

New York's Final "BitLicense" Rule: Overview and Changes from July 2014 Proposal

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bitcoin-reg.com

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Table of Contents

Introduction

1. Introduction

- Summary of Changes from and Clarifications to the July 2014 Proposal
- Summary of Requirements
- Timeline

2. What Is Covered Under BitLicense?

3. Application Process, Suspension and Revocation

4. Consumer Protections

5. Safeguarding Assets

6. Cyber Security Program

7. Anti-Money Laundering

8. Exams, Reports and Oversight

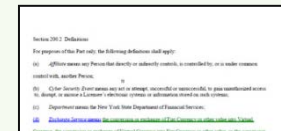
Introduction

We have a responsibility to regulate new financial products in order to help protect consumers and root out illicit activity. That is the bread and butter job of a financial regulator. However, by the same token, we should not react so harshly that we doom promising new technologies before they get out of the cradle. Getting that balance right is hard, but it is key.

– NYDFS Superintendent Benjamin Lawsky, [Speech Announcing BitLicense Final Rule](#) (Jun. 3, 2015)

- On June 3, 2015, the New York Department of Financial Services (“**NYDFS**”) issued its [final “BitLicense” virtual currency rule](#)
- In response to nearly [4,000 comment letters](#) on the “[July 2014 Proposal](#)” and 35 comments on the “[February 2015 Reproposal](#),” the NYDFS made a number of changes and clarifications, such as adding a 2-year conditional license and loosening certain Anti-Money Laundering (“**AML**”) / Know Your Customer (“**KYC**”) requirements (see [Slide 4](#) for summary of changes)
- Most virtual currency (e.g., bitcoin) businesses will have to be licensed to engage in business with New York customers (retail or institutional) or otherwise operate in New York.
 - Businesses will have 45 days from the effective date of the rule (not yet known) to apply for a license
- Mere consumers who use bitcoin or merchants that accept bitcoin will not have to register.

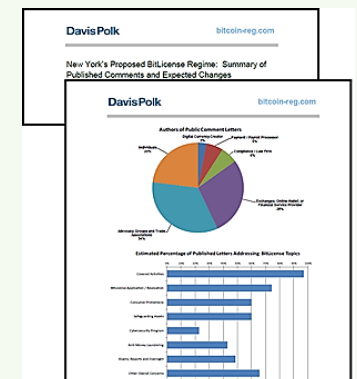
[Blackline of Final Rule vs. Feb 2015 Reproposal](#)



[Blackline of Feb 2015 Reproposal vs. July 2014 Proposal](#)



[Comment Letter Summary \(Nov. 7, 2014\)](#)



Introduction

- BitLicense was the first comprehensive virtual currency regulatory regime proposed in the United States and is now the first such regime enacted
 - FinCEN and other federal agencies have issued guidance (see [Slide 16](#)) and some states [have issued](#) money transmitter licenses to virtual currency businesses. Some state legislatures have proposed virtual currency regimes.
 - A businesses that obtains a BitLicense will still need to comply with federal, other states' and other countries' virtual currency laws, regulations and licensing requirements
 - Institutions that become licensed to engage in virtual currency activity through a NY trust charter (e.g., itBit) will nevertheless [need to comply](#) with the substantive requirements of BitLicense
- BitLicense will have a [profound](#) impact on the industry
 - BitLicense will create barriers to entry and will impose significant application and compliance costs
 - BitLicense-regulated companies will likely find it easier to establish banking relationships
 - BitLicense may promote both investment in the industry and consumer trust
- NYDFS Superintendent Lawsky has announced he will step down within weeks

BitLicense vs. New York Trust Charter



- In some cases, traditional trust licenses granted in one state are recognized in other states, eliminating the need for 50-state licensure
- itBit, a bitcoin exchange, was the first virtual currency company [to be chartered](#) as a limited purpose trust in New York permitted to engage in virtual currency activity, on May 7, 2015
- On the day itBit received its trust license it [announced](#) it would be opening for business in all 50 states. In defense of its position itBit's CEO said, "By being organized under New York banking law, you more or less have reciprocity across the rest of the United States."
- It is [unclear whether other states will agree](#) with itBit's position. For example, a spokesman for the California Department of Business oversight has said, "We're not prepared to agree that ItBit is can conduct exchange transactions with Californians under its New York certificate."

Introduction

Summary of Changes from and Clarifications to the July 2014 Proposal



A star in this memo highlights a change from the July 2014 Proposal

BitLicense Application (Slide 20)

- Fingerprints / photographs now required only for employees with access to any customer funds (whether in Fiat or Virtual Currency)
- \$5,000 application fee (previously discretionary)
- Application now only requires written policies / procedures related to BitLicense requirements (rather than all policies and procedures)
- Some applicants may also require NY Money Transmission license, but will be able to use single application
- Banks & other regulated entities that are allowed to engage in Virtual Currency activities will be subject to BitLicense's substantive requirements (likely through NYDFS's supervisory powers)

Conditional License (Slide 22)

- NYDFS can grant 2-year (+) "conditional license" with tailored requirements and examinations
- Businesses must nevertheless submit an application

Capital Requirements and Protection of Customer Assets (Slide 30)

- Licensees can hold virtual currency as capital
- Eliminated requirement of investing retained earnings and profits in specified liquid assets
- Licensees may sell, transfer or assign assets held on behalf of another person, at the direction of such other person

Material Change Clarification (Slide 24)

- Licensee may seek clarification from the NYDFS about whether a proposed change is material and would require an application
- "[C]ompanies will not need prior approval for standard software or app updates – only for material changes to their products or business models."

Control Issues and Non-Control Determination Application (Slide 25)

- Applications can be made to the NYDFS Superintendent to determine that a person does not / will not control another person
- Merely being officer or director ≠ control; Passive VC investor ≠ control

AML/ KYC Requirements (Slide 38)

- Licensee must obtain information for counterparties to its customers' transactions only to the extent practicable
- Records must now be kept for 7 years instead of 10
- Licensee subject to federal Suspicious Activity Reporting ("SAR") need not file SARs with NYDFS
- Currency Transaction Reports for NYDFS needed only for > \$10,000 virtual currency to virtual currency transactions (and only if not federally reportable)

Application Security (Slide 35)

- Removes third party software audit requirement
- Replaced by provision requiring licensee to ensure security of all applications utilized by licensee

Clarification of Scope of Virtual Currency / Business Activities (Slide 8)

- Mere software developers / end-users not covered
 - "...we have no intention of being a regulator of software developers – only financial intermediaries."
- Mere miners / mining pools likely not covered
- Non-financial uses of virtual currency technologies no longer covered
- Companies that merely "secure" virtual currency on behalf of a person no longer covered (potentially intended for "multi-sig" applications)
- Digital units used for customer affinity or rewards program / pre-paid cards not covered
- Merchants / consumers using virtual currency solely for investment purposes not covered

See two speeches by Superintendent Lawsby outlining the most notable changes from his perspective: (1) [December 2014 speech](#) and (2) [June 2015 speech](#).

Introduction

Summary of Requirements

<u>Covered Activities</u>	<ul style="list-style-type: none"> • Most business activities, excluding mere merchant/consumer/investor activities; software developers, miners • Involving centralized or decentralized virtual currencies (excluding in-game / rewards points / prepaid cards) • Involving New York or New York customers 	
<u>Cyber Security Program</u>	<ul style="list-style-type: none"> • Board-approved cyber security policy & program to protect electronic systems and sensitive data • Qualified Chief Information Security Officer • Annual reports to NYDFS 	<ul style="list-style-type: none"> • Annual penetration testing/audits • Maintain business continuity and disaster recovery plan, to be independently tested annually
<u>Consumer Protections</u>	<ul style="list-style-type: none"> • Initial and per-transaction disclosures of risks, terms and conditions • Complaint policies & disclosures • Advertising and marketing requirements (e.g., no false, misleading or deceptive representations or omissions) 	
<u>BitLicense Application / Revocation</u>	<ul style="list-style-type: none"> • Must submit detailed applications to NYDFS & become licensed <i>before</i> undertaking covered activities • Existing businesses will have transition period to apply; if denied, must cease activities 	<ul style="list-style-type: none"> • NYDFS has broad discretion to approve/deny, revoke/suspend licenses • Material change of activities or change of control requires application to NYDFS (can ask NYDFS if proposed change is material or if person would gain control from proposed transaction)
<u>On-Ramp</u>	<ul style="list-style-type: none"> • Startups and new businesses may receive a 2-year conditional license with more tailored requirements and examinations • Numerous factors will be taken into account when determining whether to grant a conditional license 	
<u>Safeguarding Assets</u>	<ul style="list-style-type: none"> • Licensed entity must hold required capital in the form of cash, virtual currency, or high-quality, highly liquid, investment-grade assets • Surety bond / trust account at NYDFS's discretion 	<ul style="list-style-type: none"> • Full reserves for custodial assets — selling / encumbering prohibited • Books and records requirements (seven years) • Capital requirements at NYDFS's discretion
<u>Exams, Reports, and Oversight</u> <u>Anti-Money Laundering</u>	<ul style="list-style-type: none"> • Largely consistent with federal AML requirements • Initial & annual risk assessments to inform AML program. Board-approved policy • Records of all transactions for seven years. • Office of Foreign Assets Control (“OFAC”) compliance 	<ul style="list-style-type: none"> • Report within 24 hours to NYDFS ≥ \$10,000 virtual currency to virtual currency one-day transactions by one person (unless fed reporting) • Suspicious Activity Reports (“SARs”) required (unless fed reporting) • Customer Identification Program • Annual internal / external audit. No structuring to evade reporting, or obfuscating identity

Introduction

Timeline

Jan. 2009 Bitcoin created by Satoshi Nakamoto	Aug. 2013 NYDFS issues subpoenas to several bitcoin businesses over AML and consumer protection concerns	Oct. 2013 Silk Road seizure	Jan. 2014 NYDFS holds virtual currency hearings	Feb. 2014 Mt. Gox halts trading , eventually filing for bankruptcy	Feb. 2014 Lawsky speech on regulation of virtual currencies; Reddit discussion	Mar. 2014 NYDFS encourages exchanges to apply for licensing (before regulations are published)	Mar. 2014 NYDFS issues public order announcing it will consider establishing BitLicense regime
Jul. 2014 NYDFS issues proposed BitLicense regulatory framework; issues notice with supporting rationale in the NYS Register	Sep. 6, 2014 End of 45-day public comment period (public comments summarized here)	Feb. 4, 2015 Reproposal issued by NYDFS, with additional comment period	May 5, 2015 FinCEN levies \$700,000 penalty against Ripple for AML failures	May 7, 2015 NYDFS issues limited purpose trust company charter to itBit, a Bitcoin exchange	May 29, 2015 Ross Ulbricht, founder of Silk Road, sentenced to life in prison	Jun. 3, 2015 Final Rules issued by NYDFS, announced by Lawsky speech	

Bitcoin Market Price (USD)



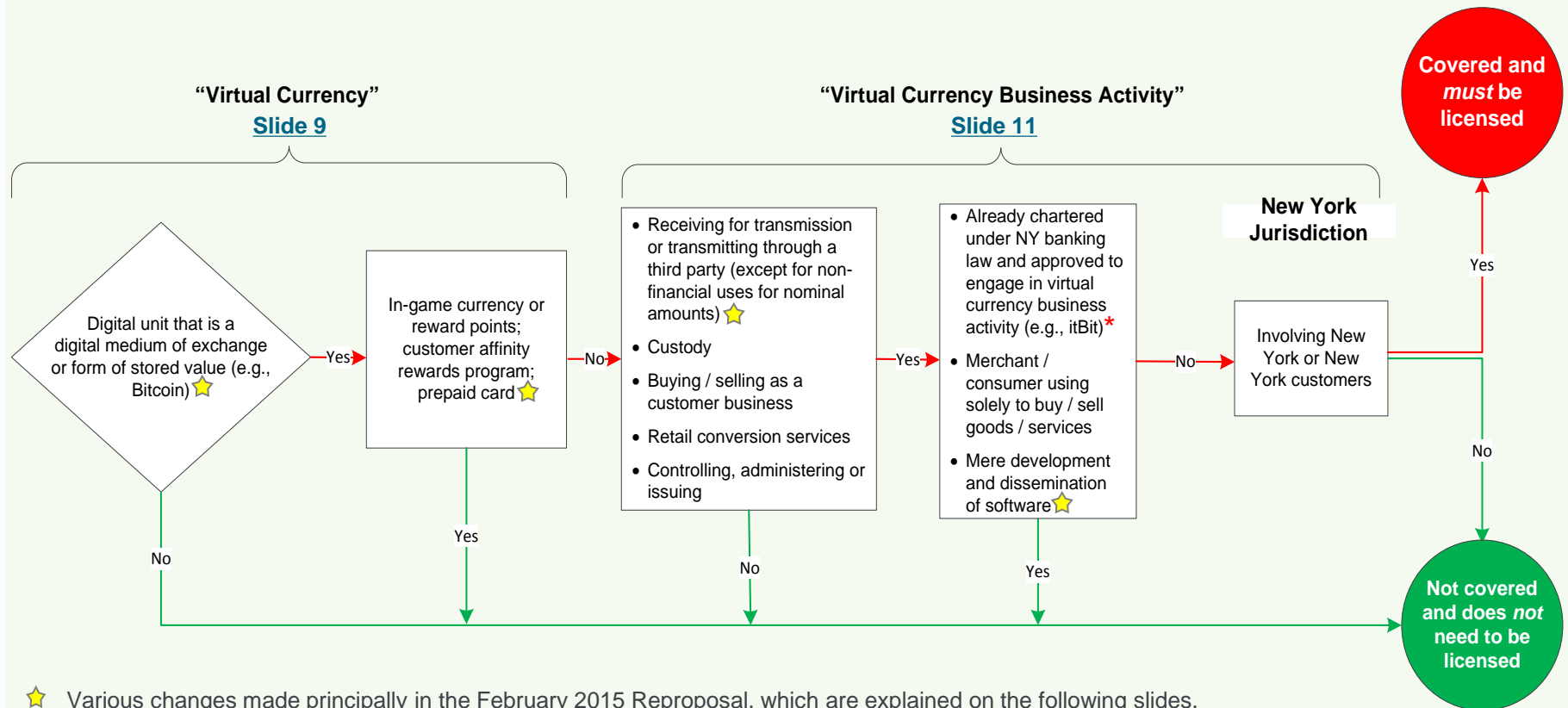
Table of Contents

What is Covered Under BitLicense?

1. [Introduction](#)
2. [What Is Covered Under BitLicense?](#)
 - Summary Flow Chart
 - Covered Virtual Currencies
 - Types of Business Activities Subject to BitLicense
 - BitLicense Regime vs. NY Money Transmitter Under NYBSL
 - Comparison to FinCEN Guidance
 - Types of Entities Subject to BitLicense
3. [Application Process, Suspension and Revocation](#)
4. [Consumer Protections](#)
5. [Safeguarding Assets](#)
6. [Cyber Security Program](#)
7. [Anti-Money Laundering](#)
8. [Exams, Reports and Oversight](#)

What Is Covered Under BitLicense?

Summary Flowchart § 200.2



★ Various changes made principally in the February 2015 Reproposal, which are explained on the following slides.

* Although such institutions would not be required to apply for BitLicenses, NYDFS Superintendent Lawsky [stated](#) that such institutions would be required to comply with the substantive requirements of BitLicense.

What Is Covered Under BitLicense?

Covered Virtual Currencies

§ 200.2(p)

BitLicense applies to business activities involving a “Virtual Currency,” which is defined as:

- Any type of digital unit that is used as a medium of exchange or form of digitally stored value
- Broadly construed** to include digital units of exchange that (i) have a centralized repository or administrator; (ii) are decentralized and have no centralized repository or administrator; or (iii) may be created or obtained by computing or manufacturing effort



“Virtual Currency” does not include digital units:

- That (i) are used solely within **online gaming platforms**; (ii) have no market or application outside of gaming platforms; (iii) cannot be converted into, or redeemed for, fiat currency or Virtual Currency; and (iv) may or may not be redeemable for real-world goods, services, purchases, or discounts ★
- That can be redeemed for goods, services, discounts, purchases, or digital units **in a customer affinity or rewards program** with the issuer and/or other designated merchants (but cannot be converted into / redeemed for fiat currency or virtual currency)
- Used as part of (fiat-only) prepaid cards* ★★

Examples:

- World of Warcraft Gold
- Nintendo Wii Points
- Airline miles
- American Express Serve



★ The February 2015 Reproposal imposed additional requirements to the online gaming exclusion that the digital units be non-convertible and non-redeemable for fiat or virtual currency.

★★ The Final Rule revised “gift cards” to “prepaid cards” but did not materially change the meaning of the term.

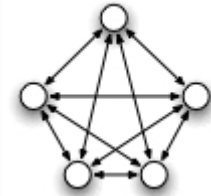
What Is Covered Under BitLicense?

Covered Virtual Currencies

§ 200.2(p)

“Decentralized” vs. “Centralized” Virtual Currencies

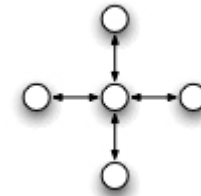
Decentralized Virtual Currency



- No centralized repository or administrator. Instead, computer networks—in some cases comprised of “miners”—maintain the currency
- Largely consistent with FinCEN [definition](#): (1) no central repository or administrator, and (2) persons may obtain the currency by their own computing or manufacturing effort
- Mostly “cryptocurrencies” based on cryptography
- **Examples:** Bitcoin, Dogecoin, Litecoin and the hundreds of other “[alt-coins](#)” based on the Bitcoin protocol



Centralized Virtual Currency



- Has a centralized repository and/or central administrator

Examples:

- Perfect Money (does not do business in United States)
- Liberty Reserve (shut down by U.S. government for money laundering)



What Is Covered Under BitLicense?

Types of Business Activities Subject to BitLicense
§ 200.2(o), (p), (q); § 200.3(c)

“Virtual Currency Business Activity” is defined as any of the following involving New York (as discussed on [Slide 18](#)):

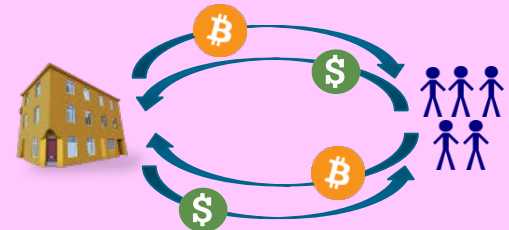
1. Receiving virtual currency for transmission or transmitting it ([Slide 12](#))



2. Holding virtual currency for others ([Slide 12](#))



3. Buying and selling virtual currency as a customer business ([Slide 13](#))



4. Exchange services as a customer business ([Slide 13](#))



5. Controlling, administering, or issuing virtual currency ([Slide 13](#))



Exempt from BitLicense ([Slide 13](#))

- Certain entities chartered under New York Banking Law
- Mere merchants, consumers, investors
- Mere software developers/distributors

What Is Covered Under BitLicense?

Types of Business Activities Subject to BitLicense

§ 200.2(o), (p), (q); § 200.3(c)

“Virtual Currency Business Activity” (*cont.*)

1. “Receiving Virtual Currency for Transmission or Transmitting Virtual Currency, *except* where the transaction is undertaken for *non-financial purposes* and does not involve the transfer of more than a nominal amount of Virtual Currency”

- “**Transmission**” is defined as “the transfer, by or through a third party, of virtual currency from a Person to a Person” (including transfers involving the “account or storage repository of a Person”
 - Person includes both natural persons and entities
- “**Receiving Virtual Currency for Transmission or Transmitting Virtual Currency.**” E.g., Alice transfers bitcoins to Business X in order to have X send it on to Bob
- “**Transmitting**” virtual currency. Problematic and vague. A business that merely transfers bitcoins among internal proprietary accounts likely is not captured because there is no “third party”
 - What about a business that has bitcoins and transfers them to a third party other than to pay for goods (e.g., a company that buys bitcoin and pays salaries in Bitcoin)? NYDFS probably did not intend for these activities to be captured, but unclear under the Final Rule.

Earlier press release language is different: “Receiving or transmitting virtual currency **on behalf of consumers.**” (subsequent little mention of the “consumer requirement”)

Non-financial purpose / nominal amount exclusion ★

- “Non-financial” applications of technology similar to the Bitcoin protocol may include innovative services for identity verification, digital document verification, and peer-to-peer transfers of digital assets
- Importantly, this exclusion **applies only** to the transmission prong of Virtual Currency Business Activity
- *Would a smart contract for transfer of a mortgage using nominal amount of bitcoin be considered for “non-financial purposes”?*

2. “Storing, holding or maintaining custody or control of virtual currency on behalf of others”★★

★ Removing the word “secure,” possibly reducing regulatory burden on multi-signature software providers. In multi-sig applications, multiple people may be required to act together to transfer virtual currency, helping to secure it--but none may, alone maintain custody or control. See [Mercatus Center Comment Letter](#).

★ Exclusion added by the February 2015 Reproposal.

What Is Covered Under BitLicense?

Types of Business Activities Subject to BitLicense

§ 200.2(o), (p), (q); § 200.3(c)

“Virtual Currency Business Activity” (cont.)

3. “Buying and selling Virtual Currency as a customer business”

- Broad and problematic language
- “Customer business” probably means buying/selling on a principal or agency basis to/from customers. Incidental sales to customers or ongoing sales to third parties that are not part of a customer-facing business are likely not included.
- [Press release](#) distinguishes “customer business” from “personal use”
“Customer” undefined—includes non-consumer customers?

4. “Performing Exchange Services as a customer business”

“Exchange Services” include the conversion or exchange of:

- Fiat currency or other value into virtual currency;
- Virtual currency into fiat currency; or
- One form of virtual currency into another form of virtual currency (e.g., bitcoins into litecoin or ripple).

5. “Controlling, administering, or issuing a Virtual Currency”

- Does not include mere miners of decentralized currencies.
- Overlaps with the definition of “administrator” under FinCEN [regulations](#)—under FinCEN [administrative ruling](#), bitcoin miners are not “administrators”
- *Creators of alt-coins without central administration? Probably not.*
 - See Comment Letters Submitted by [Ryan Selkis](#); [Hub Culture Group](#)
- *Bitcoin Foundation? Probably not.*

Exempt

- Merchants or consumers that utilize virtual currency solely for the purchase or sale of goods or services, or solely for investment purposes
- The development and dissemination of software in and of itself * ★
 - Superintendent Lawsky has [consistently reiterated](#) that BitLicense is aimed at “regulating financial intermediaries . . . not regulating software development.”

★ Investment Purposes exemption and software developer clarification added by the February 2015 Reproposal.

* Unclear when a software developer may cross the line into being a financial intermediary

What Is Covered Under BitLicense?

BitLicense Regime vs. NY Money Transmitter Regime Under NYSBL

- One [comment letter](#) questioned the need for a BitLicense Regime, claiming that “Virtual Currency Business Activities...already fit within the New York [Money Transmitter statutes].”
- Under both § 200.2(q) of the BitLicense and New York State Banking Law (“NYSBL”) § 641 (NY’s Money Transmitter statute), **similar language is used** to describe covered business activity.
- Unclear whether virtual currency fits squarely within NYSBL § 641.
- Upon [announcing the final BitLicense framework](#), Superintendent Lawsby noted: “[a]ttempting to force novel technologies and business models into existing regulatory boxes . . . may not be a sensible approach. We need, at times, to be more creative than that as regulators—even if it takes us outside our comfort zone.”
- On another occasion, Lawsby similarly claimed that the BitLicense was partially born out of the reality that the [“regulatory schemes for money transmitters were written long before there was internet...and \[are\] in need of updating.”](#)

Comparison of Covered Activity under BitLicense and NYSBL

BitLicense § 200.2(q):

“receiving virtual currency for transmission or transmitting virtual currency”

NYSBL § 641:

“engag[ing] in the business of receiving money for transmission or transmitting the same”

What Is Covered Under BitLicense?

Types of Business Activities Subject to BitLicense(*cont.*)

§§ 200.2, 200.3(c)

What qualifies as a Virtual Currency Business Activity likely calls for a facts and circumstances analysis. However:

Likely Includes	Unclear if Includes	Likely Does Not Include	Does Not Include
<ul style="list-style-type: none"> E-Wallets Exchanges Merchant / Payment Processors* Dealers Virtual currency ATMs Tumblers** Administrators of any centralized virtual currencies 	<ul style="list-style-type: none"> Mining pools (without wallets) that rely on participants' own computing power Mining companies (without wallets) that rent or sell mining contracts/services to others Investment vehicles that hold virtual currencies and issue securities Market makers Wallet software provided in the form of Software as a Services (SaaS) 	<ul style="list-style-type: none"> Companies that merely provide non-virtual currency financial or other services to virtual currency-associated businesses Consumers that mine, buy or earn as salary virtual currencies and remit them to friends or family not on behalf of others Merchants that merely accept virtual currencies directly or via payment processors and buy goods and services via bitcoin Non-profits / lobbying groups (e.g., Coin Center, Bitcoin Foundation, DATA) that support decentralized virtual currencies that don't otherwise engage in covered activities, including by paying programmer salaries† Investors in virtual currency businesses, including virtual currency-focused venture capital funds Manufacturers and sellers of dedicated virtual currency mining hardware Proprietary trading companies 	<ul style="list-style-type: none"> Consumers that mine, buy or earn as salary virtual currencies, and (i) hold those virtual currencies for investment or (ii) use them to purchase goods or services Miners Developers that merely program and release software for decentralized currencies that are not centrally administered Document notarization services that uses a nominal amount of bitcoin

* Although bitcoin payment processors previously took the position that FinCEN guidance excepts [payment processors](#), FinCEN rejected that approach.

** Tumblers (or mixers) are services that obscure the origin of virtual currencies, which can hinder the ability to trace virtual currencies to illicit sources. Because it requires “transmission,” such a service would likely be deemed “virtual currency business activity.” Such services would likely be prohibited under BitLicense under § 200.15(g) (banning licensees from knowingly transferring virtual currency to “conceal the identity of” an individual customer).

† See Bitcoin Foundation's [May 2013 letter](#) to California's Department of Financial Institutions (arguing that the Foundation need not register as a money transmitter under California law).

What Is Covered Under BitLicense?

Comparison to FinCEN Guidance

- Under FinCEN regulations implementing the Bank Secrecy Act (“**BSA**”) / USA PATRIOT Act, Money Services Businesses (“**MSBs**”) (including Money Transmitters) must register and comply with certain AML requirements.
- Starting in 2013, FinCEN has issued guidance and administrative decisions as to what kind of bitcoin and virtual currency businesses are MSBs / Money Transmitters.

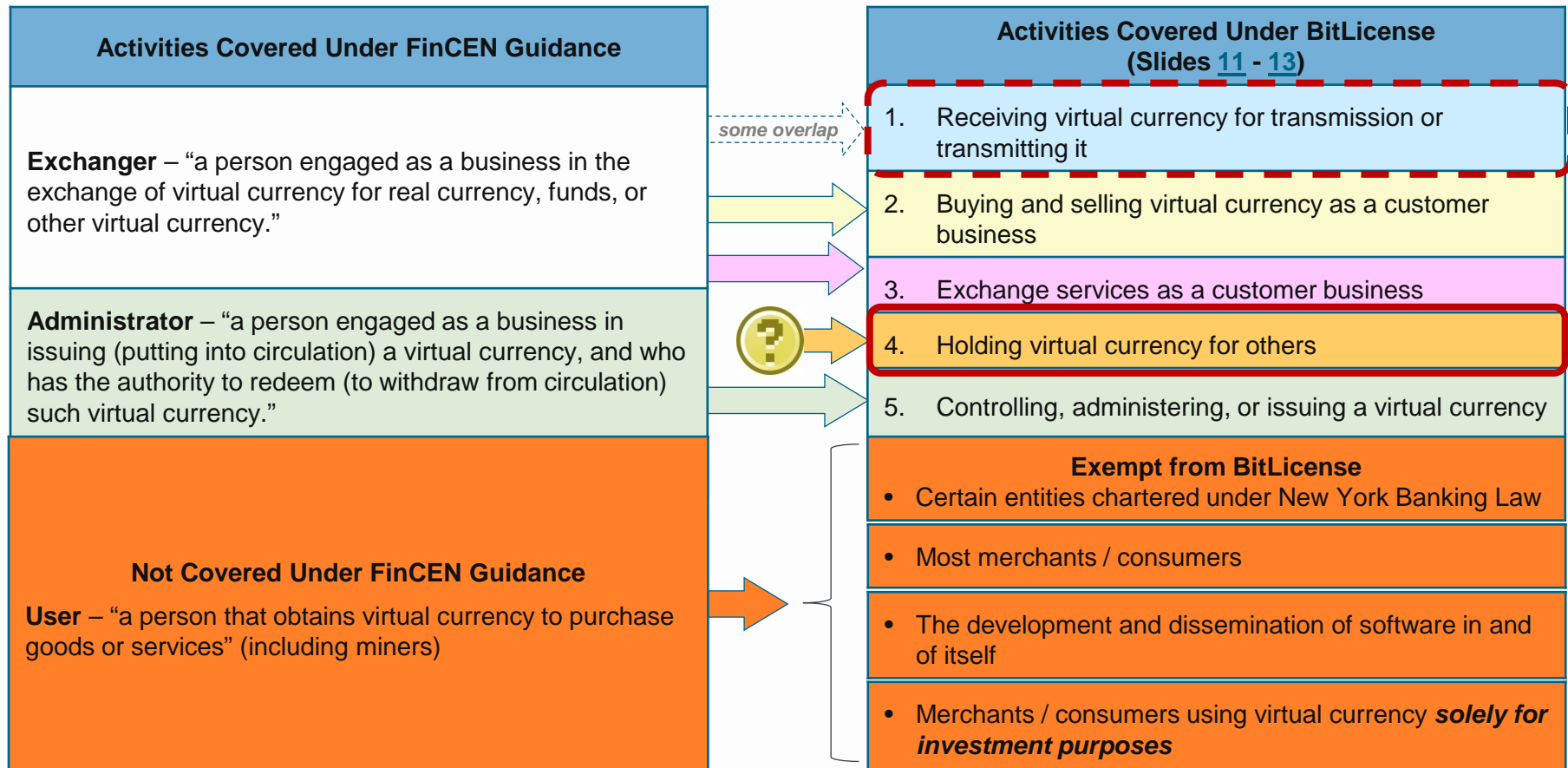
FinCEN Guidance Applicable to Bitcoin / Virtual Currency

<u>Convertible Currencies</u>	<ul style="list-style-type: none">• Virtual currency not legal tender; therefore, subject to MSB rules.• “Users” (Not MSBs), “Exchangers” and “Administrators” (MSBs).
<u>Mining</u>	<ul style="list-style-type: none">• Generally, individual miners and mining businesses are not MSBs.
<u>Investment Activities</u>	<ul style="list-style-type: none">• Generally, bona fide investment companies engaged in investing in / trading in bitcoin are not MSBs
<u>Payment Processor</u> <u>Declared Money</u> <u>Transmitter</u>	<ul style="list-style-type: none">• A company exchanging convertible virtual currency – for purposes of providing customer payments to merchants in bitcoin – is considered a money transmitter.
<u>Virtual Currency</u> <u>Exchanges</u>	<ul style="list-style-type: none">• Generally, a person must register with FinCEN as a money transmitter when engaging in convertible virtual currency transactions as an exchanger.

What Is Covered Under BitLicense?

Comparison to FinCEN Guidance (*cont.*)

- Below is a comparison of the types of virtual currency activities covered under both FinCEN Guidance and BitLicense.



What Is Covered Under BitLicense?

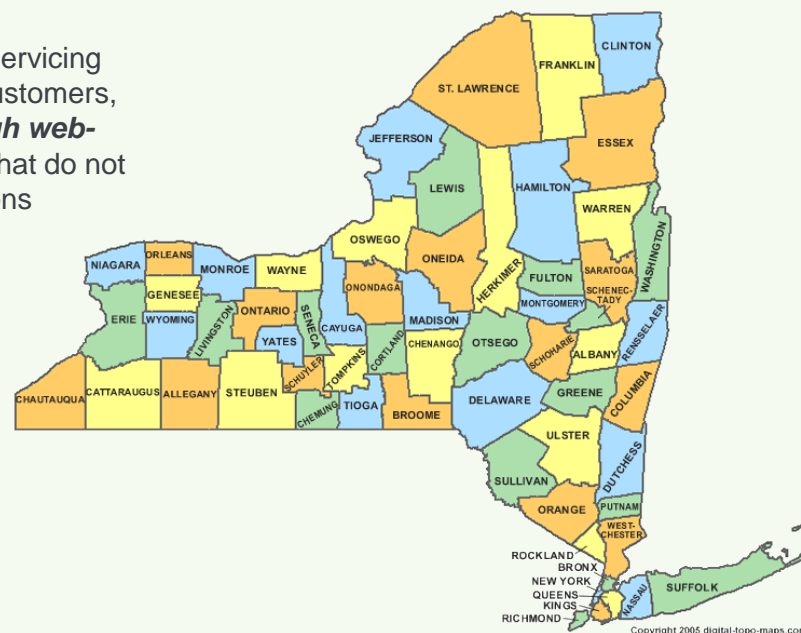
Types of Entities Subject to BitLicense

§§ 200.2, 200.3(b)

Involving New York

The only entities subject to the BitLicense regime are those conducting Virtual Currency Business Activities . . .

- **“involving”** New York or
 - **“involving”** any person that
 - resides,
 - is located,
 - has a place of business,
 - or is conducting business in New York
- Likely to include servicing or soliciting NY customers, **including through web-based services** that do not exclude NY persons
- Certain businesses may choose to limit New York-facing activity to limited-purpose subsidiaries.
 - No prohibition on dividends to parent/shareholders
 - The extent of New York jurisdiction is very broad.
 - Companies that are located in or operated from New York are unlikely to be able to subsidiarize.

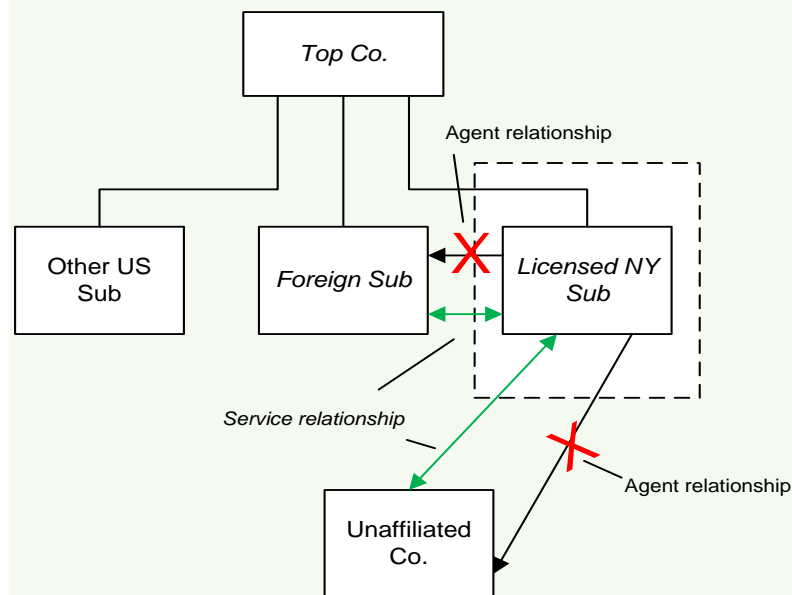


What Is Covered Under BitLicense?

Types of Entities Subject to BitLicense

§§ 200.2, 200.3(b) (*cont.*)

Relationships Between Licensees and Affiliates and Third Parties



- Using an unlicensed agent (affiliated or not) to undertake virtual currency business activity is prohibited
- However, relationships with unlicensed service providers (affiliated or not) that do not themselves undertake Virtual Currency Business Activity are not explicitly prohibited
 - Unclear where providing services crosses into agency requiring license

- In response to a question regarding subsidiarization [at a 2014 speech](#), Superintendent Lawsby indicated that the NYDFS may treat virtual currency subsidiary licensees the same way that it treats specially created insurance subsidiaries (known as PUPs)
 - NYDFS regulates the activities of an insurance holding company of a licensed PUP in order to [forestall potential abuses](#). As noted in its [investigation into 'shadow insurance'](#) shell companies, the NYDFS stated: “regulators must remain vigilant about potential threats lurking in unexpected business lines and at more weakly capitalized subsidiaries within a holding company system.”
- Similarly, NYDFS will likely be able to reach into BitLicensees’ holding company, affiliates or subsidiaries, and will likely do so to forestall potential abuses:
 - NYDFS’s Superintendent may examine an affiliate of the licensee for the purpose of determining the financial condition of the licensee, its safety and soundness practices, or its compliance with laws, rules and regulations (§ 200.13(d))

Table of Contents

Application Process, Suspension and Revocation

1. [Introduction](#)
2. [What Is Covered Under BitLicense?](#)
3. [**Application Process, Suspension and Revocation**](#)
 - Obtaining a BitLicense
 - Conditional License
 - Discretion in Approving / Denying Application; Suspending / Revoking
 - Approval of Material Changes to Business
 - Change of Control; Mergers and Acquisitions
4. [Consumer Protections](#)
5. [Safeguarding Assets](#)
6. [Cyber Security Program](#)
7. [Anti-Money Laundering](#)
8. [Exams, Reports and Oversight](#)

Application Process, Suspension and Revocation

Obtaining a BitLicense

§§ 200.2(i), 200.3(a), 200.4, 200.5, 200.21

Before engaging in any Virtual Currency Business Activity, * an entity must file an application for a license that includes:

Information About Participants			Information About the Applicant
Participant	Definition	Required information	<ul style="list-style-type: none">Organizational chart of management structureCurrent and projected financialsDescription applicant's businessDetails of all banking arrangementsAll written policies and proceduresAffidavit describing any pending or threatened actions, all litigation, and all proceedings before any governmental agencyCopies of insurance policiesVerification from NYS Dep't of Taxation and Finance of compliance with all NYS tax obligationsExplanation of methodology used to calculate the value of virtual currency to fiat currencyDemonstration of how applicant will comply with BitLicense regime
Principal Officer	Any "executive officer," including CEO, CFO, COO, etc.	<ul style="list-style-type: none">Detailed biographical and historical informationIndependent background report (by agency acceptable to NYDFS)Current financial statementFingerprints and photographs(This is similar to information requested by Interagency Biographical and Financial Report and New York money transmitter "Individual Forms")	<div>Other Requirements</div> <ul style="list-style-type: none">Non-refundable application fee of \$5,000 🌟Any other information "as the superintendent may require"
Principal Stockholder	<p>Any person "who, directly or indirectly, owns, controls, or holds, with power to vote ten percent or more of any class of outstanding capital stock..."</p> <ul style="list-style-type: none">10% threshold comparable to other frameworks (e.g., N.Y. money transmitter regime).Definition likely captures not just stockholders of the entity, but in certain cases, stockholders of parent companies.Can make application onerous if there is a long string of attributed ownership based on 10% level since information is needed from all Principal Stockholders.		
Principal Beneficiary	<ul style="list-style-type: none">Defined as a person "entitled to ten percent or more of the benefits of a trust."		
All employees with access to fiat or virtual currency customer funds 🌟			

* Existing businesses have 45 days from the effective date of regulation (not yet announced at the publication of this memo) to apply. If denied, they must immediately cease Virtual Currency Business Activity involving New York or New York customers.

★ Changed in the February 2015 Reproposal to cover only employees that have access to customer funds (rather than all employees).

★★ The July 2014 Proposal did not specify a dollar amount.

Application Process, Suspension and Revocation

Conditional License

§ 200.4(c)

- As an alternative to requiring full compliance with all BitLicense requirements immediately, NYDFS may issue a **conditional license** to an applicant that does not satisfy all the regulatory requirements upon licensing.★

Conditional License	
Heightened Review	<ul style="list-style-type: none">Holders of conditional licenses may be subject to heightened review (i.e., scope and frequency of examination or otherwise)
Additional Conditions	<ul style="list-style-type: none">Superintendent may impose / remove any reasonable condition(s) on a conditional license
Expiration and Renewal	<ul style="list-style-type: none">The conditional license will expire 2 years after its date of issuance unless revoked earlier by Superintendent.Superintendent may in his or her sole discretion renew a conditional license for an additional length of time, or remove its conditional status
Suspension and Revocation	<ul style="list-style-type: none">A conditional license may be suspended / revoked on any ground which Superintendent might refuse to issue an initial license, for violation of any provision of the BitLicense regime, good cause, or for failure to pay a judgment related to virtual currency business
Non-Exhaustive Determining Factors for Approval of Conditional License; Addition / Removal of Specific Conditions	<ul style="list-style-type: none">Nature and scope of businessAnticipated volume of businessNature and scope of the risks to consumers, virtual currency markets, financial markets and general publicMeasures taken to limit / mitigate risksWhether registered with FinCENWhether licensed, registered, or otherwise authorized by any governmental or self-regulatory authority to engage in financial services or other business activitiesFinancial services or other business experienceHistory as a conditional license holder

★ The conditional license alternative was added in the February 2015 Reproposal in response to comments.

Application Process, Suspension and Revocation

Discretion in Approving or Denying Application, Suspending or Revoking BitLicense
§ 200.6

NYDFS 90-Day Review Process	Suspension/Revocation	No License Revoked Without a Hearing
<ul style="list-style-type: none">NYDFS must approve/deny an application within 90 days of when the NYDFS deems an application to be complete (may be extended at Superintendent's discretion)<ul style="list-style-type: none">Coupled with the NYDFS's discretion to ask for additional information from an applicant, there is a risk that applications may not be acted upon for long periods of time (however, existing businesses that apply within the 45-day transitional period would not need to cease activity unless and until the NYDFS denies an application)As with other financial services applications, there will likely be additional information requests, increasing the time and cost to secure a BitLicenseThe license will be granted if, after an investigation of the applicant's financial condition, experience, and "character and general fitness" the NYDFS finds that the applicant's business will be conducted honestly, fairly, equitably, carefully, and efficiently within the purposes and intent of the regulations, and in a manner commanding the confidence and trust of the communityNYDFS has discretion to attach conditions to approval of a license	<ul style="list-style-type: none">BitLicenses may be suspended or revoked:<ul style="list-style-type: none">for any of the grounds for which the NYDFS could originally deny the license application;for a violation of any BitLicense provision;for good cause, including default and likely default on existing obligations and engaging in unlawful, dishonest, wrongful or inequitable conduct that may harm the public; andfor failure to pay a judgment arising from or relating to the licensee's virtual currency business activities.	<ul style="list-style-type: none">The licensee will be given at least 10 days notice in advance of a hearing of the location, time, and nature of the action against the licensee
		Preliminary Injunctions
		<ul style="list-style-type: none">The NYDFS may obtain a preliminary injunction against any licensee for any violations of the BitLicense rule, the Financial Services Law, Banking Law, or Insurance Law

Application Process, Suspension and Revocation

Approval of Material Change to Business

§ 200.10

Material Change Approval Requirement	Definition of a “Material Change” or a “Materially New Product, Service or Activity” ★★★
<ul style="list-style-type: none">▪ Licensee must obtain NYDFS’s written approval to offer any materially new product, service, or activity, or to make a material change to an existing product, service, or activity, involving New York or New York residents ★▪ Prior to making any change, <i>the licensee may seek clarification from the NYDFS about the materiality of any proposed change</i> ★★	<ul style="list-style-type: none">▪ A change proposed to an existing product, service, or activity that may cause that product, service, or activity to be materially different from that previously listed on the application;▪ A proposed change which may raise a legal or regulatory issue about the permissibility of the product, service, or activity; or▪ A proposed change which may raise safety and soundness or operational concerns
Approval Process	NYDFS Superintendent on Materiality
<ul style="list-style-type: none">▪ Licensee must submit a written plan describing the proposed new product, service, or activity, or the proposed material change, including its impact on the overall business of the licensee▪ Licensee must also submit “such other information as requested”	<ul style="list-style-type: none">▪ In presenting the final BitLicense framework, Superintendent Lawsky noted: “A good example of a material change would be if a firm that was licensed as a wallet service decided to begin offering exchange services. We have no interest in micro-managing minor app updates. We’re not Apple.”

★ Adding a “materiality” condition; previously applied to *any* new products, services, or activities.

★★ Added in the February 2015 Reproposal (providing licensees with a process to open a dialogue with NYDFS over the materiality of any given change).

★★★ Revised in the Final Rule (retaining identical definition from the July 2014 Proposal and incorporating “materially new product, service, or activity” language).

Application Process, Suspension and Revocation

Change of Control; Mergers and Acquisitions

§ 200.11

Change of Control Approval Requirement	“Control Person” Definition*
<ul style="list-style-type: none">▪ A person seeking to acquire control of a licensee must submit an application to and receive the approval of the Superintendent▪ Similarly, applications must be submitted and approved for mergers / acquisitions of a substantial part of the assets of a licensee<ul style="list-style-type: none">▪ Note that internal corporate reorganizations are <u>not</u> exempted. This approach is consistent with legal-entity level regulation rather than regulation of the whole consolidated company	<ul style="list-style-type: none">▪ Possession, directly or indirectly, of the power to direct or cause the direction of the management and policies of a licensee▪ ≥10% voting power of stock of licensee = control▪ No person shall be deemed a control person solely by reason of being an officer or director ★▪ NYDFS Superintendent Lawsky noted that passive venture capital investors <u>will not be deemed</u> to have control.
Approval Process	Non-Control Determination Application
<ul style="list-style-type: none">▪ NYDFS will approve or deny change-of-control applications within 120 days of the <u>completed</u> application▪ NYDFS will consider the public interest, needs, and convenience of the public when deciding whether to approve or deny	<ul style="list-style-type: none">▪ The superintendent may determine upon application that a <i>person does not or will not upon the taking of some proposed action control another person</i>▪ Such a determination shall be made <i>within 30 days or such further period</i> as prescribed by the Superintendent

* The Superintendent also has broad discretion to determine whether a person is a “control person” by examining five factors: (i) such person’s intent to invest vs. intent to acquire control, (ii) such person’s ability to influence management or policy, (iii) such person’s ability to propose directors in opposition to those recommended by management, (iv) such person’s ability to seek board representation, and (iv) such person’s ability to participate in soliciting proxy votes with respect to any matter.

★ Change added in Final Rule

Table of Contents

Consumer Protections

1. [Introduction](#)
2. [What Is Covered Under BitLicense?](#)
3. [Application Process, Suspension and Revocation](#)
4. **[Consumer Protections](#)**
 - Mandatory Risk and Other Disclosures
 - Complaints, Anti-Fraud, and Advertising / Marketing
5. [Safeguarding Assets](#)
6. [Cyber Security Program](#)
7. [Anti-Money Laundering](#)
8. [Exams, Reports and Oversight](#)

Consumer Protections

Mandatory Risk and Other Disclosures

§ 200.19

Initial Disclosures	Per-Transaction Disclosure
<p><i>Disclosures by licensee to new customers required as part of establishing a relationship/opening an account, and prior to initial transaction:</i></p> <ul style="list-style-type: none">Material risks of licensees' products, services, and activities and virtual currency generally:<ul style="list-style-type: none">Prescribed list of risks in the rule (e.g., not legal tender, no FDIC/SIPC protection, regulatory risks)Any other material risksGeneral terms and conditions, including at a minimum:<ul style="list-style-type: none">Customer liability for unauthorized transactionsCustomer stop-payment rightsLicensee right to disclose information about customer's accountCustomer right to periodic account statements and valuationsCustomer right to receipt for transactionsCustomer right to prior notice of change in licensee's policies	<ul style="list-style-type: none">Prior to each transaction, written disclosure of specific terms of transaction including:<ul style="list-style-type: none">Amount of transactionFees charged to customer for transactionType and nature of the transactionWarning that transaction may not be undone once executedAfter each transaction, receipt describing the transaction and detailing liability (NYDFS may request form of receipt)
	Acknowledgement Requirement
	<ul style="list-style-type: none">Licensee must ensure that customers acknowledge receipt of all required disclosures
	Writing / Language Requirement
	<ul style="list-style-type: none">Disclosure must be in clear, conspicuous, and legible writing, in English <u>and</u> other predominant language(s) spoken by customers

Consumer Protections

Complaints, Anti-Fraud, and Advertising / Marketing
§§ 200.18, 200.19(g), 200.20

Complaints	Anti-Fraud Requirements
<ul style="list-style-type: none">▪ Must establish and maintain written policies and procedures for resolving complaints▪ Must disclose on websites and in physical locations (as appropriate):<ul style="list-style-type: none">▪ Licensee's contact information for complaints▪ Consumer's right to directly contact the NYDFS with complaints▪ NYDFS's contact information▪ Must report changes in complaint policies to NYDFS within 7 days	<ul style="list-style-type: none">▪ Reasonable steps to detect and prevent fraud▪ Must have written anti-fraud policy, including, at a minimum:<ul style="list-style-type: none">▪ Identification and assessment of fraud-related risk areas▪ Procedures and controls to protect against identified risks▪ Allocation of responsibility for risk monitoring▪ Procedures for periodic evaluation and revision of anti-fraud procedures, controls, and monitoring mechanisms▪ Prohibition on fraudulent activity
Advertising / Marketing	
<ul style="list-style-type: none">▪ Must include licensee's name and provide notice that it is licensed by NYDFS in any advertising materials directed at New York or New York residents<ul style="list-style-type: none">▪ <i>What does this mean for web-based advertising that is seen by New York residents but isn't specifically geared towards them?</i>▪ Must maintain copies of all advertising materials for examination by the NYDFS for 7 years★▪ All advertising must comply with federal and state disclosure requirements▪ Prohibition on false, misleading, or deceptive representations or omissions	

★ February 2015 Reproposal limited the length of time that licensee must maintain advertising and marketing materials to 7 years (the July 2014 Proposal did not specify a length of time).

Table of Contents

Safeguarding Assets

1. [Introduction](#)
2. [What Is Covered Under BitLicense?](#)
3. [Application Process, Suspension and Revocation](#)
4. [Consumer Protections](#)
5. [**Safeguarding Assets**](#)
 - Capital Requirements and Investments
 - Custody and Protection of Customer Assets
 - Books and Records
6. [Cyber Security Program](#)
7. [Anti-Money Laundering](#)
8. [Exams, Reports and Oversight](#)

Safeguarding Assets

Capital Requirements and Investments

§ 200.8

Required Capital Levels

Capital Levels. Licensee must maintain sufficient capital based on an assessment of the specific risks applicable to each licensee. Minimum capital requirements will be determined by the Superintendent for each licensee based on a variety of factors generally related to risks to customers and counterparties. Superintendent has discretion to set high capital levels if proposed business does not appear sound.

Factors Superintendent Must Consider

- Assets, liabilities, liquidity, risk exposure, actual and projected virtual currency business activity
- Whether licensee is already licensed and regulated under New York law
- Financial protection provided to customers through a trust or bond account

Ongoing Review of Capital Levels. Capital requirements may change as licensees' activities and financials change.

Acceptable Forms of Capital. Each licensee ***must hold required capital in the form of cash, virtual currency, or high-quality, highly liquid, investment-grade assets***, in such proportions as are acceptable to the Superintendent★

Permitted Investments of Retained Earnings and Profits★★

- Only these instruments:
 - Certificates of deposit issued by financial institutions regulated by a U.S. federal or state regulatory agency
 - Money market funds
 - State or municipal bonds
 - U.S. government or government agency securities
- Investment grade, Maturity up to 1 year, Denominated in USD

Assessment of Investment Requirements★★

- Dividends to parent/shareholders not prohibited
- These U.S.-centric requirements are not workable for foreign businesses and may effectively require use of special-purpose NY-licensed subsidiaries
- Requirements are vague as drafted – unclear how this will affect a business's ability to invest in new businesses
- Certain virtual currency businesses have strategic investments in subsidiaries or other virtual currency businesses
 - Regulations should be drafted to permit such investments.

★ Addition of ability to hold virtual currency as capital was added in the February 2015 Reproposal in response to comments.

★★ The February 2015 Reproposal eliminated the requirement that retained earnings and profits be invested in specified liquid assets.

Safeguarding Assets

Custody and Protection of Customer Assets

§ 200.9 (Cont.)

- **Bond or Trust Account.** Each licensee must maintain a **surety** bond or trust account in U.S. dollars for the benefit of customers in an amount and form decided by NYDFS.★
 - Surety Bond: the guarantor of the bond agrees to pay a second party (obligee) if the bond principal fails to meet its obligations to the second party.*
 - Trust Account: a trust account **must be maintained with a Qualified Custodian** (any bank, trust company, national bank, savings bank, savings and loan association, federal savings association, credit union, or federal credit union in NY, subject to the approval of the Superintendent). ★
- **Full Reserves.** Licensees who store, hold, or maintain custody or control of virtual currency on behalf of a person must hold that same type and amount of currency owed or obligated to the person.
 - The February 2015 Reproposal (and Final Rule) notably deletes the word “**secure**” from the full reserves requirement. This is significant as it may allow certain licensees that provide multi-sig services to not hold reserves for multi-sig balances.★
- **No Encumbrances.** Licensees are prohibited from selling, transferring, lending, or otherwise using virtual currency held on behalf of another person, except for the sale, transfer or assignment of such assets at the direction of such other person.
 - Effectively prohibits fractional reserve banking with virtual currency balances.
 - No provision for licensee to overcome this prohibition with disclosure or customer consent.

*See [Comment Letter Submitted by the Surety & Fidelity Association of America \(Aug. 19, 2014\)](#) (NYDFS should make a specific determination as to whether licensees must maintain a surety or fidelity bond).

★ The February 2015 Reproposal specified that the bond must be a “surety” bond, and that trust accounts, if required must be maintained with a “Qualified Custodian.”

Safeguarding Assets

Books and Records

§ 200.12

- Each licensee must keep the following books and records for NYDFS's review:
 - Amount, date, time, payment instructions and fees for each transaction
 - Names, account numbers, and physical addresses of (i) the parties to each transaction that are **customers or accountholders** of the licensee; and (ii) **to the extent practicable**, any other parties to the transaction ★
 - General ledger of all assets, liabilities, ownership equity, income and expense accounts
 - Bank statements and bank reconciliation records
 - Any statements or valuations sent or provided to customers or counterparties
 - Records or minutes of board meetings
 - Records demonstrating AML compliance and records of all breaches
 - Records of all customer complaints and investigations thereof
 - All other records required by the BitLicense regulations or by NYDFS
- Records must be kept in their original form for **at least 7 years** from the date of creation.★★
- Records of non-completed, outstanding, or inactive transactions must be retained for *five years* from the date that the property is deemed abandoned.

★ This change reflects numerous comment letters (e.g., [Electronic Frontier Foundation](#), [Internet Archive and Reddit](#) and [Information Technology and Innovation Foundation](#)).

★★ The February 2015 Reproposal added that physical addresses must be provided by parties to the transactions that are customers or account holders, and limited the requirement that records be kept in original form from 10 to 7.

Table of Contents

Cyber Security Program

1. [Introduction](#)
2. [What Is Covered Under BitLicense?](#)
3. [Application Process, Suspension and Revocation](#)
4. [Consumer Protections](#)
5. [Safeguarding Assets](#)
6. [**Cyber Security Program**](#)
 - Overview
 - Chief Information Security Officer, Annual Reports and Application Security
 - Business Continuity and Disaster Recovery
7. [Anti-Money Laundering](#)
8. [Exams, Reports and Oversight](#)

Cyber Security Program

Overview

- Cyber Security has become one of the most discussed topics amongst regulators and intergovernmental agencies.
- The SEC has issued [guidance](#) surrounding cyber security, while the NYDFS has recently discussed the incorporation of cybersecurity into its bank examination process.
- As part of its [Cyber Security Initiative](#), the SEC's Office of Compliance Inspections and Examinations conducted examinations of more than 50 registered broker-dealers, and [released](#) a summary of results on February 3, 2015.
- The NYDFS has been proactive on cybersecurity issues.
 - In December 2014, NYDFS Superintendent Lawsky [announced](#) NYDFS's plan to expand its information technology examination procedures to emphasize cyber security.
 - The NYDFS issued a [report on cyber security in the banking sector](#) (May 2014), a [report on cyber security in the insurance sector](#) (Feb. 2015), and a [report criticizing the cyber security of banks' vendors](#) (Apr. 2015).

"My hope is that if Mt. Gox had been under our jurisdiction under these rules...we would have been able to prevent [its loss of \$450 million worth of bitcoin to hacking]...We're going to go in and test the cyber security readiness of these firms in New York, to make sure they're doing everything they can to prevent that kind of hacking attack."

– Superintendent Lawsky, [CNBC](#) (Nov. 2, 2014)

"[W]e are...considering using the cyber security rules in the bitcoin [regulation] as a model for the rest of our regulated institutions...Cyber security is rapidly becoming one of the most important issues any regulator, and I think frankly financial institutions, will face over the next year or two..."

– Superintendent Lawsky, [Money 20/20](#) (Nov. 2, 2014)

Cyber Security Program

Overview

§ 200.16

Each Licensee Must Establish and Maintain an Effective Cybersecurity Program

Must be designed to perform these core functions:	Audit functions must include:*
<ul style="list-style-type: none">• Identify the information stored on the licensee's systems, the sensitivity of the information, and how and by whom it can be accessed• Protect the licensee's electronic systems and information therein from unauthorized access or use• Detect attempts at unauthorized access to licensee's electronic systems and data• Respond to detected cyber attacks to mitigate negative effects• Recover from cyber attacks and restore normal services	<ul style="list-style-type: none">• Penetration testing of electronic systems (at least) annually; vulnerability assessment (at least) quarterly• Audit trail of all financial transactions and accounting secured by:<ul style="list-style-type: none">• Safeguards to insure against tampering• Protection of hardware by limiting electronic and physical access and maintaining access logs (albeit no longer a requirement to maintain hardware in locked cages) ★• Maintain records of all alterations to the audit trail system• Maintain audit trail records for at least 7 years ★★

Possible Best Practices - Framework for Improving Critical Infrastructure Cybersecurity

- The National Institute of Standards and Technology (NIST) published a [Framework for Improving Critical Infrastructure Cybersecurity](#) on February 12, 2014. The framework was developed pursuant to a 2013 Presidential Executive Order on [cyber preparedness](#). Although the framework relates to critical infrastructure, the SEC has recently [indicated](#) that following the framework may be a best practice.
- The SEC issued a [cyber security guidance update](#) for investment companies and advisers on April 28, 2015. The update recommends that firms (1) conduct a periodic assessment regarding stored information, privacy threats, controls and other internal procedures, and potential consequences of a cyber breach; (2) create a strategy for responding to cyber threats; and (3) implement written policies and procedures for such strategies.
- In a comment letter, the [New York State Society of CPAs](#) requested that the NYDFS "incorporate by reference an appropriate and comprehensive cybersecurity standard that is accepted in the financial services industry [such as the NIST SP 800 Series]."

★ The BitLicense Reproposal notably deletes the requirement that a licensee have a third party audit its software. This requirement is replaced by a new provision that requires a licensee to ensure the security of all applications utilized by the licensee through an annual review (see "Application Security" on [next slide](#)).

★★ Changed in the February 2015 Reproposal (from 10 to 7).

Cyber Security Program

Chief Information Security Officer, Annual Reports and Application Security

§ 200.16

Effective Cybersecurity Program	
Personnel / Annual Report	Written cyber security policy addressing:
<ul style="list-style-type: none">• Must designate a qualified employee as Chief Information Security Officer (“CISO”)• Must prepare a report to the board of directors assessing the cyber security program and any inadequacies at least annually• Must employ, train, and provide continuing training for cyber security personnel	<ul style="list-style-type: none">• Information security• Data governance and classification• Access controls• Business continuity and disaster recovery planning and resources• Capacity and performance planning• Systems operations and availability concerns• Systems and network security• Systems and application development and quality assurance• Physical security and environmental controls• Customer data privacy• Vendor and third-party service provider management• Monitoring and implementing changes to core protocols not directly controlled by licensee• Incident response
Application Security ★	
<ul style="list-style-type: none">• Cybersecurity program must include written procedures, guidelines and standards reasonably designed to ensure the security of all applications used by licensee• All application security procedures, guidelines, and standards must be reviewed and updated by the CISO at least annually	

★ The newly added “Application Security” provision in the February 2015 Reproposal replaces the July 2014 Proposal’s requirement that a licensee have a third party audit its software.

Cyber Security Program

Business Continuity and Disaster Recovery

§ 200.17

- Must establish and maintain a written business continuity and disaster recovery (“BCDR”) plan which must:
 - Identify documents, data, infrastructure, personnel, and competencies essential to the licensee’s business
 - Identify personnel responsible for implementing BCDR plan
 - Include a plan for communicating with necessary personnel during an emergency
 - Include back-up system maintenance procedures
 - Include data back-up procedures
 - Identify third parties necessary to continue operation
- Must distribute BCDR plan to employees, provide training, and maintain accessible copies.
- Must notify Superintendent of any emergency that may affect ability to fulfill regulatory obligations or which may have an adverse effect on licensee, counterparties, or the market.
- BCDR plan must be tested at least annually by independent internal personnel or a qualified third party.



Image from <http://bit.ly/1nL5eN6>

Table of Contents

Anti-Money Laundering

1. [Introduction](#)
2. [What Is Covered Under BitLicense?](#)
3. [Application Process, Suspension and Revocation](#)
4. [Consumer Protections](#)
5. [Safeguarding Assets](#)
6. [Cyber Security Program](#)
7. [**Anti-Money Laundering**](#)
 - Summary of AML Program Requirements
 - Comparison of AML Requirements: FinCEN Regulations and BitLicense Regime
 - AML Program
8. [Exams, Reports and Oversight](#)

Anti-Money Laundering

Money laundering is too nice a word. Money laundering is the facilitation of all kinds of horrific crimes that I think everyone in this room never wants to see happening. Narco-trafficking being one, but acts of terrorism, funding rogue nations, etc., all take place through massive money laundering ...

The choice for the regulators is: permit money laundering on the one hand, or permit innovation on the other, and we're always going to choose squelching the money laundering first. It's not worth it to society to allow money laundering and all of the things it facilitates to persist in order to permit 1000 flowers to bloom on the innovation side.

-[Superintendent Lawsby](#), NYDFS BitLicense Hearings, January 2014

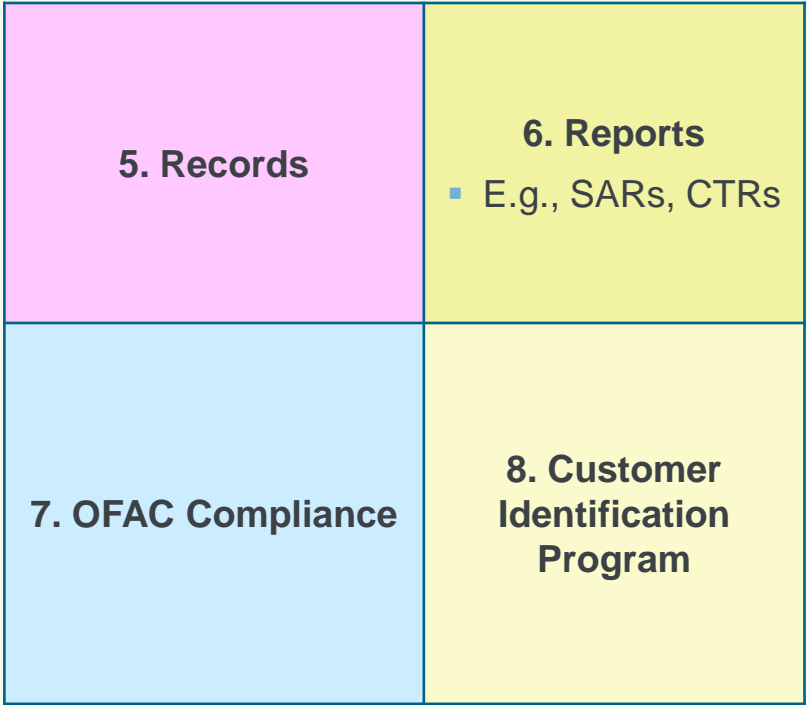
Anti-Money Laundering

Summary of AML Program Requirements
§§ 200.12(a), 200.15

BitLicense requires a **comprehensive AML program**. Some requirements are more stringent than federal AML requirements. The AML program must have the following elements:



Slide 41



Slide 42

Anti-Money Laundering

Summary of AML Program Requirements

§§ 200.12(a), 200.15 (cont.)

1. Risk Assessment <ul style="list-style-type: none">Initial and annual (or more often “as risks change”) risk assessment considering legal, compliance, financial, and reputational risksAML program should reflect risk assessment	2. Compliance Function <ul style="list-style-type: none">System of internal controls, policies and procedures to ensure ongoing compliance with all AML laws, rules and regulationsDesignated AML compliance officer(s)An overall AML policy must be reviewed/approved by board of directors<i>The NYDFS will consider whether the applicant has complied with the anti-money laundering laws and with other rules and regulations, as a factor in its determination of whether an application should be granted.★</i>
3. Audit Function <ul style="list-style-type: none">Annual (or more often) independent testing for compliance with and effectiveness of AML program by qualified internal or external personnel/party<ul style="list-style-type: none">Internal personnel responsible for the design, installation, maintenance, or operation of the AML program, or the policies and procedures that guide its operation, are disqualified from performing the audit function.Audit report must be submitted to NYDFS	4. Prohibitions <ul style="list-style-type: none">No structuring/assisting in structuring transactions to evade reporting requirementsNo allowing/facilitating obfuscation or concealment of identity of individual customer or counterparty<ul style="list-style-type: none">E.g., tumblers/mixersVirtual currencies built to obfuscate identity may be prohibited (e.g., Zerocoin), although there is no explicit prohibition on virtual currencies without a public ledgerNo relationships with shell companies that are not physically present in any country

★ The Final Rule specifies that NYDFS will consider whether applicants for BitLicenses have complied with the laws, rules and regulations (which includes AML laws).

Anti-Money Laundering

Summary of AML Program Requirements

§§ 200.12(a), 200.15 (cont.)

5. Records <ul style="list-style-type: none">▪ Must maintain detailed records for at least 7 years including: the identity and physical addresses of the licensee's customers/ account holders and, to the extent practicable, any other parties to the transaction; the transaction amount or value (including denomination(s)); date(s) transaction was initiated/completed; description of the transaction; and method of payment*	6. Reports <ul style="list-style-type: none">▪ Notify NYDFS within 24 hours of transactions/ series of virtual currency to virtual currency transactions by a person that exceed \$10,000 in value in one day (a.k.a., Currency Transaction Reports or CTRs), unless the transactions are subject to federal CTR reporting requirements ☆▪ SARs must be filed within 30 days if licensee is not subject to federal SAR filing requirements ☆
7. OFAC Compliance <ul style="list-style-type: none">▪ Customers must be checked against the Specially Designated Nationals ("SDN") list maintained by OFAC▪ Risk-based policies, procedures and practices to ensure compliance with OFAC regulations "to the maximum extent possible"	8. Customer Identification Program <ul style="list-style-type: none">▪ Reasonably identify/verify customer's identity, including name and physical address, when either customer opens an account or licensee establishes service relationship with customer▪ Enhanced due diligence policies, procedures and controls for non-U.S. licensees and for accounts of non-U.S. persons▪ Verify identity of accountholders initiating transactions with a value > \$3,000

*Compare to FinCEN's "Funds Transfer Rule" which requires recordkeeping for all parties to a transaction (customer and counterparty) in certain circumstances for transactions in excess of \$3,000.

☆ The Final Rule clarified that CTRs are required only for virtual currency to virtual currency transactions that are not subject to federal reporting requirements.

☆☆ The Final Rule provides that SARs only need to be submitted if the licensee already does not have the requirement to submit SARs under federal law (compare to CTR requirement, which may require particular CTRs to be filed with NYDFS even if licensee is subject to certain federal CTR requirements).

Comparison of AML Requirements: FinCEN Regulations and BitLicense Regime

	FinCEN Requirements for Money Transmitters	BitLicense
Maintain a formal AML/KYC compliance program to monitor transactions (consisting of procedures and internal controls)	✓ (formal risk assessment not required)	✓ (must be based on a written risk assessment)
Collect and verify customer information (i.e., maintain a "CIP")	✓ (whenever a customer opens an account)	✓
Check customer identities against government sanction lists	✓ (whenever a customer opens an account)	✓
Report suspicious activity to FinCEN (i.e., file SARs)	✓ (\$2,000+)	✓ (report to FinCEN; if licensee not subject to the SARs under federal law, then report to NYDFS within 30 days; no threshold amount specified)
Report transactions over \$10,000 to FinCEN (i.e., file CTRs)	✓	✓ (report to FinCEN and to NYDFS) ★
Provide ongoing training to Compliance employees	✓	✓
Designate Compliance Officer	✓	✓
Ensure periodic independent audits of compliance program	✓	✓
Recordkeeping	✓ (create and retain records; may be required to retain records for a period of 5 years)	✓ (maintain detailed records over period of 7 years)

★ Licensees must report to the NYDFS virtual currency to virtual currency transactions that are over a \$10,000 value, that are made by one person in a single day, and that are not subject to currency reporting requirements under federal law.

Anti-Money Laundering

AML Program

§§ 200.12(a), 200.15(e)(1)

Commentary

- AML violations affect an applicant's ability to obtain a New York BitLicense. To the extent that a business must register with FinCEN and is subject to federal AML requirements, the BitLicense AML requirements are largely consistent. However, some businesses that are not required to register with FinCEN may be required to obtain a BitLicense (see [Slide 17](#)).
- Notable virtual currency money laundering charges: **Silk Road** and **Silk Road 2.0**.
 - [Silk Road](#) was an online marketplace where virtual currency was used to facilitate money laundering, in addition to other criminal activity.
 - Similar to Silk Road, [Silk Road 2.0](#) was one of a dozen "dark market" websites – sites offering a range of illegal goods and services for sale on the TOR network – seized by a joint federal government task force.
 - In January 2015, Ross Ulbricht, creator of Silk Road, was [found guilty](#) on charges of money laundering, drug trafficking and computer hacking, among other charges, and in June 2015 he was sentenced to [life imprisonment](#).
- Charlie Shrem — former vice chairman of the Bitcoin Foundation — was, along with Robert Faiella, accused of unlawfully converting dollars into bitcoin for users of Silk Road.
 - Shrem and Faiella pleaded guilty in Sept. 2014 to one count of [aiding and abetting the operation of an unlicensed money transmitting business](#).
 - In Dec. 2014, Shrem received a [two-year prison sentence](#); in Jan. 2015, Faiella was given a [four-year prison sentence](#).
- Additionally, Ripple Labs, in a recent [settlement agreement](#) with FinCEN and the US Department of Justice admitted that it had operated without an adequate BSA/AML compliance program, sold its virtual currency XRP before registering as a Money Services Business with FinCEN, failed to report transactions above \$2,000, and failed to file SARs in a timely manner.
 - In May 2015, Ripple Labs entered into a civil settlement with the US Department of Justice for [\\$700,000](#).

"[As alleged](#), Robert Faiella and Charlie Shrem schemed to sell over \$1 million in bitcoins to criminals bent on trafficking narcotics on the dark web drug site, Silk Road. Truly innovative business models don't need to resort to old-fashioned law-breaking, and when bitcoins, like any traditional currency, are laundered and used to fuel criminal activity, law enforcement has no choice but to act. We will aggressively pursue those who would coopt new forms of currency for illicit purposes."

- Manhattan U.S. Attorney Preet Bharara



Table of Contents

Exams, Reports and Oversight

1. [Introduction](#)
2. [What Is Covered Under BitLicense?](#)
3. [Application Process, Suspension and Revocation](#)
4. [Consumer Protections](#)
5. [Safeguarding Assets](#)
6. [Cyber Security Program](#)
7. [Anti-Money Laundering](#)
8. [**Exams, Reports and Oversight**](#)
 - NYDFS Examinations
 - Reports and Financial Disclosures
 - Ongoing Compliance

Exams, Reports and Oversight

NYDFS Examinations

§ 200.13

- **Examination Authority.** NYDFS can examine the licensee, as necessary or advisable
- **Frequency of Examination.** Not less than once every two years
- **Scope of Review**
 - Financial condition of the licensee
 - Safety and soundness of the conduct of its business
 - Policies of its management
 - Whether licensee is complying with laws, rules, and regulations
- **Additional Subjects of Examination.** In addition to the licensed entity, the NYDFS has the authority to review:
 - Any of licensee's activities **outside of NY** that the NYDFS determines **may affect licensee's business involving NY** or NY Residents
 - **Affiliates** of the licensee as necessary

Exams, Reports and Oversight

Reports and Financial Disclosures

§ 200.14

Financial Statement Requirements	
Quarterly (to be submitted within 45 days of end of quarter)	Annual (to be submitted by end of fiscal year)
<ul style="list-style-type: none">• Balance sheet• Income statement★• Statement of comprehensive income• Statement of net liquid assets• Statement of cash flows• Statement of change in ownership equity• Statement demonstrating compliance with the BitLicense rule• Financial projections and strategic business plans• List of all off-balance sheet items• Chart of accounts including descriptions• Report of permissible investments by the licensee pursuant to these Regulations	<ul style="list-style-type: none">• Audited financial statements• Audit opinion and an attestation by an independent certified public accountant• Evaluation by the auditor regarding the effectiveness of the licensee's internal control structure• Statement of management's responsibilities for:<ul style="list-style-type: none">• Preparing the annual financial statements;• Establishing and maintaining adequate internal controls and procedures for financial reporting; and• Complying with all applicable laws, rules, and regulations.• Assessment by management of licensee's compliance with applicable laws, rules, and regulations• Officer or director certification of the financial statements attesting to their truth and correctness

★ The quarterly financial statements requirement were clarified in the February 2015 Reproposal, e.g., to eliminate the requirement for a statement of retained earnings and statement of net worth.

Exams, Reports and Oversight

Ongoing Compliance
§ 200.7

Notice Requirements

- Licensee must notify NYDFS in writing of any criminal action against or insolvency of (at the commencement of any such proceeding) the licensee or any of its directors, or Principal Stockholders, Officers, or Beneficiaries.
- Licensee must notify NYDFS in writing of any proposed change to the methodology for calculating the value of virtual currency in fiat currency.
- Licensee must submit a report to the Superintendent immediately if it discovers a violation of law, rule, or regulation related to virtual currency activity.

Internal Oversight

- Each licensee must designate qualified individuals to coordinate and monitor the licensee's compliance with all applicable federal and state laws, rules and regulations.

Required Compliance Programs

- Anti-fraud
- Anti-money laundering
- Cyber security
- Privacy and information security
- Any other policy required under these regulations

Further Information on Bitcoin and Virtual Currency Regulation

Bitcoin-reg.com

■ Bitcoin and Virtual Currency Regulation Resources

■ <http://bitcoin-reg.com/>

■ Contains Davis Polk resources relating to regulation of Bitcoin and other virtual currencies:

- *Comment Letters*
- *Advocacy Pieces*
- *Davis Polk Articles*
- *Federal Regulation*
- *State Regulation*

Davis Polk

Bitcoin and Virtual Currency Regulation Resources

Davis Polk Materials

Davis Polk Materials
NY BitLicense
- Comment Letters and Advocacy
Federal Regulation
- FinCEN and Treasury
- CFPB
- CFTC
- Congressional Research Service/GAO
- Federal Reserve
- FDIC
- FINRA
- FTC
- IRS
- SEC
- OCC
State Regulation
- New York State
- Conference of State Bank Supervisors
- State and City Proposals/Bills
- Other States/Organizations
Non-U.S. Jurisdictions
Archived Materials

Davis Polk Materials

- [Bitcoin: Overview of U.S. Legal Treatment – Presentation by Associate Reuben Grinberg at the All Payments Expo](#) (February 24, 2015)
- [Davis Polk Summary of Published Comments on and Expected Changes to BitLicense](#) (November 7, 2014)
- [Davis Polk BitLicense Proposal Visual Memorandum](#) (July 31, 2014)
- [The Failure of Mt. Gox and Other Recent Bitcoin Catastrophes: Why Banks Should Care](#) (March 7, 2014)

Bitcoin: Overview of U.S. Legal Treatment

All Payments Expo

Reuben Grinberg
Davis Polk & Wardwell
February 24, 2015



Davis Polk

bitcoin-reg.com

New York's "BitLicense" Final Regulations ^{TOP}

The New York Department of Financial Services (NYDFS) published its [final BitLicense regulations](#) for virtual currency businesses in June 2015. Firms engaged in "Virtual Currency Business Activity" that involves New York or a New York resident are required to apply for a BitLicense within 45 days of the effective date of the regulation. Applicants for a license are required to have, among other things, Anti-Money laundering/Know Your Customer, Consumer Protection and Cybersecurity programs. The NYDFS initiated an [inquiry](#) into virtual currencies in 2013, [proposed the BitLicense regime](#) in July 2014 as summarized in our [visual memo](#), and published a [revised proposal](#) in February 2015.

The original July 2014 proposal received approximately 4000 comments, while the February 2015 reproposal received 35 comments. We [summarized](#) 35 notable comment letters on the July 2014 proposal,

New York July 2014 "BitLicense" Proposal: Visual Memorandum

July 31, 2014



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bitcoin-reg.com

New York's Proposed BitLicense Regime: Summary of Published Comments and Expected Changes

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About

This page contains Davis Polk resources relating to regulation of Bitcoin and other virtual currencies. We will continue to post relevant materials and resources as they become available. Send comments to bitcoin@davispolk.com.



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Davis Polk in the Media

Events

- "Bitcoins and Other Virtual Currency in International Commerce: Overcoming Legal and Regulatory Challenges", Strafford Publications – CLE Session (April 22, 2015)
- "Bitcoin: Overview of U.S. Legal Treatment" presentation at the All Payments Expo, Las

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