

Client Alert

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New York DFS Proposes Sweeping Virtual Currency Licensing Scheme

By **Obrea Poindexter, Jeremy Mandell and James Nguyen**

Yesterday, the New York Department of Financial Services (“NYDFS”) issued a proposed rule for public comment setting forth a novel and comprehensive “BitLicense” regulatory scheme for entities engaged in “Virtual Currency Business Activities.” The BitLicense proposal would require any entity engaged in Virtual Currency Business Activities, as defined below, to obtain a license and otherwise comply with any new requirements, if the activities involve the state of New York or a New York resident. The proposal will be published in New York State’s Register on July 23, 2014, and comments on the proposal are due September 6, 2014. The NYDFS also published a copy of the proposal on various social media sites, including Reddit and Twitter.

The NYDFS says the BitLicense proposal is the product of a nearly year-long initiative by the NYDFS to assess and determine the “appropriate regulatory response” to the emergence and popularity of virtual currencies. The result of this initiative is a proposal that would impose extensive regulation on entities involved in virtual currency systems.

SCOPE OF BITLICENSE PROPOSAL

The BitLicense proposal broadly covers virtual currency activities that involve the state of New York or a New York Resident in which a person:

- Receives or transmits virtual currencies on behalf of consumers;
- Secures, stores, or maintains custody or control of virtual currency on behalf of consumers;
- Performs retail conversion services, including converting or exchanging virtual currency for fiat currency or other virtual currency;
- Buys or sells virtual currency as a business; or
- Controls, administers, or issues virtual currency.

As a result, the BitLicense proposal would expand the scope of virtual currency regulation beyond earlier FinCEN guidance, which generally focused on exchangers—i.e., the “bottleneck,” or point of entry, into virtual currencies. Certain entities that have prior approval from the Superintendent of the NYDFS, and are otherwise subject to New York Banking Law, would be exempt from the licensing requirement, and merchants and consumers that use virtual currency for the purchase and sale of goods are exempt from the licensing requirement.

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PROPOSED LICENSING REQUIREMENTS

In addition to an extensive application process (and yet to be determined application fees), licensees under the proposal would be subject to:

- Capital requirements, as determined (but not yet disclosed) by the superintendent;
- Restrictions on investments of retained earnings and profits;
- Prior approval before material changes are made to an existing product or service;
- Extensive recordkeeping requirements, subject to a 10-year retention period;
- Regular (i.e., at least every two years) examinations by the NYDFS; and
- Requirements for quarterly reports on financial condition and annual audited financial statements.

Licensees also would be expected to:

- Develop an anti-money laundering compliance program that meets accountholder verification and reporting requirements;
- Develop a cybersecurity program that includes regular penetration testing;
- Designate a chief information security officer;
- Designate a compliance officer; and
- Develop business continuity and disaster recovery plans.

PROPOSED CONSUMER PROTECTIONS

In addition to the requirements listed above, the proposal would require licensees to:

- Disclose, prior to entering into an initial transaction, material risks associated with the licensee's products and virtual currency generally;
- Disclose, prior to entering into an initial transaction, the terms and conditions of the licensee's services, which must include the customer's right to receive a periodic account statement from the licensee;
- Make certain disclosures on advertising and marketing materials;
- Provide detailed receipts for each transaction; and
- Develop and maintain written policies and procedures to timely resolve complaints fairly and in a timely manner.

The BitLicense proposal is sweeping and could adversely impact businesses offering virtual currency-related services. We will continue to analyze the BitLicense proposal and consider its potential effects on current and future virtual currency systems.

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