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Another Sweeping State Virtual Currency Law

Law360, New York (July 9, 2015, 10:39 AM ET) -- Over the past year, several state banking agencies have been empowered to regulate companies that transmit "virtual currencies," such as bitcoin. On June 19, the Connecticut Department of Banking was added to the list of virtual currency regulators when Gov. Dannel Malloy signed Substitute House Bill Number 6800.

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This new statute amends Connecticut's Money Transmission Act by requiring businesses that transmit virtual currency to comply with the act and to cease operations unless they first obtain a license from the Department of Banking. This regulation will impact a variety of financial technology companies, including companies that transmit bitcoin from online wallets used by their customers to make third-party payments. This can potentially include financial technology companies that facilitate virtual currency payments to online vendors, to charities, to political organizations or even among teenagers splitting the price of a pizza.

Much of past regulation of financial technology companies that transmit virtual currency has focused on the risk that the technology could be hijacked by criminals to engage in money laundering. However, consistent with the regulatory focus of the Department of Banking, Connecticut's new virtual currency statute goes beyond merely imposing rules aimed at preventing money laundering and seeks to protect consumers by ensuring the financial health of regulated virtual currency businesses. For example, the bill permits the Connecticut banking commissioner to deny an application if "the issuance of such a license would represent undue risk of financial loss to consumers, considering the applicant's proposed business model."

The discretion afforded the Department of Banking is extremely broad. The banking commissioner is authorized to investigate the financial and business experience, character and general fitness of money transmitter applicants and may only issue a license upon finding that the business will be conducted "honestly, fairly, equitably, carefully and efficiently" and "in a manner commanding the confidence and trust of the community." The statute does not clarify how this assessment of the community's "confidence and trust" is to be made.

Similarly, the new law gives the banking commissioner discretion with respect to bond requirements for virtual currency businesses. Unlike traditional money transmitters, which are subject to established bond requirements based on the amount of their money transmissions, virtual currency licensees are subject to a bond requirement to be set by the banking commissioner, apparently on a case-by-case basis, in an amount "calculated

reasonably to address the current and prospective volatility of the market in such currency or currencies." Again, the statute does not clarify how the reasonable calculation is to be done, and given the short track record of the virtual currency industry, it is difficult to predict how such a calculation will be made.

Finally, as if to underscore the breadth of the banking commissioner's power to decide how virtual currency businesses are regulated, the new law leaves open the door to additional licensing restrictions by stating that the "commissioner may, in the commissioner's discretion, place additional requirements, restrictions or conditions upon the license of any applicant who will engage or may engage in the business of transmitting monetary value in the form of virtual currency." It is unclear from the statute itself how broad this mandate to impose additional unenumerated restrictions is intended to be or whether there is any limitation on what the banking commissioner can require virtual currency businesses to do in order to use a license.

Other states may soon follow Connecticut by enacting similar virtual currency statutes. Right now, legislators in both North Carolina and Pennsylvania are considering proposed bills which, like Connecticut's statute, would integrate the regulation of virtual currency into existing money transmitter statutes. Like the Connecticut law, North Carolina's bill (H.B. 289) permits the commissioner to impose heightened requirements on virtual currency businesses, such as "requir[ing] an applicant to obtain additional insurance coverage to address related cybersecurity risks inherent in the applicant's business model as it relates to virtual currency transmission and to the extent such risks are not within the scope of the required surety bond."

Not every state is using the legislative process to regulate virtual currency. New York's recent "BitLicense" regulation was accomplished through administrative rule-making. The New York rule also applies to a broader class of businesses than the Connecticut law. The New York framework extends beyond virtual currency transmitters to apply to businesses engaged in any "virtual currency business activities," as that term is defined in the proposed rule. The New York rule also includes relatively detailed requirements regarding anti-money laundering and cybersecurity programs.

While most of these pending state regulations seek to put limits on virtual currency companies in order to protect consumers, some states are considering laws that are also intended to promote and protect virtual currency businesses. For example, a New Jersey legislator recently proposed a bill that contains unique and relatively pro-business provisions. The professed purpose of this bill, the "Digital Currency Jobs Creation Act," is to "promote innovation in the burgeoning digital currency industry, to protect consumers of digital currency services, and to create jobs in the State of New Jersey."

The New Jersey bill provides certain tax breaks to virtual currency businesses and provides that municipalities may not "prohibit, abridge, levy a tax upon, or otherwise restrict the creation, retention, transmission or any other use of the digital currency within the State [.]" The bill does not require a license, but requires a person engaging in "any digital currency custodial activity" for more than 30 days to register with the state. The bill also requires registrants to maintain policies and programs relating to cybersecurity and anti-money laundering.

Although the differences in the text of state virtual currency regulations are interesting and noteworthy, it may ultimately be more important how the various regulators interpret and enforce these new regulations. Connecticut's law, and the pending virtual currency legislation in other states, give regulators tremendous discretion in how they use their regulatory power. In short, if a regulator chooses to stifle this nascent industry, it will be able to do so, at least within its jurisdiction. In light of this possibility, virtual currency businesses will be carefully following how the discretionary provisions of these regulations are interpreted in early adopter states like Connecticut and New York.

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