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Fred Miller, Chair
Prof. Sarah Jane Hughes, Reporter
Members, ABA and ALI Advisors and Observers
Drafting Committee for the Uniform Regulation of Virtual Currency Businesses Act
Uniform Law Commission

Re: Comments on the October 2016 Draft of the Regulation of Virtual Currency Businesses Act and Related Issues Raised by the Reporter

Dear ULC Drafting Committee:

After having reviewed and discussed the October 2016 draft of the Uniform Regulation of Virtual Currency Businesses Act ("URVCBA") with the membership of the Chamber of Digital Commerce (the "Chamber"), I write to the drafting committee (the "Committee") on behalf of the Chamber to provide feedback on the draft from our viewpoint as an industry association for companies involved in digital assets and blockchain initiatives.

The Chamber is the world's largest trade association representing the digital asset and blockchain industry. Our mission is to promote the acceptance and use of digital assets and blockchain-based technologies. Through education, advocacy, and working closely with policymakers, regulatory agencies and industry, our goal is to develop a pro-growth legal environment that fosters innovation, jobs and investment.

As we have stated in prior comments, we are impressed with the work of the Committee in drafting a thoughtful regulatory approach to this emerging technology. The Committee's continuing commitment to understanding the technology underlying decentralized virtual currencies is evident in many of the revisions contained in the October 2016 draft.

However, the Chamber remains concerned that several critical issues in the URVCBA, if not further refined and revised, will create unnecessarily burdensome requirements for industry actors without corresponding consumer protection benefits and thereby create well-grounded but regrettable resistance to the adoption of its model legislation, undermining the value of these efforts. With those concerns in mind, the Chamber's comments touch on the following aspects of the current URVCBA draft: (1) reciprocity between states; (2) dual licensure requirements within states; (3) provisional licenses; (4) coverage of distributed ledger technology applications; (5) capital, surety and permissible investment requirements; (6) change in control issues; and (7) coverage of trust companies.

We look forward to further discussing the issues presented below with the Committee as time allows, and would be happy to discuss further at your convenience.

1. Reciprocity Between States

The Chamber commends the Committee for including language in the draft URVCBA, currently at Section 201(a)(2), which would exempt out-of-state entities "licensed under a law substantially similar to this act with adequate enforcement as determined by the department . . ." However, we would urge the Committee to go further, and provide that: (a) out-of-state entities licensed under any duly-enacted version of the URVCBA are presumptively exempt from licensing in the host state and (b) out-of-state entities licensed under another state law (i.e., not based on URVCBA) may be exempt if the host state regulator determines that the out-of-state entity's home state law is substantially similar to the host state's enactment of the URVCBA.

This would create a default presumption in favor of reciprocity between states that enact versions of the URVCBA. This would materially enhance the effectiveness of the URVCBA and promote the uniformity and efficiency interests of this uniform law project, all while diminishing burdens on the industry without creating undue regulatory risk. State regulators are often under-resourced and busy with many competing, important obligations, so this default position recognizes the reality that making affirmative determinations regarding other state laws (i.e., whether they are "substantially similar" enough to warrant reciprocity under Section 201(a)(2)) may take a long time to occur, if at all, in many states.[1]

And if a state has enacted a version of the URVCBA, there should generally be minimal risk that the state has seen the need to change so many provisions upon enactment that it would no longer be "substantially similar." The Uniform Law Commission already tracks states that enact versions of its model laws on its website, so there would be an easy baseline mechanism for determining whether reciprocity is available. Finally, states enacting the URVCBA would still be free to "turn off" the reciprocity grant if they have a strongly-held policy against it; again, this would simply create a default position that favors reciprocity.

Enhancing and promoting reciprocity should be among the very top priorities of the URVCBA. In this regard, the Chamber would reiterate that the state-by-state regulatory approach in the United States is unnecessarily burdensome—and that the experience of the Chamber's membership underscores this difficult reality. To date, the state-by-state approach has stifled entrepreneurial innovation by placing gratuitous compliance burdens that are far too expensive to all but the biggest companies. Although the state-by-state approach imposes a variety of challenges to industry actors, some of the key obstacles presented now include: (1) the fact that

[1] For the same reasons, the Committee should not adopt the bracketed language in Section 201(a)(2) that would condition reciprocity on the enactment of a formal agreement between states.

[2] *See, e.g.*, N. Gregory Mankiw, "Principles of Economics" (7th Ed. 2012, at p. 611) (explaining that "[m]oney has three functions in the economy: It is a medium of exchange, a unit of account, *and* a store of value. These three functions *together* distinguish money from other assets in the economy . . .") (emphases added).

obtaining a license in one state does not give permission to operate in other states, and (2) the fact that the process of obtaining licenses in each state is a very costly and burdensome process.

As noted in previous comments, Chamber members who are pursuing licenses on the state level budget an estimated $2-5 million per year in compliance costs just to meet states' requirements. These amounts far exceed what many start-ups can afford. Beyond the financial cost of obtaining licenses, the laws of each state, as applied to the digital asset and blockchain industry, are not always clear in scope. To address these pressing concerns, the Chamber strongly encourages the Committee to create a default reciprocity mechanism between states that enact a version of the URVCBA.

2. Dual Licensure

We understand that the Committee, in the course of its October 28-29, 2016 meetings, has not decided whether to require dual licensure for virtual currency businesses that would be covered by the URVCBA. We strongly encourage the Committee not to require dual licensure for such entities.

If an entity is required to be licensed by the URVCBA as adopted by a state, it should not also need a money transmission license under the Uniform Money Services Act ("**UMSA**") or other money transmitter statute in force within a state. The substantive coverage of the URVCBA is very similar to many states' money transmitter laws, so requiring entities to obtain licenses under both statutes would impose immense costs with minimal (if any) corresponding regulatory benefit. Thus, the same general concerns regarding excessive cost and burden of the current interstate licensure regime, as discussed in Section 1 above, would also support an intrastate exemption from money transmission licensing for entities licensed a state's enactment of the URVCBA.

Moreover, dual licensure requirements would undermine many of the advances made in this draft toward the goal of encouraging industry innovation, including the inclusion of a provisional license (or "on-ramp") provision, as discussed below. The Chamber also remains concerned that industry actors licensed under the URVCBA without a provision making it clear that such licensees, whether full or provisional, are exempt from the licensing requirements of the state's broader money transmitting business regime, will face significant risk of enforcement under 18 U.S.C. § 1960.

The Chamber understands that the URVCBA is intended to cover only virtual currency business activity, and that to the extent an entity conducts traditional money transmission, its activities may not be substantively covered under the URVCBA (e.g., custody of customer fiat currency). But this issue could be addressed in context of the exemption; specifically, by clarifying that the entity is subject to applicable substantive provisions of the state's money transmitter law but exempt from the requirement to obtain a money transmission license. If this approach is taken, consideration should be given to how any conflicts or ambiguities between the enacted URVCBA and money transmitter law should be resolved. Since the entity's license would be

under the enacted URVCBA, we suggest that any conflicts or ambiguities be resolved with reference to applicable URVCBA language.

For the above reasons, we strongly encourage the Committee to include an exemption for all URVCBA licensees within a state, full and provisional, from the same state's money transmitter law.

3. The Provisional License Option and *De Minimis* Exemption

The Chamber understands that the Committee, from its October 28-29 meetings, remains committed to including a provisional license (or "on ramp") option, as set forth in Section 210, for entities whose business volume does not exceed a certain quarterly threshold (currently projected to be $1 million). We further understand that the Committee intends to incorporate a full *de minimis* exemption for entities whose quarterly business volume does not exceed a lower threshold (currently projected to be $50,000).

The Chamber commends the Committee on its commitment to the provisional license concept, and applauds the prospective inclusion of the *de minimis* exemption. In light of the negative impact of a state-by-state approach to regulation in the United States, as discussed in Section 1 above, the Chamber considers inclusion of a provisional license feature integral to encouraging industry innovation. The *de minimis* exemption will further promote development of start-up and academic communities in this space while posing no material regulatory risks.

While generally supporting these important concepts, the Chamber urges the Committee to consider several additional refinements to maximize their effectiveness in practice. First, the Chamber would recommend that the Committee consider increasing the contemplated provisional license threshold to $2 million. Based on the Chamber's experience and discussion with members, $1 million of activity per quarter is still a relatively low amount of activity, thus potentially rendering the full licensure requirement overbroad. In this regard, we would note that provisional licensees are still expected to comply with substantial and important requirements, including the obligations set forth in Articles 3 (examinations), 5 (disclosures) and 6 (compliance) of the UCVRBA. At a minimum, though, the Committee should not go below the currently contemplated threshold of $1 million.

Furthermore, with respect to the *de minimis* exemption, the Chamber understands that some consideration was given at the October 28-29, 2016 meeting as to whether such entities would still need to comply with disclosure requirements (i.e., as set forth in Article 5). The Chamber would discourage the Committee from imposing such a requirement, which would diminish the utility of the exemption. At most, entities qualifying for the *de minimis* exemption should be required to post a clear notice on their websites stating simply that they are exempt from licensing in certain states. That would apprise potential customers that they are dealing with an exempt entity, enabling those customers to make appropriate and informed transaction decisions accordingly.

4. Excluding Distributed Ledger Technology Applications

The definition of "virtual currency" in Section 103(25) may still capture transfers of digital assets on a distributed ledger that are not used as currency, contrary to the Committee's express intention. While the definitions clearly exclude the networks underlying virtual currencies, as well as contributions of connectivity software and computing power to such networks, it is not clear that when "currencies" such as bitcoin are repurposed to enable other use cases (decentralized notarization, decentralized intellectual property ledgers, etc.), that such use cases will not be covered by the URVCBA.

Section 103(25) provides, subject to certain carve outs, that virtual currency includes any digital representation of value used "as a medium of exchange, a unit of account, *or* a store of value." Presumably, these references were intended to capture the defining characteristics of money (i.e., the "currency" aspect of "virtual currency"). But it is a settled matter among leading economists that money features *all three* of those characteristics, not just one or two.[2] As currently drafted with the disjunctive "or," for example, the virtual currency definition could theoretically pick up digital representations of any asset. As one economist has explained, "every asset is, by its very nature, a potential store of value."[3]

In other words, then, the virtual currency definition potentially reaches beyond "currency-like" use cases, with the greatest danger of overbreadth being transfers of digital assets—which, again, are inherently stores of value. Although some overbreadth is addressed through existing exemptions, a troubling degree of potential digital asset applications may still arguably be captured by the URVCBA. For example, a company tokenizing valuable sculptures and transferring ownership of the sculptures through a distributed ledger may still be dealing in a "virtual currency" and transferring that virtual currency between users within the meaning of the proposed definitions, even though tokenized sculptures were clearly not an intended object of regulation under the URVCBA.

The Chamber acknowledges that many commonly-understood digital currencies (possibly including bitcoin) might not satisfy the "unit of account" characteristic, which could render the definition underbroad if all three commonly-understood characteristics of money were required.[4] To mitigate these competing risks of under- and over-breadth, we recommend making clear that "virtual currency" includes only digital representations of value that exhibit the medium of exchange *and* store of value characteristics. Alternatively, the Committee could adopt language that the state of Washington recently included (in proposed bills to address virtual currency) to address this very same concern. That language clarifies that virtual currency does not include

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[2] *See, e.g.*, N. Gregory Mankiw, "Principles of Economics" (7th Ed. 2012, at p. 611) (explaining that "[m]oney has three functions in the economy: It is a medium of exchange, a unit of account, *and* a store of value. These three functions *together* distinguish money from other assets in the economy . . .") (emphases added).

[3] Robert Clower, "A Reconsideration of the Microfoundations of Monetary Theory", *Economic Inquiry* 6.1 (1967): 1-8.

[4] *See* Bitcoin as Money?, Federal Reserve Bank of Boston (Sept. 4, 2014), at p. 10-11, available at https://www.bostonfed.org/economic/current-policy-perspectives/2014/cpp1404.pdf.

"uses of virtual distributed ledger systems to verify ownership or authenticity in a digital capacity when the virtual currency is not used as a medium of exchange."[5]

5. Capital, Surety and Permissible Investments

We strongly urge the Committee to reconsider its current approach to capital, surety and permissible investment issues. As currently structured, these requirements could make it prohibitively expensive for companies to do business in a state that enacts the URVCBA, even if the entity otherwise qualifies for a license.

(a) Permissible Investments

The most pressing issue is the requirement in Section 208 that licensees maintain an additional 10.5% of "the value of the virtual currency over which the licensee has custody or control on behalf of users." This surplus requirement has no equivalent in the money transmitter context, creating a substantial and unwarranted disadvantage for virtual currency companies as compared to traditional money transmitter counterparts. Moreover, as explained below, the current structure of the URVCBA makes a permissible investment requirement altogether unnecessary.

To illustrate, as MoneyGram explains in its annual report, many state regulators require maintenance of permissible investments "in an amount equivalent to outstanding payment obligations," with such investments generally restricted to highly-liquid assets such as "cash and cash equivalents, U.S. government securities and other highly rated debt instruments."[6] Money transmitters who issue stored value and payment instruments, such as MoneyGram, generally take customer money (i.e., from the issuance of those instruments) onto their own balance sheet as assets, and book a corresponding liability to the customer.[7] In the money transmitter context, then, the permissible investment requirement ensures that at any given point in time, issuers of stored value and payment instruments such as MoneyGram have sufficiently liquid assets to satisfy the demands of holders of its outstanding liabilities. The permissible investment requirement makes sense in context of such business models.

But in the URVCBA, the Committee has decided that "[v]irtual currency in the custody or control of a licensee on behalf of others may not be invested by the licensee," and that such virtual currency remains property of the customer at all times.[8] So long as these requirements remain in place, it is not clear why a permissible investment requirement is needed with respect to virtual currency held in custody. The licensee already must hold the customer's virtual currency unit-for-unit, in like kind, and as property of the customer; these requirements amply ensure that the asset will be there when the customer wants to withdraw or transfer it.

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[5] RCW 19.230.010(30) (proposed bill as of October 6, 2016).
[6] See MoneyGram International Inc. Form 10-K (for the period ending Dec. 31, 2015), at p. 42-44, available at http://files.shareholder.com/downloads/AMDA-1TA9OX/2040629614x0x879800/41273702-7759-4946-918E-1C82A3B25E23/2015_10_K.pdf.
[7] *See id.*
[8] URVCBA, Sec. 208(b), Sec. 503.

At bottom, if a licensee isn't permitted to invest a customer's virtual currency assets in the first place, there is no apparent reason for a permissible investment requirement. To the extent a licensee also custodies customer fiat currency, the licensee should be permitted to invest such fiat currency subject to permissible investment requirements under the state's traditional money transmitter law—but *not* be required, as argued in Section 2 above, to obtain a traditional money transmitter license.

(b) Surety Requirements

We understand surety requirements to generally address the concern that a company can satisfy all customer claims in the event of the company's failure. Although the URVCBA's requirement to hold customer assets unit-for-unit should address liquidity concerns in the ordinary course, we acknowledge that unexpected adverse incidents could occur that might require resort to a backup source (such as a surety bond) to satisfy customer claims.

With respect to surety requirements, Section 204(a) of the URVCBA requires a "deposit of funds or investment property or other security" acceptable to the applicable regulator, "in an amount and type given the nature and extent of risks in the applicant's business model." Under Section 204(b), a surety bond may be used to satisfy this, but regulators may not require licensees to use surety bonds as the particular method to do so.

The Chamber generally supports this approach to surety issues. Although it would be desirable to have more predictability on this front, it is likely impractical for the URVCBA to prescribe a hard-and-fast formula for this issue given that requirements will (and should) vary materially based on qualitative factors such as business models, sources of funding, and market conditions.

At this point in time, it is also appropriate to have language providing that regulators may not require entities to obtain surety bonds in satisfaction of this requirement. Based on members' ongoing efforts to obtain surety bonds for traditional money transmitter licenses, while it is possible to obtain such bonds, annual premiums can run as high as 7-10% and the minimum bond amount for applicants in all applicable states is nearly $7.7 million. This means that annual premiums can run well over $500,000—a prohibitive figure for small or medium size companies seeking to operate on a nationwide basis. This practical reality makes it very important for the URVCBA to preserve other options, such as trust accounts (as the New York BitLicense allows) to satisfy this regulatory requirement.

Before the URVCBA is finalized, however, the Chamber recommends that industry members engage with the Committee to come up with informal guidance on appropriate surety levels for states to consider. This could be included in the final drafting notes as an attempt to promote harmonization and practical requirements across states. There are several states, for instance, that currently require unrealistically high surety bond amounts for money transmission, such as Pennsylvania and Colorado. Especially where, as here, the URVCBA will require licensees to hold customer assets unit-for-unit, in most conceivable scenarios those amounts will be far more

than is needed in the event that a licensee fails. The Chamber and its legal advisors would be happy to spearhead such discussions at the Committee's request.

(c) Capital/Reserve Requirements

We understand capital/reserve requirements to generally address the same basic regulatory issue: that a company has the financial wherewithal to sustain ordinary course operations and to manage an orderly wind-down in the event of its failure.

With respect to capital requirements, we note that the current draft of the URVCBA remains open-ended, requiring licensees to either maintain a minimum net worth of $35,000 or a certain percentage of virtual currency business activity, e.g., 2-5% (over an undetermined period of time). We understand that the Committee, from its October 28-29, 2016 meetings, is leaning toward a percentage-based measurement for capital and is also considering a separate cash reserve requirement for wind-down, which does not currently exist in the URVCBA. We suggest that the Committee choose one or the other, but not both, given that they seem largely duplicative in purpose.

Based on input from members, the Chamber would likely support a percentage-based capital requirement on the lower end of the proposed range. But in the interest of achieving a more tailored way of addressing the regulatory concern underlying these requirements, the Chamber also suggests looking at other metrics, as the 2-5% figure may not necessarily relate to whether a particular company can manage an orderly wind-down. Specifically, a more relevant metric might be the company's average monthly operating expenses; a regulator could require capital based on such expenses for the company, multiplied by the expected time it would take to wind down a company of that complexity. For instance, the SEC requires systemically important clearing agencies to hold liquid net assets funded by equity equal to at least six months of current operating expenses, so that the entity can continue operations during a recovery or wind-down.[9] We raise this example to illustrate the relevant metric, and not necessarily to suggest that six months is appropriate; in fact, given the size and complexity of systemically important clearing agencies, a shorter timeframe is likely more appropriate for virtual currency companies.

6. Change in Control

Based on the experience of Chamber members, the 10% control threshold in Section 306 of the URVCBA is too low. For many new and emerging companies, this would mean that a change of control would occur whenever they secured meaningful venture capital funding. Although Section 306(e) contains a list of factors for determining whether there is, in fact, a change of control, we have found that regulators tend to focus solely on the percentage of ownership as the true test. Thus, if the Committee is committed to retaining a percentage of ownership concept

[9] *See* "SEC Adopts Rules for Enhanced Regulatory Framework for Securities Clearing Agencies" (Sept. 28, 2016), *available at* https://www.sec.gov/news/pressrelease/2016-199.html.

for determining whether someone has "control" over a licensee, we recommend raising the control threshold to 30%.

Additionally, we suggest including an option for passive investors to submit a simple certification to the applicable regulatory body that their stake—despite exceeding a presumed control threshold—is solely for investment purposes and not for exercising control. This mechanism is well-established in securities regulation,[10] and would be more efficient than requiring all such passive investors to submit "detailed information" about their company, directors, officers, shareholders and beneficiaries, as currently required by Section 306(b) of the URVCBA. This certification option would make the regulatory authority aware of the passive investor's stake, and the regulatory authority could make appropriate follow-up inquiries of the licensee if necessary.

7. Exempting Trust Companies

The Chamber understands that the Committee, based on its October 28-29, 2016 discussions, has not decided whether to include an exemption for out-of-state trust companies in the URVCBA. For the reasons below, the Chamber encourages the Committee to include such an exemption.

In general, the Chamber believes that the touchstone for whether certain out-of-state entities should be exempt is the degree of regulation to which they are subject in their home jurisdictions. Under this logic, many states have appropriately concluded that both out-of-state trust companies and banks should be exempt from money transmission licensure. The core commonality is that both of these entities are subject to "safety and soundness" regulation (i.e., prudential supervision) in their home states, which, in general, is more comprehensive and rigorous than the suite of consumer protection regulations that apply to money transmitters.[11]

Consistent with these principles, providing an exemption for out-of-state trust companies will appropriately recognize the additional regulatory burdens and oversight that trust companies have opted into, and provide appropriate deference to the prudential supervision that sister state regulators will undertake with respect to such entities.

Doing so will also pose minimal risk that companies will use this exemption as a "loophole"; to become a chartered trust company, an entity must affirmatively submit to substantially greater regulation and oversight as compared to money transmitters. The process of obtaining a trust charter, in our experience, can take six months to a year and require hundreds of thousands of dollars in legal, consulting and licensing fees. In other words, this is not an option that "fly by night" entities will find attractive (or even viable) to evade licensing requirements.

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[10] See SEC Schedule 13G, *available at* http://www.secfile.com/wp-content/uploads/2013/04/sched13g.pdf.

[11] To illustrate, the CSBS Multistate Trust Institutions Act states that the purpose of the act is to permit trust companies "to engage in the trust business on a multistate and international basis to the extent consistent with the safety and soundness of the trust institutions engaged in a trust business in this state and the protection of consumers, clients, and other customers of such trust institutions." CSBS Multistate Trust Institutions Act, § 1.001 (emphasis added).

Finally, the Chamber notes that states enacting the URVCBA will always have the flexibility to remove the exemption, if the state strongly disfavors such exemption as a policy matter. But for states that do not have a strongly-held view on the issue, including the exemption as a default matter would substantially and appropriately further the uniformity goals of the URVCBA.

We thank the Committee for the opportunity to highlight further possibilities for refining the URVCBA. The Committee has been charged with the difficult task of creating a model law that both protects consumers and promotes innovation. We thank the Committee for its diligent, thorough and thoughtful work on this legislation. Should you have any further questions about these or other topics, please do not hesitate to contact me at Perianne@digitalchamber.org.

Respectfully Submitted,

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