Members of the Study Committee, Advisors and Observers received an Interim Report from the Chair, Commissioner Fred Miller, on June 6, 2014. That Interim Report outlined the January 2014 charge to the Study Committee from the Scope and Program Committee, viz., to study the need for and feasibility of state legislation on alternative and mobile payment systems. More specifically, the initial charge mentioned an array of possible topics for study:

New payments providers such as Bitcoin and mobile or alternative payments companies are currently being licensed and regulated differently in various jurisdictions. The ULC has addressed this issue previously with the drafting of the Uniform Money Services Act (2000, amended in 2004), which dealt with the licensing and regulation of non-bank financial services providers like Western Union and PayPal. At that time, few new electronic payments providers were in business, but a decade later consumers are now using new methods and services to move their funds when they are held by non-bank entities. In the absence of an overarching federal payments regulatory framework, state laws may need to be harmonized to the extent possible. This Study Committee will consider the need for and feasibility of enacting state legislation on alternative and mobile payments systems.

Part II of this report describes the initial work to the point by the Chair and Reporter. Part III discusses reasons why the Uniform Law Commission should study the regulation of alternative currencies and mobile payments now. Part IV briefly describes various Federal and State efforts related to alternative and mobile payments. Part V describes the types of issues related to State Money Services regulations the Study Committee might consider.
Part VI sets forth ways in which the Uniform Commercial Code might be amended or expanded to cover the use of alternative currencies and mobile payments, investment accounts holding virtual currencies, and possible classifications of virtual currencies and mobile payment receivables for Article 9’s purposes. Part VII includes a short list of newly issued reports for the Study Committee’s consideration. There is no conclusion – as the task of drawing conclusions and making recommendations for further work is left to the Study Committee.

II. Initial Work

Since the Study Committee was formed, the Chair, the ULC Staff, and the Reporter have compiled and distributed a large volume of materials on alternative electronic and mobile payments providers and issues being faced by both consumer and business users. The Chair issued an Interim Report on June 6, 2014 that suggested that the Study Committee should be looking to the fall of 2014 as a target date for refining the scope of the Study Committee’s work and to formulate additional details on the relevant issues within that scope. That Interim Report also set forth six issues for preliminary consideration for both of these purposes. Those issues were:

1. Are Bitcoin and other similar currencies going to survive? The IRS has denominated them as “property” and given their fluctuation in value, extensive and expensive tax issues may make this “currency” unfeasible. How does the IRS’ guidance affect the adoption of alternative currencies by users? Do other feasibility issues exist?
2. Is there similarity between whatever is decided falls within the scope of the term “alternative payments” and the risks the Uniform Money Services Act focused on and, if so, should that act be amended, or should a new act be drafted for ULC approval and promulgation?
3. How will any state law fit within the growing but diverse federal law, which is still developing, and should any state law supplement or displace some or most laws enacted by states on the matter to date?
4. Because of ongoing developments in alternative and mobile payments, how can a 53-jurisdiction state law be sufficiently flexible so as not to be outdated upon arrival, or avoid stifling future desirable developments?
5. Following events such as the collapse of the world’s leading Bitcoin exchange earlier this year, should consumer or other user protections be considered as part of the Study Committee’s work in addition to other licensing and prudential regulation?
6. Is some or all of any final law (whether a matter of scope or one or more issues) better suited for federal enactment rather than state legislation, given the potential for the applicability of securities regulation and other existing, or future, federal laws, such as the Electronic Fund Transfer Act, as well as the different and probably expanding regulatory structures for different kinds of players? On the other hand, if the “currency” may be “property,” how should it relate, for example, to UCC Articles 2 (at least by analogy) and 9 on sales and secured transactions, respectively? Should Article 4A be expanded to reach alternative electronic and mobile payments, or can a case be made that they will fall under Article 4A naturally?

In addition, Study Committee members, advisors and observers have received in digital form a wealth of information about both alternative currencies and payments and mobile payments directly from the Chair and the ULC Chicago office.

III. Why Study the Regulation of Alternative and Mobile Payments Now?

Since the Uniform Money Services Act was amended in 2004, there has been considerable investment in and growth in the use of alternative e-payments systems and of both mobile payments and mobile banking (although mobile banking does not appear to be part of the Charge to the Study Committee from the Scope and Program Committee).

The Uniform Money Services Act primarily focused on the licensing and prudential regulation of non-depository providers of payments and payments services. The recent growth in investment in alternative and mobile payments – as opposed again to mobile banking – comes outside the traditional depository institutions’ arena and indeed outside what could be called legacy payment systems that are not themselves operated by banks such as NACHA. PayPal, Western Union, Green Dot, a number of other non-depository payments processors, firms such as Dwolla, prepaid card companies, and even a consortium of telecom providers known as ISIS Mobile Commerce are all engaged in offering transaction services and value storage options to consumers and businesses.

One of the more fundamental issues in the future of regulation of alternative payments, and particularly of virtual currencies as forms of payments, is to achieve a working definition of what is a virtual currency. The Study Committee will wish to consider this issue carefully. For the moment, we recommend that we proceed with the definition included in the May 2014 U.S. Government Accountability Office’s Report on Virtual Currencies entitled “Virtual Currencies: Emerging Regulatory, Law Enforcement, and Consumer Protection Challenges.” That definition provided:
Virtual currencies [are] digital representations of value that are not government-issued ... Some virtual currencies can be used to buy real goods and services and exchanged for dollars or other currencies.

*Id.* at 1.

Growth in use of alternative and mobile payments has been accompanied by calls for a more harmonized method of offering products across state boundaries inside the United States and a recognition that payments services using mobile providers and non-banks also is increasingly the payment method of choice for non-domestic remittance payments and B2B payments. The Dodd-Frank Act’s 2010 amendments to the Electronic Fund Transfer Act and corresponding amendments of Regulation E that relate to remittance payments – which can be made through depository institutions, non-depository institutions, and telecom providers alike – only govern remittances that begin inside the United States and flow out of its borders to a beneficiary in a foreign destination. Some alternative payments in which the underlying funds are not held in an insured depository institution are not governed by the EFTA. Accordingly, a sizeable and rapidly growing volume of payments transmissions and of stored value sits just outside the primary federal statute governing these newcomers to the payments world.

**IV. What Regulatory Efforts Have the Federal Government and the States Taken to Date?**

**A. Federal Efforts and Actions**

Federal bank regulators have not claimed jurisdiction to regulate alternative and mobile payments or their providers so far. The new chair of the Board of Governors of the Federal Reserve System, Janet Yellen, told Congress in no uncertain terms that the Board did not have authority to regulate Bitcoin.

Federal efforts to regulate alternative payments come from different sources. Among the regulatory efforts over the past 18 months are:

- guidance issued on several occasions since March 2013 by the Financial Crimes Enforcement Network (“FinCEN”), on the application of the Bank Secrecy Act to alternative payments such as Bitcoin;
- guidance from the Internal Revenue Service on the treatment of Bitcoin as “property” as opposed to “currency” for purposes of determining capital gains for income tax purposes;
- an Investors Alert and two enforcement actions by the Securities and Exchange Commission; and
- two reports by the General Accountability Office on virtual currencies – one in 2013 calling for greater clarity in the federal tax treatment of virtual currencies, and one released on June 27, 2014,
calling in part for the Consumer Financial Protection Bureau to take a closer look at the regulation of virtual currencies in consumer transactions.

The Consumer Financial Protection Bureau and the Federal Trade Commission both have held hearings on consumer protection issues related to mobile payments and providers.

Congress held hearings on alternative payments in 2013 and 2014, and on mobile payments in 2012. In the hearings focused on alternative currencies and payments, the consensus of witnesses was that it was not yet time to undertake a major regulatory push for either alternative or mobile payments.

B. State Efforts and Actions

On the other hand, the States have been more vocal and active. In addition to the ULC's Study Committee, the Conference of State Bank Supervisors (CSBS) has created an Emerging Payments Task Force to study issues, and with the CSBS, in April 2014 several states have issued guidance for consumers and investors on alternative currencies – and others have suggested they will consider issuing “BitLicenses,” the equivalent of “money transmitter” licenses, to Bitcoin exchanges. Additionally, on the mobile payments front, states such as California have issued cease and desist orders to at least the Bitcoin Foundation and to one mobile payments start-up company for operating without proper licensing and bonding.

Much changed, as Chairman Miller noted, when Mt. Gox, the world’s largest Bitcoin exchange suspended transactions in early February 2014 and then filed for reorganization under Japan’s bankruptcy laws and a Chapter 15 petition (Ancillary and Cross-Border Cases) in Texas. The reputed loss of roughly $500 million in value drew attention to user protection issues that non-depository providers such as Bitcoin exchanges including Mt. Gox might impose on users in many nations.

V. What Types of State “Money Services” Regulatory Actions Should Be Considered? Should State Regulation of Alternative Payments and Mobile Payments be Modernized or Harmonized -- or Both? Should State Regulation Be Expanded to Provide More Direct User Protections? Should the States Continue to Focus on More Traditional Licensing and Prudential Regulation?

User protections in value storage and transaction execution are not really new issues, as Study Committee members, advisors, and observers already know. They can range from protections for redemption of value (such as are provided by bonding and deposit insurance), to timely completion of the transaction orders, to accuracy of transaction execution and remedies for errors of many varieties, including warranties, dispute resolution procedures, and private rights of action and class action authority. User protections also include licensing, bonding and
prudential regulation along the lines of the Uniform Money Services Act. Special
collaborative challenges arise with payments that cross international borders before the payment
transaction in complete; in this connection, there is little law except for the system
rules and contracts of providers such as PayPal, and more recently in remittance
payments originated in the United States.

Some could argue that there is less reason – or much less reason – for the Study Committee to look at mobile payments than exists for alternative payments and virtual currencies. The primary reason for this is the fact that mobile payments are either already governed by the Electronic Fund Transfer Act and Regulation E when the underlying funds are held by a depository institution, or are moving through telecommunications providers already subject to considerable federal regulation. In other words, mobile payments are more like variations in the form and format of payments methods than a truly new payment system because they utilize existing “rails” or clearing and settlement systems to complete transfers and reconcile the pending debits and credits. We leave the decision to the Study Committee whether to continue to look at mobile payments in the scope of its work.

Regardless of how broadly the Study Committee decides to pursue virtual currencies, alternative payments and mobile payments, it will confront one significant difficulty – that the issues to be considered are constantly moving targets with new entrants, new advice or positions from regulators worldwide, and new products on at least a weekly basis. The pace of developments has complicated the preparation of the relatively lengthy, but conceptual list of questions presented in Appendix A to this Preliminary Report that relate to the regulation of virtual currencies and mobile payments as “money services,” and forms of property for investment and taxation purposes. The Study Committee may expect to receive addenda as additional developments arise over the next few months.

VI. What, if Any, Adjustments to the Uniform Commercial Code Might the Study Committee Consider?

Chairman Miller identified issues relating to Articles 2, 4A, and 9 of the Uniform Commercial Code in his June 2014 Interim Report to the Committee, without specifying the types of issues that might require attention. (See page 1 of this Preliminary Report.) For the moment, this Preliminary Report does not delve into Article 4A issues because Article 4A does not apply to transactions governed by the Electronic Fund Transfer Act (which may cover some issues related to mobile and virtual payments) (see UCC 4A-108), and because the bank-to-bank nature of Article 4A transactions seems to suggest that Article 4A is less suitable for adaptation to alternative and mobile payments concerns. Article 4A also does not apply to transactions not denominated as “legal tender” and to date no sovereign other than the Oglala Lakota Nation has issued a virtual currency that it recognizes as “legal tender.”
A. Issues arising that Article 2 of the UCC might address

The Interim Report mentioned possible uses of Article 2’s provisions by analogy. Thinking beyond the prospects of analogy, however, so long as one thinks of virtual currencies as “property” and not “currency” one can identify a few Article 2-based issues for consideration. These include:

Should Article 2 be extended to cover transactions in virtual currencies, apart from transactions being paid for by the use of virtual currencies? That is, should it apply to transactions in which virtual currencies are bought and sold for themselves? This issue is somewhat complicated by the absence of a tangible form for the “property” being sold and purchased, but that problem might be solved.

How should virtual currencies be valued for purposes of sales and purchases that otherwise are governed by Article 2? Should the rule on “foreign currency” be adapted for virtual currencies? (Or should the counter-parties to these contracts be left to establish the value by contract?)

How should transactions in which the payments were to be made through virtual currencies be enforceable if the virtual currency is unavailable for the completion of the transaction, as apparently happened when Mt. Gox suspended its transaction executions in February 2014? Are parties required to provide for this contingency? Could 2-614 be used?

Would actions for specific performance of the payment obligation in a particular virtual currency be allowed?

B. Issues arising that Article 8 of the UCC might address

The Interim did not mention Article 8 as a likely home for new provisions dealing with virtual currencies. Some governments have already classified virtual currencies as commodities. For an up-to-date listing, see J. Dax Hansen, Sarah L. Herman, and Ryan Mrajik, Perkins Coie, “Virtual Currencies: International Actions and Regulations, June 2014, http://www.perkinscoie.com/virtual-currencies-international-actions-and-regulations/. Related questions include:
Will the federal government classify virtual currencies as "commodities" as numerous other governments have classified them?

C. Issues arising that Article 9 of the UCC might address

Whether existing collateral classifications should be amended or expanded to include virtual currencies and mobile payment receivables?

This list of Uniform Commercial Code Articles and commercial law issues is not reproduced in the list in Appendix A. They are presented here for the purpose of enabling the Study Committee to determine whether to include them in the final scope of its work.

VII. Recent Publications and Reports for the Committee’s Consideration

In addition to the materials previously distributed by the ULC Staff to Study Committee members, Advisors and Observers, the following publications and reports have been issued that we believe will assist all involved in their consideration of the issues presented in this Preliminary Report. We will continue to distribute documents that may aid the Study Committee in its deliberations.


