February 13, 2015

Via Electronic Delivery
David Cotney
Chairman
Emerging Payments Task Force
Conference of State Bank Supervisors
1129 20th Street NW
Washington, DC 20036

Re: Draft Model Regulatory Framework for Virtual Currency Activities

Dear Chairman Cotney and Members of the Task Force:

The Clearing House Association L.L.C.[1] and the Independent Community Bankers of America[2] (collectively, the "Associations") respectfully submit to the Conference of State Bank Supervisors ("CSBS") this comment letter on the recently released Draft Model Regulatory Framework regarding the licensing and oversight of persons and entities engaged in certain types of virtual currency transactions (the "Model Framework").

The Associations believe that appropriate regulation can increase public trust in virtual currency systems, reduce prudential risks posed by virtual currency market participants, and

[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® (ICBA), the nation's voice for more than 6,500 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. ICBA members operate 24,000 locations nationwide, employ 300,000 Americans and hold $1.3 trillion in assets, $1 trillion in deposits and $800 billion in loans to consumers, small businesses and the agricultural community. For more information, visit www.icba.org.

provide important protections for consumers that engage in virtual currency transactions. The Associations welcome the opportunity to provide comments on the Model Framework, and look forward to participating further in the regulatory process.

I. Introduction

The Associations believe that virtual currencies, such as Bitcoin, represent significant innovations in the financial services industry. Virtual currency system participants and transactions also pose consumer and prudential risks. Virtual currencies frequently are promoted as alternatives to or substitutes for existing, well-established and highly regulated payment products and systems, such as credit cards, debit cards, and ACH payments; yet, virtual currency systems and transactions frequently do not afford consumer or prudential protections commensurate with those available to users of closely regulated, traditional payments systems and products.

Establishing reasonable regulations to manage the consumer and prudential risks related to the purchase, holding, and use of virtual currency is critical to protecting consumers and others who put their trust in virtual currency businesses. To date, however, federal regulators have demonstrated little intent of acting to extend consumer and prudential regulations to virtual currency businesses and activities, and in some cases have indicated that they lack authority to do so.[3] Consequently, in the near term, it is likely that states will play a central role in establishing these protections with respect to virtual currency businesses and activities.

The Associations believe that it is appropriate and important for CSBS to offer encouragement and guidance to states that seek to regulate virtual currency businesses, and the Associations generally support the approach proposed in the Model Framework. However, the Associations believe that greater specificity and certain clarifications and additions to the Model Framework are appropriate, including to ensure that regulated banking entities are not subjected to the burden of unnecessary and duplicative regulation as virtual currency businesses. Additional enhancements, such as complementing the Model Framework with the creation of a model statute for virtual currency activities ("Model Statute") that states can choose to adopt, would support greater consistency in regulatory efforts. In addition, the Associations wish to offer more specific feedback on certain of the Questions for Public Comment released by CSBS.

[3] For example, Federal Reserve Chairwoman Janet Yellen has stated that the Federal Reserve lacks authority to regulate virtual currencies. *Yellen on Bitcoin: Fed Doesn't Have Authority to Regulate It in Any Way*, (February 27, 2014), http://blogs.wsj.com/moneybeat/2014/02/27/yellen-on-bitcoin-fed-doesnt-have-authority-to-regulate-it-in-any-way/. We note that, while FinCEN requires certain virtual currency companies to register as money services businesses, prudential and consumer protection issues are beyond the scope of FinCEN's jurisdiction.

II. Exemption for Regulated Banking Entities

The Associations support the establishment of comprehensive regulations to ensure that providers of virtual currency products and services are subject to oversight (and offer consumer and prudential protections) comparable to those applicable to regulated banking entities that offer traditional, functionally similar payment services and products. Therefore, the Associations have encouraged state and federal authorities that are considering regulation of virtual currency businesses to focus on those entities and activities that pose consumer and prudential risks due to the absence of existing, comprehensive regulation and supervision.

Traditional banking entities already are subject to extensive prudential requirements and to oversight that is more stringent than that applicable to licensed money transmitters under existing state statutes. Such oversight encompasses virtually all aspects of an institution's safety and soundness, including requirements related to capital adequacy and reserves, activity restrictions, systems and data security, business contingency, ownership and control, reporting, and maintenance of books and records, and involves ongoing examinations. Traditional banking entities also are required by federal law to engage in due diligence and ongoing monitoring of customers and transactions to help avoid providing banking access to prohibited persons and to detect and prevent money laundering and other illicit activity. Such institutions also typically are subject to consumer protection requirements promulgated by the Consumer Financial Protection Bureau (the "CFPB"), including the CFPB's proscription of unfair, deceptive, or abusive acts or practices. Federal prudential regulators also have taken the view that failure by their regulated institutions to implement and maintain appropriate policies to protect consumers and resolve consumer complaints can threaten institutional safety and soundness.

State money transmitter laws are designed to ensure the safety and soundness of entities engaged in money transmission and to protect consumers that entrust funds to money transmitters. Because traditional banking entities are subject to significant federal regulation and oversight with respect to both prudential concerns and consumer-protection matters, virtually all states, either by statute or as a matter of policy, exempt such entities from the requirement to obtain money transmitter licenses, as does the Uniform Money Services Act ("UMSA").[4]

The Associations urge CSBS to expand the Model Framework to more comprehensively address the scope of regulated activities and entities. The Associations further request that the CSBS clarify expressly that regulated banking entities and institutions should not be subject to regulation by the states as virtual currency businesses.[5] Because regulated banking entities engaged in virtual currency business activities will be subject to compliance with the requirements of both the CFPB and that institution's prudential regulator (even absent specific federal legislation or regulation to address virtual currency), requiring traditional banking institutions to comply with an additional state licensing requirement will unnecessarily burden

[4] *See* UMSA § 103(4), http://www.uniformlaws.org/shared/docs/money%20services/umsa_final04.pdf.

[5] Absent an express exception for regulated banking entities, national banks would nonetheless generally be exempt from any potential state virtual currency regulatory framework due to preemption by federal banking laws.

such entities without improving protection for consumers that engage in virtual currency transactions with them.

III. Model Statute

The Associations support the Model Framework and the scope suggested in it, but the Associations also see an opportunity for the CSBS to promote greater consistency in the states' regulatory efforts with the introduction of a Model Statute. Federal legislation establishing prudential standards for virtual currency businesses appears unlikely at present. In its absence, a Model Statute would provide a significant foundation that encourages wider and quicker adoption of relevant rules by states. Introducing a Model Statute would help states identify many of the concerning regulatory issues and solutions, reducing the likelihood of gaps in consumer and prudential protections.[6]

IV. Specific Responses to CSBS Questions for Public Comment

a. Regulatory Flexibility and the Separate Regulation of Virtual Currency Businesses and Activities

As a starting point, states that seek to regulate virtual currency businesses must determine whether to seek to apply existing money transmitter licensing statutes or to adopt a new statute or regulation that is tailored to virtual currency businesses. Existing state money transmitter licensing statutes provide one potential avenue of subjecting virtual currency businesses and transactions to some prudential regulations, and several states, including Washington and North Carolina, have indicated that at least certain types of virtual currency activities and transactions may constitute money transmission under their state statutes. For many states, however, regulating virtual currency business activities under existing statutes would require expanding the definition of "money" or "funds" in such statutes.[7] Given the variation in state money transmitter laws (and the potential impact of such a redefinition on state laws outside the money transmission context), it is difficult fully to assess the risks and benefits of doing so.

Further, existing money transmitter laws are likely inadequate to address a number of the unique risks posed by virtual currency systems and transactions. A comparison of the proposed requirements included in the Model Framework to typical state money transmitter

[6] The need for such a model statute is illustrated by the recent press coverage of Coinbase's announcement that Coinbase Exchange would be the "first regulated bitcoin exchange based in the U.S," which prompted regulators in New York to clarify that New York has not yet issued any virtual currency licenses and resulted in California's financial regulator issuing a "consumer alert" warning that "Coinbase Exchange is not regulated or licensed by the state." Developments such as this emphasize the need for clarity in the regulation and licensing of virtual currency business activities. A model statute would help to clarify the regulatory framework, making clear which virtual currency businesses are in fact regulated and which are not.

[7] Texas, for example, has stated that the definition of "money or monetary value" under the Texas Money Services Act does not encompass virtual currencies. *See* Texas Department of Banking, Supervisory Memorandum – 1037 (April 30, 2014), http://www.dob.texas.gov/public/uploads/files/consumer-information/sm1037.pdf.

laws highlights some of the risks that are particularly significant in the virtual currency context and that are not a focal concern under most money transmitter licensing statutes and regulations. For example, the Model Framework notes the need to include disclosure requirements designed to ensure that consumers are fully aware of the key risks associated with virtual currency transactions (such as volatility, lack of reversibility, and risk of loss) – risks which are not present, or are not required to be disclosed, in the context of a standard money transmission transaction. The Model Framework also notes the need to require compliance with federal BSA/AML requirements. Finally, the Model Framework calls for state regulators to require that virtual currency businesses establish cyber security programs, policies, and procedures, and notify customers in the event of breach. As demonstrated by the recent theft of over $5 million worth of bitcoins from virtual currency exchange BitStamp, cyber theft is a key risk faced by virtual currency businesses, while it is a much less significant risk in the context of standard money transmission.

In addition to the unique risks posed by virtual currency activities, there is also a unique need for flexibility in regulation of virtual currency businesses due to the emerging nature of the industry. Adopting a separate statute specific to virtual currency activities provides states with a greater ability to pursue an iterative approach to regulation of virtual currency businesses as the industry develops, without reopening existing money transmitter statutes and, thereby, creating uncertainty for traditional money transmitters that are not engaged in virtual currency activities. Indeed, the Associations view the limited overlap between traditional money transmitters and virtual currency businesses as another basis for adopting separate statutes specific to virtual currency activities.[8]

Therefore, given the unique issues and risks associated with virtual currencies, the Associations recommend adoption of a separate and distinct licensing framework for the regulation of virtual currency companies and that such a framework should be appropriately tailored to the characteristics and risks of virtual currencies. The Associations note that New York, the only state to date to affirmatively address regulation of virtual currency activities, has opted to do so via a new regulation, not a modification of New York's existing money transmitter statute.

b. Consumer Protection

Much of the marketing and promotion of virtual currency is focused on merchants. The efficiency of accepting payments in virtual currency is touted. Often, the lack of chargeback risk is specifically called out. Such promotional efforts highlight the fact that certain aspects of virtual currency that are particularly attractive to commercial participants in the system are the very aspects that pose increased risk to consumers. Namely, a consumer has no remedy if virtual currency is stolen, as in the BitStamp example cited above, or if the consumer is a victim of fraud.

[8] While the Associations have noted instances in which a virtual currency business is incidentally engaged in money transmission involving fiat currency, in general, the Associations have not observed a significant pattern in which fiat currency money transmission and virtual currency business activities both form key parts of a single company's business. Were this to become a common activity, however, states could consider a mechanism by which a licensed money transmitter obtains a virtual currency endorsement, and vice-versa.

The Associations believe that it is vital to ensure that consumers fully understand these risks and their rights in the event that something goes wrong. Therefore, the Associations support robust consumer disclosure requirements for virtual currency transactions. Such disclosures can play a key role in protecting consumers, even with respect to risks that are not otherwise addressed in a state virtual currency licensing statute.

For example, CSBS specifically requested comment on the role of cyber risk insurance in the virtual currency industry. As discussed above, virtual currency businesses are uniquely vulnerable to cyber theft. The Associations do not have a view on the advisability of requiring licensed virtual currency businesses to obtain cyber risk insurance. However, the Associations believe that consumers should be fully informed regarding the risks of entrusting funds to a given virtual currency business. Therefore, the Associations urge that the Model Framework be revised to clarify that licensees must disclose the presence or absence of insurance against theft or loss, whether cyber theft or theft by other means.

In addition to robust and thorough disclosures, the Associations support the inclusion in the Model Framework of surety bonding and trust account requirements, as well as permissible investment restrictions. As a fundamental principle, consumers should be fully protected against the loss of funds entrusted to a virtual currency business. The Associations advise that the Model Framework be revised to reflect this key principle and clarify the bases on which consumers have the right to recover from licensees' surety bonds and trust accounts, which should include loss, theft, fraud and failure of the licensee. In particular, the Associations advise that, like money transmitters and traditional banking institutions, licensed virtual currency companies be subject to permissible investment restrictions designed to ensure that funds are invested in a safe and secure manner. In general, this would preclude permitting licensees to invest in virtual currency-backed securities or other more speculative or volatile investments.

c. Customer Identification

The Associations are well aware of the significant burden associated with customer identification and credentialing. Many types of virtual currency businesses, such as vaults and many exchanges, permit customers to establish accounts and maintain fiat and virtual currency balances. In many cases, all virtual currency deposited by customers is transferred to bitcoin addresses controlled by the exchange, and the customer's only evidence of ownership is the exchange's books and records. The Associations encourage CSBS to require that virtual currency businesses that perform functionally similar activities to those of traditional depository financial institutions establish and implement customer identification programs that are at least as stringent as those required of such financial institutions under state and federal law. Such requirements are necessary to ensure that virtual currency businesses do not provide bad actors with a back door into the financial system or with a convenient means of laundering funds or concealing illicit activity.

d. Use of the NMLS to Increase Information-Sharing and Efficiency in the Licensing Process

The Associations view recent efforts to expand use of the Nationwide Mortgage Licensing System ("NMLS") to financial services providers outside the traditional mortgage-lending space, such as payday lenders, money transmitters, check cashers, and other types of consumer financial services providers, as a positive model for potential expansion of existing NMLS infrastructure to include licensure of virtual currency market participants. Given the

emerging nature of the virtual currency industry and the limited information available regarding many businesses and their principals, the NMLS could play a significant and positive role in facilitating access to key information by consumers and regulators.

While the Associations are sensitive to the burden involved in completing background checks and complying with credentialing requirements, the Associations believe that the consumer and prudential benefits that result from these requirements outweigh such burdens. Particularly given the anonymity inherent in many virtual currency systems and the international nature of many virtual currency businesses, it is important to ensure that regulators have full information regarding those who seek licensure in their states and that consumers know with whom they are doing business.

Further, the Associations note that greater access to information regarding prospective licensees and their principals benefits not only consumers and regulators, but also virtual currency business themselves. As discussed above, the Associations' members engage in due diligence on all customers that seek to establish accounts, including verification of identity.[9] Such due diligence, combined with ongoing monitoring of transaction patterns, has proven quite successful in enabling financial institutions to establish that their customers are who they say they are and has greatly inhibited bad actors whose activities are inherently unlawful, such as terrorists and money launderers, from accessing and using the financial system.

In determining whether to establish banking relationships with virtual currency businesses, financial institutions undertake the risk-based due diligence required by law and their own internal risk management policies. If financial institutions can more easily access information regarding virtual currency companies, their finances, business operations, principals, and risk-management policies and procedures, they will be better able to make informed, individualized judgments regarding the establishment of banking relationships with prospective customers that are engaged in virtual currency business activities. In addition, licensure may offer greater assurance to financial institutions that a virtual currency business is legitimate.

[9] See 31 C.F.R. § 1020.220(a)(2).

V. Conclusion

Thank you for the opportunity to provide these comments regarding the draft Model Framework. 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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