March 27, 2015

*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: Revised Proposal Regarding Regulation of the Conduct of Virtual Currency Businesses – Addition of Part 200 to Title 23 NYCRR**

Dear Mr. 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 revised proposed regulations regarding the licensing and oversight of persons and entities engaged in certain types of virtual currency transactions (the "Revised Proposal"). This comment letter follows our earlier comment letter,[3] submitted in October 2014, on the original proposed regulations (the "Original Proposal") released by the Department in July 2014.

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[1] Established in 1853, The Clearing House is the nation's oldest payments company and banking association. The Clearing House is owned by 21 of the largest commercial banks in America, which employ 1.4 million people domestically and hold more than half of all U.S. deposits. The Payments Company within The Clearing House clears and settles approximately $2 trillion daily, representing nearly half of the U.S. volume of ACH, wire and check image transactions. The Clearing House Association is a nonpartisan advocacy organization within The Clearing House that represents, through regulatory comment letters, amicus briefs and white papers, the interests of its owner banks on a variety of systemically important bank policy issues.

[2] The Independent Community Bankers of America®, the nation's voice for more than 6,000 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. With 52,000 locations nationwide, community banks employ 700,000 Americans, hold $3.6 trillion in assets, $2.9 trillion in deposits, and $2.4 trillion in loans to consumers, small businesses and the agricultural community. For more information, visit ICBA's website at www.icba.org.

[3] In the interest of limiting the length of this letter, the Associations have opted not to include the original letter as an attachment. However, to the extent still applicable, the Associations reiterate the concerns

As expressed in the Associations' comment letter to the Original Proposal, the Associations believe that virtual currencies have significant potential to foster innovation and to increase consumer choice in the payments industry. However, virtual currencies also pose unique consumer and prudential risks. The Associations believe that a fundamental principle of virtual currency regulation must be to ensure that consumers and others who put their trust in virtual currency businesses enjoy the same protections as are provided to those who make use of traditional, highly regulated, payment systems and products. The Revised Proposal appropriately retains the commitment to consumer and prudential protection reflected in the Original Proposal. However, the Associations recommend that the Department make certain additional clarifications and refinements to further advance the purpose of protecting those who place their trust in virtual currency businesses while providing flexibility for this developing industry.

## I. Specific Comments on the Revised Proposal

### a. Definition of Virtual Currency.

#### i. Affinity and Rewards Programs.

As the Associations noted in commenting on the Original Proposal, we support the Department's proposed exclusion of rewards points or units from the definition of Virtual Currency, given that such units typically have limited uses and thus cannot easily operate as substitutes for other payment products. In the Revised Proposal, however, the scope of the types of units that are excluded from the definition (provided in Section 200.2(p)) is unclear – the Original Proposal's requirement that such units must be usable only as part of an affinity or rewards program has been removed, but such units are later described by reference to their ability to be redeemed for units in "another customer affinity or rewards program." The Associations again encourage the Department to clarify that, to fall within this exclusion, a point or unit must be issued solely in the context of a customer affinity or rewards program. This limitation is necessary to ensure that the carve-out applies only to limited-scope programs and does not create an exclusion that could apply more broadly than is intended (e.g., to any point or unit that can be redeemed as part of an affinity or rewards program even if the point or unit can be earned outside of the affinity or rewards program).

At the same time, the Associations encourage the Department to remove language from the Revised Proposal that would require customer affinity or rewards points to be treated as Virtual Currency if redeemable for Fiat Currency. Cashback rewards programs (in which rewards points can be redeemed for cash or cash-denominated credits or discounts as well as for other benefits) are common. Provided that points redeemable for cash are excluded from the definition of Virtual Currency only if issued to participants in an affinity or rewards program, as the Associations propose above, such points do not function as substitutes for traditional payment products, and therefore, do not pose the consumer or prudential risks inherent in the virtual currencies that are the primary focus of regulatory attention.

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expressed in the original letter, and direct the Department to that letter for a more in-depth discussion of those issues, including, without limitation, the treatment of licensed financial institutions under the regulations.

ii. Gift Cards.

The Associations previously expressed concern that gift cards and similar limited-use stored value products could be captured by the definition of Virtual Currency provided in the Original Proposal. Therefore, the Associations support the exclusion, as provided in Section 2002.(p) of the Revised Proposal, of "digital units used as part of Gift Cards" from the definition of Virtual Currency. However, the definition of Gift Card included in new Section 200.2(f) does not track current regulatory or industry terminology, and thus is likely to introduce confusion regarding the types of products that are excluded from the definition of Virtual Currency. For example, the term "electronic payment device," which is used in the definition of Gift Card in the Revised Proposal, is itself not defined, and there is no customary definition for this term accepted within the industry.

Further, the proposed definition of Gift Card appears to combine both the concept of a traditional, closed-loop gift card (generally defined as a prepaid product usable only at a single merchant or affiliated group of merchants) with that of a general-use prepaid card (generally defined as usable at multiple unaffiliated merchants). In the Associations' view, excluding all prepaid products that are usable at multiple unaffiliated merchants from the definition of Virtual Currency creates an exception that is too broad. Given the absence of a definition, the addresses and keys used to transfer bitcoins arguably constitute a "electronic payment device," and all virtual currency associated with such credentials could, therefore, be found to fall within the scope of this exclusion. Further, excluding all general-use prepaid products could allow virtual currency businesses to avoid regulation by offering access to and facilitating transactions using virtual currency balances through card numbers, access codes, or physical form factors.

The Associations encourage the Department to adopt a definition of Gift Card that more closely accords with existing regulatory definitions of closed-loop gift cards, such as that provided for "store gift card" in Regulation E.[4] If the Department is concerned that traditional, dollar-denominated general-use prepaid cards may unintentionally fall within the definition of Virtual Currency, a more straightforward means of ensuring their exclusion would be to expressly provide that Fiat Currency does not constitute Virtual Currency, even if digitally stored or represented.

b. Conditional Licensing Provisions.

Section 200.4(c) of the Revised Proposal provides the Superintendent with the discretion to issue conditional licenses to applicants that do not satisfy all of the requirements set forth in the regulation as of the date of licensing. The Associations support allowing reasonable flexibility for newer companies that may need additional time to fully comply with the regulations, while adhering firmly to the principle that such entities nonetheless must be licensed and supervised. Further, the Associations believe that it is appropriate to provide (as the Revised Proposal does) that conditional licensees may face heightened supervision. However, the Associations encourage the Department to consider establishing criteria for determining when conditional licenses may be issued and what requirements of the regulations may be waived. For example, it may be appropriate to allow start-up entities additional time to

[4] 12 C.F.R. §1005.20(a)(2).

begin submitting audited financial statements, but the Associations believe it would be inappropriate to issue a license, conditional or otherwise, to an entity that would not be able to fully comply with consumer-disclosure requirements.

c. Permissible Investments.

All depository institutions, whether state or federally chartered, are subject to stringent minimum capital requirements. Further, the investment vehicles in which such institutions may maintain capital required to meet regulatory minimums are limited by law to high-quality, low-risk assets. Capital requirements and associated limitations on permissible investments help to ensure that depository institutions will be able to satisfy their obligations to accountholders by minimizing their exposure to volatile or risky investments.

In the view of the Associations, Section 200.8(b) of the Original Proposal appropriately limited the investments in which licensees may hold funds to certificates of deposit issued by state or federally regulated financial institutions, money market funds, and government bonds and securities. By permitting licensees to meet minimum capital requirements by investing in virtual currency, the Revised Proposal significantly reduces the protective benefit of the permissible investment restrictions. As the last year has demonstrated, virtual currency prices can be highly volatile. Further virtual currencies carry risks of theft or loss that standard types of permissible investments do not. Given this volatility and risk, allowing licensees to maintain funds necessary to meet capital requirements in virtual currencies undermines the protective intent of capital requirements and the associated permissible investment restrictions. Therefore, the Associations urge the Department to restore the limitations included in the Original Proposal and limit licensees to investment in low-risk, low-volatility instruments for their capital requirements. If the Department does permit licensees to meet minimum capital requirements through funds held in virtual currencies, at a minimum, the Department should require that such funds be maintained in a highly secure manner that limits the licensee's exposure to loss due to cyber theft – for example, in offline ("cold") storage, or through a service that requires multi-signature authentication for a transfer of funds.

d. Asset Protection.

The Associations recognize the importance of ensuring that licensees adopt appropriate measures for the protection of virtual currency assets entrusted to them, as well as other significant assets of their respective businesses. Therefore, the Associations are generally supportive of the concepts embodied in proposed Section 200.9. However, the Associations are concerned that, perhaps unintentionally, this section would render it impossible (or, at a minimum, commercially unreasonable) for many types of entities to engage in virtual currency business activity. For example, the prohibitions set forth in section 200.9(c) limit not only what a licensee can do with customers' virtual currency, but any and all "assets" that are "stored, held, maintained by, or under the custody or control of" a licensee. While this limitation is reasonable in the context of virtual currency that is under a licensee's control, because it is broadly drafted, it would severely constrain the ability of licensees to engage in traditional banking services. For example, if a bank or credit union were to obtain a license under the proposed regulations, Section 200.9(c) would eliminate the right of that institution to use deposited funds in a customary fashion (such as making loans). The Associations encourage the Department to clarify that the limitations set forth in Section 200.9 apply only to assets held as a part of a licensee's virtual currency business activities. Section 200.9(b), which is akin to the one

hundred percent reserve requirements applicable to many money transmitters, also has the effect of severely limiting the ability of entities that hold virtual currency to leverage or otherwise use such funds to generate revenue. The Department has indicated that it seeks to ensure consistent regulation of functionally similar activities. Consistent with that position, the Associations encourage the Department to weigh the benefits of distinguishing virtual currency businesses that hold virtual currency for the purpose of transmission or effecting a transaction (and may be subject to more stringent limitations on their use of such funds) from those that perform a function more similar to that of a traditional custodian or deposit-taking entity.

e. Transaction Recordkeeping.

Financial institution recordkeeping plays a critical role in enabling law enforcement to track movement of funds through the financial system, as well as in facilitating civil recovery of funds by customers that are victims of fraud. The Associations support the requirements, reflected in the Revised Proposal, that licensees maintain transaction records and monitor for and report suspicious transaction activity. However, the Associations are concerned by the revision of Section 200.15(e)(1) to remove the requirement that licensees retain records of all parties to a virtual currency transaction. Given that virtual currency transactions may involve transfers directly to or from individuals (in which case, the non-customer party may not have a relationship with an entity with a recordkeeping obligation) or across state or national borders (in which case the second entity, if any, many not have any legal obligation to maintain appropriate customer or transaction records), weakening this requirement creates a real risk that, in many cases, the source or destination of transferred virtual currency may be unknown. As a result, the ability of law enforcement to track and trace funds and of victims of fraud or theft to seek civil recovery will be limited. The Associations urge the Department to reinstate the requirement that licensees record the identity and physical address of any party to a virtual currency transaction.[5]

f. Surety Bonding.

The Associations believe that ensuring appropriate protection for customers that are victims of fraud is an essential aspect of virtual currency regulation. In our initial comment letter, the Associations encouraged the Department to expand Section 200.19(g) to clarify that customers of a licensee are entitled to recover from the licensee's surety bond even if the licensee was not involved in the fraudulent activity that caused the loss. However, the Revised Proposal entirely eliminates the provision allowing customers to recover from a licensed entity's surety bond, even in circumstances when the licensee is the architect of the fraud. The Associations find this revision puzzling and worrisome, particularly given that the requirement (in Section 200.9(a)) that licensees maintain a surety bond for the benefit of customers remains intact. The Associations encourage the Department to restore the express right of fraud victims to recover from the licensee's surety bond in the final regulation.

[5] We note that, although many have argued that maintaining records of both parties to a transaction poses technical challenges for exchanges, a large fraction of transaction volume on many exchanges is between the exchange's own customers, and therefore, in significant percentage of cases, an exchange does have the ability to track the identity of both sender and receiver.

## II. Regulated Financial Institutions

The Associations are encouraged by the progress that the Department has made in developing a flexible, and yet appropriately protective, approach to regulation of virtual currency business activities. The Associations note, however, that the Revised Proposal, like the Original Proposal, fails to distinguish traditional, highly regulated financial institutions from unregulated entities that currently operate without state or federal oversight. For example, as discussed above, were proposed Section 200.9, as written, to be applied to most traditional regulated financial institutions, it would severely constrain their ordinary-course use of deposited funds, even those unrelated to virtual currency business activities. And while the Associations strongly support the inclusion in the regulations of strong surety bonding requirements and permissible-investment restrictions, regulated financial institutions are already subject to deposit-insurance requirements and stringent limitations on use of capital, in each case more restrictive than those proposed in the regulations. Ultimately, any regulated financial institution that elects to engage in virtual currency business activities will already be subject to substantial statutory and regulatory prudential and consumer protection requirements, as well as the oversight of state and/or national banking regulators. Therefore, there is no incremental prudential or consumer protection benefit to further requiring compliance by such institutions with the proposed regulations, and significant potential for negative impacts of doing so.

Given the substantial compliance burden such entities already face, subjecting traditional financial institutions to licensing obligations with respect to virtual currency business activities will discourage such institutions from offering these services to their customers. The Associations believe that the interest of consumers is likely better served by encouraging traditional financial institutions, which are already subject to stringent prudential and consumer regulation, to participate in this space, and we encourage the Department to consider the benefit of providing an exemption from licensing requirements for such institutions. Indeed, we note that the Revised Proposal broadens proposed Section 200.3 to provide that any New York-chartered financial institution that obtains the approval of the Superintendent is exempt from licensing. While the Associations remain concern by the vague and undefined requirement approval requirement, we assume that this exemption reflects the reasonable judgment of the Department that requiring these already-regulated institutions to comply with a duplicative licensing requirement that is not tailored to traditional financial institutions has little public benefit.[6] The Associations see no reason why the same treatment should not be extended to regulated financial institutions generally (as does New York's money-transmitter statute).

[6] The Associations note that the regulations are likely to be subject to federal preemption, at least as applied to national banks. However, the Associations believe that the potential for confusion regarding the effect of such preemption among institutions and their customers, as well as the concerns noted above, warrants the express exclusion of regulated financial institutions as a whole from the regulations.

## III. Conclusion

Thank you for the opportunity to provide these comments regarding the Revised Proposal. 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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