



Chamber of Digital Commerce
(202) 302-6064
www.digitalchamber.org

Conference of State Bank Supervisors
1129 20th Street, N.W.
Washington, DC 20036
Attn: Emerging Payments Task Force

**Re: STATE REGULATORY REQUIREMENTS FOR VIRTUAL CURRENCY ACTIVITIES
CSBS DRAFT MODEL REGULATORY FRAMEWORK AND REQUEST FOR PUBLIC COMMENT**

Ladies and Gentlemen:

The Chamber of Digital Commerce welcomes this opportunity to provide comments on the Draft Model Regulatory Framework (“Draft Framework”) for state virtual currency regulatory regimes in support of the CSBS Policy on State Regulation of Virtual Currency. The Chamber is the trade association for entities in the digital currency and digital asset community. Our membership includes both crypto and non- crypto currency related businesses. The member business models range from miners, issuers, currency exchanges, ATM providers, transaction processors, software and other technology companies, financial institutions and investors. This breadth and depth of membership permits us a unique vantage point on which to provide these comments.

We appreciate the efforts of the CSBS to promote consistent state regulation of virtual currency activities as well as its recognition of the need for flexibility in adapting regulation and oversight, given the nascent and evolving nature of virtual currency business models. We commend the state regulators on their transparent and inclusive approach to studying virtual currency activities. Our comments and suggestions below are intended to help better inform state regulators as they work to adapt their regulatory structures to virtual currency activities and business models.

As discussed in our comments, the Chamber stands ready to work with the CSBS and the state regulators in a constructive and collaborative relationship. Our goal is to ensure that the various aspects of this industry are appropriately understood, and the regulatory approach achieves the stated public policy objectives of financial safety and stability, consumer protection and compliance with anti-money laundering laws, while remaining sufficiently flexible to facilitate and nurture continued innovation.

Finally, we note as a general comment, the preferred term of the Chamber and the community is “digital currency” instead of the term “virtual currency”. The term “virtual currency” was coined initially in the context of virtual gaming and is generally regarded as being more limited in scope than the term “digital currency”, which is used to refer to a number of different types of currencies stored and transferred electronically, including both crypto and non-crypto currencies. Said another way, all virtual currencies are digital currencies, but not all digital currencies are virtual currencies.

Questions for Public Comment

1. Policy Implementation – Entities engaged in virtual currency activities might not be engaged in traditional money transmitter activities involving only fiat, government-backed currencies. Similarly, traditional money transmitters might not be engaged in virtual currency activities.

- a. Within the umbrella of state money transmitter regimes, how can state regulators appropriately tailor licensing and supervision to each set of licensees?**
- b. In order to properly tailor licensing and regulatory regimes to virtual currency activities, should states consider a virtual currency-specific “amendment” or “endorsement” to a traditional money transmitter license?**

Regulation of virtual currency activities should focus on function. If the business model involves the transmission of value, it should be regulated as such. If it involves the exchange of one type of value for another, it should be regulated as currency exchange or conversion. If it involves the holding of customer value it should be considered in the context of stored value, albeit not as prepaid access. If the business model involves none of the above, it should not be regulated.

The critical issue with respect to virtual currencies is understanding precisely the role of the entity and whether its “virtual currency activities” actually involve the use of the virtual currency in a monetary context, whether as a medium of exchange or a store of value. For example, companies that solely create software would not be subject to regulation under the money transmitter laws. Likewise, companies should not be subject to such regulation if their business models do not involve the transfer of value or exchange of currencies but do require the use of minimal amounts of what may be termed a crypto- currency as a kind of “fuel” to permit the software to function.

An approach to regulation like that of the New York Department of Financial Services offers the opportunity to address specific issues where the business models of companies engaged in virtual currency activities differ from traditional money transmitters. In the absence of a separate regulatory or licensing scheme, regulatory guidance (and/or regulatory amendment) should be provided to make clear how such issues would be addressed.

2. Licensing Process

- a. Though states largely have the same licensing requirements, there is not a common implementation process. Please comment on the functionality of the NMLS or other licensing systems.**
- b. Would a common application and guide to licensure enhance the efficiency of the licensing system?**
- c. Obtaining required criminal background checks has been flagged as an administrative challenge in the licensing process. What procedures can states uniformly adopt to facilitate obtaining criminal background checks as part of the licensing process?**
- d. Credentialing business entity key personnel can be a hands-on process, but has proved indispensable for financial services licensing. Are there alternative means of credentialing that may facilitate the process?**

Companies involved in virtual currency activities are multi-jurisdictional by virtue of the fact that they operate on the Internet. Any artificial restraints on their ability to operate without regard to geographical boundary within the United States adversely impacts the significant cost effectiveness and efficiencies that their business models offer to consumers and businesses. Although these systems offer more convenient transactions that are faster and much less costly than those conducted through more traditional money transmission systems, the costs associated with an inconsistent and varied multi-state licensure system - both in the application process and in on-going maintenance - substantially undermine these efficiencies.

The NMLS is a welcomed first step toward reducing some of the costs associated with complying with the many different state money transmitter licensing schemes currently in place in the United States. The NMLS offers organizations a central platform on which they can submit certain information required by each state that requires a money transmitter license to provide services to residents in those states. It also provides a means to readily update certain information maintained on each licensee by the participating states.

However, the NMLS in its current form can only be regarded as a first step. While it has brought a certain level of uniformity to the state licensing process, with respect to information collection, at this time many states still have differing state specific requirements that require additional supplemental submissions. In addition, many states ask additional questions and request more documents during the processing of an application.

As more states become participants in the NMLS, the efficiencies offered by the NMLS should improve. Even greater efficiencies can be derived from adopting a single application form and process.

A coordinated application processing system in addition to a uniform application and submission process would be an even more significant major step forward. Alternatives could include (1) one state - such as the designated home state of an applicant - taking responsibility for processing the application or (2) a committee of state regulators processing the application on behalf of all of the states in accordance with specific guidelines.

The cost savings for all - both applicants and states - would be significant. Applicants would not incur the time and expense of preparing multiple applications and paying multiple application fees. While they may pay a higher fee for the processing of a single uniform application, inevitably the cost should be less than having to pay fees to every state. From the perspective of the state departments, the costs of processing applications would similarly be reduced. States would not be required to dedicate as much staff to this task, including the time and effort to understand the unique nature of each applicant's business models. More time could be reserved for supervisory responsibilities.

Recognizing that implementing such changes takes time, in the interim a common set of guidelines for application processing would be most helpful, and hopefully, such guidelines would eliminate the necessity for the same types of questions being asked by multiple states after the applications are filed.

Adoption of a standard personal biographical and financial information form - like that used by the federal banking agencies - would reduce the number of separate forms that must be completed by key individuals. Likewise adoption of a common set of standards for conducting the criminal background checks would reduce the costs for both the applicants and states. The submission of

one set of fingerprints per individual through the NMLS should be more than sufficient. The NMLS could coordinate the background check and prepare a single report that could be accepted by every state on the system.

Similarly, the credentialing of the key individuals could be conducted by NMLS in accordance with established guidelines. This would eliminate the need to undertake this time-consuming process on a state-by-state basis.

Consideration also needs to be given to when and how to conduct credentialing in young companies, where the turn-over of key individuals may be quite rapid as the business model evolves, and multiple investment rounds introduce new controlling parties. Timely processing of such requests is also important.

3. Training and Education – Educating regulators about virtual currency business activities and business models is an important part of building a responsive and robust regulatory structure.

- a. What education may be necessary for state regulators to aid in the licensing process?**
- b. What resources are available to explain technology and business models across the virtual currency industry?**

Without a doubt, education is critical with respect to effectively regulating virtual currency related businesses. First and foremost, the regulators must understand the underlying technology and the nature of the activity to even determine if a business model or specific business activities require licensing. Likewise, regulators need to understand how the model works in order to determine how the activity or model should be regulated and what types of issues it may present from a regulatory perspective.

Due to pace of technological development in the industry, education will be an ongoing process. Not only will regulators need to understand the changes that are announced daily but they will be more effective if they can also anticipate changes that are coming. For example, a regulatory regime based on business models in place today could well be outdated within a year or two.

One of the key objectives of the Chamber is education – of policymakers, regulators, the industry and consumers. The Chamber is committed to providing the regulatory community with access to appropriate information about virtual currency business activities and business models.

As part of its efforts, the Chamber has been developing a full range of programming to provide educational opportunities with respect to the industry, the issues it faces and its compliance obligations. These including webinars, seminars and the AML Compliance Bootcamp for Digital Currencies, all of which are open to state regulators.

The Chamber also proposes establishing a public-private partnership with the state regulatory system, possibly in conjunction with CSBS, to provide an organized forum for regulators to learn about the latest technological and business developments within the digital currency space. The Chamber would coordinate initially on a monthly basis through a webinar presentation to help regulators understand better the nature of the underlying technologies and how they are being adopted in business models. On a quarterly or biannual basis it would coordinate lengthier programs to provide greater opportunity to learn about the technology. Other meetings and programs would be scheduled as needed.

4. Technological Innovations – What changes and innovations have been seen and/or can be anticipated in the technological aspects of virtual currencies and the resulting marketplace?

Although the first virtual/digital currencies emerged in the mid-1990s, we have seen an explosion of virtual currencies and related technologies in the last several years. They involve both crypto-currencies like Bitcoin and non-crypto currencies.

The open-sourced nature of Bitcoin and other crypto-currencies has unleashed a massive wave of innovation within the financial services industry and with respect to other types of products and services that are not financial in nature. This is likely to continue for the foreseeable future in part because of the need to build out an infrastructure to support digital currencies, and in part as new functionalities are discovered for the technology. In short, we are only in the very early stages in the development in this area.

We also anticipate a dynamic period of experimentation on the part of businesses and consumers as they become familiar with virtual/digital currencies and modify their payments habits as they adjust to these innovative technologies.

Adoption will accelerate significantly over the next two to five years. As noted above, the marketplace for digital/virtual currencies is international and almost instantaneously accessible. The technology is agnostic to geographical borders. Adoption across the US and in other nations will only continue to grow as consumers and businesses recognize the cost/benefits of using digital currencies. Moreover, the business models will not be limited to those domiciled in the US.

Black and white categorization of business models will also become more and more difficult. For example, the distinction between centralized and decentralized systems will blur especially as more features are added to different types of business models, whether a wallet is added to an exchange platform, prepaid access is added to a wallet or the currency or a certain portion of it is backed by an asset like a fiat currency or gold.

We anticipate that there will be significant and dramatic developments in the technology underlying both types of currencies in the coming months and years. We also anticipate that we will see the underlying technologies for both types of digital currencies adopted for other purposes unrelated to digital currencies, presenting a particular challenge for regulators to understand what functional elements of such technology should and should not be regulated.

For example, the blockchain technology and the use of sidechains may represent one of the most dynamic areas of innovation. Significant projects are already underway to facilitate the transfer of any type of digital asset across the Internet, with an audible timestamp. The blockchain can be utilized to transfer property or indicia of ownership of such property such as land deeds, car titles, stocks, bonds, government documents such as birth certificates, social security numbers, marriage licenses, and electronic health records. The blockchain protocol permits these documents to be encrypted and transferred securely. Other nonfinancial uses of the blockchain technology are also being explored. While the initial blockchain projects were undertaken using the Bitcoin protocol, other algorithms are being written to accommodate different types of blockchain projects.

5. Denomination of Capital, Permissible Investments, and Bond Coverage – Capital, permissible investments, and surety bond requirements exist to create financial security in the event of failed transactions or a failed business. For financial services companies

dealing in virtual currencies, should these safety funds be denominated in the applicable virtual currency or in dollars?

Disclosure to and understanding of the consumer as to how the value of the virtual currency is determined should be the key factors in determining whether the “safety funds” can be denominated in the virtual currency. The licensee should be permitted to maintain the “safety funds” in virtual currency if the licensee appropriately discloses to the customer how the value will be determined and whether if anything backs the currency. The customer should have sufficient information to understand that in the event of a failed business or transaction, his or her value is that of the virtual currency and that the value of the currency may fluctuate in the event of a crisis.

6. Distressed or Failed Companies – Certain requirements in the Draft Framework are designed to provide regulators with tools for dealing with distressed or failed companies. Please comment on the practical issues and challenges facing regulators in the case of a distressed or failed company. What other tools should regulators have for resolving a failed virtual currency company, minimizing consumer harm and market impact?

The financial difficulties or failure of licensee whose business model involves virtual currency should be addressed in the same way as any other licensee. Ensuring appropriate consumer disclosure with regard to the relationship between the consumer and the licensee and the consumer’s value entrusted in whatever way to the licensee, as discussed in the answer to Question 5, is critical. Appropriate regulatory oversight and monitoring should help minimize market impact.

7. Consumer Protections – What consumer remedies should policy makers consider for virtual currency financial activities and transactions?

The Chamber supports the provision of consumer protections typically provided under federal and state law to customers of state licensed money transmitters business or similar companies to customers of virtual currency related services involving similar functions. As noted above, the emphasis of such protections should be on appropriate consumer disclosures with respect to how the value of the currency is determined, the rights of the consumer with respect to settlement and error resolution, and how the use of them in transactions may differ from the use of fiat currency in order to avoid any potential assertions of unfair, deceptive or abusive acts or practices. Given the borderless nature of the virtual currencies and the focus of the Consumer Financial Protection Bureau on virtual currencies, consumer remedies should be consistent with those available under federal laws.

8. State Insurance or Trust Funds – Some states have laws to create a trust or insurance fund for the benefit of instrument holders (i.e. holders of checks, money orders, drafts, etc.) in the event that a licensed money transmitter defaults on its obligation or is otherwise unable to make payment on the instrument. Is it appropriate to allow holders of instruments denominated virtual currency access to such insurance or trust funds?

A holder of virtual currency is not the same as the holder of instruments denominated in virtual currency.

The first should not be entitled to any protection under state trust or insurance fund solely as result of being the holder of virtual currency; the holder of the currency owns the virtual currency and the transfer of the currency from one person to another should be immediate and irreversible.

There is no one who stands between them in the transaction. However, if the licensee is entrusted with the virtual currency and has ownership or power to direct the currency for any period of time, even a moment in time, then the owner of the currency who contracts with a licensee to hold or transfer such virtual currency should be entitled to the same protection as any person who relies upon a money transmitter to hold funds before and during the transfer of such funds.

Where an instrument denominated in a virtual currency, the holder of the instrument should receive the same treatment as any holder of an instrument issued or sold by a licensee.

9. BSA/AML – Fraud and illicit activities monitoring are increasingly technology based and proprietary, especially for virtually currency companies. Are state and federal exam procedures current with regards to new methods of detecting BSA/AML activity?

The Chamber has not yet had an opportunity to review state or federal examination procedures that have been developed for reviewing the BSA/AML compliance programs of virtual currency related licensees.

As a general matter, virtual currency related companies are subject to the same kinds of abuses that other types of financial services companies experience. However, these licensees are not burdened by legacy IT systems and are able to develop and quickly implement robust systems for detecting and monitoring potential abuse of their systems for money laundering, terrorist financing and other types of criminal activity.

As the methodologies for money laundering and terrorist financing are continuously evolving, it is inevitable that the exam procedures will need to be continuously evolving to ensure that licensees are appropriately compliant.

As noted in the answer to Question 3, education of examiners is very important to understand the nature of the technology, the potential risks for abuse and the efforts being made to mitigate such abuses. The industry itself is working on developing some exciting tools that will address the unique risks and challenges that it faces.

As noted above, the Chamber is hosting the AML Compliance Bootcamp for Digital Currency. It anticipates that at least 6 sessions of this 3 day course will be scheduled in 2015. It is honored to have the Bootcamp approved by CSBS for Continuing Education credits for CSBS Certified MSB Examiner and Certified AML Specialist accreditation. The Bootcamp has also been approved by ACAMS for credit.

The Chamber expects to be adding additional training opportunities to give state examiners increased opportunity to understand the nature of virtual currency activities and business models and what steps these companies are taking to mitigate their risks.

10. Customer Identification – The Draft Framework includes maintaining records on the identification of virtual currency owners. Credentialing consumers for identification purposes can be accomplished to varying degrees, from basic account information to verified personal identification. What is the appropriate level of identification?

Companies engaging in virtual currency activities and with virtual currency business models generally take very seriously the need to collect and verify the personal identifying information of their customers. They are deploying technology solutions and data bases used by other types of

financial services companies or developed specifically for this industry. In addition, new products are in development that will enhance existing capabilities and could establish best practices that exceed that of other financial institutions.

The rules for credentialing consumers and maintaining identification records should be consistent with federal requirements imposed on financial institutions that offer functionally equivalent services.

11. Regulatory Flexibility – The Draft Framework stresses regulatory flexibility to accommodate different activity levels and business models and to avoid inhibiting innovation.

- a. Given the rapidly evolving nature of virtual currencies, what should be the nature of any necessary flexibility?**
- b. How can laws and regulations be written to strike a balance between setting clear rules of the road and providing regulatory flexibility?**

Any new regulatory initiatives should preserve, and to the extent necessary, provide the flexibility regulators require to adjust regulatory and compliance standards in a rapidly evolving industry. Although many state regulators already have substantial flexibility to make the necessary adjustments for effectively regulating virtual currency activities and business models, they need to understand the technology and business models are changing very quickly, that rules and regulations must be adapted quickly if the regulatory framework is to remain relevant, that consistency in application is important, and on-going education about the technology and businesses will continue to be paramount.

The laws and regulations must be consistent across functional activities, and no one function should be put at a disadvantage due to regulatory initiatives.

12. Reporting Requirements – Most states require money transmitter licensees to submit periodic reports of business activities.

- a. For licensed virtual currency companies, what types of information and data should be included in periodic reports?**
- b. What technology solutions exist to mitigate regulatory reporting requirements?**

The nature of the technology and the business models in the virtual currency space means that most if not all data necessary for monitoring the activities of a business is readily available. With appropriate guidance on regulatory expectations, the data can be assembled and the records made available to regulators in electronic form.

The type of the information and data that should be included will differ depending on the products and services of the licensee but should be consistent with the type of information required of other licensees performing similar functions to the extent that the products and services are the same.

The Chamber is actively working to identify new technology solutions and as part of the Chamber's outreach effort to the state regulators, it proposes to coordinate with the CSBS and state regulators on devising and implementing appropriate recordkeeping and reporting requirements, given existing and emerging technologies.

13. Technological Solutions to Improve Supervision – State exams and reporting requirements reflect an institution at a point in time. Conversely, operational standards and internal compliance audits increasingly offer the opportunity for real time data collection, interacting with transmission data to ensure adequate funding, anti-money laundering compliance, fraud protection, and consumer protection. What technology solutions can regulators and licensees deploy to close information gaps in a manner that makes the supervisory process more efficient and “real time?”

By definition, virtual currency activities occur and business models operate in real time or near real time. They are fully automated and the success of operations requires immediate access and processing of data. As a result, virtual currency related business ventures may offer the best opportunity within the financial services sector to regulators seeking to accomplish regulatory supervisory activities in real time.

The response to the question of “what technology solutions can regulators and licensees deploy to close information gaps” is best generated from a working group between the industry and the regulators to ensure that the regulators understand the nature of the information that may be generated from these businesses and the business understand the precise nature of what the regulators need in the supervisory process. Ultimately, the types of solutions that both are looking for are continuing to evolve rapidly. As every day of every month brings new developments that will assist in making the supervisory process more efficient and “real time,” an ongoing dialogue is essential. The Chamber again offers its services in facilitating this dialogue.

14. Cyber Risk Insurance. Companies have begun looking to insurance to help manage cyber risks, and there are a growing number of companies offering cyber liability insurance. What role should cyber risk insurance have in a licensed virtual currency entity's approach to managing cyber risks? Please discuss the potential costs and benefits for virtual currency companies securing cyber risk insurance.

As in many other areas of the financial services sector and other sectors of our economy, virtual currency companies are actively reviewing cyber risk insurance alternatives and some are beginning to sign up for coverage.

The Chamber has initiated substantial outreach efforts in this area and is planning a series of webinars to assist the industry in better understanding its options, with the first occurring in March 2015.

15. Commercial Fund Transfer Liability – Article 4A of the Uniform Commercial Code establishes liability for wire transfers, relying on definitions strictly applicable to banks. Are provisions like those in Article 4A necessary for commercial transfers denominated in virtual currencies? If so, is the Article 4A construct an appropriate model to be adapted in a manner that is not bank-centric?

The Chamber’s Government Affairs and Public Policy Committee has established a working group that is examining this issue. The Chamber will share the findings and recommendations of this group when it is completed.

16. Banking Services for Virtual Currency Companies – Banking arrangement information is necessary for evaluating the safety and soundness of a licensee. However, virtual currency businesses are not immediately understood by most banks that provide traditional money

services accounts. What are the risks facing banks that consider banking virtual currency companies, and how can those risks be mitigated?

The Chamber is very active on this issue. It participated in the US Department of the Treasury's January 2015 Roundtable on Access to Financial Services by Money Services Businesses. As noted by Chamber representatives at the Roundtable meeting, the most significant problem is the banking industry's knowledge gap with respect to virtual currencies. Among other things, there is a lack of understanding of what a virtual currency is, that there are multiple types of virtual currencies, and that the risk factors associated with each kind can be very different. There also is a broad misconception that virtual currencies are riskier than other types of financial instruments. Possibly the most important factor is the lack of awareness within the banking industry of the steps that many of the companies in this space are taking to address anti-money laundering and OFAC compliance issues.

The Chamber also recognizes that there is an educational gap in the virtual currency community and is taking steps to increase the knowledge base of and an understanding of such issues within the community. To this end, as noted above, the Chamber is hosting a series of AML Compliance Bootcamps for Digital Currencies. To help bridge the informational gap in the banking industry, the Chamber is also funding scholarships to encourage bankers to learn more about digital currencies and what the community is doing to protect itself and its business partners.

17. Merchant-Acquirer Activities – Companies processing credit card payments between a buyer's bank and a seller's bank (Merchant-Acquirers) have historically been presumably exempt from money services businesses statutes because of their nexus to the highly regulated banking system. A company processing virtual currency payments for merchants who accept virtual currency as payment for goods and/or services may exchange virtual currency to dollars, which can then be transferred to the merchant's bank account. Is this activity akin to the activities of traditional Merchant-Acquirers, or is it the exchange and subsequent transmission of value that is typically regulated by the states?

This is a factually intensive analysis that needs to be examined on a case by case basis. This activity should be regulated in the same way and to the same extent as traditional card based merchant processing.

18. Cost – State regulators are cognizant of the costs associated with licensure and ongoing compliance. What processes can be implemented to reduce these costs, including any shared services or technology-based reporting?

The community is looking at this issue and companies are evaluating their alternatives. Some companies are already relying upon shared services especially with respect to AML compliance. The technology savvy of the companies lends itself to finding the most efficient ways to automate regulatory requirements including reporting. The critical issue in this process is ensuring that the regulatory standards are adequately and effectively enunciated to permit appropriate code to be written to capture the process.

The Chamber is monitoring this situation closely as the costs associated with compliance can be daunting to young companies. The Chamber anticipates that it will be facilitating more conversation on this issue in the community in the months to come.

19. Escheatment – How should virtual currency be treated under state escheatment laws?

Virtual currency should be treated in the same way as fiat currency and the rules applied to financial intermediaries that hold fiat currency should similarly be applied to those companies that hold virtual currency on behalf of customers. We note however in certain business models, the financial intermediary may not hold the virtual currency and that the owner of the currency may retain full control.

The Chamber suggests that CSBS provide leadership on this point, clarifying this issue for states that require escheatment policies to be provided as part of the application process. Such guidance will help to avoid unnecessary confusion on this point.

Conclusion

We again wish to express our appreciation for the opportunity to submit these comments. The Chamber is committed to working with CSBS and the state regulators in facilitating an appropriate understanding of digital currencies and the supporting infrastructure and technologies. If you have any questions regarding our response, please do not hesitate to contact me at (202) 585-6520 or by email at cvanCleef@manatt.com or Perianne Boring, Chamber of Digital Commerce President, at (202) 302-6064 or by email at president@digitalchamber.org

Sincerely,

Carol R. Van Cleef
Counsel, Chamber of Digital Commerce
Partner, Manatt, Phelps & Phillips LLP