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Legal/Regulatory November 14, 2013, 5:17 pm 4 Comments

## **Virtual Money Draws Notice of Regulators**

By NATHANIEL POPPER



Michael Appleton for

The New York Times Benjamin M. Lawsky, the New York financial services superintendent.

Updated, 8:15 p.m. | New York's top financial regulator is looking at issuing a "BitLicense" for businesses that conduct transactions in virtual currencies like bitcoin.

Benjamin M. Lawsky, the state's superintendent of financial services, <u>announced on Thursday</u> that he would conduct a public hearing to discuss the expanding world of digital money. Participants will discuss the feasibility of a license that would make the virtual currency market more like those for other forms of money.

If the plans go ahead, it would be an important step in bringing bitcoin and other virtual currencies closer to the financial mainstream. In another move in the same direction, the Federal Election Commission held a hearing on Thursday at which it considered whether to legalize campaign donations made in virtual currencies.

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Since bitcoin was created in 2009 by anonymous programmers, it has been treated with derision by many financial insiders and authorities, who have described it as a speculative mania. Many authorities still hold to that position, but the currency's online network, which is not controlled by any centralized authority, has survived several crises.

On Thursday, the value of a single bitcoin was trading near a record high, at \$425, on the exchange Mt. Gox. The price has skyrocketed in recent weeks.

Several regulators have been looking at ways to make sure virtual money cannot be used for laundering money or other criminal purposes. In October, the federal authorities arrested the operator of an online marketplace where they said bitcoin could be used to buy drugs and other illegal goods.

"The cloak of anonymity provided by virtual currencies has helped support dangerous criminal activity, such as drug smuggling, money laundering, gunrunning and child pornography," Mr. Lawsky said in a letter announcing the hearing, which has not yet been scheduled.

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FROM: Benjamin M. Lawsky, Superintendent of Financial Services

**DATE:** November 14, 2013

**RE:** Notice of Intent to Hold Hearing on Virtual Currencies, Including Potential

NYDFS Issuance of a 'BitLicense'

In August 2013, the New York State Department of Financial Services (NYDFS) issued a public notice that it has launched an inquiry into the appropriate regulatory guidelines for virtual currencies. In that notice, we wrote that it is important for regulators to balance both allowing new technologies and industries to flourish, while also working to ensure that consumers and our country's national security remain protected.

NYDFS launched its inquiry in part because of evidence that the cloak of anonymity provided by virtual currencies has helped support dangerous criminal activity, such as drug smuggling, money laundering, gun running, and child pornography. Indeed, the same week that NYDFS issued its public notice, a national magazine published an interview with an alleged key figure in the black market drug website "Silk Road," who cited the virtual currency Bitcoin as a key ingredient in the site's efforts to commit illegal acts. Law enforcement authorities have subsequently taken action in the Silk Road case.

Virtual currencies may have a number of legitimate commercial purposes, including the facilitation of financial transactions. That said, NYDFS also believes that it is in the long-term interest of the virtual currency industry to put in place appropriate guardrails that protect consumers, root out illegal activity, and safeguard our national security. Failing to do so would not only threaten the virtual currency industry as a legitimate business enterprise, but could also potentially expose virtual currency firms to extraordinarily serious criminal penalties.

As the next step in our inquiry, we are providing notice that NYDFS intends to hold a public hearing on virtual currency regulation in New York City in the coming months at a time and location to be determined. We will announce logistical details for the hearing in the near future.

<sup>1</sup> Notice of Inquiry on Virtual Currencies," NYDFS, August 12, 2013, see: <a href="http://www.dfs.ny.gov/about/press2013/memo1308121.pdf">http://www.dfs.ny.gov/about/press2013/memo1308121.pdf</a>

<sup>&</sup>lt;sup>2</sup> "Meet The Dread Pirate Roberts, The Man Behind Booming Black Market Drug Website Silk Road," Forbes, Andy Greenberg, August 14, 2013, see: <a href="http://www.forbes.com/sites/andygreenberg/2013/08/14/meet-the-dread-pirate-roberts-the-man-behind-booming-black-market-drug-website-silk-road/">http://www.forbes.com/sites/andygreenberg/2013/08/14/meet-the-dread-pirate-roberts-the-man-behind-booming-black-market-drug-website-silk-road/</a>

This upcoming public hearing is part of an ongoing fact-finding effort informing NYDFS's determination regarding the appropriate regulatory guidelines for virtual currencies. As part of its August 2013 notice, NYDFS stated that it was concerned that certain virtual currency firms may be engaging in money transmission, which is an activity that is licensed and regulated by our Department. However, we also said that we were considering whether to issue new regulatory guidelines tailored specifically to the unique characteristics of virtual currencies.

Our public hearing will review the interconnection between money transmission regulations and virtual currencies. Additionally, the hearing is also expected to consider the possibility and feasibility of NYDFS issuing a 'BitLicense' specific to virtual currency transactions and activities, which would include anti-money laundering and consumer protection requirements for licensed entities. Among the issues related to the potential issuance of a BitLicense that we are considering include but are not limited to the following:

- What specific types of virtual currency transactions and activities should require a BitLicense?
- Should entities that are issued a BitLicense be required to follow specifically tailored anti-money laundering guidelines?
- Should entities that are issued a BitLicense be required to follow specifically tailored consumer protection guidelines?
- Should entities that are issued a BitLicense be required to follow specifically tailored regulatory examination requirements?

To be clear, NYDFS has not made a determination at this point about the necessary regulatory guidelines for virtual currencies. Our Department is currently engaged in a broad-based inquiry on virtual currency. The virtual currency industry represents a new frontier in electronic commerce, and it is important that regulators obtain the necessary information – through a rigorous, deliberate fact-finding effort – to set appropriate guardrails for this industry.

Indeed, it is not clear at this point whether virtual currencies will become a long-term, prevalent fixtures of the electronic commerce world. But given the increased demand from consumers and investors, as well as demonstrated concerns regarding money laundering, regulators would be remiss if they turned a blind eye to virtual currencies. We have a responsibility to take a hard look at these issues.

We look forward to continuing to work with the virtual currency industry as our inquiry proceeds.

<sup>&</sup>lt;sup>3</sup> For the avoidance of doubt, a potential "BitLicense" could apply to firms involved with all virtual currencies, not just Bitcoin.



FROM: Benjamin M. Lawsky, Superintendent of Financial Services

**DATE: August 12, 2013** 

**RE: Notice of Inquiry on Virtual Currencies** 

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New York has a long history of promoting technological innovation – both within the financial sector and across our economy.

As innovative products emerge, it is critical to take steps that allow new technologies and industries to flourish, while also working to ensure that consumers and our national security remain protected.

The emergence of Bitcoin and other virtual currencies has presented a number of unique opportunities and challenges. Building innovative platforms for conducting commerce can help improve the depth and breadth of our nation's financial system. However, we have also seen instances where the cloak of anonymity provided by virtual currencies has helped support dangerous criminal activity, such as drug smuggling, money laundering, gun running, and child pornography.

If virtual currencies remain a virtual Wild West for narcotraffickers and other criminals, that would not only threaten our country's national security, but also the very existence of the virtual currency industry as a legitimate business enterprise.

Indeed, it is in the common interest of both the public and the virtual currency industry to bring virtual currencies out of the darkness and into the light of day through enhanced transparency. It is vital to put in place appropriate safeguards for consumers and lawabiding citizens.

As such, the Department of Financial Services (DFS) has launched an inquiry into the appropriate regulatory guidelines that it should put in place for virtual currencies. DFS has already conducted significant preliminary work regarding this inquiry, including making requests for information from virtual currency firms. Based on that initial work, we are concerned that – at a minimum – virtual currency exchangers may be engaging in money transmission as defined in New York law, which is an activity that is licensed and regulated by DFS.

Under current DFS regulations, firms engaging in money transmission are required to post collateral in order to better safeguard customer account funds. Additionally, they are required to undergo periodic safety and soundness examinations, as well as comply with applicable anti-money laundering laws. These guidelines for money transmitters help protect consumers and root out illegal activity.

However, DFS is also considering whether it should issue new regulatory guidelines specific to virtual currencies – rather than simply apply existing money transmission regulations. As such, we could also move forward with new guidelines that are tailored to the unique characteristics of virtual currencies.

We believe that – for a number of reasons – putting in place appropriate regulatory safeguards for virtual currencies will be beneficial to the long-term strength of the virtual currency industry.

First, safety and soundness requirements help build greater confidence among customers that the funds that they entrust to virtual currency companies will not get stuck in a digital black hole. Indeed, some consumers have expressed concerns about how quickly their virtual currency transactions are processed. Taking steps to ensure that these transactions – particularly redemptions – are processed promptly is vital to earning the faith and confidence of customers.

Second, serving as a money changer of choice for terrorists, drug smugglers, illegal weapons dealers, money launderers, and human traffickers could expose the virtual currency industry to extraordinarily serious criminal penalties. Taking steps to root out illegal activity is both a legal and business imperative for virtual currency firms.

Finally, both virtual currency companies – and the currencies themselves – have received significant interest from investors and venture capital firms. Similar to any other industry, greater transparency and accountability is critical to promoting sustained, long-term investment.

We look forward to working with the virtual currency industry and other stakeholders as our inquiry proceeds, and we move to put in place appropriate regulatory guardrails to protect consumers and our national security.