

NY Financial Regulator Lawsky Releases Final BitLicense Rules for Bitcoin Firms; Rules to only regulate intermediaries with custody of customer funds, not software developers

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Abstract: [...]investor changes will only require approval when an investor gains control over the management and policies of the firm.

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Full text: Outgoing New York Superintendent of Financial Services Benjamin Lawsky released sweeping new rules for licensing virtual-currency businesses in the state Wednesday, staking part of his legacy on carving out regulatory oversight for an industry that many experts believe could transform the financial system.

Mr. Lawsky, who has said he will leave his post at the end of this month, announced the so-called BitLicense rules during a speech at the BITS Emerging Payments Forum in Washington.

The new rules, posted simultaneously on the Department of Financial Services' website, require certain providers of virtual currency services operating in New York state--in particular, those with custody of customers' funds and which exchange virtual currencies for dollars and other fiat currencies--to apply for a specially tailored DFS license. The regulation lays out a variety of specific conditions to keep that license up to date with regard to protections of consumers and anti-money-laundering compliance, capital adequacy, changes of ownership and cybersecurity.

Mr. Lawsky said it was necessary to create this first-of-its-kind regulation for virtual currencies because existing money-transmission laws date back to the Civil War and "simply wouldn't work" for digital currency, a technology "unlike anything we had ever seen before."

The BitLicense's publication culminates an almost two-year draft-and-review process in which providers of bitcoin-based services occasionally locked horns with Mr. Lawsky over their fears that tougher regulation in the country's most important financial hub could quash innovation in this nascent technology. The BitLicense is expected to become a template for other state financial regulators to follow.

But Mr. Lawsky, whose staff significantly moderated the terms of a much stricter first draft proposal released in July last year, argues that the revised version addresses many of the industry core concerns so as to carve out exemptions that create opportunities for innovators. He said it creates adequate rules that "help protect consumers and root out illicit activity," but which seek not "to doom promising new technologies before they get out of the cradle."

Running through five industry concerns with the BitLicense process, he said the final rules won't require approval for standard software updates--only material changes to technology--and will only regulate intermediaries with custody of customer funds, not software developers. He said licensees that want both a BitLicense and a traditional money-transmitter license won't have to duplicate the application process, and that there will be no need to file "suspicious activity reports," or SARs, when these anti-money-laundering actions have already been handled by the U.S. Treasury Department's Financial Crimes Enforcement Network, or FinCEN. Finally, investor changes will only require approval when an investor gains control over the management and policies of the firm.

Mr. Lawsky did, however, reject industry arguments that DFS should leave anti-money-laundering requirements to FinCEN. "Again, we recognize that we are not going to please everyone," he said.

The new law may not placate Mr. Lawsky's toughest critics in the industry, many of whom have never forgiven him for the combative stance with which he opened this process, delivering subpoenas to numerous bitcoin

businessmen in August 2013. Some are angered by what they see as a conflict of interest as New York's top regulator plans a new career providing consulting services, including advice on the virtual-currency industry. New York's top financial regulator "will be able to use the name he made attacking Bitcoin to wend his way into the Bitcoin business world," wrote Jim Harper, a fellow at the libertarian Cato Institute and the former Global Policy Counsel at the industry advocacy group the Bitcoin Foundation, in a blog post last month. New York Department of Financial Services spokesman Matthew Anderson said critics "have their facts wrong" in describing Mr. Lawskey's new firm as a "bitcoin consultancy." It "will be focused on compliance, crisis management, cybersecurity, and other issues" and may not do any work related to bitcoin, he said. Mr. Anderson added that, based on government service rules Mr. Lawskey cannot provide advice related to the DFS. If any client wants advice on getting a BitLicense, he said, the outgoing superintendent "cannot and will not do that. Period."

The BitLicense comes as Wall Street firms are increasingly expressing interest in incorporating bitcoin's core technology, a digital ledger known as the blockchain, into the back-office and payment functions of the financial system. Exchange operator Nasdaq OMX Group has launched a pilot program to use the blockchain to handle how certain securities are transferred settled among investors, for example, the New York Stock Exchange has invested in Coinbase, a bitcoin services provider that has launched a high-tech digital-currency exchange, and Goldman Sachs Group Inc. has led a venture funding round in bitcoin consumer service provider Circle Internet Financial.

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