



# New York's Proposed "Bitlicense" Rules

## Presented by:

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# Scope of Law

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- Applies to any person or company engaging in “Virtual Currency Business Activity”
- “involving New York or a New York resident”
- No exception for money transmitters, banks, or agents
- Exclusion for persons chartered under NY Banking Law to “conduct exchange services” and approved by DFS to conduct Virtual Currency Business Activity
- Does not apply to “merchants and consumers that utilize virtual currency solely for the purchase or sale of goods or services”

# Definition of Virtual Currency

- “Any type of digital unit that is used as a medium of exchange or a form of digitally stored value that is incorporated into payment system technology.”
- “Broadly construed” as including digital units that
  - Have a centralized repository or administrator; or
  - Are decentralized with no repository or administrator; or
  - May be created or obtained through computing or manufacturing effort.
- Excludes in-game currency “with no market or application outside” of gaming platform and digital units used in affinity and rewards programs that can be used solely with issuer or other designated merchants, and which can’t be converted into fiat currency

# Virtual Currency Business Activity

- Receiving virtual currency for transmission **OR** transmitting the same
- Securing, storing, holding, or maintaining custody or control of virtual currency on behalf of others
- Performing “retail conversion services”
  - Virtual currency → fiat
  - Fiat → virtual currency
  - Virtual currency → virtual currency
- Buying and selling virtual currency “as a customer business”
- Controlling, administering, or issuing virtual currency

# Application Process

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- Nonrefundable fee in amount set at DFS discretion
- DFS conducts investigation to decide
  - Broad inquiry into applicant's financial condition, business experience, character, and general fitness
  - No standard for review; entirely discretionary
- DFS can impose any conditions it “deems appropriate”
- 90-day clock from date DFS deems application complete; DFS can extend

# Application Requirements

## ■ Applicant

- Org chart and allocation of duties for principals and management
- Current financial statement and projected balance sheet and income and expense statement for next year
- ***Description of “proposed, current, and historical” activities, including products/services to be provided and targeted customer base***
- “Details of ***all*** banking relationships”
- ***All written policies and procedures***
- All pending legal proceedings, including principals
- Insurance policies where applicable
- Methodologies used to calculate value of virtual currency in fiat
- Anything else DFS requires

## Application Requirements (cont.)

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- Principals (officers, directors, 10% shareholders)
  - ***Detailed bios and “personal histories”***
  - ***Background report by independent investigator***
  - Financial statements
  - Fingerprints

# Application Requirements (cont.)

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- General requirements
  - Applicant must “demonstrate ability to comply” with its obligations under the Bitlicense rules
  - Meet capital requirements set at discretion of DFS
  - Maintain a bond or trust amount in U.S. dollars in amount and form set at discretion of DFS



# Ongoing Obligations

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- ***Comply with all federal and state laws and regulations***
- Compliance program
- Capital/custodial requirements
- Maintain books and records (including all transactions) for ***ten years***
- Reporting requirements
- AML program

## Ongoing Obligations (cont.)

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- Maintain a cyber security program
- Comply with consumer protection requirements
- Comply with advertising and marketing requirements
- Maintain a business continuity and disaster recovery plan

# Compliance Obligations

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- Designation of compliance officer
- Maintain and enforce written policies, approved by board of directors, including
  - Anti-fraud
  - AML
  - Cyber security
  - Privacy and information security

# Capital/custodial requirements

- ***Must maintain capital amounts set at DFS discretion***
- May invest profits and retained earnings ***only in*** CDs, money market funds, state or muni bonds, U.S. gov. securities
- Any licensee that “secures, stores, holds, or maintains custody or control” over virtual currency, ***must hold on a 1-1 basis, by type***
- May not sell, transfer, lend, or encumber any virtual currency or “any other asset” (e.g. USD) under custody or control

# Maintain books and records

- Must maintain in original form for 10 years (5 for inactive accounts, which then become abandoned property)
- For *each* transaction:
  - Amount
  - Date and “precise time”
  - “Payment instructions”
  - Fees paid or received
  - “***Names, account numbers, and physical addresses of the parties to the transaction***”

# Maintain books and records (cont.)

- General ledger including all assets, liabilities, capital, income, expense accounts, and profit and loss accounts
- Bank statements and “reconciliation records”
- “Statements or valuations” sent/received to/from customers or counterparties
- Records demonstrating AML compliance, including customer identification, “records linking customers to their accounts and balances,” and “all compliance breaches”
- Communications and documents related to investigation of customer complaints or “concerning facts giving rise to possible violations” of law
- All advertising and marketing (including hardcopies of web pages, “road show materials” and “presentations”)
- Audit trails
- Anything else DFS requires
- ***Must give DFS “immediate access” to all records of licensee or affiliates, “wherever located”***

# Reporting requirements

- **Quarterly financial statements**, including:
  - Balance sheet, income statement, profit and loss statement, statements of retained earnings, statement of net liquid assets, statement of net worth, and statement of cash flows
  - Change in ownership
  - Chart of all accounts, including a description of each
  - **Financial projections and business plans**
- Annual financial statements audited in accordance with GAAP, and certified by an officer or director, along with a **CPA opinion**
- Any criminal activity or insolvency (including principals)
- Any rule violation (including any other jurisdiction?)
- Report of annual testing of AML controls

# AML Program

- Initial risk assessment and annual updates
- Internal controls and annual testing (with report to DFS)
- AML policy and compliance officer
- Maintain records of all virtual currency transactions
- “Enhanced due diligence” for foreign customers and “high-risk” customers and “high-volume accounts”
- Customer identification program
- ***Reverification for any transaction > \$3,000***
- ***Reporting to DFS of all transactions > \$10,000/day and SARs reporting, and OFAC check***



# Cyber Security Program

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- Comprehensive written program required
- Designation of responsible CISO
- Annual reporting to DFS
- Audit trails
- Annual penetration testing
- ***Independent, third party source code review***
- ***“Employ cyber security personnel”***

# Consumer Protection

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- Disclosure of risks to all customers – including the usual parade of virtual currency horrors
- Disclosure of terms and conditions
- Disclosure of the terms of the transaction, ***prior to every transaction***
- Provision of receipt for every transaction, including exchange rate, statement of refund policy, and statement of liability for non-delivery
- Maintain an active anti-fraud policy

# Advertising and marketing

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- Must include a licensed by NY DFS legend
- Comply with all state and federal disclosure requirements
- ***“Shall not directly or by implication, make any false, misleading, or deceptive representations or omissions”***

# Ongoing Supervision

- ***License can be revoked or suspended almost at DFS' will:***
  - “on any ground” DFS could have refused license
  - for “a violation of any provision” of the Bitlicense rules (which include the obligation to comply with all state and federal laws and regulations)
  - “for good cause shown” – “licensee has defaulted or is likely to default in performing its obligations or financial engagements or engages in unlawful, dishonest, wrongful, or inequitable conduct or practices that may cause harm to the public”
- Hearing required but only 10 days’ notice
- DFS can seek a preliminary injunction
- ***DFS also broadly empowered to investigate, impose penalties, and “take any other action” for rule violations***

## Ongoing Supervision (cont.)

- ***DFS approval required for material changes***
  - Licensees must obtain prior written approval from DFS for any “new service, product, or activity” or to make a “material change” to existing services, products, or activities
  - Licensees must submit a detailed plan and any information requested by DFS
  - No standard or timetable for decision; at discretion of DFS
- **DFS approval required for any change in control**
  - ***10% change triggers, or M&A (including assets)***
  - Application required; 120 day clock (can be extended)
  - No standard; at discretion of DFS

## Ongoing Supervision (cont.)

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- DFS can conduct full examination at will (and no less than once every 2 years)
  - No standard
  - ***Can include “any activities of the Licensee outside of the State of New York” if DFS deems relevant***
  - ***Can include affiliates if DFS deems relevant***

# Takeaways

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- Rules are incredibly broad in scope
- DFS is afforded nearly complete discretion
- Ongoing obligations are incredibly intensive
- No tailoring of degree of regulation to different risk levels posed by different kinds of virtual currency businesses

# Next steps

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- Advocacy
  - Participate in NY; the more substantive the comments the better
  - Talk to the other states to make sure that others don't follow NY's lead
- Strategy for addressing NY if rules are not changed
  - Apply for a license or figure out how to avoid being subject to regulation in NY



# Questions? Please call or email:

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