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February 16, 2015

VIA E-MAIL AND FEDERAL EXPRESS

Emerging Payments Task Force
Conference of State Bank Supervisors
1129 20th Street, N.W., Ninth Floor
Washington, D.C. 20036

Re: Draft Model Regulatory Framework for Virtual Currency

Dear Members of the Task Force:

We are writing in response to the request for comments on the Draft Model Regulatory Framework for Virtual Currency and the related Questions for Public Comment, proposed by the Conference of State Bank Supervisors ("CSBS") on December 16, 2014. We also provide comments herein, as relevant, to the Policy Statement on State Virtual Currency Regulation issued by CSBS along with the Framework.

We commend the thoughtful approach the CSBS has taken to regulation of virtual currencies, and we support the goal of ensuring that virtual currencies are properly regulated. While we recognize that this emerging technology comes with risks, we seek to ensure that any regulatory framework is appropriately targeted and does not impose duplicative, unclear, or unnecessarily burdensome requirements that could inadvertently stifle important innovations that could benefit businesses and consumers.

As an initial matter, we urge the CSBS to recognize that whether virtual currency should be subject to regulation in any particular state is a policy question for each state to decide. For example, regulators and other policymakers in some states have determined that virtual currency does not fall within the ambit of their regulation of money transmission, and it is appropriate for each state to make its own policy decisions. We also encourage the CSBS to continue, in the words of the Policy Statement, to "recognize the value of consistency and clarity" across such state law requirements and to "support[] state efforts at consistent and uniform regulation including through model regulatory requirements and the drafting of uniform regulatory and/or statutory provisions." Consistency is particularly important here if differences in state law regimes and authorities will not enable a uniform adoption of the CSBS proposed framework. If the

states create an inconsistent patchwork of regulation it could lead to calls for uniform and preemptive rules at the federal level.

I. Scope: Definition of Virtual Currency

Before addressing the individual topics within the Draft Framework and the questions posed for comment, we think it is important to consider the key threshold issue of how to define virtual currency. The Draft Framework does not specifically provide a definition, although the Policy Statement discusses virtual currency as follows:

> [V]irtual currencies are digital representations of value that can be a medium of exchange, a unit of account, and/or a store of value. Virtual currencies include, but are not limited to digital currencies and crypto-currencies such as Bitcoin. Virtual currencies have legitimate purposes and can be purchased, sold, and exchanged for goods or services or with other types of virtual currencies or with sovereign-issued legal tender such as the U.S. dollar. Virtual currencies may be centralized or de-centralized, convertible or non-convertible.

We urge the CSBS to specifically include a definition for Virtual Currency as part of the Draft Framework, and we propose that the definition of Virtual Currency should be limited to currencies like Bitcoin -- decentralized units of value exchanged over open markets. We ask the CSBS to clarify that in order to fall within the ambit of the Draft Framework, a Virtual Currency must therefore have the properties of a currency – *i.e.*, it must be "a medium of exchange that acts as a substitute for fiat currency, but which does not have that status in the United States." We would propose a definition of "fiat currency" for this purpose as "government-issued currency that is designated as legal tender through government decree, regulation, or law and refers exclusively to paper money and coin that circulate as cash."

We also strongly urge the CSBS to make clear that certain other products that could in some sense be considered to be digital representations of value are *not* virtual currency – specifically, private (single-issuer) units of value, such as customer rewards "points", affinity programs like payment card rewards, and airline frequent flyer miles. We think it is relatively uncontroversial that such programs are quite different from virtual currencies and do not implicate any of the risks inherent in decentralized (often anonymous) virtual currency networks. For example, we note that the New York Department of Financial Services (NYDFS) included an exclusion for such programs in its proposed regulations of virtual currency.

Therefore, we would propose that the CSBS include specific language to exclude from coverage as Virtual Currency digital representations of value "that are used exclusively as part of a customer affinity or rewards program and can be redeemed for

goods, services, discounts or purchases with the issuer and/or other designated merchants or redeemed for units in another customer affinity or rewards program."

II. The Draft Framework

We next address the substantive topics that the Draft Framework proposes that state regulatory regimes of Virtual Currency should include.

1. Licensing Requirements – State licensing requirements for entities engaged in virtual currency activities must include: (a) Credentialing of business entity owners, directors and key personnel; (b) Details on the banking arrangements of the business entity.

We ask the CSBS to consider including in the Framework provisions that would address licensing of institutions that may already be subject to licensing and other regulation at the state or federal level.

First, if a bank (or other depository institution) or its holding company were to engage in activities that would subject it to potential Virtual Currency licensing obligations, we believe states should have the option to provide such institutions an exemption or a process to apply to the relevant state for an exemption. Such options would be appropriate given the comprehensive regulatory and supervisory framework that already governs such banking institutions.

Second, we believe states should also be permitted consider providing a similar exemption or an exemption application process for an entity that is already licensed and regulated at the state level as a money transmitter. As discussed below in response to Question 1 for Public Comment, we recommend that the Draft Framework provide separate regulatory regimes for Virtual Currency activities and for money transmitters. Nonetheless, we think states should have the option to elect to supervise and regulate already-licensed money transmitter firms that engage in Virtual Currency activities under their existing money transmitter regime.

Finally, at a minimum, we strongly urge that the Draft Framework's Licensing Requirements process embrace principles that would avoid imposing duplicative license application requirements on financial institutions that are already subject to state licensing and supervision. For example, if a state bank or state-licensed money transmitter were required to obtain a separate license for Virtual Currency activities, that firm should not have to undergo an additional, duplicative credentialing process for the firm's owners and key personnel who have already undergone such a licensing process in the state.

2. Use of Licensing Systems – In order to efficiently and effectively process and evaluate license applications, it is important for states to have a robust licensing system

in place. A critical piece of such a system is the ability of states to share licensing and enforcement data in real time.

We support the Framework's goal of effective and efficient licensing systems for those states which choose to adopt Virtual Currency licensing regimes. We recommend that the CSBS continue to explore the possible creation of uniform licensing forms that could be used to streamline multi-state licensing operations for Virtual Currency activities, such that applicants could file the uniform application that, in turn, could potentially be shared with multiple states.

We think that the sharing of enforcement data, however, is a different question from sharing licensing information and raises different considerations, including with respect to states that may take the position that such data is confidential supervisory information that may generally not be shared with third parties. We recommend that the question of sharing enforcement data be separated from the Framework's discussion of Licensing Systems, and considered in light of related federal regulatory schemes and obligations, which may be impacted as well. Generally, we would urge the CSBS to focus on sharing of application/licensing information where the benefits are understood and appreciated and not expand sharing to other areas where the benefits and issues are less clear and that could be quite burdensome, *e.g.*, sharing of state-specific transaction data.

3. Financial Strength and Stability – (a) Net worth or capital requirements, with flexibility for Commissioner to set requirements based on activities and volume; (b) Permissible investments; (c) Information on method of calculating value of virtual currency; (d) Surety bond requirement, with flexibility for Commissioner to determine amount based on business model and activity levels, not number of locations; (e) Policies, procedures, and documentation for disaster recovery and emergency preparedness plans.

We support the Draft Framework's inclusion of flexibility for state regulators to apply any financial strength and stability requirements based on the specific business model and activities of relevant firms. At the same time, we urge that the principles used in exercising flexibility should be clear to licensees and the public so as to avoid the development of regulation via enforcement actions or litigation rather than clear guidance.

We also recommend that the Framework take into account consistency with existing capital and other financial strength requirements for firms that engage in Virtual Currency activities but are already regulated, *e.g.*, as a state-licensed money transmitter. Many of the types of requirements identified here are already included in the regulatory regime for money transmitters and should be tailored so as not to impose inconsistent requirements.

5. Cyber Security – (a) Required cyber security program and policies and procedures; (b) Customer notification and reporting requirements for cyber security events; (c) Third party cyber security audit, with flexibility for Commissioner to determine the appropriate level of the audit based on business model and activity levels

As noted above, we support the CSBS's efforts to achieve consistent and uniform regulation across states. We are concerned here, as in other areas, that different, static and prescriptive regulation of cyber security programs at the state level could potentially result in 50 different and inconsistent cyber security regimes, compliance with which would be burdensome and lead to confusion. In addition, for federally regulated financial institutions, these state regulations could potentially conflict with the existing cyber security regulations that help to protect the U.S. banking industry. Static prescriptive regulations may cause considerable problems in a dynamic and rapidly changing threat environment.

Therefore, we recommend that entities that are already subject to the data security provisions of the Gramm Leach Bliley Act and regulation by a federal banking regulator should be exempt from this Section. Such entities are already subject to requirements for appropriate policies and procedures and examination of their programs. For other entities, we support the elements in the Draft Framework that focus on appropriate policies and procedures and audit type reviews with flexibility to adapt to different business models and activities, as well as changing technology and threat environments. We believe that, in the virtual currency ecosystem, it is critical for cyber security standards to extend beyond traditional financial institutions. The approach should not be a strict, prescriptive framework that would be difficult to update and adapt, and would also require extensive resources at the state level to analyze and enforce evolving cybersecurity "best practices". We recommend that the Framework incorporate such cyber security audits as part of the initial examination process to ensure that licensees are employing best practices and should refer to an appropriate basis for evaluating a Licensee's cyber security program, such as the US Department of Commerce's National Institute of Standards and Technology (NIST) 800 Series, a family of publications that cover cyber security best practices across multiple dimensions.

6. Compliance and BSA/AML – (a) Required implementation and compliance with BSA/AML policies, including documentation of such policies; (b) Required compliance with applicable federal BSA/AML laws and recognition of state examination and enforcement authority of BSA/AML laws; (c) Verification of accountholder identity.

Licensed money transmitters are required to have an anti-money laundering program that complies with applicable federal laws and regulations, and compliance with applicable federal requirements is often deemed to constitute compliance with state requirements. We respectfully encourage CSBS to adopt the same approach to avoid duplicative or unnecessarily burdensome regulation. We believe that ensuring

compliance with BSA/AML policies can be achieved most effectively by reference to existing State and Federal rules.

7. Books and Records – (a) Required access to books and records by regulatory authorities; (b) Commissioner to determine form and format of books and records production; (c) Compliance with federal requirements (including Electronic Funds Transfer Act and Bank Secrecy Act); (d) Audited financial statements consistent with generally accepted accounting principles ("GAAP") as recognized in the United States, with flexibility for Commissioner with regard to compliance timeline; (e) Transaction volume; (f) Transaction-level data, including, but not limited to: (i) Names, addresses, and IP addresses of parties to transaction, (ii) Identifiable information of virtual currency owner, (iii) Transaction confirmation, (iv) For foreign transactions, country of destination; (g) Agent lists and information regarding agents' compliance with applicable state and federal laws and rules; (h) Commissioner to have authority to require periodic reports of condition and to determine frequency and information to be contained therein; (i) Applicability of state escheatment laws.

Again, consistent with the goal of consistency and uniformity, we recommend the Framework provide for a generally applicable record retention term of three years, which is a comparable term for other similar regulatory regimes.[1] We believe that a three-year term provides sufficient information for regulators in the case of a compliance review without creating unnecessary burdens on businesses.

8. Supervision – (a) Facilitating and supporting regulatory cooperation and information sharing with other state and federal regulators: (i) Authority to consult and coordinate, (ii) Authority to conduct joint or concurrent examinations, (iii) Authority to use and adopt reports of examination prepared by other state and federal regulators, (iv) Preserving confidentiality of regulatory information by exempting regulatory information from state public records disclosures laws; (b) Investigative subpoena authority; (c) Authority to initiate enforcement actions, including: (i) Formal or informal actions, (ii) Removal of officers and directors, (iii) Impose civil money penalties, (iv) Authority to take control, (v) Authority to appoint a receiver.

We support the inclusion here of provisions for coordination and joint or concurrent examinations. For example, if a licensed money transmitter were to engage in Virtual Currency Business Activities, the firm could rely to some extent on similar personnel, systems and platforms, which would be subject to examination under both regimes. Coordination of, or joint or concurrent, examinations of such a firm operating under both sets of regulations would promote efficacy and efficiency.

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[1] *See, e.g.*, 3 N.Y.C.R.R. § 406.9(b) (requiring three year record-retention for New York licensed money transmitters).

III. Responses to Questions for Public Comment

We next address select questions that CSBS proposed for public comment.

1. Policy Implementation (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?

We believe that the Draft Framework should provide for separate regulatory regimes for Virtual Currency activities and for money transmitters, so that states have the flexibility to adopt a regulatory regime that they believe most appropriate as a matter of policy. While we appreciate that there may be some similarities, Virtual Currency is a new technology and business, posing a new and unique set of challenges.

To the extent there are similarities or overlap with other, existing regulatory regimes, we recommend that existing requirements be taken into consideration in the development of requirements for Virtual Currency activities. For example, as noted above, existing capital or other financial strength requirements should be considered for consistency with new, similar requirements on Virtual Currency. Similarly, to the extent that firms that are licensed under existing regimes have already satisfied application requirements (such as credentialing of business entity owners and personnel), these requirements should not need to be satisfied again for a Virtual Currency license. More generally, where an existing money transmitter licensee extends itself into a virtual currency business, the States should have the option to deem the satisfaction of traditional money transmitter regulatory requirements as sufficient for the licensee to engage in the virtual currency business.

2. Licensing Process (a) 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?

We support efforts to explore ways to streamline multi-state licensing processes, such as through the development of uniform application forms and processes that would enable applicants to submit one application for multiple states' licensing processes. We think it is critical that attention be paid to how the development of such processes works in practice to deliver consistency in an efficient way. Improving the uniformity of licensing procedures, done well, could reduce unnecessary and duplicative efforts for both regulators and business, a benefit to all involved.

11. Regulatory Flexibility (b) How can laws and regulations be written to strike a balance between setting clear rules of the road and providing regulatory flexibility?

We encourage the Draft Framework to embrace key principles in striking this important balance. First, the regulations should be adapted to the nature, context, and technology of the relevant activity, here virtual currency transaction processing. Second, the regulations should be appropriately calibrated to achieve their goals but not so burdensome that they function as a disincentive to firms in the regulated marketplace. Otherwise, the regulations can push more activity underground, or out of the regulated sphere, the opposite of the desired effect. Several of our other specific comments in this letter are based on these principles. In general, we support the ability of regulators to be flexible, in a transparent manner, when necessary, but there should be clarity about what constitutes a Virtual Currency, and what activities are and are not covered by the licensing regime.

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?

There should not be a change in the regulatory framework that applies to card processing activities merely because of the nature of the funds settled into the merchant account. Any exemption from money services statutes for these types of services should continue to apply regardless of the nature of the settled funds.

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We thank CSBS for its consideration of our comments. If you have any questions, please feel free to contact me directly at (212) 909-6344, or my partner David A. Luigs at (202) 383-8145.

Respectfully submitted,

/s/ Eric R. Dinallo

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