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May 16, 2014

Honorable David Cotney, Massachusetts Commissioner of Banks

Chairman

Emerging Payments Task Force

Conference of State Bank Supervisors

Re: Public Hearing on Emerging Payments

Dear Commissioner Cotney:

Thank you for this opportunity to address the Conference of State Bank Supervisors about alternative payment system issues. The Emerging Payments Task Force has an important charge to examine novel payment systems and their effect on state law, licensing, and importantly, on consumer protection.

I commend the Task Force and the Conference for reaching out for public input and for inviting viewpoints from around the country. Soliciting the views of federal and state officials as well as consumer advocates and industry representatives is important to thoroughly exploring these issues. I regret that I cannot attend the Chicago hearing in person and I very much appreciate your permitting me to submit my views in writing. I would like to focus my attention in this letter on the importance of transparent disclosures with respect to virtual currencies such as Bitcoin.

Virtual currency is an intriguing innovation and Massachusetts is proud to be home to market leaders in new technologies. At the same time, if consumers use virtual currency without understanding it, they may place themselves at risk of losing their money. We know that there is pent up demand for payment systems in the commercial world that are faster and cheaper than our current array of payment systems. Innovation and technology will likely be the key to achieving those desirable ends. Innovations such as mobile points of sale, chip and PIN technology in credit cards, banking apps, and virtual wallets for mobile devices are all concrete examples of the change that is already taking place. All such systems share common challenges which have to be addressed at the same time that we embrace the benefits that such technology brings. For example, security, reliability, predictability, and stability are all desirable features that consumers expect of virtual currencies, if these innovations are to achieve widespread adoption.

Although there is not yet widespread adoption, the interest in virtual currency, and Bitcoins in particular, is high. Recently, MIT students and alumni raised $500,000 from 25 donors to distribute Bitcoins to MIT students this coming fall semester as an experiment in Bitcoin usage. The experiment intends to encourage innovation in finance and help increase positive perception of the

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virtual currency. This intriguing experiment highlights the innovative spirit in Massachusetts to tackle new technologies head-on and be a leader in making the “groundbreaking” into the “mainstream.”

The interest in virtual currencies and Bitcoin is likely in part due to its potential benefits. Virtual currencies have benefits to retail and other industries. Virtual currencies provide for a payment network that is interoperable across national borders and language barriers to provide for simple payments in a globalized world. Merchants that accept Bitcoin, for example, do not have to pay the same transaction or processing fees required by credit card processors. The payment processes are cheap, fast, and provide an easy method to transfer funds without the need for an intermediary.

Virtual currencies can also have significant benefits to consumers. Consumers, like merchants, would benefit from a cheap, fast, and easy payment system. Virtual currencies have security benefits that could tag or code the virtual currency to a particular individual to help protect from theft. But the transaction itself is recorded on a public “ledger” that does not reveal personal identifying information about users, such as name, social security number, or account number, so consumers are able to guard against identity theft through simple anonymity. This anonymity, it should be noted, does come at a cost: Bitcoins, for example, have been used for illicit transactions on black markets such as Silk Road, a deep web source that was used for illegal drug and other purchases before being brought down by federal authorities at the end of last year. Another benefit is for the possibility to “color-code” the virtual currency to allow only particular types of purchases, such as coding a particular unit of virtual currency to allow purchasing of only “food” or “clothes” and not other items such as “drugs” or “weapons.”

Virtual currencies have many potential benefits, but they also have substantial risks. As we saw from the failure of the Bitcoin exchange Mt. Gox, these exchanges where consumers can trade for virtual currency are subject to hacking and spontaneous closure without notice to consumers. If a consumer loses the private key or PIN to a virtual wallet, the virtual currency locked inside the wallet is irretrievable. Because virtual currencies would be stored on a hard drive or a smartphone, the virtual currency would be equally irretrievable if the hard drive crashed or the smartphone stopped working. Virtual currencies are not insured by the Federal Deposit Insurance Corporation or other similar entity. Unlike credit cards, there is no way to reverse or cancel a purchase or dispute a transaction after the transaction goes through. And if something goes wrong with a transaction or other process, there is no clear authority to which consumers can complain and find some resolution.

Another major risk of virtual currencies is that they have a volatile value. Bitcoins, for example, have minute-to-minute and even second-to-second fluctuations in value versus a unit of traditional currency such as the US Dollar. A few months ago, the Bitcoin was worth $1200, a month ago it was $600, and on May 1 it was approximately $455. Volatility of virtual currencies can decrease over time and with increased adoption and acceptance of the systems. But before the average consumer will use these virtual currencies, consumers must be able to trust the value of the virtual currency and have an understanding of the payment systems or procedures.

Virtual currencies that are decentralized, such as Bitcoin, are different from the common monetary and payment systems. One major feature of this decentralization is that no one “owns” the Bitcoin system—it essentially has a peer-to-peer structure where computers around the world work in tandem to process Bitcoin transactions. This type of payment system is really a new frontier and the workings

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of this system are being developed from scratch. Consumers, as users of Bitcoin or other virtual currencies, do not yet have enforceable rules of the road for transactions and processes that would provide users with a clear idea of their rights and obligations pertaining to owning a Bitcoin and what to do if something goes wrong.

The key is disclosure and transparency. Disclosure and transparency are bedrocks of American consumerism and consumers cannot make optimum decisions in a market without essential disclosures and a basic understanding about the product that some fundamental transparency would provide. Here are some fundamental issues that the Task Force may want to consider:

1. What disclosures should be provided about Bitcoin and other virtual currencies?
2. Who should have the responsibility to provide these disclosures?

What types of disclosures should be provided to consumers about Bitcoin and other virtual currencies?

There are a number of disclosures that could be provided to consumers. Answers to the following questions represent the basic types of disclosures that should be considered with respect to virtual currencies.

1. Where do Bitcoins come from?
2. How are they created?
3. What is the nature of their value—is it volatile or stable?
4. What is the current value? How many dollars equals one unit of virtual currency?
5. What is the history of bitcoin values? How often does that amount change?
6. Where can consumers store Bitcoins?
7. How can bitcoins be protected from theft?
8. What happens if bitcoins are lost or stolen?
9. Do consumers have any recourse if Bitcoins are lost or stolen?
10. How can a consumer protect the value of his or her Bitcoin?
11. Last, but not least by any means, what are the federal and state tax consequences of buying and selling Bitcoins or making purchases using Bitcoins?

Who should have the responsibility to provide disclosures?

This is a more difficult question to answer and an even harder one to potentially enforce. Because the sources of virtual currencies are decentralized, there may be multiple sources of information, education, or technical assistance. The Task Force may wish to consider disclosures according to the source and its function or role in the Bitcoin pipeline.

1. Consumers should be able to obtain all the basic disclosures from Bitcoin exchanges, but what about merchants who accept Bitcoins as payment?
2. What kind of disclosures, if any, should the merchant have to make?
3. How will the merchant price its items, in dollars or Bitcoins? If the merchant prices an item in Bitcoins, it could vary in price minute to minute and even second to second. If the merchant prices an item in dollars and accepts an equivalent value of Bitcoins at the time the purchase

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was made, consumers then need to understand how valuation of Bitcoin works and understand its potential to increase and decrease in value.

1. Most merchants that accept Bitcoins are paid through an exchange that converts the Bitcoin into dollars, so the merchant is actually receiving real currency and not Bitcoin. In those situations, what kinds of merchant disclosures make sense?

Despite the potential benefits, the current risks for the average consumer of using Bitcoin or another virtual currency as a payment system do seem rather substantial. Over time, if the volatility in value diminishes and the benefits achieve their potential, there could be a day in the future when the average consumer buys his or her morning cup of coffee with Bitcoins or some other virtual currency. But right now Bitcoin and virtual currencies in general are not very practical payment technologies for ordinary consumers. The software is complicated and the value fluctuates significantly. As the Task Force and the Conference consider alternative payment systems, I ask you to consider the importance of disclosure and transparency as it relates to consumer protection in the area of virtual currency.

Thank you for the opportunity to submit this letter.

Sincerely yours,

Barbara Anthony