October 20, 2014

Via Electronic Delivery

Dana V. Syracuse
Office of General Counsel
New York State Department of Financial Services
One State Street, New York, NY 10004
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Re: Regulation of the Conduct of Virtual Currency Businesses – Addition of Part 200 to Title 23 NYCRR

Dear Ms. Syracuse:

The Clearing House Association L.L.C.[1] and the Independent Community Bankers of America[2] (collectively, the "Associations") respectfully submit to the New York State Department of Financial Services (the "Department") this comment letter on the recently released proposed regulations regarding the licensing and oversight of persons and entities engaged in certain types of virtual currency transactions (the "BitLicense Regulations").

The Associations believe that appropriate regulation can increase public trust in virtual currency systems, reduce prudential risks posed by virtual currency market participants, and provide important protections for consumers that engage in virtual currency transactions. The proposed BitLicense Regulations represent a significant and positive step toward addressing the current consumer and prudential risks presented by virtual currency systems. The Associations

[1] The Clearing House. Established in 1853, The Clearing House is the oldest banking association and payments company in the United States. It is owned by the world's largest commercial banks, which collectively employ over 2 million people and hold more than half of all U.S. deposits. The Clearing House Association L.L.C. is a nonpartisan advocacy organization representing - through regulatory comment letters, amicus briefs and white papers - the interests of its owner banks on a variety of issues. Its affiliate, The Clearing House Payments Company L.L.C., provides payment, clearing and settlement services to its member banks and other financial institutions, clearing almost $2 trillion daily and representing nearly half of the automated clearing-house, funds transfer, and check-image payments made in the U.S. *See* The Clearing House's web page at www.theclearinghouse.org.

[2] The Independent Community Bankers of America® (ICBA), the nation's voice for more than 6,500 community banks of all sizes and charter types, is dedicated exclusively to representing the interests of the community banking industry and its membership through effective advocacy, best-in-class education and high-quality products and services. ICBA members operate 24,000 locations nationwide, employ 300,000 Americans and hold $1.3 trillion in assets, $1 trillion in deposits and $800 billion in loans to consumers, small businesses and the agricultural community. For more information, visit www.icba.org.

welcome the opportunity to provide comments on the BitLicense Regulations, and look forward to participating further in the regulatory process.

I. Introduction

The Associations believe that virtual currencies, such as Bitcoin, represent significant innovations in the financial services industry. Virtual currency system participants and transactions also pose consumer and prudential risks. Virtual currencies frequently are promoted as alternatives to or substitutes for existing, well-established and highly regulated payment products and systems, such as credit cards, debit cards, and ACH payments; yet, virtual currency systems and transactions frequently do not afford consumer or prudential protections commensurate with those available to users of closely regulated, traditional payments systems and products.

Establishing reasonable regulations to manage the consumer and prudential risks related to the purchase, holding, and use of virtual currency is critical to protecting consumers and others who put their trust in virtual currency businesses. While the Consumer Financial Protection Bureau (the "CFPB") has indicated some interest in consumer protection issues related to virtual currencies, the CFPB has not expressed intent to regulate virtual currency businesses or transactions. Further, the Associations do not believe that new federal legislation to establish prudential standards for virtual currency companies is likely in the near future, and it does not appear that federal prudential or consumer regulators currently have authority to establish licensing or safety and soundness requirements for such entities.[3] Consequently, consumer and prudential protections and licensing requirements for virtual currency companies likely need to be issued by states, like New York, if virtual currency businesses and transactions are to be regulated in the near term.

The Associations believe that the need for New York to act to regulate virtual currency businesses and transactions is clear, and that the approach proposed in the BitLicense Regulations is generally appropriate. In regulating virtual currency companies and activities, the Associations propose that the Department should be guided by the principle that functionally similar products and services should be subject to similar levels of consumer and prudential regulation. In the Associations' view, the Department's proposed BitLicense Regulations make significant progress toward this objective with respect to most virtual currency businesses that would be subject to the new requirements; however, the Associations believe that certain clarifications and improvements to the proposed regulations are appropriate, including to ensure that regulated banking entities are not subjected to the burden of unnecessary and duplicative regulation as virtual currency businesses.

[3] For example, Federal Reserve Chairwoman Janet Yellen has stated that the Federal Reserve lacks authority to regulate virtual currencies. *Yellen on Bitcoin: Fed Doesn't Have Authority to Regulate It in Any Way*, (February 27, 2014), http://blogs.wsj.com/moneybeat/2014/02/27/yellen-on-bitcoin-fed-doesnt-have-authority-to-regulate-it-in-any-way/. We note that, while FinCEN requires certain virtual currency companies to register as money services businesses, prudential and consumer protection issues are beyond the scope of FinCEN's jurisdiction.

II. Exemption for Regulated Banking Entities

The Associations support the establishment of comprehensive regulations to ensure that virtual currency products and services are subject to oversight (and offer consumer and prudential protections) comparable to those applicable to traditional, functionally similar payment systems and products offered by regulated banking entities. However, we believe that the BitLicense Regulations should focus on those entities and activities that pose consumer and prudential risks due to the absence of comprehensive regulation and supervision.

Traditional banking entities (as further defined below, "Regulated Banking Entities") already are subject to extensive prudential requirements and to oversight that is more stringent than what would apply under the proposed BitLicense Regulations and that encompasses virtually all aspects of an institution's safety and soundness, including requirements related to capital adequacy and reserves, activity restrictions, systems and data security, business contingency, ownership and control, reporting and maintenance of books and records, and ongoing examinations. Regulated Banking Entities also are required by federal law to engage in initial due diligence and ongoing monitoring of customers and transactions to help avoid banking access for prohibited persons and to detect and prevent money laundering and other illicit activity. Given the stringency of the existing standards and oversight to which Regulated Banking Entities are subject, applying the prudential requirements of the proposed BitLicense Regulations to these entities would add duplicative regulatory burdens with no attendant additional benefit to the public.

All Regulated Banking Entities also are subject to consumer protection requirements administered by the CFPB, including the CFPB's proscription of unfair, deceptive, or abusive acts or practices. Further, federal prudential regulators have taken the view that failure by a Regulated Banking Entity to implement and maintain appropriate policies to protect consumers and resolve consumer complaints can threaten institutional safety and soundness. Therefore, federal prudential regulators generally consider Regulated Banking Entities' handling of consumer protection matters to be within the regulators' examination and oversight authority. Because any Regulated Banking Entity that engages in Virtual Currency Business Activity (as defined in the BitLicense Regulations) will be subject to compliance with the requirements of both the CFPB and that institution's prudential regulator (even absent specific federal legislation or regulation to address virtual currency), requiring Regulated Banking Entities to comply with the BitLicense Regulations will unnecessarily burden Regulated Banking Entities without improving protection for consumers that engage in virtual currency transactions with such entities.

III. Specific Comments on Proposed BitLicense Regulations

a. Scope of Regulated Activity

Because virtual currencies are maintained in digital form and much virtual currency activity crosses state and national borders, we believe that it is critical to establish an appropriate definition of the entities and activities that are subject to the BitLicense Regulations. At the same time, we urge the Department to ensure that the BitLicense Regulations focus on those entities and activities that pose the greatest consumer and prudential risks, namely, those that currently operate without sufficient regulation and

oversight, rather than subjecting Regulated Banking Entities, which already are subject to extensive prudential and consumer regulations, to additional, duplicative regulatory burdens.

i. Definition of Virtual Currency.

The Associations believe that broad definitions of "Virtual Currency" and "Virtual Currency Business Activities" are necessary to ensure that the activities that create the greatest consumer and prudential risks are subject to licensure and ongoing regulation. However, we believe that the current proposed definition of Virtual Currency, set forth at proposed Section 200.2(m), is (perhaps unintentionally) overly broad, and captures units of exchange that pose limited consumer and prudential risks.

Section 200.2(m) contains a limited exclusion for in-game and rewards currencies. We recommend that this exclusion be broadened to clarify that all limited-use stored value products that meet certain requirements be excluded from the definition of Virtual Currency set forth in Section 200.2(m). Specifically, we propose that the following be excluded:

1. Units of value (such as rewards currencies or points) that are issued solely in the context of a customer affinity or rewards program.

2. Units of digitally stored value that can be used only for purchases of goods or services at a specific merchant or defined group of affiliated merchants (such as electronic gift cards or digitally stored merchant credit offered to a consumer after a return), whether denominated in fiat currency or an alternative currency.

Limited-use stored value products of the types described above are not intended or generally used as replacements for traditional payment products, but rather serve a different, limited purpose. Such limited-use products generally are treated as posing lower consumer risks due to the consumer's greater ability to assess the riskiness of entering into a transaction with a single or limited group of merchants, and the money laundering risk associated with such products is generally considered to be lower given the reduced ability to convert such products into fiat currency. Therefore, the Associations recommend that such limited-use stored value products be excluded from the definition of Virtual Currency set forth in Section 200.2(m).

In addition, the Associations recommend that Section 200.2(m) be revised to clarify that fiat currency does not constitute Virtual Currency, even if digitally stored or represented. The activities defined as Virtual Currency Business Activities in Section 200.2(n), when they involve fiat currency, are already the subject of extensive state and federal regulation, and therefore we believe that subjecting them to regulation under this statute does not provide additional consumer or prudential protection.

ii. Definition of Virtual Currency Business Activities.

As discussed above, the Associations believe a broad definition of Virtual Currency Business Activity is both necessary and appropriate, and that the initial definition set forth in Section 200.2(n) is a positive first step. However, we encourage the Department to revise Section 200.2(n) to clarify that Virtual Currency miners are subject to regulation if engaged in mining for other than personal, family, or household purposes.

Although not all virtual currencies are mined, most decentralized virtual currencies rely on mining to generate new currency and introduce it into circulation. Miners also play a critical role in ensuring that virtual currency transaction records are added to the public transaction registry (in the Bitcoin context, the "blockchain"), which is necessary to allow transactions to be deemed final. In addition to bearing responsibility for adding such records to the blockchain, the virtual currency network itself is made up of (and the blockchain is maintained on) servers operated by miners.

Under the current definition, Virtual Currency mining itself does not appear to constitute a Virtual Currency Business Activity. Therefore a miner would only be subject to regulation if it engages in activities that fall within one of the other covered categories, such as if it is found to be in the "customer business" of buying and selling Virtual Currency or performing "retail conversion services." Section 200.2(n) does not further define "customer business" or "retail conversion services." Given the increasing sophistication and size of many mining operations, as well as their critical systemic role, it is appropriate for the Department to exercise oversight over commercial mining activity. Therefore, we recommend that the definition of Virtual Currency Business Activity be clarified to indicate that mining Virtual Currency solely for personal, family, or household use does not require licensing, but that engaging in mining as a business activity (whether or not the miner sells Virtual Currency to consumers) does give rise to a licensing obligation. This is consistent with FinCEN's January 30, 2014 Administrative Ruling on the Application of FinCEN's Regulations to Virtual Currency Mining Operations, which provides that miners that sell virtual currency for fiat currency solely for their own purposes are not engaged in money transmission for Bank Secrecy Act purposes.

iii. Exemption for Regulation Banking Entities

Section 200.3(c)(1) of the BitLicense Regulations contemplates that some financial institutions (specifically, those that are "chartered under the New York Banking Law to conduct exchange services") would be exempt from licensing (and thereby, from the requirements applicable to licensees), provided that they obtain permission from the Department to engage in Virtual Currency Business Activity. The Associations strongly encourage the Department to revise Section 200.3(c) to exempt a broader range of traditional banking entities from licensing and to remove the requirement that such institutions obtain departmental permission prior to engaging in Virtual Currency Business Activity. Section 641 of Article 13(B) of the New York Banking Law provides an exemption from money transmitter licensing obligations for state and federally chartered banks, credit unions, and trust companies, as well as foreign banking companies that are licensed or authorized to operate in the United States generally or New York specifically pursuant to state or federal law and certain other entities. We refer to these entities in this comment letter as "Regulated Banking Entities." In providing such an exemption, New York (like many states) recognizes that there is limited value to the public in imposing requirements on such institutions with respect to activity that is already subject to stringent regulation and oversight. The Associations believe that, for the same reason, the Department should exempt Regulated Banking Entities from the BitLicense Regulations.

b. Prudential Regulations.

Most entities engaged in Virtual Currency Business Activity are not currently subject to safety and soundness oversight or regulatory examination. The failure of Mt. Gox in February of

this year, which appears to have been due to poor recordkeeping, inadequate capital reserves, and cyber attacks, demonstrates the prudential risks and the impact on consumers of the failure of a virtual currency exchange. As retail acceptance of virtual currencies grows, so will the impact of failures of commercial enterprises operating in the virtual currency system.

Therefore, the Associations believe that it is appropriate, as the Department has proposed in the BitLicense Regulations, to impose strong capital requirements, define permissible investments, require the maintenance of books and records, and ensure that entities engaged in Virtual Currency Business Activities have appropriate cybersecurity and business-continuity policies and procedures in place. We also support the Department's proposal to require entities engaged in Virtual Currency Business Activities to implement and maintain strong anti-money laundering, OFAC screening, and customer-identification programs and to report suspicious transactions and activities. The Associations agree that oversight and regular examinations of licensees is necessary and appropriate to ensure compliance with these obligations and the safety and soundness of virtual currency businesses.

We understand that members of the virtual currency community have expressed concerns regarding the impact of these proposed requirements on small companies, including start-ups. While we understand the challenges that compliance may pose for such entities, the failure of a small company or its noncompliance with critical safety and soundness obligations can still have very significant consumer and prudential impacts. Mt. Gox had revenues of less than $300,000 in 2013, and yet its failure resulted in the loss of approximately seven percent of all Bitcoins then in circulation. Therefore, we urge the Department to require all companies engaged in a Virtual Currency Business Activity, regardless of size, to obtain licenses and comply with the prudential requirements proposed in the BitLicense Regulations.

c. Consumer Protection Issues.

Much of the marketing and promotion of virtual currency is focused on merchants. The efficiency of accepting payments in virtual currency is touted. Often, the lack of chargeback risk is specifically called out. Such promotional efforts highlight the fact that certain aspects of virtual currency that are particularly attractive to commercial participants in the system are the very aspects that pose increased risk to consumers. Namely, a consumer has no remedy if virtual currency is stolen or if the consumer is a victim of fraud. (We note that proponents of virtual currency often argue that cash is also unrecoverable if lost or stolen; however, this is only true if the funds are stolen from the consumer's possession – a customer that deposits cash with a depository institution does not lose value if that specific banknote is stolen from the institution's vault in a bank robbery, and banks generally carry insurance against burglary and robbery.)

The BitLicense Regulations constitute a significant step toward protecting consumers against fraud and theft. The Associations believe the disclosures required to be made to consumers are vital to ensuring that consumers fully understand the risks of virtual currency transactions and their rights in the event that something goes wrong. In addition, we believe that the requirement that licensees maintain a trust account, bond, or insurance policy in favor of customers is an important measure to ensure that customers are made whole when fraud occurs.

To further provide for protection of consumers in the event of fraud, the Associations recommend that Section 200.19(g) be revised to clarify that consumers that are victims of fraud are entitled to claim compensation from a licensee's trust account, bond, or insurance company whether or not the licensee was responsible for or involved in the fraud. The current proposed provision could be read to limit the consumer's ability to recover to situations in which the licensee was a party to the fraud, which would leave consumers without recourse in the event of third-party fraud.

In addition, we recommend that Section 200.19(g) be broadened to protect customers in the event that units of Virtual Currency in the custody of a licensee are used in an unauthorized transaction due to theft. In the context of other payment systems, such as credit and debit cards, customers have the right, both under federal law and card network regulations, to be made whole in the event of fraudulent or unauthorized transactions, even if the provider of the payment system or instrument is not responsible for the fraud or unauthorized activity. Consumers face the same risks in virtual currency systems, and we do not believe that consumers should be afforded fewer protections (or should be without protection) in virtual currency transactions.

IV. Conclusion

Thank you for the opportunity to provide these comments regarding the proposed BitLicense Regulations. If you have any questions or wish to discuss our comments, please do not hesitate to contact us using the contact information provided below.

Yours very truly,

/S/

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