer cases to DFS's enforcement division to investigate and take appropriate enforcement actions to ensure that companies pay penalties for violations, remediate issues, and where applicable, return lost funds to customers. In January, the Department reached a \$100 million settlement with Coinbase after an investigation found that

¹³ *Notice Regarding Paxos-Issued BUSD*. New York Department of Financial Services. https://www.dfs.ny.gov/consumers/alerts/Paxos_and_Binance

the platform was vulnerable to serious criminal conduct, such as money laundering, suspected child sexual abuse material-related activity, and potential narcotics trafficking.¹⁴ The Coinbase settlement followed a \$30 million penalty DFS levied on Robinhood Crypto in 2022 for significant anti-money laundering, cybersecurity, and consumer protection violations. As necessary, DFS partners with law enforcement and federal agencies such as the U.S. Financial Crimes Enforcement Network, the U.S. Office of Foreign Assets Control, and Department of Justice to prosecute criminal conduct.

The core provisions of the DFS regulatory and supervisory framework, which is frequently cited by domestic and foreign regulators as the gold standard, are robust financial standards,¹⁵ strong consumer protections,¹⁶ sophisticated cybersecurity requirements,¹⁷ and strong anti-money laundering and anti-fraud provisions.¹⁸

Virtual currency entities also are subject to custody and capital requirements tailored to virtual currency-specific risks.¹⁹ For example, entities must hold virtual currency of the same type and amount, on a one-to-one basis, as that owed or obligated to a consumer.²⁰ This is distinct from traditional banking based on a fractional reserve system, which enables entities to maintain only a portion of assets deposited by consumers and lend or use the rest for their own business.

¹⁴ New York Department of Financial Services. (2023, January 4). *Superintendent Adrienne A. Harris Announces \$100 Million Settlement with Coinbase, Inc. after DFS Investigation Finds Significant Failings in the Company's Compliance Program* [Press release].

https://www.dfs.ny.gov/reports_and_publications/press_releases/pr202301041.

¹⁵ 23 NYCRR § 200.14.

¹⁶ 23 NYCRR §§ 200.18, 200.19.

¹⁷ 23 NYCRR §§ 200.16, 500.

¹⁸ 3 NYCRR §§ 116, 504; 23 NYCRR § 200.15.

¹⁹ 23 NYCRR §§ 200.8, 200.9,

²⁰ *Ibid.* at 200.9.

The Department further underpinned these regulatory requirements with guidance in January 2023,²¹ reiterating expectations for sound custody and disclosure practices, and the paramount importance of the equitable and beneficial interest in the asset always remaining with the customer. Entities must have in place policies, processes, and procedures to appropriately segregate customer funds and provide appropriate disclosures.²²

In addition to requirements related to holding of customer assets, DFS-regulated virtual currency entities must have capital on hand to mitigate risk associated with cyber events, market volatility, or other exogenous events.²³ The required capital amount is calculated based on specific risks presented by each entity's business model and other safety and soundness factors, such as custody (cold storage and hot wallets); transmitted assets (volume and value); and projected wind-down costs, where minimum capital requirements are established for each category. Once the capital amount is initially determined with the Department, entities must maintain at least 110% of that amount at all times. Entities must submit reports to evidence they are meeting the minimum required amount against changes to the entity's business model through regular submissions of assets under custody, transmitted volumes and value, and wind down cost considerations directly to the Department. The Department reviews the adequacy of each submission and independently verifies the calculation submitted. If an entity falls below the 110% threshold at any time, they must notify DFS immediately, and provide more frequent submissions until any concerns are fully resolved.

DFS's virtual currency regulation also includes specific consumer protection requirements, including for advertising and marketing practices, proper disclosures, transaction

²¹ New York Department of Financial Services. (2023, January 23). *Guidance on Custodial Structures for Customer Protection in the Event of Insolvency*.

https://www.dfs.ny.gov/industry_guidance/industry_letters/il20230123_guidance_custodial_structures

²² *Ibid.*

²³ 23 NYCRR § 200.8.

receipts, and fraud prevention.²⁴ Entities also are required to have policies, processes, and procedures to resolve complaints in a fair and timely manner.²⁵

All virtual currency entities regulated by DFS are subject to our cybersecurity regulation, as are our traditional banking institutions and insurance companies.²⁶ DFS's cybersecurity regulation has become the model for other state and federal regulators since it was enacted in 2017. Recently, the Department has proposed amendments to our existing framework, taking into account new and evolving cybersecurity threats with the most effective controls and best practices.²⁷ Furthermore, our virtual currency regulation includes specific provisions to ensure individuals and their data are protected from the rise of hacks—a particularly salient concern with respect to virtual currency.

Lastly, from the development of the BitLicense regime and in the time since, the Department has prioritized addressing the inherently high risk that virtual currency business activity presents with respect to illicit transactions. These safeguards include requirements for annual risk assessments and independent testing, and annual certifications of compliance with transaction monitoring and filtering programs through the Department's Part 504 certification requirements.²⁸ For example, in April 2022, the Department produced guidance to emphasize to all virtual currency business entities the importance of blockchain analytics to effective policies, processes, and procedures, including, for example, those relating to customer due diligence, transaction monitoring, and sanctions screening.²⁹ The Department uses such tools itself as part of supervision.

²⁴ 23 NYCRR §§ 200.18, 200.19, 200.20.

²⁵ 23 NYCRR § 200.20(a).

²⁶ 23 NYCRR § 500.

²⁷ See [Regulatory Activity - Financial Services Law | Department of Financial Services \(ny.gov\)](#) and [Regulations - Financial Services: Proposed 2nd Amendment to Insurance Regulation 23 NYCRR 500: Cybersecurity Requirements for Financial Services Companies – rp23a2 text 20221109.pdf](#).

²⁸ 3 NYCRR § 504.3(a)(2).

²⁹ See [Industry Letter - April 28, 2022: Guidance on Use of Blockchain Analytics | Department of Financial Services \(ny.gov\)](#).

Our regulatory rigor also applies to stablecoins. I wanted to briefly outline how DFS regulates and oversees this type of business activity. Employing DFS’s robust virtual currency regulatory framework described above, we use additional regulations, guidance, and company-specific supervisory agreements to tailor our oversight to the nuances of specific products and services. Our regulation and oversight of stablecoins is a prime example of how we develop specific guardrails for novel activity. DFS was the first agency to provide regulatory clarity for these products, which has helped protect New York consumers and provided the industry needed confidence and direction to create a strong, resilient market for these businesses in the state.

There are many different kinds of stablecoins, including fiat-backed, commodity-backed, and algorithmic.³⁰ As noted above, in addition to licensing entities to do business in New York and keeping bad actors from operating in the state, DFS also must approve separately each product a company seeks to offer, including the issuance of any stablecoins. The Department has not approved the issuance of any algorithmic stablecoins, which have very different characteristics in terms of design, backing, and issuance. The collapse of the algorithmic stablecoin, Terra, was well-reported in the news last year and had a ripple effect across the cryptocurrency ecosystem, ultimately leading to the bankruptcy of fintech firms Celsius and Voyager (neither of which was licensed or chartered by DFS) and hedge funds such as Three Arrows Capital. However, the Department’s strict coin listing requirements mitigated the impact of the Terra collapse to New Yorkers in a manner that cannot be said for any other jurisdictions because Terra had not been approved by DFS for custody or listing in New York State.

³⁰ Algorithmic stablecoins attempt to maintain their peg by using algorithms that automatically adjust the circulating supply in response to market dynamics. The largest and most famous example of this was UST, which imploded in Summer 2022 and led to billions in losses across the cryptocurrency space. These algorithmic stablecoins in particular generally fail to meet the key defining characteristic of a stablecoin (stability) and should be viewed with utmost caution.

In June 2022, DFS provided guidance related to the issuance of U.S. Dollar-backed stablecoins (DFS Stablecoin Guidance). The DFS Stablecoin Guidance makes public the baseline requirements DFS expects from regulated entities, based on the work DFS has done in stablecoin supervision since 2018.

There are three key elements to the DFS Stablecoin Guidance: strict reserve requirements, confidence in redeemability, and transparency. Any stablecoin approved by the Department and issued by a DFS-regulated virtual currency entity must be one-to-one backed at all times by cash or cash equivalents held in custody with U.S. state- or federally-chartered depository institutions with deposits insured by the Federal Deposit Insurance Corporation and/or with asset custodians approved in advance by DFS. Entities must adopt clear, conspicuous policies which allow for “timely” redemption not more than two full business days after the issuer receives a redemption request (*i.e.*, “T+2” conversion in response to redemption requests). Lastly, issuers are required to undergo monthly audits by an independent certified public accountant (CPA) and provide public bi-monthly attestations on the underlying reserves to provide the marketplace with the transparency needed to have confidence in their assets.

Together, these stablecoin-specific requirements, combined with the constellation of regulatory requirements unique to the Department, provide a level of transparency for existing and would-be issuers for how to responsibly build their business in a regulated environment.

Far from creating a disincentive to enter the market, DFS’s strong regulation has drawn virtual currency companies to do business in New York. Crypto startups based in New York City have consistently raised more capital than companies in any other region of the country, including Silicon Valley and Miami. In 2021, nearly half of that capital was raised by New

York-based companies.³¹ The Department continues to receive applications from a variety of companies which understand the critical need for a robust regulatory framework that is designed to ensure their safety and soundness and the protection of their customers. Further, other jurisdictions, regulators, and economic development agencies recognize the value of the DFS framework and are seeking to replicate it. From Illinois, California, and at the federal level; to the United Kingdom, United Arab Emirates, and Singapore; DFS is engaged with regulators around the world seeking to build a regulatory framework that leverages DFS's expertise and experience.

Recent market events have demonstrated that DFS's regulatory framework is operating as intended. Now, more than ever, consumers need to know that their assets are protected. And I would argue that the most important consumer protection is often not one written in the black and white of the law, but a nimble and strong regulator with the knowledge, flexibility, and agility to move at the pace of industry.

I am proud of the work DFS has done to develop a comprehensive supervisory framework and to foster a well-regulated virtual currency industry in the state, and we would welcome further collaboration with you to take advantage of our lessons learned.

Thank you, and I look forward to your questions.

³¹ Bellusci, M. (2022, February 1). Global VC Funding for Blockchain Firms Surged to Record \$25B in 2021: CB Insights. *Coindesk*. <https://www.coindesk.com/business/2022/02/01/global-vc-funding-for-blockchain-firms-surged-to-record-25b-in-2021-cb-insights/> citing: CB Insights "2021 State of Blockchain Report."