



SINCE 1902

CONFERENCE OF STATE BANK SUPERVISORS

**STATE REGULATORY REQUIREMENTS FOR VIRTUAL CURRENCY ACTIVITIES  
CSBS DRAFT MODEL REGULATORY FRAMEWORK AND  
REQUEST FOR PUBLIC COMMENT  
December 16, 2014**

**Introduction**

To support the CSBS Policy on State Regulation of Virtual Currency and to promote consistent state regulation of virtual currency activities, CSBS has developed the following Draft Model Regulatory Framework (“Draft Framework”) for state virtual currency regulatory regimes. Because of the nascent and evolving nature of virtual currency business models, CSBS stresses the importance of applying the Draft Framework requirements in a manner that includes flexibility to adapt regulation and oversight to yet unforeseen changes – to address new risks and to facilitate and not inhibit continued innovation.

**Request for Comment**

State regulators are committed to a transparent and inclusive approach to studying virtual currency activities. CSBS requests public comment on the Draft Model Framework and seeks feedback on specific questions that will help inform state regulators as we continue to develop a regulatory structure for virtual currency activities. All comments will be made available at [www.csbs.org](http://www.csbs.org). CSBS reserves the right to reject comments with inappropriate content.

Comments may be submitted by any of the following methods:

*Electronic Comments*

Submit all electronic comments via the comments portal [here](#). Preferred file format is PDF (Portable Document Format).

*Paper Comments*

Send paper comments to Attn: Emerging Payments Task Force, Conference of State Bank Supervisors, 1129 20<sup>th</sup> Street NW, 9<sup>th</sup> Floor, Washington, D.C. 20036

*Due Date*

Comments are requested on the Draft Model Regulatory Framework for Virtual Currency no later than February 16, 2015.

*Contact Information*

For questions, please email [emergingpayments@csbs.org](mailto:emergingpayments@csbs.org).



## **Draft Framework**

State financial regulatory regimes applying to virtual currency activities should include:

1. **Licensing Requirements** – State licensing requirements for entities engaged in virtual currency activities must include:
  - a. Credentialing of business entity owners, directors, and key personnel
  - b. Details on the banking arrangements of the business entity
  
2. **Use of Licensing Systems** – In order to efficiently and effectively process and evaluate license applications, it is important for states to have a robust licensing system in place. A critical piece of such a system is the ability of states to share licensing and enforcement data in real time.
  
3. **Financial Strength and Stability**
  - a. Net worth or capital requirements, with flexibility for Commissioner to set requirements based on activities and volume
  - b. Permissible investments
  - c. Information on method of calculating value of virtual currency
  - d. Surety bond requirement, with flexibility for Commissioner to determine amount based on business model and activity levels, not number of locations
  - e. Policies, procedures, and documentation for disaster recovery and emergency preparedness plans
  
4. **Consumer Protection**
  - a. Required consumer protection policies and documentation of such policies
  - b. Holding an actual amount of virtual currency in trust for customers and ensuring that amount is identifiable separately from any other customer or virtual currency business entity holdings
  - c. Required policies and documentation of complaints and error resolution
  - d. Required receipt to consumers with disclosures regarding exchange rates
  - e. Required disclosures to consumers about risks that are particular to virtual currency
  - f. Required disclosure of virtual currency insurance coverage, which at a minimum includes notice that virtual currency is not insured or otherwise guaranteed against loss by any governmental agency
  - g. Public disclosure of licensing information and agency contact information
  
5. **Cyber Security**
  - a. Required cyber security program and policies and procedures
  - b. Customer notification and reporting requirements for cyber security events



- c. Third party cyber security audit, with flexibility for Commissioner to determine the appropriate level of the audit based on business model and activity levels
6. Compliance and Bank Secrecy Act/Anti-Money Laundering
  - a. Required implementation and compliance with BSA/AML policies, including documentation of such policies
  - b. Required compliance with applicable federal BSA/AML laws and recognition of state examination and enforcement authority of BSA/AML laws
  - c. Verification of accountholder identity
7. Books and Records
  - a. Required access to books and records by regulatory authorities
  - b. Commissioner to determine form and format of books and records production
  - c. Compliance with federal requirements (including Electronic Funds Transfer Act and Bank Secrecy Act)
  - d. Audited financial statements consistent with generally accepted accounting principles (“GAAP”) as recognized in the United States, with flexibility for Commissioner with regard to compliance timeline
  - e. Transaction volume
  - f. Transaction-level data, including, but not limited to:
    - i. Names, addresses, and IP addresses of parties to transaction
    - ii. Identifiable information of virtual currency owner
    - iii. Transaction confirmation
    - iv. For foreign transactions, country of destination
  - g. Agent lists and information regarding agents’ compliance with applicable state and federal laws and rules
  - h. Commissioner to have authority to require periodic reports of condition and to determine frequency and information to be contained therein
  - i. Applicability of state escheatment laws
8. Supervision
  - a. Facilitating and supporting regulatory cooperation and information sharing with other state and federal regulators
    - i. Authority to consult and coordinate
    - ii. Authority to conduct joint or concurrent examinations
    - iii. Authority to use and adopt reports of examination prepared by other state and federal regulators
    - iv. Preserving confidentiality of regulatory information by exempting regulatory information from state public records disclosure laws
  - b. Investigative subpoena authority
  - c. Authority to initiate enforcement actions, including:
    - i. Formal or informal actions



- ii. Removal of officers and directors
- iii. Impose civil money penalties
- iv. Authority to take control
- v. Authority to appoint a receiver



## Questions for Public Comment

1. Policy Implementation – Entities engaged in virtual currency activities might not be engaged in traditional money transmitter activities involving only fiat, government-backed currencies. Similarly, traditional money transmitters might not be engaged in virtual currency activities.
  - a. Within the umbrella of state money transmitter regimes, how can state regulators appropriately tailor licensing and supervision to each set of licensees?
  - b. In order to properly tailor licensing and regulatory regimes to virtual currency activities, should states consider a virtual currency-specific “amendment” or “endorsement” to a traditional money transmitter license?
  
2. Licensing Process
  - a. Though states largely have the same licensing requirements, there is not a common implementation process. Please comment on the functionality of the NMLS or other licensing systems.
  - b. Would a common application and guide to licensure enhance the efficiency of the licensing system?
  - c. Obtaining required criminal background checks has been flagged as an administrative challenge in the licensing process. What procedures can states uniformly adopt to facilitate obtaining criminal background checks as part of the licensing process?
  - d. Credentialing business entity key personnel can be a hands-on process, but has proved indispensable for financial services licensing. Are there alternative means of credentialing that may facilitate the process?
  
3. Training and Education – Educating regulators about virtual currency business activities and business models is an important part of building a responsive and robust regulatory structure.
  - a. What education may be necessary for state regulators to aid in the licensing process?
  - b. What resources are available to explain technology and business models across the virtual currency industry?
  
4. Technological Innovations – What changes and innovations have been seen and/or can be anticipated in the technological aspects of virtual currencies and the resulting marketplace?



5. Denomination of Capital, Permissible Investments, and Bond Coverage – Capital, permissible investments, and surety bond requirements exist to create financial security in the event of failed transactions or a failed business. For financial services companies dealing in virtual currencies, should these safety funds be denominated in the applicable virtual currency or in dollars?
6. Distressed or Failed Companies – Certain requirements in the Draft Framework are designed to provide regulators with tools for dealing with distressed or failed companies. Please comment on the practical issues and challenges facing regulators in the case of a distressed or failed company. What other tools should regulators have for resolving a failed virtual currency company, minimizing consumer harm and market impact?
7. Consumer Protections – What consumer remedies should policy makers consider for virtual currency financial activities and transactions?
8. State Insurance or Trust Funds – Some states have laws that create a trust or insurance fund for the benefit of instrument holders (i.e., holders of checks, money orders, drafts, etc.) in the event that a licensed money transmitter defaults on its obligation or is otherwise unable to make payment on the instrument. Is it appropriate to allow holders of instruments denominated in virtual currency access to such insurance or trust funds?
9. BSA/AML – Fraud and illicit activities monitoring are increasingly technology based and proprietary, especially for virtually currency companies. Are state and federal exam procedures current with regards to new methods of detecting BSA/AML activity?
10. Customer Identification – The Draft Framework includes maintaining records on the identification of virtual currency owners. Credentialing consumers for identification purposes can be accomplished to varying degrees, from basic account information to verified personal identification. What is the appropriate level of identification?
11. Regulatory Flexibility – The Draft Framework stresses regulatory flexibility to accommodate different activity levels and business models and to avoid inhibiting innovation.
  - a. Given the rapidly evolving nature of virtual currencies, what should be the nature of any necessary flexibility?
  - b. How can laws and regulations be written to strike a balance between setting clear rules of the road and providing regulatory flexibility?
12. Reporting Requirements – Most states require money transmitter licensees to submit periodic reports of business activities.



- a. For licensed virtual currency companies, what types of information and data should be included in periodic reports?
  - b. What technology solutions exist to mitigate regulatory reporting requirements?
13. Technological Solutions to Improve Supervision – State exams and reporting requirements reflect an institution at a point in time. Conversely, operational standards and internal compliance audits increasingly offer the opportunity for real time data collection, interacting with transmission data to ensure adequate funding, anti-money laundering compliance, fraud protection, and consumer protection. What technology solutions can regulators and licensees deploy to close information gaps in a manner that makes the supervisory process more efficient and “real time?”
14. Cyber Risk Insurance. Companies have begun looking to insurance to help manage cyber risks, and there are a growing number of companies offering cyber liability insurance. What role should cyber risk insurance have in a licensed virtual currency entity's approach to managing cyber risks? Please discuss the potential costs and benefits for virtual currency companies securing cyber risk insurance.
15. Commercial Fund Transfer Liability – Article 4A of the Uniform Commercial Code establishes liability for wire transfers, relying on definitions strictly applicable to banks. Are provisions like those in Article 4A necessary for commercial transfers denominated in virtual currencies? If so, is the Article 4A construct an appropriate model to be adapted in a manner that is not bank-centric?
16. Banking Services for Virtual Currency Companies – Banking arrangement information is necessary for evaluating the safety and soundness of a licensee. However, virtual currency businesses are not immediately understood by most banks that provide traditional money services accounts. What are the risks facing banks that consider banking virtual currency companies, and how can those risks be mitigated?
17. Merchant-Acquirer Activities – Companies processing credit card payments between a buyer's bank and a seller's bank (Merchant-Acquirers) have historically been presumably exempt from money services businesses statutes because of their nexus to the highly regulated banking system. A company processing virtual currency payments for merchants who accept virtual currency as payment for goods and/or services may exchange virtual currency to dollars, which can then be transferred to the merchant's bank account. Is this activity akin to the activities of traditional Merchant-Acquirers, or is it the exchange and subsequent transmission of value that is typically regulated by the states?



18. Cost – State regulators are cognizant of the costs associated with licensure and ongoing compliance. What processes can be implemented to reduce these costs, including any shared services or technology-based reporting?
  
19. Escheatment – How should virtual currency be treated under state escheatment laws?