



164 Townsend Street #11
San Francisco, CA 94107

February 9, 2015

Conference of State Bank Supervisors

1129 20th Street NW, 9th Floor

Washington, D.C. 20036

Attn: Emerging Payments Task Force

Re: **Draft Model Regulatory Framework for Virtual Currency**

Bitnet Technologies (“Bitnet”) respectfully submits the following information to the Conference of State Bank Supervisors (“CSBS”) for its consideration in refining its draft model regulatory framework for virtual currency firms.

We believe that market participants and regulators have common interests in fostering the creation of a virtual currency marketplace that delivers both tangible value and appropriate protections to consumers and other market participants. We recognize the leadership that CSBS has shown in taking an open-minded approach to developing a model regulatory framework for virtual currency and hope this important effort will encourage the formation of a broadly-based consensus among regulators, firms, advocates, and investors on issues critical to the development of a vibrant and responsible virtual currency marketplace.

Bitnet respects the need to protect consumers and prevent money laundering at the core of CSBS’s proposal. Essential to that effort is creating a regulatory framework that supports, rather than impedes, continued growth and innovation in a rapidly evolving technological ecosystem. The type of principles-based approach set out in the proposed model regulatory framework provides a very promising approach to this challenge, and we appreciate the opportunity to provide comments. Bitnet is deeply committed to promoting responsible business practices in our company and working closely with regulators to help virtual currency achieve positive public policy outcomes. If helpful, we stand ready to provide additional information on the matters discussed below or others relevant to the proposal.

Via electronic mail

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We recognize that regulation has an important role to play in the creation of a sustainable virtual currency marketplace and submit the following comments for your consideration:

- Bitnet provides a payment platform that processes transactions based on the terms and conditions established by the merchant and accepted by the consumer. As part of this activity, Bitnet neither maintains direct relationships with individual consumers, nor functions as a virtual currency exchange.
- Consistent with exclusions of merchant-acquirer activities from the scope of money services business statutes currently recognized in many state regulatory regimes, Bitnet and other firms processing virtual currency payments solely as agents of merchants should be exempt from the licensing framework.

I. WHO WE ARE AND HOW BITNET WORKS

a. About Bitnet

Bitnet plans to provide a payment platform that facilitates merchant acceptance of virtual currency as a form of payment and conversion of those funds into U.S. Dollars and other fiat currencies. Merchants will contract with Bitnet to process virtual currency payments, and our service will reduce the costs and risks to merchants of accepting virtual currency payments by providing real-time quotes that convert the cost of a good or service into a virtual currency equivalent and facilitating the conversion of the virtual currency accepted by merchants in such transactions through third-party virtual currency exchanges. We will provide recommendations for best practices to our merchant customers on matters such as refund policy for virtual currency transactions, but Bitnet will have no direct relationship with consumers who elect to pay for goods or services with virtual currency, and our business model will not generate revenue from individual consumer relationships.

Our company is headquartered in San Francisco, California with a software development center in Belfast, Northern Ireland and currently employs 38 people. Our executive team features over 150 years of combined experience in the payments sector, including substantial experience with VISA and CyberSource, and we are bringing this deep domain expertise into the virtual currency marketplace for the benefit of our merchant customers and their consumers.

b. Bitnet's Investment in Responsible Business Practices

Our commitment to operating in conformity with applicable regulatory mandates and industry leading practices is reflected in the investments we are making to develop compliant business and operating models. We are working with experts in the field to develop and implement anti-money laundering and compliance programs. For example, we plan to implement a Know Your Customer program that will include all merchants using our services. We are also implementing a real-time monitoring system to track and analyze a multitude of attributes about each transaction to identify any anomalies that could indicate suspicious activity.

c. The Mechanics of a Bitcoin Transaction over Bitnet

A payment transaction via Bitnet occurs in the following sequence:

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Payment Request

Step 1: The consumer decides to pay with bitcoin.

Step 2: The merchant's system calls the Bitnet API and provides the order details.

Step 3: Bitnet receives price quotes in real time from a number of independent virtual currency exchanges.

Step 4: Bitnet generates and transmits to the merchant an invoice that converts the guaranteed fiat currency price to bitcoin (or other virtual currency equivalent selected by customer).

Step 5: The consumer is presented with the invoice that expresses the checkout price in an equivalent amount of bitcoin along with a scannable QR code or clickable link to initiate payment from the consumer's wallet.

Payment Transaction

Step 6: The consumer scans the QR code or clicks the provided link to transfer bitcoin from their wallet to Bitnet.

Step 7: Bitnet monitors the Bitcoin network for new transactions to be broadcast, propagated, and "confirmed."

Step 8: Upon confirmation of the transaction, Bitnet immediately trades the bitcoin for fiat currency on a virtual currency exchange.

Settlement and Funding

Step 9: Each day, the exchange transfers Bitnet's fiat currency trading balance to Bitnet's bank.

Step 10: Based on its record of the day's transactions, Bitnet instructs the bank to disburse the funds to merchant accounts.

Step 11: Bitnet's bank transfers the amount of fiat currency owed to merchant accounts.

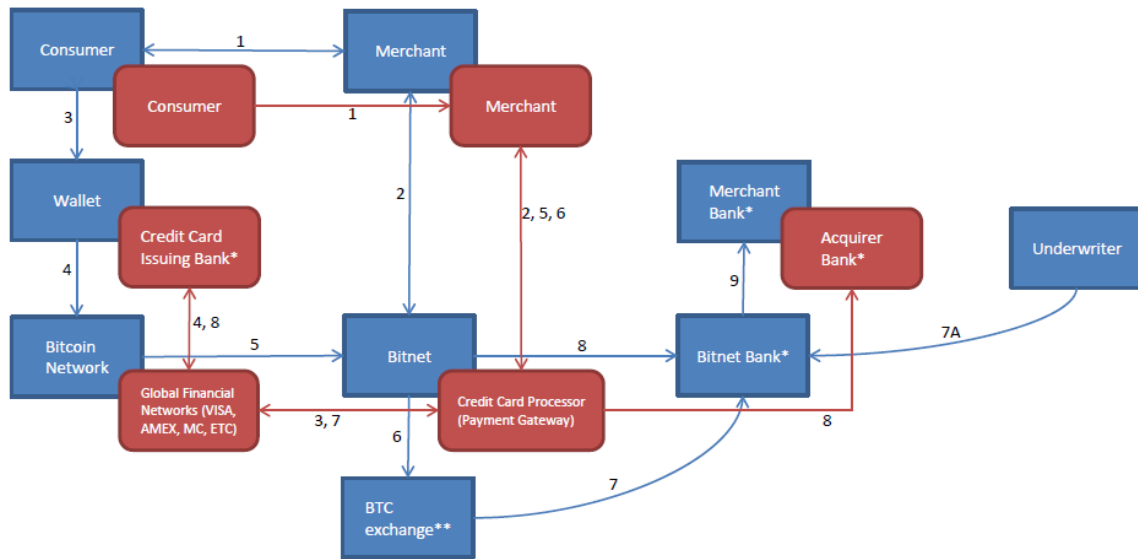
II. BITNET AND OTHER FIRMS PROCESSING PAYMENTS SOLELY AS AGENTS OF MERCHANTS THAT ACCEPT VIRTUAL CURRENCY SHOULD BE EXEMPT FROM THE PROPOSED LICENSING FRAMEWORK.

We believe that merchant-acquirers should be exempt from requirements imposed as part of the model regulatory framework for the following reasons:

- a. The payment processing function that Bitnet provides merchants is fundamentally similar to activities performed by credit card processors.

As set forth more fully above, Bitnet receives virtual currency on behalf of merchants and facilitates the conversion of such virtual currency into fiat currency through independent exchanges. In so doing, Bitnet neither transacts directly with customers, nor engages in conversions of virtual currency. As a result, Bitnet functions in a way that is fundamentally similar to credit card processors, which also process transactions on behalf of merchants by maintaining automated, secure systems that direct consumer payments through regulated financial institutions to the merchant's bank account.

The following diagram shows the flow of transactions using Bitnet and credit cards:



Bitnet

1. The consumer decides to pay with Bitcoin.
2. The merchant calls the Bitnet Api, passing the order details.
3. The consumer is presented with a QR code or clickable link to initiate payment.
4. The consumer uses their wallet to send the BTC to the Bitcoin network.
5. Bitnet monitors the network until the payment is confirmed.
6. Bitnet trades the BTC for fiat currency at the exchange.
7. The BTC Exchange deposits the days trading balance to Bitnet's bank.
 - A. We are insured against exchange failure and can always pay out to merchants.
8. Bitnet instructs the bank to payout to the merchants.
9. Bitnet's bank disburses the monies to the various merchant accounts.

Credit Card Processor (Payment Gateway)

1. The consumer decides to make a purchase from a merchant.
2. The merchant submits an Authorization request transaction for approval.
3. The payment processor passes the request through the associations to the issuing bank and awaits response to be presented to merchant.
4. The Issuing Bank approves or declines the authorization request and puts a hold on cardholder funds – the "Authorization hold".
5. Merchant receives the approved or declined authorization transaction.
6. Merchant submits a Capture transaction.
7. Payment Processor sends batch request for settlement to card scheme.
8. Card Scheme receives settlement payment from issuer and sends settlement payment to acquirer. Acquirer funds merchant account with net proceeds of transaction.

*Regulated by current NY Money Transmitter Laws.

**Regulated by FinCEN and will be subject to the current proposal.

In either of these payment systems, the processor's role is fundamentally the same: to facilitate transactions on the merchants' behalf.

Notably, as CSBS's draft framework recognizes,¹ credit card processors are not generally required to have a bank or money transmitter license, although credit card acquirers are. By analogy, pure virtual currency payment processors such as Bitnet should not be required to register, although the virtual currency exchanges and banking

¹ CSBS Draft Model Regulatory Framework for Virtual Currency Activity and Request for Comment, Question 17, pg. 7.

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partners they rely on should be regulated entities. This is consistent with the well-established principle that payments chains typically contain one regulated entity, rather than requiring that all participants in a transaction be subject to the same regulations. More generally, many states have exemptions in place that exclude payment processors purely acting as an agent of the payee from the scope of money transmission regulation. This further strengthens the case for the framework excluding virtual currency payment processors from the scope of regulated virtual currency entities.

Applying such an agency exemption to virtual currency payment processors similar to the one enjoyed by fiat currency payment processors will not result in a material gap in the regulatory framework. As a provider of payment processing services to merchants on an outsourced basis, Bitnet will maintain relationships with merchants, banking partners, and virtual currency exchanges (which will be subject to direct requirements under the draft framework). As a result, Bitnet will be responsible for adhering to various business and regulatory requirements of those counterparties and subject to oversight as a third-party service provider to covered entities.

- b. Merchants and consumers alike benefit significantly from relying on agents to process virtual currency payments, and those benefits are important to the continued growth and development of the virtual currency ecosystem.

Merchants benefit substantially from relying on firms such as Bitnet to process virtual currency payments. Without Bitnet and other payment processing firms, merchants would have to establish individual accounts at various exchanges and handle individual conversions of virtual currency accepted from consumers. As a result, merchants would face increased exposure to exchange rate volatility and be required to make substantial investments in IT and cyber-security. By contrast, reliance on specialized processing firms like Bitnet guarantees merchants payment for all virtual currency transactions, reduces risks related to chargebacks and fraud, and lowers processing fees. In turn, this increases consumers' options to pay with virtual currency, and many firms such as overstock.com and gyft.com have begun offering additional rewards to consumers that make purchases in virtual currency.

Individually and collectively, these benefits are important to increasing acceptance of virtual currency by merchants across the United States and around the globe, a key driver of continued growth in the volume and velocity of virtual currency payments and ultimately of a reduction in the volatility of the overall ecosystem. For U.S. consumers, expanded access to virtual currency transactions will reduce the costs of purchasing goods and services.. CSBS should take care to evaluate how the costs related to proposed regulation might erode these benefits in states that adopt its framework and craft an approach that is not broader than necessary.

- c. The consumer protection and money laundering risks of virtual currency payment processors like Bitnet are significantly lower than those of consumer exchange and hosted wallet services.

Virtual currency transactions that Bitnet processes by definition begin with a customer who already owns virtual currency and is simply looking to use it to transact. Using virtual currency to make purchases reduces each consumer's exposure to the price volatility currently linked to holding virtual currency by reducing the consumer's balance of such currency by the amount of the transaction. Since Bitnet does not offer services directly to consumers, it also does not have the customer asset protection and disclosure risks that rightly merit regulation of consumer exchange and hosted wallet services. Viewed in this context, many of the consumer protection provisions of the draft framework have little meaningful application to Bitnet's operations.

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Bitnet's payment processing also reduces the risks to merchants of transacting in virtual currency. Merchants that use Bitnet to process virtual currency transactions benefit from the ability to convert funds received instantly to fiat currency and from receiving a guaranteed payment amount from Bitnet. Further, Bitnet requires its merchants to provide information on consumers making payments so merchant acceptance has significantly lower AML risks than other parts of the current virtual currency ecosystem where firms often do not know the identity of their counterparty for digital currency transactions.

III. CONCLUSION

In conclusion, we request that the CSBS modify the draft policy statement to exclude virtual currency merchant acquisition from the scope of covered activity and add text stating that agent of the payee exemptions should apply equally to fiat and virtual currency providers.

We respectfully request consideration of our comments and suggestions. Should you have questions or require further information about any matter relevant to the draft framework, please do not hesitate to contact me at 415-887-8227 or by email to john.mcdonnell@bitnet.io.

Sincerely,



John McDonnell

Chief Executive Officer

Bitnet Technologies Corp