October 20, 2014

Dana V. Syracuse, Esquire
Office of General Counsel
Department of Financial Services
One State Street
New York, New York 10004

Subject: ETA's Comments on Proposed Virtual Currency Regulatory Framework

Dear General Syracuse:

On behalf of the Electronic Transactions Association ("ETA") thank you for the opportunity to comment on the Department of Financial Services' ("DFS") proposed regulations (the notice of proposed rulemaking, or "NPRM") concerning virtual currencies. We appreciate the time and effort that went into drafting the proposed rules and complement DFS on such a professional proposal.

ETA is an international trade association representing more than 500 companies, from financial institutions and transaction processors to independent sales organizations and equipment suppliers. The purpose of ETA is to influence, monitor and help shape the merchant acquiring industry by providing leadership through education, advocacy, and the exchange of information.

Our comments on the proposed rule reflect the breadth of our membership and fall into three categories:

1. The scope of the definition of Virtual Currency needs to be carefully crafted so that it clearly excludes services and products not intended to be covered;
2. The exemptions from the licensing requirements should be amended to include payment processors, payment gateways and licensed money transmitters (and on this point we proposed specific language); and,
3. The impact of the regulations on currency companies must be carefully worded so as to maintain a level playing field in the payments field.

Each area is addressed, in turn.

Scope of the Regulations

A number of our members share a common core of concerns. They are engaged in activities such as affinity or rewards programs or in online gaming platforms, and read the proposed regulations as potentially (and, we suggest, inadvertently) including their activities. We urge DFS to review its definitional sections to ensure that companies engaged in these types of transactions are not subject to unnecessary or duplicative regulation.

At section 200.2(m), the NPR broadly defines "virtual currency," providing two narrow exceptions.

> *Virtual Currency* means any type of digital unit that is used as a medium of exchange or a form of digitally stored value or that is incorporated into payment system technology. . . . Virtual Currency shall not be construed to include digital units that are used solely within online gaming platforms with no market or application outside of those gaming platforms, nor shall Virtual Currency be construed to include digital units that are used exclusively as part of a customer affinity or rewards program, and can be applied solely as payment for purchases with the issuer and/or other designated merchants, but cannot be converted into, or redeemed for, Fiat Currency.

Particularly due to the inclusion of "a form of digitally stored value" in the definition set forth in in section 200.2(m), we are concerned that the broad definition of "virtual currency" may cover certain products (discussed below) that should be excluded from the scope of this proposal. From a regulatory perspective, we think these products do not pose the same money laundering or market stability risks as those presented by crypto currencies and, to the extent they pose regulatory risk, they are subject to scrutiny by other, equally effective, regulations and oversight.

To this end, we respectfully request a clarification that 1) prepaid access, stored value cards, or prepaid cards denominated in fiat currency, and 2) closed loop digital payment methods be excluded from the definition of "virtual currency."

Prepaid Access

Excluding prepaid access products from the definition will prevent confusion and uphold the current regulatory framework that governs these products, so that prepaid access providers can continue to operate with certainty. As DFS is aware, prepaid products are and have been the subject of considerable scrutiny by the U.S. Treasury's Financial Crimes Enforcement Network ("FinCEN") and, more recently, by the Consumer Financial Protection Bureau ("CFPB"). To the extent a prepaid product is connected to a financial institution, it is also subject to oversight by federal and state functional regulators. Prepaid products not directly connected to a financial institution but not meeting a FinCEN exemption are classified as money service businesses, must register at the federal level, and are regulated by the states. In short, prepaid is fully regulated; adding additional regulations here will not increase the safety of the product, rather only increase the regulatory burden (and resulting costs) on companies serving the under-banked population. Moreover, exclusion of prepaid access would be consistent with the approach taken by FinCEN and the state of Texas, both of which have taken the position that prepaid access does not fall within the scope of virtual currency because prepaid access is limited to access to funds denominated in real or fiat currency.[1]

Digital Units Used Within Closed Loop Digital Payment System

This comment focuses on the second part of the second exception, the exemption that provides that only digital units used solely for purchases with the issuer and/or other designated merchants, "but cannot be converted into, or redeemed for, Fiat Currency," are exempt from the definition of virtual currency.

[1] See FIN-2013-G001, *Application of FinCEN's Regulations to Persons Administering, Exchanging, or Using Virtual Currencies* (March 19, 2013); Texas Department of Banking Supervisory Memorandum 1037 (April 3, 2014).

This is a concern because we think the definition may not take into account on-going commercial developments. For example, there are many current instances where loyalty points may be accumulated by consumers and subsequently converted into fungible forms of payment methods such as gift cards denominated in fiat currency.

Here the issue is that digital units are being issued outside of the commonly accepted definition of consumer affinity or loyalty programs for use with a broad spectrum of merchants. For example, digital units in online marketplaces may be *purchased* by consumers to be used exclusively within those online marketplace platforms. These forms of "digital stored value," while not associated with consumer loyalty or affinity programs, may only be used in within those designated platforms and cannot be converted to or redeemed for fiat currency.

Without this important exclusion and if the proposed regulations are construed broadly, such closed-system payment methods could become too difficult to administer and ultimately discontinued, to the detriment of consumers.

Payment Processors and Payment Gateways Should be Excluded from the License Requirement

Section 200.3 sets forth the licensing requirement for, and excludes as exempt from the licensing requirement, persons chartered by the New York Banking Law and merchants and consumers using Virtual Currency "solely for the purchase or sale of goods or services." Improperly omitted from this list of exempt persons is the one other group of entities usually necessary in the payment chain, payment processors.

Payment Processors and Payment Gateways act as an intermediary between retailers that want to accept electronic payment cards (such as debit and credit cards) for consumer purchases and the financial institutions that issue the cards and hold consumer accounts. The term "processing" can be described as those functions associated with authorizing, capturing and settling merchants' transactions.

We urge DFS to follow FinCEN's lead. Just as FinCEN defined money transmitters and money services businesses to exclude payment processors and payment gateways (FIN-2012-R004), DFS should clearly exclude payment processors and payment gateways from requiring a virtual currency license. FinCEN's money transmitter regulations, as amended, define the term *money transmitter* to include a person that provides money transmission services (defined as the acceptance of currency, funds, or other value that substitutes for currency from one person AND the transmission of currency, funds, or other value that substitutes for currency to another location or person by any means), or any other person engaged in the transfer of funds. 31 C.F.R. § 1010.100(ff)(5)(A) & (B).

In its 2012 ruling, FinCEN stated that, "[g]enerally, the acceptance and transmission of funds only integral to the sale of goods or the provision of services, other than money transmission services, will not cause the person that is accepting and transmitting the funds to be a money transmitter." The ruling referenced the agency's earlier "Merchant Payment Processor" ruling which stated that an entity is not deemed to be a money transmitter when (a) the entity acts on behalf of merchants collecting payments, and not on behalf of the customers obligated to

make them; and (b) the role of the entity is limited to submitting debit authorizations granted by the customer to the merchant to the customer's bank, extracting the money from the customer's bank account and depositing it into the entity's account, and passing the money on from the entity's account to the merchant's. FIN 2003-8, *Definition of Money Services Business (Merchant Payment Processor)*, Nov. 19, 2003.

While payment processors and payment gateways have a critical responsibility in the payments chain – routing the transaction data in order to effectuate payments – ultimately, they are providing merchants access to a pipeline. Payment processors do not contract with consumers for the transfer of value to merchants. Because of the nature of a processors' role and the precedent set by FinCEN in its own money transmission regulations, the ETA believes that payment processors should be clearly exempted from the licensing requirement in Section 200.3 of the proposed regulation of virtual currencies.

In this regard, we recommend that the following language be added to the exemption set out in section 200.3(c) from the license requirement:

> 3) Persons that operate a payment processing or payment gateway system ("Processors") that provides processing, clearing, or settlement services and functionality, in connection with or for, wire transfers, credit card transactions, debit card transactions, stored-value transactions, automated clearing house transfers, prepaid access, virtual currency transactions or similar funds transfers ("Processing Activities"); provided that if a person acts as both a Processor and money transmitter, as defined in FinCEN's money transmitter regulations, the exemption provided in this Section XX (3) shall only apply to the person's Processing Activities and not to its activities as a money transmitter.

Licensed Money Transmitters Should be Excluded from the License Requirement

We also urge DFS to exempt from the license requirements of section 200.3(c) persons or entities that are licensed as Transmitters of Money under the New York Banking Law.

Persons or entities that are engaged in the business of receiving money for transmission or transmitting money are required to obtain a money transmitter license from the superintendent of DFS. Similarly, persons doing business as a money transmitter must register as a Money Services Business (MSB) with FinCen and are subject to FinCen's reporting, and recordkeeping regulations. FinCEN defines money transmission to include the transmission of value that substitutes for currency. In 2013, FinCen issued interpretive guidance to clarify that virtual currency such as Bitcoin either has an equivalent value in real currency, or acts as a substitute for real currency and an entity that accepts and transmits a convertible virtual currency is a money transmitter under FinCEN's regulations.

We urge DFS to follow FinCEN's lead and clarify that an entity that is in the business of receiving Virtual Currency for transmission is a money transmitter under DFS's money transmitter laws and so long as the entity is licensed as a money transmitter in New York and approved for engaging in Virtual Currency Business, it should be exempt the licensing requirement in Section 200.3.

Licensed money transmitters operate under the supervision of the DFS and are subject to the licensing and other requirements of the NY Banking law which are also designed to protect consumers and prevent illegal activity. By enabling consumers and small businesses to send funds to vendors, family members and friends, money transmitters play an essential role in financial inclusion. Requiring licensed money transmitters to obtain another license under Section 200.3 would create an additional and unnecessary regulatory burden on money transmitters and subject them to conflicting regulatory requirements when dealing with virtual and real currencies. ETA believes that DFS' interest in protecting consumers and rooting out illegal activity without stifling beneficial innovation would be served by having licensed money transmitters seek approval for engaging in Virtual Currency Business Activity without having to get another license and be subject to conflicting regulations.

In this regard, we recommend that the following language be added to the exemption set out in section 200.3(c) from the license requirement:

> (4) Persons that are licensed Transmitters of Money under the New York Banking Law to engage in the business of receiving money for transmission or transmitting the same and are approved by the superintendent to engage in Virtual Currency Business Activity.

Maintaining a Level Playing Field in Payments

Our virtual currency members understand and appreciate that some level of regulation is required in this field. To this end, we appreciate the good intentions of the DFS' draft regulations, but have three areas of concern:

1. Overly proscriptive regulations raise barriers that stymie growth of jobs & innovation;
2. Disregard of existing framework of AML regulations and adoption of disparate requirements will result in an unnecessary regulatory burden on companies doing business across the United States; and,
3. Clarification of Definitions and Exceptions

Overly Proscriptive Regulations Raise Barriers

Under this topic, we have a series of particular suggestions:

- Clarify that the duties of the compliance officer requirement may be fulfilled by a principal officer - § 200.7.
- Tier capital requirements, §200.8, using in the bond requirement of § 200.9(a) in place of capital up to an appropriate size and complexity.
- Tier requirement for types and degree of reports and financial disclosures - § 200.14
- Consider modifying the cyber security requirements (§ 200.16) to a more risked-based approach. While our members recognize the need for robust financial disclosure and cyber security, they note that the standards required by the regulations pose serious burdens to market entry.
- Remove or limit the restriction in investing profits in virtual currencies - S200.8

Disregard of Existing Framework of AML Regulations

Under this heading we have one general comment focused on anti-money laundering compliance. We think the best solution in this area is that DFS use FinCEN's rules with regard to both the requirements to maintain an anti-money laundering program and the requirements of such a program. FIN-2013-G001, March 19, 2013, *Application of FinCEN's Regulations to Persons Administering, Exchanging, or Using Virtual Currencies*. Establishing different requirements will greatly increase the regulatory compliance burden on New York state licensees. Moreover, if other states follow New York's lead and adopt disparate requirements, the result will be an enormous regulatory burden on companies doing business across the United States, discouraging innovation and increasing consumers' costs. While we appreciate – and share – the objective that virtual currencies not be used for improper purposes, we strongly recommend that a uniform rule across the country, uniformly enforced, is the best solution in this area.

Further to that end, we suggest that DFS adopt established thresholds for performing customer identification and maintaining records of transactions using existing frameworks. Here are three examples: (1) United States Postal Service sells money orders up to $3,000 without any identification; (2) the European Union's 3rd Money Directive imposes no customer identification requirements to purchase and maintain reloadable prepaid cards up to 2,500 Euros; and, (3) FinCEN's Prepaid Access Rules (a subset of the Money Service Business rules referenced earlier) provide a $1,000 *de minimus* risk threshold with regard to open loop prepaid access.

Finally, several of our members recommended that DFS eliminate the § 200.15(d) requirement that a licensee file a Virtual Currency Transaction Report ("VCTR") with regard to transactions for one individual and either in, or aggregating over, a U.S. dollar value of $10,000 in one day. Virtual currency transactions are, by Internal Revenue Service Rules, sales of assets and reportable as capital gains and losses on appropriate tax returns. IR-2014-36 (March 25, 2014). They are, therefore, sales of digital units, or assets and not fiat currency.

Clarification of Definitions and Exceptions

This final section is a list of issues we think DFS should consider as it brings its rules into final form:

1. We suggest that DFS amend the "Transmission" definition (§ 200.2(l)), to take into consideration the use of payment processors and state clearly that "Transmission shall not include 'accepting and transmitting funds only integral to the sale of goods or the provision of services, other than money transmission licensed services.'" This would ensure that DFS' definitions are in accordance with FinCEN's guidance, referenced earlier.
2. We think the definitional section on "Virtual Currency Business Activity," needs clarification as to its internal wording, such as the meaning of "customer business" and "retail conversion services." "Buying and selling" virtual currency as a customer business seems applicable to a business such as an investment or mutual fund company, while performing retail conversion services seems applicable to an exchanger versus a merchant processor. The meaning eventually ascribed by DFS to

these terms in § 200.2(n) will have substantial impact on participants in this field and should, therefore, be clarified early in the process.

3. We reemphasize here our earlier proposal that DFS add an exemption from the licensing requirements section (§ 200.3) for payment processors that operate consistently with FinCEN regulations and guidance. 31 CFR § 1010.100(ff)(5)(ii)(B); FIN 2003-8, *Definition of Money Services Business (Merchant Payment Processor)*, Nov. 19, 2003.

Thank you again for the opportunity to comment on the DFS' proposed rules. The proposal reflects a tremendous amount of high-level effort by the Department for which the staff deserves – and gets -- a great complements from all the commenters and ETA.

Please let us know if our comments suggest any questions. We are available to discuss our letter with you at your convenience. My contact information is 202-677-7403 or stalbott@electran.org.

Sincerely,

Scott Talbott
Senior Vice President, Government Affairs
Electronic Transactions Association