On Cryptocurrencies

Submitted by mlongacre@csbs.org on Mon, 09/27/2021 - 14:35

The Honorable Pat Toomey
Ranking Member
Senate Banking Committee
Washington, D.C. 20510

Dear Ranking Member Toomey,

The Conference of State Bank Supervisors (CSBS)[1] appreciates the opportunity to highlight the critical role of state bank regulators in supervising money transmission and virtual currencies. State regulators charter and supervise 79 percent of all U.S. banks and are the primary regulators of more than 28,000 nonbank financial service providers, including 587 money transmitters of which 60 reported cryptocurrency transmissions in 2020.[2] States have been licensing and regulating money transmitters that transmit cryptocurrencies for almost a decade because states focus on activities-based regulation. CSBS is pleased to share this experience and recommend an activities-based approach to the subject.

Activities-Based Regulation

For over 100 years, states have licensed, regulated, and supervised transmitters of money. The state system ensures consumer funds are safe while enabling new and innovative businesses to thrive by regulating the activity of money transmission, not the technology used to perform the activity. Over the course of time, money has been transmitted via a wide array of technologies: steamship, wire communications, agent networks, issuance of negotiable instruments, magnetic cards, online payments, mobile wallets, distributed ledger technologies, and others. From a jurisdictional perspective, the technology used to transmit money is irrelevant: if a person receives money for transmission and is not exempt from licensure (e.g., a bank), then the person must be licensed and comply with state money transmission laws.[3]

In the first half of the 2010s, cryptocurrencies were primarily marketed as a replacement for fiat currencies. As such, the first broadly adopted activities using cryptocurrencies were akin to a person-to-person mobile wallet. Because companies began offering products that involved receiving money or monetary value for transmission, many companies sought money transmission licenses. The legal framework for this regulated activity was purposeful. After the advent of online and mobile payments services, state laws were updated to include receiving money or monetary value for transmission, ensuring the fundamental act of transmitting value was protected.[4]

However, cryptocurrency transmission is just one activity that can be performed using distributed ledger technologies. As business models have matured, many licensed money transmitters that transmit cryptocurrency have focused their business plans on other business cases for crypto. These aspects of their business models are outside the purview of money transmission. The use cases are too numerous to list, but as they relate to financial services, the activities include trading securities and commodities, futures contracts, custody, lending, and deposit taking.

As the federal government reviews the business cases for new crypto technologies, CSBS encourages Congress and federal regulators to focus on the activities at issue and making clarifications in existing laws, regulations, and interpretations. An activities-based approach must be performed with collaboration from all stakeholders or risk one regulatory view overextending into areas where it would hurt innovation and consumers. For example, there are too many use cases for stablecoins to be universally considered securities. Some stablecoins are undoubtedly securities, but others are designed as a medium of exchange to make it easier to buy goods or services. Clear guidelines should be in place differentiating between a security and a medium of exchange, removing the ambiguity currently facing consumers and the industry.[5]

The activity squarely within the regulatory purview of the states is money transmission, including cryptocurrency. The states have actively been working to harmonize money transmission standards, including the way the standards apply to the transmission of cryptocurrencies. A secondary, and emerging activity is consumer lending. In the state system, there are very specific usury triggers and licensing requirements that apply to lenders regardless of how the transaction is facilitated.

Money Transmission Modernization Act

Last month, the state system achieved a major milestone by approving the Money Transmission Modernization Act, commonly referred to as the Money Transmitter Model Law (Model Law). The Model Law is a single set of nationwide standards and requirements created by industry and state experts. This Model Law creates a common regulatory baseline across the country and represents a crucial step in advancing multistate harmonization in the money transmission industry.

The Money Transmitter Model Law addresses the growth in nationally licensed money transmitters through updates to licensing and supervision standards across the states.

Specifically, the Model Law:

- Ensures states can coordinate in all areas of regulation, licensing, and supervision to eliminate unnecessary regulatory burden and more effectively utilize regulator resources;
- Protects the public from financial crime;
- Standardizes the types of activities that are subject to licensing or otherwise exempt from licensing; and
- Modernizes safety and soundness requirements to ensure customer funds are protected in an environment that supports innovative and competitive business practices.

In addition to these general objectives, the Money Transmitter Model Law contains an article addressing virtual currency. Currently, virtual currencies that are accepted by multiple parties as a value that is exchanged for money, goods, or services fit squarely within the definition of money transmission. However, ambiguity between state and federal regulators has necessitated a separate article that makes clear virtual currency is included in money transmission when received for transmission.

The Money Transmitter Model Law benefits industry, consumers, and state regulators by creating a streamlined system for all individuals engaging in the act of money transmission. By focusing on the activity at hand and engaging in transparent stakeholder engagement, State regulators are able to further an activities-based approach to regulation that supports innovative business practices while ensuring a safe and sound supervisory system.

Networked Supervision

The Money Transmitter Model Law is rooted in CSBS' Vision 2020 initiative, a program geared toward multistate regulatory harmonization of nonbank financial services and the development of next generation technologies. Vision 2020 significantly streamlined money services business (MSB) licensing and supervision, providing a strong tailwind for further empowering states to operate as one network.

The success of Vision 2020 and advancements in technology accelerated innovation and collaboration, which have been features of state regulation for many years. CSBS refers to this strengthened collaboration as " Networked Supervision."

In January of this year, the CSBS Board of Directors approved public priorities that outline actions the states will collectively take to advance Networked Supervision. The priorities focused on MSBs, including money transmitters, encompass coordinated "One Company One

Examination" supervision, common licensing, operational and legal standards, and an industry advisory group. These public priorities emphasize the states' commitment to harmonization, collaboration, and innovation throughout the state regulatory system. This commitment is furthered by the development of new technologies to aid the states in accomplishing various objectives towards a streamlined system that benefits consumers, industry, and regulators alike.

Earlier collaborative efforts include the formation of the Multi-state MSB Examination Task Force (MMET) in 2012 and the creation of the Money Services Business Call Report (MSB Call Report) in 2017. The MMET provides governance among participating state regulators with the goal of protecting consumers; ensuring the safety and soundness of Multi-State MSBs; identifying and preventing money laundering and fraud; supervising and examining MSBs in a seamless, flexible, and risk-focused manner; minimizing regulatory burden and expense; and

fostering consistency, coordination, and communication among the participating state regulators. The MSB Call Report was developed to enhance and standardize the information available to state regulators concerning the activities of MSB licensees (money transmitters, payment instruments, stored value/prepaid, etc.). The report includes national and state-specific MSB activity information that is submitted on a quarterly basis.6 The call report has given state regulators world-leading insight into the flow of virtual currency transmissions.

FinCEN is also a key federal partner in networked supervision initiatives. State regulators examine money transmitters for BSA/AML compliance, and regularly communicate exam issues with FinCEN. Information sharing agreements are in place between states and FinCEN, as well as between FinCEN and the Nationwide Multistate Licensing System (NMLS)7 for the purposes of sharing MSB Call Report data.

Conclusion

State supervisors facilitate an effective and coordinated system of nonbank regulation and supervision, ensuring high standards for consumer protection and access to necessary financial services and credit. State regulators' local licensing authority and regulatory agility allows them to effectively monitor the industry and protect consumers while fostering prudent innovation in the evolving nonbank financial services industry.

The diversity of emerging use cases for distributed ledger technology, including money transmission, securities, derivatives, and commodities, creates a complex web of overlapping regulatory jurisdictions. It is more important than ever that states continue to work together and with their federal counterparts to create clear lines of accountability and oversight to protect consumers and support innovation.

State banking regulators commend Ranking Member Toomey for soliciting information surrounding cryptocurrency technologies and supervision of money transmission. Federal and state regulators share a supervisory mission to protect consumers, promote safety and soundness, and enable innovation in the payments and lending space. If Congress decides to legislate in this space, members should build on the work state regulators have already done in harmonizing regulation. State regulators stand ready to lend their expertise in these areas to help fill in gaps in existing federal statutes and regulation. It is vitally important to continue this robust coordination and collaboration to foster an effective and efficient activities-based regulatory system.

Sincerely,

John Ryan
President & CEO

CC: The Honorable Sherrod Brown

Footnotes

1 CSBS is the nationwide organization of state banking and financial regulators from all 50 states, American Samoa, the District of Columbia, Guam, Puerto Rico, and the U.S. Virgin Islands. CSBS supports the state banking agencies by serving as a forum for policy and supervisory process development, by facilitating regulatory coordination on a state-by-state and state-to-federal basis, and by facilitating state implementation of policy through training, educational programs, and exam resource development.

2 The purpose of the NMLS MSB Call Report is to provide timely, comprehensive, and uniform information and reporting frequencies concerning financial condition, transactional activities, and compliance with state permissible requirements on entities licensed as money services businesses. For more information, see https://nationwidelicensingsystem.org/slr/common/Pages/MoneyServicesBusinessesCallReport.aspx.

4 In the Uniform Law Commission's Uniform Money Services Act, money transmission was defined to include receiving money or monetary value for transmission. Monetary value was defined as "a medium of exchange, wh or not redeemable in money." Medium of exchange is described in the commentary as "value that is being exchanged [and] accepted by a community, larger than the two parties to the exchange." By regulating the transmission of commonly accepted value, the Uniform Money Services Act set a baseline for activities-based regulation that has withstood two decades of rapid technological innovation.

5 Many stablecoins likely fit within the definition of stored value. The CSBS Money Transmission Modernization Act defines stored value as "monetary value representing a claim against the issuer evidenced by an electronic or digital record, and that is intended and accepted for use as a means of redemption for money or monetary value, or payment for goods or services." When stablecoins perform this activity, they likely should be considered money transmission. When stablecoins are an investment of money in a common enterprise with a reasonable expectation of profit from the efforts of others, they likely should be considered securities. CSBS welcomes the opportunity to explore clear lines between these definitions and acceptable safe harbors that would differentiate the activities.

6 For a background and overview of the NMLS MSB Call Report, see MSB Call Report Overview and Definitions.

7 CSBS operates the Nationwide Multistate Licensing System (NMLS) which is the system of record for non-depository, financial services licensing or registration in participating state agencies, including the District of Columbia and U.S. Territories of Puerto Rico, the U.S. Virgin Islands, and Guam.

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