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To: Sarah Jane Hughes, Members, and Observers; ULC Regulation of Virtual Currency Businesses Act Committee.

This letter offers Coin Center's final comments on the ULC's model Regulation of Virtual Currency Business Act. Due to the context-specific nature of all comments, we are providing the Committee with a red-lined version of the act in the form of an attached annotated PDF. None of our suggestions offer substantive changes to the policy consensus we reached at the recent meeting. However, several of the proposed changes are of critical importance to ensure that Coin Center can fully support the final Act. These changes primarily relate to:

1. Removing errant use of the phrase "virtual currency credentials" from the act in favor of using the defined term "control" of virtual currency wherever necessary. *See comments on red-line page 3, lines 18-20; page 4, line 6; page 34 lines 1-2 (All page numbers refer to the pages of the current draft act, not the PDF pagination.).*
2. Removing "change of location" language from the definition of "transfer." *See comment on red-line page 4, lines 2-4.*
3. Clarifying the personal use exemption. *See comment on red-line page 15, lines 1-3.*
4. Crafting *de minimis* and provisional licensing thresholds calibrated by specific activity (*i.e.* the defined verbs: store, transfer, exchange, administer) rather than aggregate activities. *See comments on red-line page 15, line 8; page 38, lines 18-19.*
5. Eliminating technology-specific and impracticable recording requirements from the recordkeeping section. *See comment on red-line page 42, lines 9-13.*

The first suggested change, removal of the phrase "virtual currency credentials," is our top priority. We would not be able to support the final act unless this change is made.

Moreover, we believe it was settled in the recent meeting that all mention of virtual currency credentials would be struck from the act. The current definition of "control" is

technology-neutral, and can therefore apply to persons whose possession of a “credential” affords them (as stated in the definition of control) “power to execute unilaterally or prevent indefinitely virtual currency transactions.” Keeping the phrase credentials throughout the act only muddies the waters. The technology-neutral definition of “control” is flexible enough to expand beyond “credential” possession to other forms of power over other persons’ virtual currency, and it avoids an outcome where a license is required from a person that has some part of a credential but not a sufficient part to have control. We understand that the phrase may have been left in the draft by mistake, but we must stress that this is our single most important issue with the language as it stands. We would not be able to offer our support for the final act if mention of credentials remained throughout the text.

The second change, removing “change of location” language from the definition of “transfer,” is also critical for creating greater clarity for innovators in this space. We believe it was settled in the recent meeting that this subsection (C)¹ would be struck from the final draft. As discussed, virtual currency does not exist in any geographic location. Therefore, there is no logical way to interpret this section in relation to the actual technology. Transfers between the accounts of the same resident are already covered by subsection (B) immediately preceding this section. We would not be able to support this model act if this section remained.

The third change, clarifying the personal use exemption,² ensures that *all* personal uses of the technology are exempted. The current language only covers activities involving “relinquishing” virtual currency. The language should be “obtains or relinquishes.” As discussed in the meeting, personal investments or mining activity that involves “buying” should not be covered just as “selling” should not be covered. This is a high priority change for us.

Regarding the fourth change, crafting *de minimis* and provisional licensing thresholds,³ it was our understanding that in the last meeting it was agreed to break this out into the three types of activities and make the long-term custodial activities “administration” and “storage” have a lower threshold than the mere short term transactional activities “transfer” and “exchange” in order to match the amount of risk they present to end-users. As such we have proposed language for the *de minimis* exemption that would create a \$5,000 threshold for long-term activities (storing and administering) and a \$15,000 threshold for short-term transactional activities (transferring and exchanging). Similarly for the provisional license upper-threshold we have proposed \$35,000 for long-term activities and \$100,000 for short-term activities.

Regarding the fifth change, eliminating technology-specific and impracticable recording requirements from the recordkeeping section,⁴ the currently specified technology-specific recordkeeping requirements (*e.g.* IP Addresses, passwords, etc.) are confusing and dangerous. We had understood that this language would be struck from the final version. There is no specific requirement to record this information under federal anti-money laundering

¹ See comment on red-line page 4, lines 2-4.

² See comment on red-line page 15, lines 1-3.

³ See comments on red-line page 15, line 8; page 38, lines 18-19.

⁴ See comments on red-line page 42, lines 9-13.

obligations so we see no reason to record it here, for consumer protection purposes. This is a high priority change for us. Requiring the recordation of this information in a way not already performed by the provider may create a cybersecurity vulnerability in that passwords and other credentials may be recorded in unsecured media as per the assumed compliance obligations of this act. This would be very bad for end-user security and privacy.

Additionally, in the following subsection,⁵ rather than requiring personally identifiable information for all “principal” parties to the transaction, we suggest “any parties to the transaction that are customers of the licensee.” Other, non-customer parties may not be known to the licensee, and the NY Bitlicense (as well as FinCEN) only requires recordation of information about other parties to the extent practicable. This is a high priority change for us.

Finally, there are several smaller comments and suggestions to be found in our red-line; while none of these changes are critical for Coin Center’s support, we believe they are helpful for clarity and style. Some changes also relate to the reporter’s notes which are, on the whole, excellent, but have a few minor issues regarding characterization of certain technological details. We encourage you to review the red-line PDF, attached to this letter, in full, and once again thank you sincerely for taking such care in the drafting of this important model law.

Thank you for your time and please always feel free to email me at peter@coincenter.org if you have any questions.

Sincerely,

Peter Van Valkenburgh,

Director of Research

⁵ See comments on red-line page 42, line 12.

DRAFT
FOR DISCUSSION ONLY

REGULATION OF VIRTUAL CURRENCY BUSINESSES ACT

NATIONAL CONFERENCE OF COMMISSIONERS
ON UNIFORM STATE LAWS

May 4-7, 2017 Style Committee Meeting

This Draft reflects comments received from the Drafting Committee and Observers
on the Draft prepared for the March 3-5, 2017 Drafting Committee Meeting

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By
NATIONAL CONFERENCE OF COMMISSIONERS
ON UNIFORM STATE LAWS

The ideas and conclusions set forth in this draft, including the proposed statutory language and any comments or reporter's notes, have not been passed upon by the National Conference of Commissioners on Uniform State Laws or the drafting committee. They do not necessarily reflect the views of the Conference and its commissioners and the drafting committee and its members and reporter. Proposed statutory language may not be used to ascertain the intent or meaning of any promulgated final statutory proposal.

April 14, 2017

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REGULATION OF VIRTUAL CURRENCY BUSINESSES ACT

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1 **REGULATION OF VIRTUAL CURRENCY BUSINESSES ACT**

2 **[ARTICLE] 1**

3 **GENERAL PROVISIONS**

4 **SECTION 101. SHORT TITLE.** This act may be cited as the Regulation of Virtual
5 Currency Businesses Act.

6 **SECTION 102. DEFINITIONS.** In this act:

7 (1) “Applicant” means a person that applies for a license under this act.

8 (2) “Bank” means a federally or state-chartered depository institution or a holder of a
9 charter granted by the Comptroller of the Currency to a person engaged in the business of
10 banking other than deposit-taking. The term does not include:

11 (A) an industrial loan company or a state-chartered trust company or limited
12 purpose trust company unless the department has authorized the company to engage in virtual
13 currency business activity, or

14 (B) a trust company or limited purpose trust company chartered by a state with
15 which this state does not have a reciprocity agreement governing trust company activities.

16 (3) “Control” means:

17 (A) When used in reference to transactions or relationships involving virtual
18 currency, the term means power to execute unilaterally or prevent indefinitely virtual currency
19 transactions.

20 (B) When used in reference to a person providing virtual currency products of
21 services to others, the term means the direct or indirect power to direct the management,
22 operations, or policies of the person through legal or beneficial ownership of voting power in the
23 person or pursuant to contract, arrangement, or understanding.

1 (4) “Convertible virtual currency” means virtual currency that:
2 (A) has an equivalent value in legal tender and can be exchanged for legal tender
3 or bank credit; or
4 (B) can be exchanged for an account denominated in legal tender.
5 (5) “Department” means the [name of state agency implementing this act].
6 (6) “Exchange” means to assume control of virtual currency from or on behalf of a
7 resident, at least momentarily, in order to sell, trade or convert:
8 (A) virtual currency for legal tender or bank credit or for one or more forms of
9 virtual currency; or
10 (B) legal tender or bank credit for one or more forms of virtual currency.
11 (7) “Executive officer” means an individual who is a director, officer, manager,
12 managing member, partner, or trustee of a person who is not an individual.
13 (8) “Legal tender” means a medium of exchange or unit of value, including the coin or
14 paper money of the United States, issued by the United States or otherwise recognized by the
15 United States as a lawful means for payment of taxes and the discharge of debts.
16 (9) “Licensee” means a person licensed under this act.
17 (10) “Person” means an individual, estate, partnership, business or nonprofit entity, or
18 other legal entity. [The term does not include a public corporation, government or governmental
19 subdivision, agency, or instrumentality.]
20 (11) “Provisional registrant” means a person that has registered with this state to conduct
21 virtual currency business activity but whose volume of virtual currency business activity with
22 residents is less than the threshold required for licensure under Article 2 of this act but greater
23 than the amount specified in section 103 that excludes the person from coverage under this act.

1 (12) “Reciprocity agreement” means an arrangement between the department and the
2 appropriate licensing agency of another state that permits a licensee to engage in virtual currency
3 business activity in this state under a license granted by the other state.

4 (13) “Record” means information that is inscribed on a tangible medium or that is stored
5 in an electronic or other medium and is retrievable in perceivable form.

6 (14) “Registry” means the Nationwide Multistate Licensing System and Registry.

7 (15) “Resident” means, as to a specific state, a person that is domiciled in, is physically
8 located in for more than 183 days of the previous 365 days, or has a place of business in the state.

9 (16) “Responsible individual” means an individual who has managerial authority with
10 respect to the licensee’s virtual currency business activity with residents.

11 (17) “Sign” means, with present intent to authenticate or adopt a record:

12 (A) to execute or adopt a tangible symbol; or

13 (B) to attach to or logically associate with the record an electronic
14 symbol, sound, or process.

15 (18) “State” means a state of the United States, the District of Columbia, Puerto Rico, the
16 United States Virgin Islands, or any territory or insular possession subject to the jurisdiction of
17 the United States. [The term does not include a federally recognized Indian tribe or nation.]

18 (19) “Storage” means maintaining control of virtual currency ~~or virtual currency~~
19 ~~credentials~~ on behalf of a resident by any person other than the resident.

20 (20) “Transfer” means to assume control of virtual currency ~~or virtual currency~~
21 ~~credentials~~ from or on behalf of a resident and to

22 (A) credit the virtual currency to the account of another resident or person;

23 (B) move the virtual currency from one account of a resident to another account of

1 the same resident; or

2 ~~(C) change the location of virtual currency or of an account containing virtual~~
3 ~~currency from this state to another state or from this state to another jurisdiction, wherever~~
4 ~~located, regardless of whether the same resident is the owner of the virtual currency or account;~~



5 or

6 (D) relinquish control of virtual currency ~~or of virtual currency credentials~~ to
7 another person.

8 (21) “US Dollar equivalent of virtual currency” means the equivalent value of a particular
9 virtual currency in U.S. dollars shown on a virtual currency exchange based in the United States
10 for a particular date or time period as required in this act.

11 (22) “Virtual currency”:

12 (A) means a digital representation of value that:

13 (1) is used as a medium of exchange, unit of account, or store of value; and

14 (2) is not legal tender, whether or not denominated in legal tender; and

15 (B) does not include:

16 (1) software or a protocol governing transfer of the digital representation of
17 value;

18 (2) a transaction in which a merchant grants value as part of an affinity or
19 rewards program, which value cannot be taken from or exchanged with the merchant for legal
20 tender, bank credit, or convertible virtual currency; or

21 (3) a digital representation of value used within an online game, game
22 platform, or a family of games sold by the same publisher or offered on the same game
23 platform.

1 (23) “Virtual currency administration” means issuing virtual currency with the authority
2 to redeem the currency for legal tender, bank credit or other virtual currency.

3 (24) “Virtual currency business activity” means:

4 (A) exchanging, transferring, or storing virtual currency with or on behalf of
5 residents or engaging in virtual currency administration, whether directly or through an
6 agreement with a virtual currency control services vendor;

7 (B) holding electronic precious metals or electronic certificates of precious metals
8 on behalf of other persons or issuing shares or electronic certificates representing interests in
9 precious metals; or

10 (C) exchanging otherwise non-convertible digital units for one or more forms of
11 convertible virtual currency or for legal tender or bank credit outside the online game, game
12 platform, or family of games offered by the same publisher from which the original digital units
13 were received.

14 (25) “Virtual currency control services vendor” means a person that has control of virtual
15 currency solely pursuant to agreement with a person that, on behalf of another person, assumes
16 control of virtual currency.

17 ***Legislative Note: Definition of the Terms “Bank” and “State”***

18 *States that wish to include state-chartered trust companies under the definition of the term*
19 *“bank” should consider adding a sentence at the end of the definition of “bank” that expresses*
20 *the type of trust companies that are eligible for the exemption for “banks” in Section 103. Entities*
21 *that obtain “fintech” charters from the Office of the Comptroller of the Currency will be exempt*
22 *from the requirements of this act under in Section 103.*

23
24 **Reporter’s Notes on Section 102**

25 The definitions are by far the most complex aspects of this drafting project and have
26 received extensive attention in Drafting Committee meetings and in comments submitted by
27 Observers. A handful of definitions are of primary importance – the definitions of “virtual
28 currency,” “virtual currency business activity,” “control” of virtual currency, and “virtual

1 currency administration.” After some preliminary observations, the following commentary
2 proceeds in alphabetical order through the definitions.
3

4 *Scope of the term “virtual currency.”* The definition of “virtual currency” closely tracks
5 the definition urged by Conference of State Bank Supervisors (“CSBS”) in its September 15,
6 2015, Framework. The incumbent Bank Commissioners voted on the CSBS Framework prior
7 to its release. Thus, using a definition that is nearly what the CSBS approved is designed to
8 promote uniform enactment and compliance ease.
9

10 There were two other potential sources of a definition for “virtual currency.” The first
11 emerged in guidance that the Department of Treasury’s Financial Crimes Enforcement
12 Network (“FinCEN”) issued in March 2013 for purposes of explaining the connection between
13 certain entities offering services in virtual currency and FinCEN’s prior guidance on what is
14 “money transmission” for purposes of FinCEN regulation implementing the federal Bank
15 Secrecy Act. Fin. Crimes Enf. Network, Application of FinCEN’s Regulations to Persons
16 Administering, Exchanging, or Using Virtual Currencies, FIN-2013-G001 (March 18, 2013).
17 FinCEN’s guidance also defines when persons engaged in money transmission need to register
18 as “money services businesses with FinCEN to avoid potential criminal liability under 18
19 U.S.C. §1960 for failure to be registered with FinCEN.
20

21 FinCEN defines the divide between “currency” or “real currency” and “virtual currency”
22 with the former being “... the coin and paper money of the United States or of any other country
23 that [i] is designated as legal tender and that [ii] circulates and [iii] is customarily used and accepted
24 as a medium of exchange in the country of issuance.” 31 C.F.R. §1010.100(m).
25

26 FinCEN views the term “virtual currency” to be “a medium of exchange that operates like a
27 currency in some environments, but does not have all the attributes of real currency.” FIN-2013-
28 G001, *supra*. The line currently drawn carves out digital representations of bank money as may
29 be loaded onto electronic travelers’ checks or credit cards in part because providers of those
30 services are subject to longstanding regulation. The distinction between “virtual currency” and
31 digital representations of “legal tender” as the terms are defined in this Draft lies in the fact that
32 traditional demand deposit accounts are representations of legal tender or other “hard assets” in a
33 manner that makes the account holder a creditor of a federally insured depository institution
34 under the Federal Deposit Insurance Act. 12 U.S.C. §1813(l) (2013).
35

36 The second source comes from work completed in 2014 by the Financial Action Task
37 Force (“FATF”), a multinational group focused on identifying and deterring money laundering
38 and terrorist finance. “Virtual Currencies: Key Definitions and Potential AML/CFT Risks,”
39 *available at* [http://www.fatf-](http://www.fatf-gafi.org/publications/methodsandtrends/documents/virtual_currencies_key_definitions_and_potential_aml/cft_risks)
40 [gafi.org/publications/methodsandtrends/documents/virtual_currencies_key_definitions_and_potenti](http://www.fatf-gafi.org/publications/methodsandtrends/documents/virtual_currencies_key_definitions_and_potential_aml/cft_risks)
41 [al_aml/cft_risks](http://www.fatf-gafi.org/publications/methodsandtrends/documents/virtual_currencies_key_definitions_and_potential_aml/cft_risks). FATF’s explains its vision of “virtual currency” as:
42


43 Virtual Currency is a digital representation of value that can be digitally traded and
44 functions as (1) a medium of exchange; and/or (2) a unit of account; and/or (3) a store of
45 value, but does not have legal tender status (i.e., when tendered to a creditor, is a valid and
46 legal offer of payment) in any jurisdiction. It is not issued or guaranteed by any jurisdiction,

1 and fulfills the above functions only by agreement within the community of users of the
2 virtual currency. Virtual currency is distinguished from fiat currency (a.k.a “real currency,”
3 “real money,” or “national currency”), which is the coin and paper money of a country that
4 is designated as its legal tender; circulates; and is customarily used and accepted as a
5 medium of exchange in the issuing country. It is distinct from e-money, which is a digital
6 representation of fiat currency used to electronically transfer value denominated in fiat
7 currency. E-money is a digital transfer mechanism for fiat currency—i.e., it electronically
8 transfers value that has legal tender status.
9

10 *Id.*, at 4. As FATF explained, “virtual currency – regardless of how denominated by its issuer or
11 issuers – is not issued or guaranteed by sovereign governments (for the most part) and, like barter
12 transactions, requires advance agreement by obligor and obligee that payment for goods, services or
13 exchange may be made with it. Thus, it differs from bank credits and e-money as FATF sees the
14 borders between transactions based on “fiat currency” and those that are not.
15

16 While respectful of the work required to achieve FATF’s definition, its definition is intended
17 for a purpose or purposes beyond the scope of this Drafting Committee’s work. Adoption for this
18 purpose would have required states to determine whether particular virtual currency was “legal
19 tender” in any jurisdiction on an updated basis that has little to do with how virtual currency
20 businesses that perform “trusted intermediary” or custodial services should be regulated by the
21 states.

22 Additional discussion of the choices considered in deciding upon the definition of the
23 term “virtual currency” appear in later portions of these Reporter’s Notes on Section 102.
24

25 *Scope of the term “virtual currency business activity.”* The definition of “virtual
26 currency business activity” is designed to capture those activities with sufficient similarity to
27 money transmission or other money services as to become proper targets for regulation under
28 this act, and to restrict the activity to that performed with or on behalf of residents of the
29 jurisdiction that seeks to license the provision of such activities in a jurisdiction in the United
30 States. As a result, three active verbs – Exchange, Transfer, and Store – cover the core concepts
31 animating what constitutes “virtual currency business activity.” (Those terms are defined
32 themselves in Section 102.) To qualify as a virtual currency business activity, the function must
33 be between a provider and an end-user (either a consumer or a business user), and the provider
34 must obtain from the user sufficient credentials  allow the provider to transact or prevent
35 transactions without further participation by the end-user.
36


37 From this point, the notes proceed in alphabetical order. Wherever suitable to the goals of
38 this act, definitions were taken from the ULC’s Drafting Rules (2012 ed.). Definitions of some
39 terms, such as “department” do not require explanation at this time.
40

41 “*Bank.*” Entities meeting this definition are exempt from the provisions of this act.
42 Others are not. For example, this draft excludes trust companies from the definition of the term
43 “bank.” Thus, trust companies seeking to engage in virtual currency business activities would
44 need to comply with the provisions of this act. State statutes authorizing trust companies vary as
45 do states’ attitudes about the ability of out-of-state trust companies to engage with residents of
46 their states if the trust company does not hold a trust company charter from their states. This

1 issue rose in prominence when New York State issued a trust company charter to ItBit in 2015.
2 ItBit’s ability to engage in transactions with residents of other States was challenged by other
3 States. In April 2016, ItBit withdrew from offering its services to residents of Texas. Since then,
4 there has been no additional information about whether the states will insist on their own charters
5 for trust companies engaging in virtual currency business activity.
6

7 This draft also excludes industrial loan companies from the definition of the term “bank.”
8 ILC’s are regulated for many purposes as banks, but the scope of their permissible activities are
9 not the same as banks and many states do not charter ILCs. Thus, inclusion of ILC’s might
10 complicate state regulation of their activities and the reciprocity provisions in Article 2.
11

12 “*Control.*” The term “control” is normally restricted to the ordinary uses in a merger and
13 acquisition context. A person with control makes decisions and directs policy and procedures
14 over the entity being regulated and may or may not be the type of person to whom the state’s
15 department issuing licenses normally would allow to perform trusted intermediary or money
16 services business activities. Changes in the identity of persons exercising, or capable of
17 exercising “control” may adversely affect the operation of a business and federal and state laws
18 regulating trusted intermediaries often define terms such as “control” for this reason. This
19 concept primarily applies to Articles 2 and 3 of this act.
20

21 The term “control” is used in this act for a second purpose, that is, power to transact in
22 virtual currency for customers unilaterally or to prevent transactions indefinitely without the
23 cooperation or action of the virtual currency business involved. Thus, Section 102 (3) has
24 separated these two uses of the word “control” to signal which type of relationship – to a
25 business entity or to a type of transactional power – intended in subsequent uses of that term in
26 this act. The definition of “control” in Section 102(3)(B) subsumes the definition of “custody”
27 from the October 2016 draft. 
28

29 “*Convertible virtual currency.*” Virtual currency exists in two forms – that which can be
30 converted into legal tender or bank credit denominated as such, and that which cannot. FinCEN
31 recognized this key distinction in its March 2013 guidance, *see supra*. Convertible virtual
32 currency is covered in this act’s definition of “virtual currency” and must be in play to effect the
33 exclusion of certain in-game units of value and merchant affinity program rewards from the
34 coverage of this act.
35

36 “*Exchange.*” The definition of the term “exchange” covers cases in which the exchanger,
37 at a specific time, has “control” of the virtual currency being exchanged. This term is not
38 intended to cover an individual that operates equipment to perform a function or service on the
39 individual’s own virtual currency. Thus, in order to maintain a distinction between businesses
40 that offer “virtual currency business” services and products to others and persons managing their
41 own virtual currency holdings, if the intermediary virtual currency business lacks control of
42 virtual currency, as the term “control” is defined in Section 103(A), then that person is not
43 engaged in the “exchange” of virtual currency for purposes of this act.
44

45 The verb “exchange” covers any sale or barter of virtual currency for, other virtual
46 currency, or “real world” goods or services other than by “miners.” “Miners” in the Bitcoin

1 system use computing power to expand the extant number of bitcoins in a decentralized currency
2 such as Bitcoin) and are exempt under FinCEN’s March 2013 guidance. This draft also exempts
3 miners from this act. Miners are not compensated directly by the persons for whom they perform
4 ledger-registration services on the blockchain. Thus, miners do not engage as known trusted
5 intermediaries with third parties except to maintain the blockchain’s record of transfers of virtual
6 currencies. Miners who mine bitcoins for their own purposes or who use virtual currencies to pay
7 for goods or services are also exempt from FinCEN’s regulations.
8

9 “*Executive officer.*” The purpose of this revision is to deal with places where the draft
10 refers to officers and directors in various contexts. This definition is intended to be entity-neutral.
11

12 “*Legal tender.*” This draft defines “legal tender” as opposed to the term “money,” which
13 is the norm in the Uniform Law Commission draft legislation. Use of the term “legal tender”
14 accommodates the revised definition of the term “virtual currency” in the CSBS’ 2015
15 Framework.
16

17 “*Person.*” This definition proceeds from the Uniform Law Commission’s customary
18 definition of the term “person” with consideration for the directions on exemptions provided by
19 the Drafting Committee as shown in Section 103’s exemptions.
20

21 “*Provisional registrant.*” The virtual currency community is composed of many types of
22 businesses at many stages of business maturity. The Drafting Committee’s tasks included
23 crafting a method for virtual currency businesses to be recognized as such under state laws in
24 their initial stages without being required to become fully licensed before offering any services to
25 residents of the state. This act separates providers of virtual currency business services and
26 products into three categories. First, those with activity volumes below \$5,000 are exempt from
27 any requirements of this act in Section 103. Second, those with activity levels between \$5,000
28 and \$35,000 for virtual currency business may register as “provisional registrants” under Section
29 210. These businesses do not need to undergo and wait for full licensure, but have
30 responsibilities for user protections and compliance with basic user protections, cybersecurity,
31 and anti-money laundering compliance that the act imposes on fully licensed individuals. Third,
32 provisional registrants must register with FinCEN as “money services businesses” to comply
33 with the “provisional registration” requirements and to avoid BSA liability as mentioned earlier
34 in this set of Reporter’s Notes.
35

36 Provisions on small-volume providers and “provisional registrants” are among the most
37 important provisions in this act to the virtual currency community and are among the most
38 innovative.
39

40 “*Reciprocity Agreement.*” Although some state banking departments and money
41 transmitter regulators have signed on to a reciprocity framework created by the Conference of
42 State Bank Supervisors, the lack of reciprocity is frequently mentioned by businesses seeking
43 licensure as a major obstacle to the growth of their businesses. Consistent with the charge to this
44 Drafting Committee, facilitating reciprocity in licensure among the states is a major goal of this
45 act – and is likely to be a major contribution to the continuation of state licensure of non-
46 depository providers in the growing spheres of internet- and mobile-enabled payments and

1 custodial services and products. Reciprocity may be authorized on a bilateral or multi-lateral
2 basis in any enacting state or by adoption of the Registry operating under the auspices of the
3 Conference of State Bank Supervisors in its current form or a later version of that Registry.
4

5 “*Transfer.*” The term “transfer” is intended not to include movement of fiat currency
6 from one user to another, or from one user to another account of the same user, or from one
7 jurisdiction to another for the simple reason that transfers that involve fiat currency are “money
8 transmission” not “virtual currency transmission.” If a transaction involved both fiat currency
9 and virtual currency, that transaction involves an “exchange” not a transfer.
10

11 “*U.S. Dollar equivalent.*” This definition is intended to assist persons entering into
12 virtual currency business activity to determine their eligibility for the exemption provided in
13 section 103, for provisional registration, and for full license applications under this act. Virtual
14 currency businesses whose business activity in the enacting state remains below \$5,000
15 measured by this definition are required under this draft to comply only with section 302’s
16 record keeping requirements (so that they can demonstrate their eligibility for section 103’s
17 exemption). Virtual currency businesses that have more than \$5,000 in virtual currency business
18 activity in the enacting state but less than \$35,000 in the same state are eligible for provisional
19 registration. Virtual currency businesses whose virtual currency business activity in the enacting
20 state exceed \$35,000 must apply for full licensure or cease doing business. In this last category,
21 virtual currency businesses may continue to offer services or products while their applications
22 are pending under a “provisional operation” safe harbor. (Provisional registrants will be required
23 to comply with some of the responsibilities placed on licensees under this act in addition to the
24 record keeping requirement of section 302 mentioned in this paragraph.)
25

26 “*Virtual currency.*” The term “virtual currency” should cover any unit of value or
27 exchange, whether or not the unit is denominated in U.S. dollars. Some issuers offer virtual
28 currencies that are denominated in dollars. The definition operates on a three-part test: it must be
29 a medium of exchange, unit of account, or store of value.
30

31 Whether a unit of virtual currency is denominated in U.S. dollars or Yen is immaterial to
32 the question of whether the person who issues it or holds themselves out as providing services
33 connected to transfer, exchange, or storage of such virtual currency should be regulated under
34 this act or regulated under state money services or money transmission statutes or regulated as an
35 insured depository institution or other form of trusted intermediary. So long as the virtual
36 currency is not deemed to be legal tender by the United States for purposes of paying taxes or
37 discharging debts among private parties, it is virtual currency for purposes of this draft
38 legislation. The decision by a non-government issuer of “virtual currency” to denominate its
39 exchange value in a particular fashion (USD, Yen, or Euros) also should not be the controlling
40 factor in determining coverage of the business entity or the transaction here.
41

42 Separately, the act excludes from the definition of “virtual currency” definition have
43 covered merchants’ affinity or rewards programs and the equivalent sorts of value online games
44 and online game platforms to the extent that the accounting units in online games and game
45 platforms should be restricted to accounting units that cannot be converted into cash, bank credit,
46 or convertible currencies. Any game unit of value that is convertible to cash, bank credit, or

1 convertible virtual currency should be covered in the definition of “virtual currency.” This
2 bright line between non-cash and cash-out possibilities is consistent with guidance FinCEN
3 issued in 2016 on what does not and does qualify as “money transmission.” Fin. Crimes Enf.
4 Network, No-action Letter, April 2016 ((unpublished); copy on file with the Uniform Law
5 Commission) provided by the Entertainment Software Association with its April 2016 comment
6 on URVCBA Draft). An exclusion of retail rewards or affinity programs from this act on this
7 basis also is consistent with the exclusion of loyalty card programs from the Unclaimed Property
8 Act approved at the 2016 Annual Meeting, even if the terminology employed varies. As the
9 Chair of the Unclaimed Property Act Drafting Committee observed during the First Reading of
10 that act, the basis for this exclusion – wherever they appear in either act – is that these “[rewards]
11 cannot be monetized into legal tender.”

12
13 The definition of “virtual currency” also includes “e-precious metals,” and e-certificates
14 for precious metals” that can be transferred from one owner to another. In August 2015,
15 FinCEN extended its March 2013 guidance concerning what types of business activity with
16 virtual currency render the business a “money services business” for the purposes of federal
17 AML requirements under 31 C.F.R. Part X. Fin. Crimes Enf. Network, Application of FinCEN’s
18 Regulations Pertaining to Persons Issuing Physical or Digital Negotiable Certificates of
19 Ownership of Precious Metals, FIN-2015-R001, August 14, 2015,
20 https://www.fincen.gov/news_room/rp/rulings/pdf/FIN-2015-R001.pdf (hereinafter “FinCEN
21 Precious Metals Certificate Guidance”). The 2015 guidance concluded that e-precious metals and
22 e-certificates for precious metals were “virtual currency” and persons offering them were
23 engaged in “money transmission” for two reasons. The first is that e-precious metals are units of
24 value held by intermediaries on behalf of others and are not units of “legal tender.” Thus, as the
25 ABA’s Advisor explained at the Annual Meeting, they are representations of value that underlie
26 the virtual currency owned by another person. E-certificates for precious metals are similar to
27 warehouse receipts in some ways, and are “negotiable” or transferable by one person to another,
28 by one person from an account to another account that person owns, or by one jurisdiction to
29 another.

30
31 In this act, “virtual currency” deemed by a Native American tribe as “legal tender” on
32 their lands remains covered by the definition of “virtual currency.” Thus, the definition of what
33 is not “legal tender in any jurisdiction” is already a complex question and is likely to grow more
34 complex. The solution presented is designed to provide guidance to future virtual currency
35 businesses and to State regulators in an arena in which the adoption of a virtual currency by a
36 sovereign could cloud the ability of regulators to distinguish between currency and virtual
37 currency. Thus, for now, the only sensible definition is the one closest to that adopted in 2015
38 by the CSBS that relies on distinguishing between what the United States government deems to
39 be “legal tender” rather than what any other sovereign deems for its own purposes to be “legal
40 tender.” What another sovereign government deems to be “legal tender” also falls under
41 FinCEN’s March 2013 guidance as “foreign exchange” to which distinct FinCEN regulations
42 apply. *See*, FIN-2013-G001, *supra* at 5.

43

1 “*Virtual currency administration.*” The definition of “virtual currency administration”
2 follows definitions set forth in the Financial Crimes Enforcement Network’s March 18, 2013
3 guidance on virtual currency and money transmission. Fin. Crimes Enf. Network, Application of
4 FinCEN’s Regulations to Persons Administering, Exchanging, or Using Virtual Currencies, FIN-
5 2013-G001, https://www.fincen.gov/statutes_regs/guidance/pdf/FIN-2013-G001.pdf. The
6 Guidance explains: “An *administrator* is a person engaged as a business in issuing (putting into
7 circulation) a virtual currency, and who has the authority to redeem (to withdraw from
8 circulation) such virtual currency.” *Id.*

9
10 “*Virtual currency business activity.*” The term “virtual currency business activity” is
11 intended to limit the scope of this act to providers of products and services that are comparable
12 to: (1) money transmission, issuance of virtual currencies from a centralized administration or
13 source, exchange of virtual currency for other virtual currencies, bank credit or legal tender, and
14 (2) custodianships on the order of a securities entitlement subject to Article 8 of the Uniform
15 Commercial Code. It is not intended to cover relationships in which the provider offers a
16 service or product that is limited and the provider cannot transact or prevent transactions
17 unilaterally. Thus, arrangements that the virtual currency community refers to as “multi-sig” –
18 that is, arrangements that require more than one credential-equivalent to be used to effect
19 transactions. The “virtual currency business activity” definition works with the definition of
20 “control of virtual currency” to cover only those providers whose products and services have (1)
21 the power unilaterally to transact, convert or redeem, or (2) the power to prevent such
22 transactions permanently.

23
24 For consistency with the “money services” and “end-user-facing” scope of the Uniform
25 Money Services Act and other money transmitter statutes, the definition of “virtual currency
26 business activity” does not cover non-currency uses of the technologies underlying virtual
27 currencies today. This definition, thus, excludes a new class of technologies at an enterprise or
28 business-wide level that are not end-user-facing and are designed to perform functions, such as
29 “enabling existing currencies to be exchanged more efficiently.” *See* Comment of Ripple, April
30 1, 2016, at 5 (on file with the Uniform Law Commission). A specific exemption for enterprise
31 solutions used by persons otherwise exempt from this act under Section 103 appears in Section
32 103.

33
34 The Drafting Committee considered, but did not adopt, use of a “facts and
35 circumstances” approach to determining which products and services should be included in the
36 definition of “virtual currency business activity.” FinCEN uses such a test in its guidance on
37 what constitutes “money services” activities that trigger its regulations governing registration of
38 “money services” businesses. A “facts and circumstances” approach is not as workable in a
39 licensure and prudential regulatory scheme as it may be in determining criminal liability under
40 FinCEN’s authority. A second reason for departing from FinCEN’s “facts and circumstances”
41 approach is that this act established two pre-licensure stages and a licensure requirement. Each
42 of these stages needs to operate on as bright a line as possible to provide certainty and uniformity
43 – and to protect persons in the two early stages from liability for not being fully licensed.

44
45 The term “virtual currency business activity” does not cover a form of virtual currency
46 escrow service known colloquially as “multi-sig,” for the prospect that more than one entity

1 may hold a key to virtual currency that can be used to effect exchanges or transfers of virtual
2 currency only when use in combination with another key or credentials. Thus, the exclusion for
3 “multi-sig” proceeds from the definition of the term “control,” which requires that the provider
4 subject to the act have power to transact unilaterally or prevent on a permanent basis
5 transactions in that virtual currency unit. If an owner of virtual currency stored one of several
6 keys needed to transfer virtual currency to a third party with a “multi-sig” firm, and two such
7 keys were required to transact business in that virtual currency, the “multi-sig” party would lack
8 the power to transact unilaterally and the power to prevent use of the other keys and, so, to
9 prevent the transaction.

10
11 Although bitcoins are “mined” (a process yielding a “bitcoin” that is a form of payment
12 or reward for solving a difficult puzzle), others virtual currencies are issued by a centralized
13 authority in exchange for legal tender or other virtual currencies to a user who seeks to obtain
14 goods or services, other virtual currency, or legal tender in exchange. It is the group of
15 centralized issuers of virtual currency at the moment of issuance who are engaged in virtual
16 currency business activity because they are holding themselves out to others as the equivalent of
17 issuers of prepaid cards (also known as prepaid value) or as offering other forms of trusted and
18 intermediated financial services. Miners not engaged in offering services to third parties (other
19 than the clearing and verification roles they play in the Bitcoin blockchain) are not engaged in
20 virtual currency business activity, and are exempt from this act under Section 103.

21
22 “*Virtual currency control services vendor.*” These service providers to persons or entities
23 that deal with end-users of virtual currency business products and services are exempt from this
24 act under Section 103.

25
26 **SECTION 103. SCOPE.**

27 (a) Except as set forth in subsection (b), this act governs the virtual currency business
28 activity of a person, wherever located, that engages in or holds itself out as engaging in such
29 activity with a resident.

30 (b) This act does not apply to the exchange, transfer, or storage of virtual currency or to
31 virtual currency administration to the extent that the activity is governed by the Electronic Fund
32 Transfer Act of 1978, 15 U.S.C. Sections 1693 through 1693r, the Securities Exchange Act of
33 1934, 15 U.S.C. Section 78a through 78oo, the Commodities Exchange Act of 1936, 7 U.S.C.
34 Sections 1 through 27f, or [insert reference to the “blue sky” laws of this state], or to activities
35 by:

36 (1) the United States, a state, a political subdivision of a state, or an agency or


1 instrumentality of Federal, state, or local government, or a foreign government and its
2 subdivisions, departments, agencies and instrumentalities;

3 (2) a bank;

4 (3) a person that is engaged in money transmission and that:

5 (A) holds a current license from this state;


6 (B) is authorized by the department to engage in virtual currency business
7 activity; and

8  complies with the provisions of this act enumerated by the department
9 that differ substantially from the obligations imposed by this state on licensed money transmitters.

10 (4) a person participating in a payment system, to the extent the person is exempt
11 or provides processing, clearing, or settlement services solely for transactions between or among
12 persons otherwise exempt from this act;


13 (5) a person engaged in the business of dealing in foreign exchange to the extent
14 the person's activity meets the definition in 31 C.F.R. Section 1010.605(f)(1)(iv);

15 (6) a person that only


16 (A) contributes connectivity software or computing power to a
17 decentralized virtual currency; 

18 (B) provides data storage or security services for a virtual currency
19 business and is not otherwise engaged in virtual currency business activity on behalf of other
20 persons; or

21 (C) provides to persons otherwise exempt from this act virtual currencies as
22 one or more enterprise solutions used solely between each other and that has no agreement or
23 relationship with any resident that is an end-user of virtual currency.

1 (7) a person that mines, manufactures, buys, sells, exchanges, or otherwise
2 ~~relinquishes~~ control of virtual currency solely for personal, family, or household purposes if the
3  person does not engage in any virtual currency business activity on another person's behalf.

4 Personal, family, or household purposes include buying or selling virtual currency as an
5 investment, researching virtual currency or related technologies, and obtaining virtual currency
6 as payment for the purchase or sale of goods or services.

7 (8) except as to section 302, a person whose virtual currency business activity with
8 residents is reasonably expected to be valued, in the aggregate, on an annual basis at ~~\$5,000~~ or
9 less measured by the US Dollar Equivalent of the virtual currency. 

10 (9) an attorney providing escrow services to residents;


11 (10) a title insurance company providing escrow services to residents;

12 (11) a securities intermediary, as defined in [insert state reference to U.C.C.
13 Section 8-102], or a commodities intermediary as defined in [insert state reference to U.C.C. 8-
14 102], other than a bank or clearing corporation not otherwise exempt under this section that

15 (A) engages in the ordinary course of business in virtual currency business
16 activity with residents in addition to maintaining securities accounts to which securities are
17 credited and is regulated as a securities intermediary for securities under federal law or under
18 other law of this state or another state; and


19 (B) affords protections to residents comparable to those set forth in [insert
20 state reference to U.C.C. Article 8, Part 5] to its customers;

21 (12) a secured creditor under [insert state reference to U.C.C. Article 9] or
22 judgment creditor with a lien on collateral that is virtual currency, if the virtual currency business
23 activity of the creditor is limited to enforcing its security interest or judgment and related lien

1 and disposing of the collateral in compliance with [insert state reference to U.C.C. Article 9];
2 (13) a virtual currency control services vendor;
3 (14) a licensed money transmitter under [insert reference to the state’s money
4 services or money transmission act] that has been authorized by the department to engage in
5 virtual currency business activity, and also complies with [Articles] 3, 5 and 6 of this act; and
6 (15) a person that receives no compensation for providing virtual currency
7 products, services, or transactions from residents, or that is engaged in testing products or
8 services with the person’s own funds; or
9 (16) such persons or classes of persons that, given facts particular to the person or
10 class, the department may determine should be exempt from this act, whether or not the person
11 or class is covered by requirements imposed on money service businesses under federal law. 

12 **Legislative Note:** *If a state adjusts the US Dollar Equivalent for the exemption provided in this*
13 *act under subsection (b)(8) to a figure higher than \$5,000, the state should consider adding*
14 *compliance with section 502 as well as section 302 to the obligations of the person.*

15
16 **Reporter’s Notes on Section 103**

17
18 *Scope generally.* The goal of this draft legislation is not to regulate “virtual currencies” as
19 such. Rather, it is to regulate persons that issue virtual currencies or that provide services that
20 allow others to exchange, transfer, or store virtual currencies. Accordingly this act is intended to
21 govern persons ld themselves out as providing services to a holder of virtual currency
22 comparable to service that would be deemed “money transmission” under the Uniform Money
23 Services Act or other state “money transmission” statutes. Additionally, “currency” exchange
24 services to the public and persons that offer to take control of virtual currency for other persons.
25 This goal is to regulate that person in a manner that affords suitable licensure, supervision, and
26 user protections.

27
28 *Exemptions generally.* Section 103 also identifies exemptions from this act. The majority
29 of the exemption should seem familiar to persons familiar with the ULC’s “Money Services Act”
30 and with guidance published by the U.S. Department of Treasury’s Financial Crimes
31 Enforcement Network (“FinCEN”) since March 2013. The rationale for the less common cases
32 are described below.

33
34 **▪Personal Uses, Investment Uses, Receipt by Persons in the Ordinary Course of Sales of**
35 **Goods or Services.** Following the leads of FinCEN and the CSBS, Section 103 exempts

1 persons who use virtual currencies for personal purposes (including uses for investment
2 purposes or in the purchase of goods or services) or businesses that receive virtual
3 currencies comes from sales of goods or services in the ordinary course of business.
4 These persons are not engaged in the equivalent of money transmission. FinCEN laid out
5 this distinction in published guidance beginning with its March 2013 guidance, *see supra*.
6 Other activities that are exempt include investing in virtual currencies and later sale of
7 virtual currencies from one's own portfolio, purchasing virtual currencies in order to pay
8 for goods or services, and engaging in research with virtual currencies and related
9 technologies.

10
11 ▪ *Limited, Low-Volume Exemption and Exemption for companies that do not charge for*
12 *services or receive other forms of compensation.* This act has several exemptions that are
13 uncommon and deserve special attention. Foremost among these is the permanent
14 exemption for a person experimenting with a virtual currency technology and whose
15 volume of testing, etc. runs less than \$5,000. The question of whether and how to include
16 an "on-ramp" for new entrants to the virtual currency business industry was one of the
17 first issues tackled by the Drafting Committee. At the October 2016 Drafting Committee
18 meeting, the Committee decided to split its coverage of start-up businesses into two
19 categories – a permanent limited exemption for tiny volumes of activity is below a fixed
20 threshold and an "on-ramp" for entities between the permanent exemption and a higher
21 figure that still controls consumer risk, a status referred to as "provisional registration."
22 These independent categories respond to the charge to craft a licensure and prudentially
23 "lite" regulatory scheme for virtual currency businesses that would facilitate innovation
24 by virtual currency businesses.

25
26 Virtual currency businesses that are provisionally registered do not require full licensure,
27 but must comply with other obligations set forth in this act including user protections and
28 establishment and implementation of anti-money laundering and cybersecurity programs.

29
30 Provisional registrants will be expected to have registered with both the regulators in
31 States and jurisdictions offering this "on-ramp" and with FinCEN to the degree that their
32 activities meet the tests for "money service" businesses under FinCEN guidance.
33 Separating the application of this draft act into three stages as Section 103 does not alter
34 the businesses' need to follow FinCEN's regulations and guidance pertaining to which
35 types of activities are "money services" for purposes of Bank Secrecy Act and anti-
36 money laundering compliance. (It also will not excuse any business from compliance
37 with statutes and regulations enforced by Treasury's Office of Foreign Assets Control
38 (OFAC).) FinCEN's regulations impose a "registration" requirement on all businesses
39 that offer money services to the general public. Failure to register with FinCEN as a
40 "money services business" remains the law of the land regardless of what this draft act
41 otherwise provides. Thus, this draft act will not derogate any of these federal compliance
42 requirements: businesses that are exempt from this draft act or on the "on ramp" should
43 register with FinCEN to avoid penalties for non-registration imposed by FinCEN to the
44 extent their business activities align with FinCEN's interpretations of the Bank Secrecy
45 Act's requirements.

1 Observers, including the Digital Chamber of Commerce and CoinCenter have suggested
2 that the threshold for full licensure be set at \$1 million. This threshold was included in
3 legislation that was proposed in Pennsylvania in 2015. The Pennsylvania bill allowed the
4 exempt entity to remain exempt so long as the entity took “reasonably timely steps to seek
5 a license.” The version presented varies the effect on the entity as the threshold dollar
6 value is reached by requiring that it file as it approaches whatever threshold may be
7 prescribed, and orders a prompt halt and assistance in the unwinding of the entity’s
8 activity if its application is denied. Pennsylvania: House Bill No. 850, Printer’s No. 1029
9 (2015) has been in the Commerce Committee of the House of Representatives since
10 March 26, 2015. *Bill Information*, Legislative Data Processing Website (2016). Some
11 Observers continue to favor exemption at the \$1 million threshold for coverage under this
12 act. However, no comparably high threshold exists under State “money transmission” or
13 “money services” statutes.
14

15 Other observers stated interest in an absolute threshold below which neither provisional
16 licensure nor licensure would be required.
17

18 Section 103(b)(8) exempts virtual currency businesses whose annual activity, measured by
19 the “U.S. Dollar Equivalence” definition in section 102, other than for the record keeping
20 requirements of Section 302. (Even the persons exempt under section 103(b)(8) should be
21 able to prove that they deserve the exemption.) It also allows persons whose virtual
22 currency business activity is in a start-up or testing status up to \$35,000 to operate as
23 provisional registrants under section 210 of this act. If a virtual currency business has
24 activity above \$35,000, this act requires licensure unless the person is otherwise exempt
25 under section 103.
26

27 It is important to note that the U.S. Dollar Equivalence definition measured on the
28 person’s virtual currency business activity with residents of the enacting state. Thus,
29 instead of a flat \$5,000 ceiling for exemption under section 103(b)(8), that figure is \$5,000
30 per state in which the person conducts virtual currency business activity. Similarly, the
31 \$35,000 ceiling for provisional registration (or trigger for a full license application) is
32 measured with reference to virtual currency business activity in the enacting state.
33 Accordingly, the \$35,000 ceiling could allow testing under provisional registrations of
34 more than \$1,855,000 if a virtual currency business filed in 53 jurisdictions.
35

36 The threshold test can be based on a dollar volume or a number of transactions (regardless
37 of dollar amounts involved) in a period (day, week, month or year) or a number of
38 customers in a comparable time frame, but once the threshold it met, full licensure is
39 required. Subsequent fluctuations in dollar volumes or numbers of transactions or
40 customers in the period chosen would not affect the requirement to obtain and maintain
41 the license in the States or other jurisdictions involved. Thus, once a business reaches the
42 level at which licensure is required, the business can check in but not check out” except
43 by selling or winding down the business or relinquishing its license. Winding down can
44 take a considerable period of time, according to those familiar with “money transmitter”
45 licensure.
46

1 The second stage is the “on-ramp” or “provisional registration” status is described in
2 Section 210. The bracketed material in subsection 103(7), is intended to protect
3 provisional registrants who have met the requirements of Section 210. The more recent
4 addition to subsection (7) was suggested in concept by an Observer in the period prior to
5 the 2016 Annual Meeting draft, but not in time to be included in it.
6

7 Some Observers have proposed that decisions on exemptions be made on a “facts and
8 circumstances” basis. To date, the Drafting Committee has not accepted that proposal.
9 The on-ramp is not a place where “facts and circumstances” approach should be applied.
10 Without precise parameters that start-ups, state regulators, and law enforcement officials
11 can look to, the on-ramp or “provisional registration” approach will not achieve the
12 certainty and predictability for innovators intended and the goal of offering uniformity to
13 participants in this market will be frustrated.
14

15 Besides encouraging innovators, both the limited full exemption and the on-ramp are
16 intended to protect start-up businesses from inadvertently engaging in activity that should
17 be licensed in order to avoid prosecution as an unlicensed money transmitter under 18
18 U.S.C. Section 1960. As such, the on-ramp is central to the goal of encouraging
19 innovators in the virtual currency business community and, as their businesses expand, of
20 bringing them under State licensure and supervision.
21

22 The government of Australia has just published a proposed framework for what it calls a
23 “sandbox” for “fintech” innovators that provides an exemption from full licensure
24 requirements for companies that offer services to a limited number of customers with a
25 specific cap on the value of the assets the company may handle for each customer. The
26 exempt companies also have to register with the Australian government agency, the
27 ASIC, and satisfy certain additional requirements to maintain the exemption. This
28 framework applies not only to virtual currency businesses, but also to fintech companies
29 offering credit to customers and comparable services. As this framework was proposed
30 subsequent to the most recent Drafting Committee meeting for this act, this Draft does
31 not contain any provisions that are drawn from that framework.
32

33 The final stage involves full licensure under the provisions of Article 2 of this draft act.
34 This stage is closely modeled on the Uniform Law Commission’s Uniform Money
35 Services Act in terms of licensure, renewal, reporting, and other matters with important
36 adjustments to reflect the differences between businesses handling legal tender and those
37 handling virtual currency that is not legal tender. Where differences exist between the
38 Money Services Act and this draft act exist, they follow the sense of the instructions given
39 to the Drafting Committee by the Council or Style Committee.
40

41 ▪ *Persons Engaged in Foreign Exchange.* This act exempts dealers in foreign exchange from
42 the scope of this act. FinCEN refined the definition of the term “currency dealer or
43 exchanger” for purposes of 31 C.F.R. Part X in 2011 to “a dealer in foreign exchange” to
44 capture the exchange of money instruments as well as of funds or other instruments
45 denominated in foreign currency. *See* Bank Secrecy Act Regulations: Definitions and
46 Other Regulations Relating to Money Services Businesses, 76 Fed. Reg. 43585, 43589 &

1 43596 (July 21, 2011). Thus, for consistency with FinCEN’s most recent position on this
2 topic, it seems prudent to exempt dealers in foreign exchange from this act.
3


4 ▪ *Lawyers and title insurance companies.* This draft also exempts lawyers and title
5 insurance companies engaged in offering escrow services to their customers in subsection
6 (8). One Commissioner suggested an exemption from this act for judgment creditors and
7 foreclosing secured parties, but it is not included in this draft.
8

9 ▪ *Banks.* The term “bank” is defined in Section 102. One comment in the most recent
10 round preferred the definition of “bank” found in Treasury Department regulations, 31
11 C.F.R. Section 1010.100(d). The other issue in the proposed exemption for banks is the
12 treatment of state-chartered trust companies and limited-purpose trust companies. If the
13 state decides to exempt, it needs to adjust the definition of the term “bank” and of “trust
14 company” in Section 102. Since the October 2016 Drafting Committee meeting, the
15 Office of the Comptroller of the Currency has announced its plans for issuing “special
16 purpose bank charters” to certain “fintech” companies, a category that might include
17 some virtual currency businesses. Commissioners might be familiar with special purpose
18 bank charters held by retailers such as Nordstrom. The OCC special purpose bank
19 charters would carry whatever preemption of state laws and licensure requirements that
20 the final rule the OCC adopts allows. Thus, it is unclear to what extent the OCC’s plans
21 overlap with operating authority that might be granted to license applicants under this act.
22 However, what seems clear is that this act’s exemptions and on-ramp/provisional
23 registration provisions will allow innovators acting under this act to engage in
24 transactions to operate even though the OCC might not be willing to grant start-ups
25 special purpose bank charters or would do so under stiff “conditional approvals.” Thus,
26 the OCC’s plans generally increase the need for this act, the on-ramp for start-up
27 providers, and other exemptions this act currently provides greater because of the
28 likelihood that only the best-capitalized and managed “brand” names in the fintech
29 industry (as yet undefined by the OCC) will qualify for OCC special purpose national
30 bank charters. In other words, the vast majority of fintech companies that do not receive
31 OCC charters will require the uniformity and certainty that a uniform act will offer. The
32 revised definition of “bank” in Section 102 includes entities to which the OCC has
33 granted a fintech “special purpose bank charter,” a category that as currently proposed
34 would not allow “deposit-taking” requiring federal deposit insurance.
35

36 ▪ *Entities Holding “Money Transmitter” or “Money Services” Licenses from the Same*
37 *State.* After much consideration, persons holding licenses as money transmitters or
38 money services businesses in the same state are exempt if they meet two additional
39 requirements. First, they must have permission from the department to engage in virtual
40 currency business activity. Second, they must comply with the provisions of this act that
41 differ substantially from those imposed on money transmitters or money services
42 businesses under state law. The only State currently requiring both licenses for “money
43 transmission” and “virtual currency” business activities is New York, which has adopted
44 comprehensive licensure and prudential regulation provisions for both types of
45 businesses.
46

1 The last exemption, shown in subsection 103(b)(15), was suggested by an Observer. The
2 business cases that a department may recognize for a discretionary exemption under this
3 subsection will vary over time and are difficult to anticipate at this time.

4 The Observer urged that a discretionary exemption be offered generally, but also offered a
5 specific use case as justification – that of data recovery firms that undertake for compensation to
6 make ransomware payments for firms whose data has been hijacked and who offer recovery
7 services to owners of the data and to acquire virtual currencies or transmit virtual currencies
8 provided to them by customers seeking the return of their data. Because the data recovery firm
9 takes in virtual currencies from customers and offers as part of a fee-paid service to transmit
10 virtual currencies to the party demanding ransom payments, this service is not part of the
11 exemption offered under subsection 103(b)(7) and it is not intended to be covered in this draft
12 under any other express exemption in Section 103. For those unfamiliar with “data recovery
13 services,” we offer the following possible definition:
14

15 “Data recovery firm” means a business that assists others in the recovery of data
16 affected by ransomware and that takes control of virtual currency from a resident
17 in order to enable the firm on behalf of the resident to retrieve data that has been
18 [captured] by the person demanding a ransom. 

19
20 We have not included this definition in this draft prepared for purposes of review by the
21 Committee on Style because the Drafting Committee has not yet embraced it.

22 [ARTICLE] 2

23 LICENSURE

24 **SECTION 201. LICENSE.** A person may not engage in virtual currency business
25 activity, or hold itself out as being able to engage in virtual currency business activity, with a
26 resident unless the person is:

27 (1) licensed under this act;

28 (2) licensed to conduct virtual currency business activity by a state with which this state
29 has a reciprocity agreement;

30 (3) a provisional registrant operating in compliance with Section 210; or

31 (4) exempt from this act to the extent that section 103 provides that exemption.

32 **Reporter’s Note**

33 Unless one of the exemptions in Section 103 applies, and only to the extent that an
34 exemption applies, a person that engages in virtual currency business activity is subject to this act if

1 any part of the transaction that is part of its virtual currency business activity is with a resident,
2 whether by through the use of a physical location such as a virtual currency “ATM” in this state
3 used by a resident, or otherwise as part of an intended engagement with a resident. An
4 advertisement, solicitation or other holding out that appears in a newspaper or occurs by
5 telephone, email, regular mail received by a resident, or otherwise, and whether or not seen by a
6 resident, is sufficient contact to generate the need for a license from this state unless this state and
7 another state have a reciprocity agreement that covers the person’s activities in this state or the
8 transaction is consummated by the resident while physically present in another state.

9
10 No license issued by this state can be transferred or assigned except pursuant to law as in
11 a merger, and then only as long as the department or other relevant state or federal regulator does
12 not disapprove the transfer or assignment.

13
14 This act does not require that a licensee or provisional registrant be incorporated in this
15 State as a condition of operations, or the maintenance of a physical location in the state whose
16 residents are engaged in virtual currency business transactions with the provider.

17
18 The Conference of State Bank Supervisors has expressed concerns that any provisional
19 registration status not be phrased in such a manner as would convey a form of property interest
20 that would be subject to the due process requirements applicable to license suspensions or
21 revocations in many States.

22
23 The “on-ramp” or “provisional registration” in Section 210 does not give preferential
24 status to holders of Money Services Act or Money Transmitter Act licenses. It is exclusively for
25 virtual currency business activities whose providers’ good faith and objectively reasonable
26 estimates of transactions [by dollar equivalent, numbers of transactions or numbers of residents]
27 for the quarter following the registration do not exceed a threshold set by the department or in
28 this act.

29
30 A person that has applied for “reciprocal licensure” may engage in virtual currency
31 business activity under that section during the pendency of the licensure process. The term
32 “provisional operation” should be distinguished from “provisional registration” under Sections
33 201 or 210. Under this act, neither “provisional registration” nor “provisional operation” conveys
34 a property right in the person engaged in virtual currency business activity in this state.

35
36 **SECTION 202. LICENSE OR PROVISIONAL REGISTRATION NOT**

37 **TRANSFERBLE OR ASSIGNABLE.** A license or provisional registration under this act is
38 not transferable or assignable.

39 **SECTION 203. APPLICATION FOR LICENSE.**

40 (a) Except as provided in Section 204, an application under this act must be made in a
41 form and medium prescribed by the department or in the form prescribed by the registry if this

1 state uses the registry.

2 (b) The application must provide information as follows relevant to its proposed virtual
3 currency business activity except as noted:

4 (1) the legal name of the applicant, each current or proposed business address of
5 the applicant, and any fictitious or trade name that the applicant uses or plans to use in
6 conducting its virtual currency business activity with residents;

7 (2) the legal name of each executive officer of the applicant, each responsible
8 individual, and each person that has control of the applicant, and their residential and business
9 addresses, and any former name or fictitious name of each such officer, individual, or person;

10 (3) a description of the current and historical business of the applicant for the
11 period of operation up to the previous five years or so much of that period as the person has been
12 in operation, including its products and services, associated website addresses and social media
13 pages, its principal place of business, its projected user base, and specific marketing targets;

14 (4) the name, address, and telephone number of each person who manages each
15 server that the applicant expects to use in conducting its virtual currency business activity with or
16 on behalf of residents together with a copy of any agreement with such person;

17 (5) a listing of:

18 (A) each money service or money transmitter license the applicant holds
19 in any other state;

20 (B) the date the license expires; and

21 (C) all license revocations, suspensions, or other disciplinary actions taken
22 against the licensee in any other state or of any license applications rejected by any other state;

23 (6) a listing of criminal convictions of, and deferred prosecution agreements from

1 any jurisdiction or of any pending criminal proceedings against:

2 (A) the applicant;

3 (B) each executive officer of the applicant;

4 (C) each responsible individual of the applicant;

5 (D) each person that has control over the applicant; and

6 (E) each person over which the applicant has control;

7 (7) a listing of material litigation, arbitration or administrative proceeding in any
8 jurisdiction in which the applicant, any executive officer, or any responsible individual has been
9 involved in the period of up to five years prior to making the application, determined in accord
10 with generally accepted accounting principles and the extent the applicant would be required to
11 disclose the litigation, arbitration or administrative proceeding in the applicant's audited
12 financial statements, reports to equity owners, or similar statements or reports;

13 (8) a listing of any bankruptcy or receivership proceedings in any jurisdiction in
14 the period of up to the previous ten years in which any of the following was a debtor:

15 (A) the applicant;

16 (B) each executive officer of the applicant;

17 (C) any responsible individual of the applicant;

18 (D) each person that has control over the applicant; and

19 (E) each person over which the applicant has control;

20 (9) the name and address of each bank in which the applicant plans to deposit
21 funds obtained by its virtual currency business activity;

22 (10) the source of funds and credit to be used by the applicant to conduct virtual
23 currency business activity with or on behalf of residents and demonstrate that the applicant has

1 the minimum net worth and reserves required by Section 209;

2 (11) the United States Post Office address and email address to which
3 communications from the department may be sent;

4 (12) the name, United States Post Office address, and email address of the
5 registered agent of the applicant in this state;

6 (13) a copy of the certificate or detailed summary of coverage acceptable to the
7 department for each liability, casualty, business-interruption or cyber-security insurance policy
8 maintained by applicant for itself, any executive officer, any responsible individual, or its users;

9 (14) if applicable, the date of and the state where the applicant was formed and
10 provide a copy of a recent certificate of good standing issued by the state in which the applicant
11 was formed;

12 (15) if a person has control of the applicant and the person's equity interests are
13 publicly traded in the United States, provide a copy of the audited financial statement for the
14 most recent fiscal year of the person or a copy of the most recent report of the person filed under
15 Section 13 of the Securities Exchange Act of 1934, 15 U.S.C. Section 78m;

16 (16) if a person has control of the applicant and the person's equity interests are
17 publicly traded outside the United States, provide a copy of the audited financial statement for
18 the most recent fiscal year of the person or a copy of the documentation similar to that required
19 in paragraph (15) filed with the foreign regulator in the domicile of the person;

20 (17) if the applicant is a partnership or a member-managed limited liability
21 company, state the names and addresses of general partners or members;

22 (18) if the applicant is required to register with the Financial Crimes Enforcement
23 Network of the United States Department of the Treasury as a money service business, provide

1 evidence of the registration;

2 (19) a set of fingerprints for each executive officer of the applicant and each
3 responsible individual, together with an employment history and history of any investigation or
4 legal proceeding involving any executive officer or responsible individual for a period of up to
5 the previous five years, if available; and

6 (20) other information that the department reasonably may require by regulation.

7 (c) The application must be accompanied by a nonrefundable fee in an amount specified
8 by the department by regulation;

9 (d) For good cause, the department may waive one or more of the requirements of
10 subsection (b) or permit the applicant to submit other information instead of the required
11 information.

12 *Legislative Note: In states that do not delegate the setting of fees to departmental discretion, the*
13 *state should specify the amount of an initial license fee. In states that allow departments*
14 *charged with supervising and enforcing laws similar to this act, the department should set the*
15 *fees for licenses under this act. This note applies to the fee that must accompany an application*
16 *under subsection (c) and any fee to be paid before the issuance of a license under this act.*

17

18 **SECTION 204. RECIPROCAL LICENSING.**

19

Alternative A

20 (a) Instead of the application required by section 203, an applicant who is licensed to
21 conduct virtual currency business activity in another state may file an application with the
22 registry under this section.

23 (b) When an application under this section is filed with the registry, the applicant shall
24 notify the department in a record that the applicant is submitting an application to the registry and
25 shall:

26 (1) submit a certification of license history from the agency in each state

1 responsible for issuing a license to the applicant to conduct virtual currency business activity;

2 (2) pay a reciprocal licensing application fee in an amount specified by the
3 department by regulation; and

4 (3) a certification signed by an executive officer of the applicant affirming that the
5 applicant will conduct its virtual currency business with residents in compliance with the
6 requirements of this act.

7 (c) The department may permit provisional operation by an applicant that has complied
8 with this section.

9 **Alternative B**

10 (a) A person licensed by another state to engage in virtual currency business activity in
11 that state may engage in virtual currency business activity with or on behalf of residents to the
12 same extent as if the person held a license under this act if:

13 (1) the department determines that the state in which the person is licensed has in
14 force in that state laws regulating virtual currency business activity laws that are substantially
15 similar to, or more protective of rights of users than the laws of this state;

16 (2) at least 30 days before the person commences virtual currency business
17 activity with or on behalf of residents, the person submits to the department:

18 (A) notice that the person will rely on reciprocal licensing, a copy of the
19 virtual currency business activity license issued by the other state, and a certification by the other
20 state as to the history of the license;

21 (B) a reciprocal license fee in an amount specified by the department by
22 regulation;

23 (C) documentation demonstrating that the applicant is in compliance with

1 the security reserve requirements of Section 206 and the net worth and reserve requirements of
2 Section 209; and

3 (D) a certification signed by an executive officer of the applicant affirming
4 that the applicant will conduct its virtual currency business activity with residents in compliance
5 with this act;

6 (3) the department does not reject the application within 15 days after receipt of
7 the items specified in subparagraph (2); and

8 (4) the applicant does not commence virtual currency business activity with or on
9 behalf of residents until 31 days after complying with paragraph (2).

10 (b) For good cause, the department may modify the time periods set forth in this section.

11 **End of Alternatives**

12 *Legislative Note: Each state electing to authorize reciprocal licensure should select one of the*
13 *alternatives in this section. Alternative A is applicable only if the Department has agreed to*
14 *participate in the Registry operated by a subsidiary of the Conference of State Bank Supervisors.*
15 *If the jurisdiction already participates in the Registry, the bracketed subsection (a) would be*
16 *deleted from the legislation and the un-bracketed subsection (a) would begin this Alternative's*
17 *provisions and, in either event, the subsections of this Section should be renumbered accordingly.*
18

19 *In no event should the enacting state waive any requirement that the applicant have*
20 *sufficient reserves or security to cover expenses sufficient both to wind down its business with*
21 *residents and to complete transactions residents have instructed the licensee to complete.*
22

23 **Reporter's Note**

24
25 Alternative A relies on use of the Registry to facilitate reciprocal licensure or recognition
26 of licensure by states other than the first state that licensed a virtual currency business. The
27 reference to "provisional operation" in Alternative A, subsection (c) is intended to be limited to
28 persons who have applied for reciprocal licenses under this section, and does not include any
29 person who is operating under the provisional registration authority provided in Section 210. The
30 terms "provisional operation" and "provisional registration" are intended to remain mutually
31 exclusive.
32

33 This draft follows an approach for reciprocal licensure close to that currently supported
34 by the CSBS, instead of the Uniform Law Commission's Athlete Agents Act, because State
35 banking agencies are already familiar with the CSBS framework. Also, non-depository

1 providers of financial services are likely to be familiar with the CSBS model.

2
3 **SECTION 205. ACTION BY DEPARTMENT.**

4 (a) An application for a license is not complete until the department has received all
5 information required by this act, and has completed its investigation under Section 207.

6 (b) When an original application under Section 203 is complete, the department shall
7 notify the applicant in a record not later than 30 days after its decision to approve or deny the
8 application. If the department does not notify the applicant of its decision by the 31st day after
9 the application was complete, the application is approved, and, absent good cause, the department
10 shall issue the license.

11 (c) A license takes effect on the later of the following:

12 (1) the date on which the department issues the license; or

13 (2) the date the licensee provides the security required by Section 206.

14 **SECTION 206. SECURITY.**

15 (a) Before a license is issued under this [article], the applicant must deposit with the
16 department funds, a letter of credit, a surety bond, or other security satisfactory to the department
17 that:

18 (1) secures the licensee's faithful performance of its duties under this act; and

19 (2) is in an amount the department specifies based on the nature and extent of
20 risks in the applicant's virtual currency business model.

21 (b) The department may require a surety bond as security only if a surety bond is
22 generally available in the state at commercially reasonable cost.

23 (c) The security must be collectible by this state for the benefit of any claim against the
24 licensee on account of the licensee's virtual currency business activity with or on behalf of a

1 resident.

2 (d) The security must cover claims for a period the department specifies by regulation and
3 that may extend after the licensee ceases to engage in virtual currency business activity with or
4 on behalf of residents.

5 (e) For good cause, the department may increase the amount of a licensee’s security. The
6 licensee must deposit the additional security not later than [15] days after the licensee receives
7 notice of the required increase in a record from the department.

8 (f) For good cause, the department may permit a licensee to substitute or deposit an
9 alternate form of security satisfactory to the department as long as there is no time when the
10 licensee fails to comply with this section.

11 (g) A claimant does not have a direct right against the security. Only the department may
12 recover on the security. The department may retain the recovery for up to [specify reasonable
13 period of state’s choice] years after the department recovers on the security and may handle
14 claims and the distribution of recoveries to claimants in accordance with regulations promulgated
15 by the department under the [insert reference to state’s uniform money services act or money
16 transmitters act].

17 ***Legislative Note:*** *For subsection 206(g), the state should specify the time period that it believes*
18 *represents a reasonable period for an aggrieved party to discover their claim and file it with the*
19 *department, and for the department to determine whether the claim is valid and process the claim.*
20

21 **Reporter’s Note**
22

23 Surety bonds and letters of credit are not readily available to virtual currency business
24 start-ups at this time. Accordingly, the security described in Section 206 does not require surety
25 bonds or letters of credit because such a requirement effectively prevents virtual currency
26 businesses from being licensed at this time. The Drafting Committee is aware that surety bonds
27 or letters of credit are commonly required for other forms of non-depository financial services
28 licensees.
29

30 The market may improve as surety bond companies and banks are more familiar with the

1 operations of virtual currency businesses and as states clarify their positions on licensure and
2 regulation of virtual currency businesses and the relationship of virtual currency businesses to
3 traditional money services and money transmission that states otherwise regulate.
4

5 This draft replaces customary references to surety bonds or letters of credit with the more
6 expansive term “a deposit of funds or investment property.” The primary reason is that, although
7 it may be easier to obtain a letter of credit than a surety bond, banks have their own credential
8 requirements for issuing letters of credit. This act should not convey a sense that there is
9 something wrong with a virtual currency business if it cannot obtain a particular form of security,
10 such as a letter of credit or surety bond.
11

12 The amount of security required may be minimal depending on the scope of activities that
13 the applicant presents as its business model in a given state. This is particularly true because of
14 the inclusion in this act of an analogue to U.C.C. section 8-503 that specifies that the provider
15 does not have a property interest in the virtual currency it controls on behalf of its customers, and
16 that the virtual currency cannot be invested by the provider and is not subject to claims of the
17 providers’ creditors.
18

19 Forms of security may include virtual currency of the type in which the provider transacts
20 business with residents (a term limited under Section 102’s definition to residents of the enacting
21 state), a guarantee or, possibly, even a letter asserting compliance. The regulators’ ability to hold
22 security after the licensee ceases to engage in virtual currency business activity is common in
23 non-depository financial services regulation. Because of this need for security to be available
24 during a winding-down period, bonds – if available – would be problematic for licensees.
25

26 Bonds, of course, run with the person or entity that first acquired them. In the virtual
27 currency community, one expects innovators to merge or be acquired by others with more
28 frequency than might have applied to other forms of non-depository providers of financial
29 services. One Observer explained that requiring the security to survive a merger or acquisition
30 necessarily requires a form of security that is not entity-dependent, which is an important
31 consideration and likely complication with some forms of security that are typically used in non-
32 depository licensure schemes.
33


34 **SECTION 207. INVESTIGATION; ISSUANCE OF LICENSE.**

35 (a) When an applicant files an application, the department shall investigate:

36 (1) the financial condition and responsibility of the applicant;

37 (2) the relevant financial and business experience, character and general fitness of
38 the applicant; and

39 (3) the competence, experience, character, and general fitness of each responsible
40 individual, each executive officer, and any person who has control of the applicant.

1 (b) The department may conduct an investigation of the business premises of the
2 applicant, ~~including facilities and devices for storage of virtual currency or credentials for use in~~
3 ~~virtual currency business activity, and data associated with the licensee wherever those facilities~~
4 ~~may be located.~~ 

5 (c) The applicant shall pay the reasonable costs of the department’s investigation.

6 (d) Absent good cause, the department shall issue a license to an applicant if the applicant
7 has fulfilled the requirements of this [article] and has paid the costs of investigation and initial
8 license fee in the amounts prescribed by the department by regulation.

9 (e) An applicant may appeal a denial of its application, under [cite state administrative
10 procedure act], not later than 30 days after the notice of denial is sent.

11 **Reporter’s Note**

12 The addition of the phrase “absent good cause” to subsection (e) grants discretion to the
13 department to deny an application if the applicant has been allegedly engaged in violations of
14 federal anti-money-laundering or other regulations.

15

16 **SECTION 208. RENEWAL OF LICENSE.**

17 (a) At least 15 days before the anniversary of license issuance, the licensee must:

18 (1) pay a renewal fee in an amount specified by the department by regulation; and

19 (2) submit to the department a renewal report as provided in subsection (b).

20 (b) The renewal report must be submitted in a form and medium prescribed by the
21 department and must state or contain:

22 (1) a copy of the licensee’s most recent:

23 (A) reviewed annual financial statement if the licensee’s virtual currency

24 business activity in this state amounted to \$[insert the figure state employs for corporate activity

25 auditing purposes] or less in the previous fiscal year, measured as of its anniversary date;

1 (B) audited annual financial statement if the licensee’s virtual currency
2 business activity in this state amounted to more than \$[insert the figure state employs for
3 corporate activity auditing purposes] in the previous fiscal year, measured as of its anniversary
4 date; or

5 (C) if a person other than an individual has control of the licensee, a copy
6 of that person’s most recent:

7 (i) reviewed annual financial statement if the person’s gross
8 revenue amounted to \$[insert the figure state employs for corporate activity auditing purposes] or
9 less in the previous fiscal year, measured as of the anniversary date of the license; or

10 (ii) audited consolidated annual financial statement if the person’s
11 gross revenue amounted to more than \$[insert the figure state employs for corporate activity
12 auditing purposes] in the previous fiscal year, measured as of the anniversary date of the license.

13 (2) a description of any:

14 (A) material change in the financial condition of the licensee;

15 (B) material litigation involving the licensee, any responsible individual,
16 or any executive officer;


17 (C) license suspension or revocation proceeding commenced or other
18 action involving a license issued by another state on which reciprocal licensing was based; and

19 (D) federal or state investigation involving the licensee; or

20 (E) data security breach;

21 (3) any information or records required by Section 305 that the licensee has not
22 already reported to the department;

23 (4) the number of virtual currency business activity transactions with or on behalf

1 ~~of residents and the number of private keys or other virtual currency credentials of residents~~
2 ~~received by the licensee for control~~ for the period since the license was issued or the last renewal
3 report; 

4 (5) the U.S. dollar equivalent of virtual currency in the control of the licensee at
5 the end of the month at least 30 days before to the date of the renewal report and the total number
6 of residents for whom the licensee had control of virtual currency on the same date, using the test
7 for equivalency prescribed in Section 102;

8 (6) evidence that the licensee is satisfying duties under section 502 as a securities
9 intermediary with respect to virtual currency over which it has control for residents;

10 (7) evidence that the licensee continues to satisfy the requirements of Section 206;

11 (8) evidence that the licensee continues to satisfies the requirements of Section
12 209;

13 (9) a list of each location in the state where the licensee operates its virtual
14 currency business activities; and

15 (10) the name, address, and telephone number of each person who manages a
16 server used by the licensee in conducting its virtual currency business activity with or on behalf
17 of residents.

18 (c) If a licensee does not timely comply with subsection (a), the department may suspend
19 or revoke the license or institute an enforcement measure and assess any penalty provided under
20 section 403. A notice or hearing is not required for a license suspension or revocation for failure
21 to pay a renewal fee or file a renewal report. The department may lift the suspension or rescind
22 the revocation if, not later than 20 days after the license was suspended or revoked, the licensee:

23 (1) files the renewal report in compliance with this section and pays the renewal

1 fee; and

2 (2) pays any penalty assessed under Section 403.

3 (d) The department shall provide prompt notice to a licensee of the lifting of a suspension
4 or rescission of a revocation after the licensee has complied with subsection (c) (1) and (2).

5 (e) Revocation or suspension of a license under this section does not invalidate
6 transfers or exchanges of virtual currency for or on behalf of residents made during the
7 suspension, but does not insulate the licensee from liability under this act.

8 (f) For good cause, the department may extend a time period under this section.

9 (g) The department shall review the renewal of a license issued under Section 204 to
10 ensure that the state that issued the original license has not revoked, suspended, or otherwise
11 limited the license it granted.

12 (h) A licensee who has not complied with the requirements of this section or with the
13 provisions of subsection (c)(1) and (2), shall cease operations with residents on or before the
14 anniversary date of its license.

15 **Legislative Note:** *If the state enacting this act delegates the setting of fees under subsection (b)*
16 *of this Section to the department, this section should be revised to convey authority to set fees*
17 *and to establish any minimum or maximum fee levels the department is required to observe. If*
18 *not, the enacting state should set the fees required under this section.*

19
20

Reporter's Note

21 Small entities may not be required by other state laws to an audited financial statement.
22 In these cases, state law instead may require the entity to have a "reviewed" financial statement
23 and should provide it in lieu of a fully audited financial statement.

24

25 Any change in a license issued by another state or jurisdiction that was the basis for
26 reciprocal licensure under this act should be disclosed in the renewal report, if not previously
27 disclosed to the Department in this state.

28

29 Information about the persons who manage servers used by licensees under this act and the
30 locations of those servers is required in this section because regulators may need access to those
31 servers to conduct examinations of licensees. Subparagraph (c)(10) contains a requirement that the

1 licensee disclose the name, address, and telephone number of each person who manages a server
2 used by the licensee. This draft retains this requirement for the purposes of eliciting comments on
3 its practicality.

4
5 With respect to subsection (b)(6), readers may wish to consult the priority of claims rules
6 in U.C.C. Article 8. The rules in U.C.C. §8-511 puts non-creditor entitlement holders ahead in
7 priority terms of creditors of the entitlement debtor.

8
9 **SECTION 209. NET WORTH AND RESERVES OF LICENSEE OR**
10 **PROVISIONAL REGISTRANT.**

11 (a) In addition to the security required under Section 206, a licensee or provisional
12 registrant shall at the time of its application for a license or filing of provisional registration give
13 the department evidence of, and shall at all times maintain, the following:

14 (1) a minimum net worth of \$ 25,000; and

15 (2) sufficient unencumbered reserves for winding down the licensees operations.

16 (b) The licensee or provisional registrant may include in its calculation of net worth
17 virtual currency other than the virtual currency over which it has control for residents or other
18 users entitled to the protections provided in section 502 of this act.

19 (c) For good cause, the department may require a licensee or provisional registrant to
20 increase its net worth or reserves. The licensee or provisional registrant must give the department
21 evidence that it has the additional net worth or reserves required by the department not later than
22 [15] days after the licensee or provisional registrant receives in a record notice of the required
23 increase.

24 **Reporter's Note**

25 Discussion about the amount of security required for licensees and provisional registrants
26 has ranged from a fixed percent for ongoing operations and winding down expenses of roughly
27 10.5 percent of expected volume to be parallel with the standards in Basel III, to the specific
28 figure mentioned in this section. If the enacting state or a department to which the legislature has
29 delegated the function of setting the level of security required, the \$25,000 figure mentioned
30 above or a standard in the range of the two-to-five-percent standard similar to standards used in

1 recent state amendments to money services or money transmission acts.

2
3 The rationale for requiring minimum net worth and reserves was explained succinctly in
4 commentary to the 2004 final version of the Uniform Money Services Act:

5
6 Net worth requirements, in combination with bonding/security and permissible-
7 investment requirements, are a means of ensuring that a money transmitter has
8 sufficient resources to honor its obligations to customers. Only Article 2 licensees
9 are subject to net worth requirements. . . . Net worth requirements are a means of
10 screening an applicant, at the time of their initial entry into the money-services
11 business, as to their ability to meet their obligations.

12
13 UNIFORM MONEY SERVICES ACT (2004), *available at*
14 http://www.uniformlaws.org/shared/docs/money%20services/umsa_final04.pdf.

15
16 This Act gives States the option of choosing between a combination of security, net worth
17 and permissible investment requirements as prudential measures for licensees. For more
18 information, see UNIFORM MONEY SERVICES ACT (2004), *available at*
19 http://www.uniformlaws.org/shared/docs/money%20services/umsa_final04.pdf.

20
21 The 2004 amendments to the Uniform Money Services Act specified a minimum net
22 worth of \$25,000, *id.* at 38, which may need to be adjusted for the purposes of this act and to
23 account for the changes in attitudes in intervening years about minimum capital requirements
24 generally for licenses by departments in the various states.

25
26 A virtual currency business may be expected to hold virtual currency in the form in which
27 it transacts business with customers as part of its capital virtual currency, as well as other capital
28 required for its operations and the winding down of operations. Price volatility that may affect
29 the value of virtual currencies being held are less likely to affect the ongoing operations or
30 winding down of virtual currency businesses and so a fixed figure makes sense for the purposes
31 of this section.

32
33 Technology start-up companies often go through more than one level of capital funding in
34 their early years. This draft makes no recommendation as to how the requirement to maintain a
35 specific net worth should be managed as a new entrant goes through its early capital. A “mark-
36 to-market” style requirement could be particularly onerous for smaller virtual currency licensees
37 and new entrants and appears unnecessary for a regulated entity that holds its customers’ funds in
38 trust and not subject to the claims of its creditors.

39
40 The Drafting Committee considered a formula for minimum capital requirements is based
41 on the formula adopted for banks under Basel III, which requires at least 6 percent capital for
42 ongoing operations and 4.5 percent capital for winding down, based in part on the risk assessment
43 of the nature of the business activities of the licensee. Licensees could be required to have this
44 capital without regard to the value of the virtual currency over which they have control on behalf
45 of residents. Observers have questioned whether a Basel III approach was suitable for businesses
46 operating other than on a fractional reserve basis and also whether the percentages suggested –

1 respectively, of 6 and 4.5 – were not too great to encourage innovation in virtual currency
2 businesses. As a result, for this draft, we adopt the \$25,000 minimum net worth used in the 2004
3 Amendments to the Uniform Money Services Act.
4

5 The issue of what is an appropriate minimum net worth for virtual currency businesses
6 may depend on many factors, including the nature of the services or products provided, and
7 relates to the recommendation in Section 502 of this draft that the virtual currency in the control
8 of the licensee or provisional registrant is a bailment, not the property of the licensee or
9 provisional registrant and, specifically, is not subject to the claims of the creditors of the licensee
10 or provisional registrant. However, one of the values that this act may contribute to financial
11 innovations is to keep net worth requirements in scale with the likely capacity of start-ups to
12 meet the requirements and engage with the department early in their work.
13

14 With respect to the coverage of provisional registrants, comments on whether the
15 requirements should be identical to those for licensees would be welcome.
16

17 **SECTION 210. PROVISIONAL REGISTRATION.**

18 (a) A person whose volume of activity will exceed the \$5,000 ~~maximum volume~~ in USD
19 Equivalence specified in Section 103(b)(8) on an annual basis but whose volume of activity has
20 not exceeded \$35,000 in U.S. Dollar Equivalence may engage in virtual currency business
21 activity with or on behalf of residents under a provisional registration without first obtaining a
22 license under this act if the person:

23 (1) files with the department a notice in the form and medium prescribed by the
24 department of its intention to engage in virtual currency business activity with or on behalf of
25 residents;

26 (2) provides the information for an investigation as described in Section 207;

27 (3) states the anticipated activity for its next fiscal quarter;

28 (4) pays a registration fee in an amount specified by the department by regulation
29 to the department;

30 (5) if the person is required to register with the Financial Crimes Enforcement
31 Network of the United States Department of the Treasury as a money service business, provides

1 the department with evidence of the registration;

2 (6) provides evidence that the person has in place policies and procedures to
3 comply with the Bank Secrecy Act, 31 U.S.C. 5311 et seq., and other applicable laws;

4 (7) describes the source of funds and credit to be used by the person to conduct
5 virtual currency business activity with or on behalf of residents and demonstrate that the person has
6 the minimum net worth and reserves required by Section 209;

7 (8) provides the department with evidence that the person has in place policies and
8 procedures in place to comply with [Articles] 3, 5, and 6;

9 (9) provides the department with a copy of its most recent financial statement,
10 whether reviewed or audited; and

11 (10) provides evidence of, and agrees that it shall at all times maintain, the
12 following:

13 (A) sufficient net worth to engage in the level of virtual currency business
14 activity it proposes to conduct with or on behalf of residents; and

15 (B) sufficient unencumbered reserves for winding down the provisional
16 registrant's operations.

17 (b) The provisional registrant may include in its calculation of net worth virtual currency
18 other than the virtual currency that is governed by Section 502 of this act.

19 (c) Before the virtual currency business activity of a provisional registrant with or on behalf
20 of residents exceeds the lower of 75 percent of the anticipated activity measured in U.S. Dollar
21 Equivalence specified in its notice to the department under subsection (a)(3) or ~~\$35,000~~, the
22 provisional registrant must file an application for license with the department and may continue
23 to operate past the ~~\$35,000~~ threshold as long as its application for license is pending.

1 (d) For good cause, the department may suspend or revoke a provisional registration or
2 refuse to license a person that had made a provisional registration under this act. The department
3 may suspend or revoke a provisional registration without a hearing or opportunity to be heard.

4 (e) A provisional registrant must cease all virtual currency business activity with or on
5 behalf of residents on the earlier of:

6 (1) not later than 48 hours after the provisional registrant receives notice in a
7 record that the department has denied the provisional registrant’s application for a license or has
8 suspended or revoked the provisional registrant’s registration;

9 (2) not later than 48 hours after the provisional registrant receives notice in a
10 record that the department has denied approval of a proposed change in control or transfer under
11 Section 306 or a proposed merger, consolidation, or acquisition of the provisional registrant under
12 Section 307; or

13 (3) the second anniversary date of the provisional registration unless the virtual
14 currency business activity of the provisional registrant with or on behalf of residents remains
15 below 75 percent of the anticipated activity declared in the original provisional registration under
16 subsection (a).

17 **Reporter’s Note**

18
19 The upper threshold for operation as a “provisional registration” has been the subject of
20 considerable discussion during Drafting Committee meetings and in comments. Three
21 alternatives have emerged that include using the value of the virtual currency business activity in
22 US dollar equivalent terms, the number of transactions, or the number of users. Each has its
23 proponents.
24

25 Observers have urged that a threshold of \$1 million be established for this purpose.
26 Contrarians might observe that that figure is significantly greater than would be tolerated under
27 the Uniform Money Services Act or state money transmitter statutes. To the extent that the goals
28 of Section 103’s exemptions and of Section 210 are to promote innovation and allow both
29 academic research and beta testing to occur without the necessity of full licensure or the risks of
30 being prosecuted for engaging in unlicensed money transmission or prepaid access activity under

1 state laws or 18 U.S.C. Section 1960, the Drafting Committee has not adopted a \$1 million
2 threshold. Instead, it has adopted a per-state ceiling of activity at \$35,000, which is a larger
3 figure in the aggregate, but not on a per-state basis, than requested by Observers.
4

5 Section 202 prohibits the assignment or transfer of a “provisional registration,” which
6 means that in advance of an acquisition or merger of a virtual currency business operating under a
7 provisional registration under this section, the acquiring or surviving entity must register as a
8 provisional registrant and meet the other requirements for such status under this act, or be a
9 person holding a license under this act, or be an applicant for a license under this act in a state
10 that permits provisional operation by persons who have applied for full licensure under this
11 article. This provision is included at the suggestion of the CSBS in order to avoid the necessity for
12 its members to go through due process to terminate a privilege offered on a provisional basis in
13 the “on-ramp.”
14

15 Subsection (a)(7) does not exclude the provisional registrant’s ability to collect from
16 residents’ virtual currency under its control whatever fee its agreement with residents allows it to
17 collect for services rendered.
18

19 [ARTICLE] 3

20 **EXAMINATION; OPERATING REQUIREMENTS; PROPOSED CHANGES**

21 **SECTION 301. AUTHORITY TO CONDUCT EXAMINATION.**

22 (a) The department may conduct an annual examination of a licensee and such additional
23 examinations as the department deems appropriate. For good cause, the department may examine
24 a licensee without prior notice to the licensee.

25 (b) The licensee shall pay the reasonable costs of an examination under this section.

26 (c) Information obtained during an examination under this act may be disclosed only as
27 provided in Section 304.

28 **SECTION 302. RECORDS.**

29 (a) A licensee or provisional registrant shall maintain the following records of all virtual
30 currency business activity with a resident in which it has engaged for a period of up to five years
31 after the date of the activity. A person with a de minimis exemption pursuant to section
32 103(b)(8) must comply with this section and is entitled to the protection of records contained in

1 section 304. A person otherwise exempt under subsection 103(b)(8) must keep records in
2 accordance with this section and is entitled to the protection of records provided in section 304.


3 (b) The required records shall include:


4 (1) each virtual currency business transaction of the licensee or provisional
5 registrant with or on behalf of a resident or for the licensee's own account, including:

6 (A) identity of the resident;

7 (B) form of the transaction;

8 (C) amount, date, and payment instructions given by the resident,

9 ~~cryptographic credentials used by the resident to authorize the transaction, Internet Protocol~~
10 ~~address used by the resident or other person authorizing the transaction, and any other~~
11 ~~information used to authorize the transaction; and~~ 

12 (D) the account number, name and physical address of each principal party 
13 ~~to the transaction~~, and, to the extent practicable, other parties to the transaction;

14 (2) the aggregate number of transactions and aggregate value of transactions by
15 the licensee or provisional registrant with or on behalf of a resident and for the licensee's or
16 provisional registrant's own account in this state expressed in the manner required for U.S.
17 Dollar Equivalence for the prior 12 calendar months;

18 (3) each transaction in which the licensee or provisional registrant exchanges one
19 form of virtual currency for legal tender or another form of virtual currency with or on behalf of a
20 resident;

21 (4) a general ledger posted at least monthly containing all assets, liabilities,
22 capital, income, and expenses of the licensee or provisional registrant;

23 (5) each business call report that the licensee or provisional registrant must create

1 or provide to the department or the registry;

2 (6) bank statements and bank reconciliation records for the licensee or provisional
3 registrant and the name, account number, and physical address of each bank that the licensee or
4 provisional registrant uses in the conduct of its virtual currency business activity with or on
5 behalf of residents; and

6 (7) any dispute with a resident; and

7 (8) any virtual currency business activity that the licensee or provisional registrant
8 was unable to complete for any reason.

9 (c) The licensee or provisional registrant must maintain the records required by subsection
10 (a) in a form that permits the department to determine whether the licensee or provisional
11 registrant is complying with this act and any other applicable law or any order.

12 (d) If a licensee or provisional registrant maintains its records outside this state, the
13 licensee or provisional registrant shall make the records available to the department on three
14 days' notice in a record absent good cause.

15 (e) All records maintained by a licensee or provisional registrant are open to inspection by
16 the department.

17 **SECTION 303. COOPERATION AND DATA-SHARING AUTHORITY.**

18 (a) Subject to Section 304 and to law of this state other than this act concerning privacy,
19 consumer financial privacy, data protection, privilege, or confidentiality, the department may
20 cooperate, coordinate, jointly examine, consult, and share records and other information with the
21 appropriate regulatory agency of another jurisdiction, a relevant self-regulatory organization, or a
22 federal or state regulator of banking or non-depository providers, concerning the affairs and
23 conduct of a licensee or provisional registrant in this state.

1 (b) Absent good cause, the department shall:

2 (1) establish or participate with other states that enact a law substantially similar
3 to this act as determined by the department in a central depository for filings required by law;

4 (2) cooperate in the development and implementation of uniform forms for
5 applications and renewal reports and the conduct of joint administrative proceedings and civil
6 actions;

7 (3) formulate joint regulations, statements of policy, guidance and interpretative
8 opinions and releases, and common systems and procedures; and

9 (4) engage in joint notices of proposed regulations, forms, statements of policy, or
10 guidance.

11 (c) The department may not establish or participate in a central commercial depository of
12 consumers' nonpublic personally identifiable information that does not comply with Section
13 502(e)(5) or (8) of the Gramm-Leach-Bliley Act, 15 U.S.C. Section 6802(e)(5) or (8) or with 18
14 U.S.C. Sections 3401 et seq.

15 (d) In deciding whether and how to cooperate, coordinate, jointly examine, consult, or
16 share records and other information, the department may consider:

17 (1) maximizing effectiveness and uniformity of regulation and examination and
18 their implementation and enforcement for the benefit of residents and licensees and provisional
19 registrants; and

20 (2) minimizing burdens on licensees and provisional registrants without adversely
21 affecting consumer protection goals.

22 **Reporter's Note**

23 Enacting states may wish to provide a list of its statutes that impose obligations such as
24 those mentioned in the text. State data or transactional privacy laws, state data security/ breach

1 notification laws, and provisions of federal law such as Title V of the Gramm-Leach-Bliley
2 Financial Services Modernization Act of 1999 and the Fair Credit Reporting and Fair and
3 Accurate Credit Transactions Act.

4
5 **SECTION 304. CONFIDENTIALITY.**

6 (a) Except as otherwise provided in subsection (b) or (c), information or reports obtained
7 by the department from an applicant for a license, a licensee or a provisional registrant,
8 information contained in or related to an examination, investigation, or operating or condition
9 report prepared by, on behalf of, or for the use of the department, and other financial and
10 operational information not contained in a report otherwise available to the public are not subject
11 to disclosure under this state's [open records] law. To the extent that the department determines
12 that such information or records are subject to the open records law of a reciprocal-licensing
13 state, the information and records may not be released.

14 (b) Trade secrets of an applicant for a license, a licensee or a provisional registrant are
15 confidential and are not subject to disclosure under this state's [open records] law. To the extent
16 that the department determines that trade secrets are subject to the open records law of a
17 reciprocal-licensing state, the trade secrets may not be released.

18 (c) Subsection (a) does not prohibit publication of any or all of the following:

19 (1) general information about a licensee's or provisional registrant's virtual
20 currency business activity with or on behalf of residents;

21 (2) a list of persons licensed or provisionally registered under this act; or

22 (3) the aggregated financial data concerning licensees or provisional registrants in
23 this state.

24 **Reporter's Note**

25 This section treats only trade secrets as confidential. Other information that a license
26 applicant, licensee or provisional resident may submit to the department is put outside the scope

1 of the enacting state’s open records law, but is not deemed confidential.

2
3 **SECTION 305. INTERIM REPORT.**

4 (a) A licensee or provisional registrant shall file with the department a report of any of
5 the following events:

6 (1) any material change in information provided in the license application or most
7 recent renewal report of the licensee or the registration of the provisional registrant;

8 (2) a material change in the licensee’s or provisional registrant’s business or
9 business model for the conduct of its virtual currency business with residents; or

10 (3) a change of any executive officer, any responsible individual, or the person in
11 control of the licensee or provisional registrant.

12 (b) Absent good cause, the reports required by subsection (a) must be filed not later than
13 15 days after the event.

14 **Reporter’s Note**

15 For a useful guide of what is “material” for the purposes described in this Section, we
16 suggest reference to the provisions of the Securities Exchange Act of 1934 and regulatory
17 guidance and judicial determinations made under it.
18

19 **SECTION 306. CHANGE IN CONTROL OF LICENSEE OR PROVISIONAL**
20 **REGISTRANT.**

21 (a) In this section, “proposed person in control” means:

22 (1) the person who would have control of a licensee or provisional registrant after
23 a proposed transaction that would result in a change in control of a licensee or provisional
24 registrant; or

25 (2) the person who would have control of a licensee or provisional registrant after
26 a proposed transfer of all or a substantial part of the assets of a licensee or provisional registrant.

1 (b) Not less than 30 days before a proposed change in control of a licensee or provisional
2 registrant or a proposed transfer of all or a substantial part of the assets of the licensee or
3 provisional registrant, the licensee or provisional registrant shall submit the following to the
4 department in a record:

5 (1) an application in a form and medium prescribed by the department;

6 (2) in the case of a licensee to whom subsection (a)(1) applies, the information
7 and records that Section 203 would require if the proposed person in control already had control
8 of the licensee;

9 (3) in the case of a licensee to whom subsection (a)(2) applies, a new license
10 application under Section 203 by the proposed person in control;

11 (4) in the case of a provisional registrant to whom subsection (a)(1) applies, the
12 information that Section 210 would require if the proposed person in control already had control
13 of the provisional registrant; and

14 (5) in the case of a provisional registrant to whom subsection (a)(2) applies, a
15 provisional registration under Section 210 by the proposed person in control.

16 (c) The department shall approve or deny the application for a change in control of a
17 licensee or provisional registrant or for approval of a transfer of all or a substantial part of the
18 assets of the licensee or provisional registrant within the timeframe set forth in Section 205. No
19 the change in control may take place without the department's approval in a record.

20 (d) There is a rebuttable presumption that a person has control over another person if the
21 person has voting power in the other person or in a person who has 10% or more of the voting
22 power in the person that is 10% or more of the total voting power in the person. However, a
23 person is not presumed to have control over another person solely because the person is an

1 executive officer of the other person.

2 (e) The filing of records required by subsection (b) in good faith relieves the proposed
3 person in control from any obligation or liability imposed by this section with respect to the
4 subject of the application until the department has acted on the records.

5 (f) The department may revoke or modify a determination under subsection (b), after
6 notice and opportunity to be heard, when in its judgment revocation or modification is consistent
7 with this [article].

8 (g) If the proposed change in control requires approval of an agency of this or another
9 state in the case of reciprocity, and the action of the other agency conflicts with that of the
10 department, the department and other agency shall confer. If the conflict is not resolved, the
11 proposed change in control or transfer of assets cannot take place.

12 **SECTION 307. MERGER, CONSOLIDATION, OR ACQUISITION OF ASSETS**
13 **BY LICENSEE OR PROVISIONAL REGISTRANT.**

14 (a) Not less than 30 days before a proposed merger or consolidation of a licensee or
15 provisional registrant or the acquisition of assets from a licensee or provisional registration, the
16 licensee or provisional registrant shall submit the following to the department in a record:

17 (1) an application in a form and medium prescribed by the department;
18 (2) the plan of merger, consolidation, or acquisition in accordance with subsection
19 (d);

20 (3) in the case of a licensee, the information required by section 203 as to the
21 person who would be the surviving entity in the proposed merger or consolidation; and

22 (4) in the case of a provisional registrant, the information required by section 210
23 as to the person who would be the surviving entity in the proposed merger or consolidation.

1 (b) If the proposed merger or consolidation would also change the control of the licensee
2 or provisional registrant, the licensee or provisional registrant must also comply with section
3 306.

4 (c) The department shall approve or deny an application by a licensee or provisional
5 registrant under this section within the timeframe set forth in Section 205. Neither the proposed
6 merger, consolidation, nor acquisition may take place without the department's approval in a
7 record.

8 (d) A plan of merger, consolidation, or acquisition of assets must:

9 (1) describe at least the effect of the proposed transaction on the licensee's or
10 provisional registrant's conduct of virtual currency business activity with or on behalf of
11 residents;

12 (2) identify each person to be merged or consolidated and the surviving person of
13 the proposed merger or consolidation as well as the person acquiring the assets; and

14 (3) describe at least the terms and conditions of the merger, consolidation, or
15 acquisition of assets, and the mode of carrying it into effect.

16 (e) If a merger, consolidation, or acquisition requires approval of an agency of this or
17 another state in the case of reciprocity and the action of the other agency conflicts with that of
18 the department, the department and other agency shall confer. If the conflict is not resolved, the
19 proposed merger, consolidation, or acquisition cannot take place.

20 (f) The department may condition approval of the proposed merger, consolidation, or
21 acquisition of assets on acceptance by the parties of amendments to the department's plan.

22 (g) There is a rebuttable presumption that a person has control over another person if the
23 person has voting power in the other person or in a person who has 10% or more of the voting

1 power in the person that is 10% or more of the total voting power in the person. However, a
2 person is not presumed to have control over another person solely because the person is an
3 executive officer of the other person.

4 (h) The filing of records required by subsection (a) in good faith relieves the proposed
5 person in control from any obligation or liability imposed by this section with respect to the
6 subject of the application until the department has acted on the records. The department may
7 revoke or modify a determination under this section, after notice and opportunity to be heard,
8 when in its judgment revocation or modification is consistent with this [article].

9 (i) The department may condition approval of the proposed merger, consolidation, or
10 acquisition on acceptance by the parties of the department's plan.

11 **[ARTICLE] 4**

12 **ENFORCEMENT**

13 **SECTION 401. ENFORCEMENT MEASURES.**

14 (a) In this article, "enforcement measure" means an action to:

15 (1) suspend or revoke a license or provisional registration;

16 (2) issue an order to a person to cease and desist from doing virtual currency
17 business activity with residents;

18 (3) request that the court appoint a receiver for the assets of a person doing virtual
19 currency business activity with residents;

20 (4) request the court to issue temporary, preliminary, or permanent injunctive
21 relief against a person doing virtual currency business activity with residents;

22 (5) assess civil penalties under Section 403;

23 (6) realize on the security under Section 206 and initiate a plan to distribute the

1 proceeds for the benefit of residents injured by a violation of this act or another law by the
2 licensee or provisional registrant; or

3 (7) impose conditions the department considers reasonably necessary or
4 appropriate on the conduct of virtual currency business activity with residents.

5 (b) The department may take an enforcement measure against a licensee, provisional
6 registrant, or a person that is neither a licensee or provisional registrant but that is engaging in
7 virtual currency business activity with residents if:

8 (1) the person violates in a material respect a provision of this act or of a
9 regulation adopted or order issued under this act, or a law of this state other than this act that
10 applies to virtual currency business activity in which the person is involved with a resident;

11 (2) the person does not cooperate substantially with an examination or
12 investigation by the department, or fails to pay a fee or submit a report or documentation that is
13 due;

14 (3) the person, in the conduct of its virtual currency business activity with a
15 resident, engages in:

16 (A) an unsafe or unsound act or practice;

17 (B) an unfair or deceptive act or practice;

18 (C) fraud or intentional misrepresentation; or

19 (D) another dishonest act or misappropriation of money or other value
20 held by a fiduciary.

21 (4) an agency of the United States or another state takes an action against the
22 person that would constitute an enforcement measure if the department had taken the action;

23 (5) the person is convicted of a felony related to its virtual currency business

1 activity with a resident or a felony involving bank fraud or other activity that, as determined by
2 the department, makes the person unsuitable to engage in virtual currency business activity;

3 (6) the person:

4 (A) becomes insolvent;

5 (B) ceases to pay its debts when they become due;

6 (C) makes a general assignment for the benefit of its creditors;

7 (D) becomes the debtor, alleged debtor, respondent or other subject of a

8 case or other proceeding relating to it under any bankruptcy, reorganization, arrangement,

9 readjustment, insolvency, receivership, dissolution, liquidation or similar law, and is

10 unsuccessful in obtaining relief within a reasonable time; or

11 (E) applies for or permits the appointment of a receiver, trustee, or other

12 agent of a court for itself or for a substantial part of its assets.

13 (c) On application and for good cause, the department may:

14 (1) extend the due date for filing a document or report;

15 (2) waive to the extent warranted by relevant circumstances, such as a bona fide

16 error, activity enumerated under subsection (b) or an enforcement measure warranted under

17 subsection (a), or both, if the department determines that this action will not unduly adversely

18 affect the likelihood of compliance with this act.

19 **Reporter's Note**

20 In connection with subsection (b)(5), a list of examples of felonies involving bank fraud
21 or other activity that would make a person unsuitable for a position of trust in virtual currency
22 business activity could be inserted. An example of such a list from Texas Fin. Code 151.202(d),
23 (e) covers:

24 Money transmission or other money services, including a reporting, recordkeeping or
25 registration requirement of the Bank Secrecy Act, the USA Patriot Act, or comparable
26 provisions of state law;

27 Money laundering, structuring, or a related financial crime;

1 Drug trafficking;
2 Terrorist funding; or,
3 A similar law of a foreign country unless it is demonstrated to the satisfaction of the
4 department that the conviction was based on extenuating circumstances unrelated to the
5 person's reputation for honesty or obedience to the law.
6

7 **SECTION 402. NOTICE AND OPPORTUNITY FOR HEARING.**

8 (a) Except as otherwise provided in subsection (b), the department may take an
9 enforcement measure only after notice and an opportunity for a hearing appropriate in the
10 circumstances.

11 (b) The department may take an enforcement measure:

12 (1) without notice if the circumstances require action before notice can be given;

13 (2) after notice and without a hearing if the circumstances require action before a
14 hearing can be held; or

15 (3) after notice and without a hearing if the person conducting virtual currency
16 business activity with residents does not timely request a hearing.

17 **SECTION 403. CIVIL PENALTY.**

18 (a) If a person engages in virtual currency business activity with a resident in violation of
19 this act, the department may assess a civil penalty in an amount not to exceed \$[50,000] for each
20 day of violation, subject to subsection (c).

21 (b) If a person violates a material provision of this act, the department may assess a civil
22 penalty against the person in an amount not to exceed \$[10,000] for each day of violation,
23 subject to subsection (c).

24 (c) A civil penalty provided for in this section continues to accrue until the earlier of:

25 (1) the date the underlying violation ceases; or

26 (2) a date specified by the department.

1 **SECTION 404. EFFECTIVE PERIOD OF REVOCATION, SUSPENSION, OR**
2 **CEASE AND DESIST ORDER.**

3 (a) Revocation of a license under this article is effective against a licensee one day after
4 the department sends, to the address provided for receiving communications from the
5 department, by a means reasonably selected for the notice to be received by the recipient within
6 that period, notice to the licensee in a record.

7 (b) Suspension of a license, suspension of a preliminary registration, or an order to cease
8 and desist is effective against a licensee or provisional registrant one day after the department
9 sends, to the address provided for receiving communications from the department, by a means
10 reasonably selected for the notice to be received by the recipient within that period, notice to the
11 licensee or provisional registrant in a record. A suspension or order to cease and desist remains
12 in effect until the earlier of:

13 (1) entry of an order by the department under the [state administrative procedure
14 act] setting aside or limiting the suspension or order to cease and desist;

15 (2) entry of a court order setting aside or limiting the suspension or order to cease
16 and desist; or

17 (3) a date specified by the department.

18 (c) If, without reason to know of the department's notice, the licensee or provisional
19 registrant does not comply until the notice is actually received at the address provided, the
20 department may consider the delay in compliance in imposing a sanction or sanctions for the
21 licensee's or provisional registrant's failure to comply with the department's notice of
22 revocation, suspension, or an order to cease and desist.

1 seeking recovery for customers of the virtual currency business and subsection (c) specifically
2 provides the department authority to do so.

3 **[ARTICLE] 5**

4 **DISCLOSURES AND OTHER PROTECTIONS FOR RESIDENTS**

5 **SECTION 501. REQUIRED DISCLOSURES.**

6 (a) Each licensee and provisional registrant shall provide to any resident that uses the
7 licensee's or provisional registrant's products or services the disclosures required by subsection
8 (b) and any additional disclosures that the department by regulation deems reasonably necessary
9 for the protection of residents. The department shall determine by regulation the times and form
10 required for disclosures. Disclosures required by this [article] shall be made separately from any
11 other information provided by the licensee or provisional registrant and in a clear and
12 conspicuous manner in a record that residents may keep. A licensee or provisional registrant may
13 propose for the department's approval alternate disclosures as more appropriate for its virtual
14 currency business activity with residents.

15 (b) Prior to establishing a relationship with a resident, licensees and provisional registrants
16 shall make the following disclosures to the extent that they are applicable to the virtual currency
17 business activity the licensee or provisional registrant will undertake with the resident:

18 (1) a schedule of all fees and charges that the licensee or provisional registrant
19 may assess, the manner that fees and charges will be calculated if not set in advance and
20 disclosed, and, if relevant, the timing of such fees and charges;

21 (2) whether the product or service provided by the licensee or provisional
22 registrant is covered by a form of insurance or otherwise guaranteed against loss by an agency of
23 the United States, including the Federal Deposit Insurance Corporation or the Securities Investor
24 Protection Corporation, up to the full equivalent in United States dollars of the virtual currency

1 placed under the control of or purchased from the licensee or provisional registrant on the date of
2 the placement or purchase, or by private insurance against theft or loss, including cyber theft or
3 theft by other means;

4 (3) a notice that any transfer or exchange of virtual currency normally is
5 irrevocable, and of any exception to irrevocability;

6 (4) a notice describing any liability for unauthorized, mistaken, or accidental
7 transfers or exchanges and, for the purposes of enabling residents to obtain relief, describing the
8 resident's responsibility for providing notice to the licensee or provisional registrant of the
9 transfer or exchange together with a description of the basis for any recovery by the resident from
10 the licensee or provisional registrant and of general error resolution rights applicable to any
11 transfer or exchange;

12 (5) a notice that the date on or time at which a transfer or exchange is made and
13 the resident's account is debited may differ from the date or time that the resident initiates the
14 instruction to initiate a transfer or exchange;

15 (6) whether the resident has a right to stop a pre-authorized transfer and the
16 procedure to initiate a stop-payment order or to revoke the authorization for subsequent transfers;

17 (7) the resident's right to receive a receipt, trade ticket, or other evidence of a
18 transfer or exchange;

19 (8) the resident's right to at least 30 days prior notice of a change in the licensee's
20 or provisional registrant's fee schedule, other terms and conditions of operating its virtual
21 currency business activity with residents, or the policies applicable to the resident's account; and,

22 (9) a disclosure of the fact that virtual currency is not legal tender.

23 (c) At the conclusion of a virtual currency transaction involving a resident, the licensee or

1 provisional registrant shall furnish to the resident a confirmation in a record that contains:
2 (1) the name and contact information of the licensee or provisional registrant,
3 including information a resident may need to file a complaint or to ask a question;
4 (2) the type, value, date, precise time, and amount of the transaction; and
5 (3) the fee charged to the resident for the transaction, including any charge for
6 conversion of virtual currency to another virtual currency or to legal tender.

7 A licensee or provisional registrant may elect to furnish a single, daily
8 confirmation for all transactions on that day with a resident instead of a per-transaction
9 confirmation if the licensee or provisional registrant discloses its decision to furnish a daily
10 confirmation to the resident in the initial disclosures provided under this section.

11 **Reporter’s Note**

12 Subparagraph 501(b)(2) raises the question of the depth of insurance coverage that this act
13 should require, and of its relationship to capital requirements and the proposed treatment of virtual
14 currency in the control of a licensee or provisional registrant as a bailment or as a creditor-debtor
15 relationship.

16
17 At the October 2016 meeting, the Chairman asked for proposals to set suitable capital
18 requirements and for comments on the proposed inclusion of an analogue to U.C.C. 8-503. More
19 information about this subject can be found in Commissioner Edwin Smith’s memorandum on the
20 reasons this draft might rely more heavily on analogues to UCC Article 8, and specifically its
21 Section 8-503, or to encourage virtual currency businesses to opt-in to pertinent provisions of
22 U.C.C. Article 8. Commissioner Smith’s memorandum is posted on the webpage for this act.

23
24 **SECTION 502. INCORPORATION OF ARTICLE 8 OF THE UNIFORM**
25 **COMMERCIAL CODE.**

26 (a) As used in this section, (i) “UCC jurisdiction” means this state or another state that
27 has adopted Article 8 of the Uniform Commercial Code in substantially the form promulgated by
28 the American Law Institute and the National Conference of Commissioners on Uniform State
29 Laws, (ii) “UCC Article 8” means Article 8 of the Uniform Commercial Code of the UCC

1 jurisdiction determined under subsection (b)(1), and (iii) terms defined in UCC Article 8 and not
2 otherwise defined in this Act have the same meanings as in UCC Article 8.

3 (b) The relationship between a licensee or provisional registrant and a resident must be
4 evidenced by an agreement in a record authenticated by the licensee or provisional registrant and
5 by the resident. The agreement must:

6 (1) provide that the agreement is governed by the law of a UCC jurisdiction or, if
7 the agreement does not provide that it is governed by the law of a UCC jurisdiction, provide that
8 the law of another state that is a UCC jurisdiction is the securities intermediary's jurisdiction for
9 purposes of the Uniform Commercial Code and that the law in force in the state is applicable to
10 all issues specified in Article 2(1) of the Convention on the Law Applicable to Certain Rights in
11 Respect of Securities Held with an Intermediary;

12 (2) expressly state that (i) the licensee or provisional registrant is a securities
13 intermediary, (ii) the control of any virtual currency by the licensee or provisional registrant for
14 the benefit of the resident creates a securities account of which the resident is the entitlement
15 holder, and (iii) the virtual currency is a financial asset credited or held for credit to the securities
16 account of the resident; and

17 (3) not provide a standard for the licensee or provisional resident to comply with
18 its duties under Part 5 of U.C.C. Article 8 that is less protective of the resident than the standard
19 that would apply under Part 5 of U.C.C. Article 8 in the absence of an agreement between the
20 licensee or provisional registrant and the resident as to the standard.

21 (c) If there is no agreement complying with subsection (b), the relationship between the
22 licensee or provisional registrant and the resident shall be determined as if the licensee or
23 provisional registrant and the resident had so agreed.

1 (d) The licensee or provisional registrant and the resident may not agree that the licensee
2 or provisional registrant may grant a security interest in, or otherwise transfer or exchange, the
3 virtual currency for the personal account of the licensee or provisional registrant other than for
4 payment of fees, charges, and other amounts owing by the resident to the licensee or provisional
5 registrant for the virtual currency business activity conducted by the licensee or provisional
6 registrant for the account of the resident.

7 (e) The licensee or provisional registrant will at all times maintain in a state an office that
8 satisfies the requirements of the second sentence of Article 4(1) of the Convention on the Law
9 Applicable to Certain Rights in Respect of Securities Held with an Intermediary.

10 **Reporter's Notes**

11
12 A licensee or provisional registrant doing virtual currency business activity is required to
13 treat virtual currency as a financial asset under U.C.C. Article 8 and to be characterized itself as a
14 securities intermediary for this purpose. Adopting this approach from U.C.C. Article 8 enhances
15 the uses of virtual currency in two ways. First, it affords significant user protections. Second,
16 because the classifications of collateral currently available under U.C.C. Article 9 do not
17 encapsulate virtual currencies as neatly as some would prefer, section 502 of this act is likely to
18 enhance the uses of virtual currency as collateral – whether the virtual currency under “control”
19 and subject to section 502 of this act by owners who entrust their assets to the virtual currency
20 business or the “house virtual currency” that belongs to the virtual currency business. The duties
21 U.C.C. Article 8, §§ 8-503 to 8-508, the protections of §§ 8-502, 8-510, 8-115, 8-112(c), and §8-
22 109 will apply, as will the reduction in the rights of the virtual currency owner dealing with the
23 licensee or provisional registrant in § 8-511. Other related sections also should be applicable,
24 like §§ 8-107, 8-106, 8-105, 8-104 and perhaps 8-103. The approach also mandates the § 8-509
25 type agreement and, as noted in subsection (e) of this draft, includes a requirement of relevant
26 international law.

27
28 This act does not address other commercial law issues, such as when a debt is discharged
29 and the like (UCC Article 3 type issues), when an exchange or transfer of virtual currency not
30 involving a securities intermediary is final, and any warranties (Article 2 type issues), or
31 bailment rules, but the act includes a § 1-103(b) provision, which allows other state law to
32 supplement the act's provisions. Other provisions of Article 1 of the U.C.C. also may apply
33 because of their relevance to the duties in section 8-503 on which section 502 of this act is
34 modeled.

35
36 Additional explanation of the intended operation of section 502 and of the Hague
37 Securities Convention to which subsection (e) refers is included in Appendix I to this draft.

1 [ARTICLE] 6

2 POLICIES AND PROCEDURES

3 SECTION 601. MANDATED COMPLIANCE PROGRAMS AND POLICIES
4 AND MONITORING.

5 (a) A licensee or a provisional registrant, before the issuance of a license or the filing of a
6 provisional registration, shall create and thereafter maintain the following policies and
7 procedures to carry out: a cybersecurity program, a business continuity program, a disaster
8 recovery program, an anti-fraud program, an anti-money laundering and prevention of terrorist
9 activity funding program, and a program designed to govern compliance with this act and other
10 state and federal law to the extent that the law is relevant to the virtual currency business activity
11 contemplated by the licensee or provisional registrant in this state, or this act, to assist the
12 licensee or provisional registrant in achieving the purposes of the other law if violation of that
13 law has a remedy under this act. The licensee or provisional registrant shall create and maintain
14 records describing each policy and the procedure to carry them out.

15 (b) Each policy required by subsection (a) must be designed to be adequate for the
16 licensee's or provisional registrant's contemplated virtual currency business activity with
17 residents, considering all the circumstances of the participants, including residents, that may be
18 involved, and the safe operation of the virtual currency business activity involved. Each policy
19 and its implementing procedure must be compatible with other policies and the procedures
20 implementing them and not conflict with policies or procedures applicable to the licensee or
21 provisional registrant under other applicable law. A policy and the procedure implementing it, if
22 adequate, may be a policy or procedure already in existence in the licensee's or provisional
23 registrant's virtual currency business with residents.

1 (c) A licensee’s or provisional registrant’s policy for detecting fraud, at a minimum, must
2 include:

3 (1) the identification and assessment of the material risks of its virtual currency
4 business operations related to fraud;

5 (2) procedures to protect against any other material risks related to fraud
6 identified by the department or the licensee or provisional registrant; and

7 (3) procedures for periodic evaluation and revision of the anti-fraud procedure.

8 (d) Each licensee’s or provisional registrant’s policy for countermanding money
9 laundering and terrorist financing, at a minimum, must include:

10 (1) The identification and assessment of the material risks of its virtual currency
11 business operations related to money laundering and terrorist funding;

12 (2) Procedures in accordance with federal law or guidance published by federal
13 agencies responsible for enforcing federal laws pertaining to money laundering and terrorist
14 financing, and that require all reports specified by federal reporting, record keeping, and
15 suspicious-transaction reporting as set forth in 31 U.S.C. Section 5311, or 31 C.F.R. Part X, and
16 any other federal or state laws pertaining to the deterrence or detection of money laundering or
17 terrorist funding. No licensee or provisional registrant shall be required to file copies of reports
18 it may make to federal authorities unless specifically required to do so by the department.

19 (e) A licensee’s or provisional registrant’s resident protection policy, at a minimum, must
20 include:

21 (1) any action or system of records required to comply with the provisions of this
22 act and provisions of any law of this state applicable to the licensee or provisional registrant with
23 respect to virtual currency business activity with residents in which the licensee or provisional

1 registrant engages;

2 (2) a procedure for resolving disputes between the licensee or provisional
3 registrant and residents;

4 (3) a procedure for residents to report unauthorized, mistaken, or accidental
5 virtual currency business activity transactions; and

6 (4) a procedure for filing a complaint with the licensee or provisional registrant
7 and for the resolution of complaints in a fair and timely manner with notice as soon as
8 reasonably practical of the resolution and the reasons for it to the complainant.

9 (f) After the policies and procedures are created and approved by the department and
10 officers of the licensee or provisional registrant, the licensee or provisional registrant must
11 employ a responsible individual or individuals with adequate authority and experience to monitor
12 each procedure, to publicize it as appropriate, to recommend changes as desirable, and to enforce
13 the procedure.

14 (g) A licensee or provisional registrant may:

15 (1) request advice from the department or another appropriate source as to
16 compliance with this section; and

17 (2) with the department's approval, and outsource functions, policies, and
18 procedures required under this section.

19 (h) The fact that a particular policy or procedure fails in a given instance or instances to
20 meet its goals is not a ground for liability if the policy or procedure was properly created and
21 implemented, provided however that repeated failures are evidence of a failure to implement or
22 conduct operations properly.

23 (i) The policies and procedures required by this section must be made available in a clear

1 and conspicuous manner separately from other disclosures made to residents and in the medium
2 through which the resident contacted the licensee or provisional registrant.

3 **Reporter's Note**

4
5 Section 601 has been reorganized since the March 2017 Drafting Committee meeting. It
6 now contains, in addition to the contents in the prior draft, provisions formerly in Sections 603,
7 604, and 502.

8
9 The previous requirement to make duplicate filings of all reports required by federal law
10 or regulations with the Attorney General of the state for anti-money-laundering or prevention-of-
11 terrorist-financing purposes was deleted in favor of a standard that requires duplicate report filing
12 only when the licensee or provisional registrant is required to file duplicates after a specific
13 regulation or order mandates the duplicate filing. The goal of changes to this Section is to require
14 full compliance with these important requirements without adding to the compliance burdens of
15 licensees and provisional registrants.

16 **SECTION 602. MANDATED COMPLIANCE POLICY.**

17
18 (a) A licensee before submitting its application for license, and a provisional registrant at
19 the time of its registration, must establish and maintain a policy for compliance with this act in a
20 record designed to ensure, to the extent reasonable, compliance with:

21 (1) this act; and

22 (2) another state law if:

23 (A) the other law is relevant to the virtual currency business activity
24 contemplated by the licensee or provisional registrant, or is relevant to the scope of this act; or

25 (B) this act could assist in the purpose of the other law because violation
26 of that other law has a remedy under this act.

27 (b) A policy under subsection (a) must be compatible and not conflict with requirements
28 applicable to the licensee or provisional registrant under other applicable state or federal law.

29 The policy, if adequate, may be a policy in existence for the licensee's or provisional registrant's
30 virtual currency business activity with residents, whether adopted by the licensee or provisional

1 registrant on its own or under other law.

2 (c) A licensee or provisional registrant may:

3 (1) request advice from the department or another source as appropriate as to
4 compliance with this section; and

5 (2) with department approval, outsource the functions in subsection (d).

6 (d) After the policy in subsection (a) is created and approved by the department and
7 officers and directors of the licensee or provisional registrant, the licensee or provisional
8 registrant shall employ a responsible individual with adequate authority and experience to
9 monitor the policy, publicize it as appropriate, recommend changes as desirable, and enforce it.

10 (e) The fact that the policy fails in a given instance or instances to meet its goals is not a
11 ground for liability if it was properly created and operated provided however that repeated
12 failures are evidence of a failure to monitor operations properly.

13 **[ARTICLE] 7**

14 **MISCELLANEOUS PROVISIONS**

15 **SECTION 701. UNIFORMITY OF APPLICATION AND CONSTRUCTION.**

16

17 (a) In applying and construing this act, consideration shall be given to the need to
18 promote uniformity of the law with respect to its subject matter among the jurisdictions that
19 enact it.

20 (b) A reference to a requirement imposed by this act includes reference to a related
21 regulation or order of the department adopted pursuant to this act.

22 (c) In this act, a citation to a federal statute or regulation, or a state statute or regulation,
23 refers to that law as originally enacted or promulgated or as later amended, unless that would be
24 an unlawful delegation of legislative power, in which case that citation is to that law as un-

1 amended until the legislature otherwise acts.

2 **SECTION 702. RELATION TO ELECTRONIC SIGNATURES IN GLOBAL**
3 **AND NATIONAL COMMERCE ACT.** This act modifies, limits, and supersedes the
4 Electronic Signatures in Global and National Commerce Act, (15 U.S.C. Section 7001, et seq.)
5 [as amended] but does not modify, limit, or supersede Section 101(c) of that act (15 U.S.C.
6 Section 7001(c)) or authorize electronic delivery of any of the notices described in Section 103(b)
7 of that act (15 U.S.C. Section 103(b)).

8 **SECTION 703. SUPPLEMENTARY LAW.** Unless displaced by the provisions and
9 policies of this act, principles of law and equity supplement is provisions.

10 **SECTION 704. SAVING AND TRANSITIONAL PROVISIONS.**

11 (a) A license issued under [name of state’s existing Money Services Act or Money
12 Transmitter Act] that is in effect immediately before the effective date of this act remains in
13 effect as a license for its purposes and, for its duration, unless revoked or suspended by the
14 licensing authority that issued it. A person licensed under [name of state’s existing Money
15 Services Act or Money Transmitter Act] that does not intend to engage in virtual currency
16 business activity under this act is not required to inform the department of its intention.

17 (b) The department may deny a license or suspend a provisional registration to conduct
18 virtual currency business activity with residents if the department finds that the licensee or
19 provisional registrant cannot meet the requirements of this act. Such a finding by the department
20 regarding a license application or a provisional registration may not be used as grounds for
21 suspension or revocation of a license granted under the [Money Services Act or Money
22 Transmitter Act] unless the grounds in that statute independently provide a basis for action
23 against that licensee or provisional registrant. If the department denies a license or suspends a

1 provisional registration, the department must notify the licensee or provisional registrant within
2 30 days of the department's receipt of the applicant's notice of intent to engage in virtual
3 currency business with residents. An applicant for a license or a person filing a provisional
4 registration may appeal to a court of appropriate jurisdiction within 60 days after receipt of the
5 notice of denial or suspension.

6 (c) This act applies to virtual currency business activity with residents on or after the
7 effective date of this act. A person engaged in virtual currency business activity after the
8 effective date of this act that does not hold a license issued or recognized under this act, that is
9 not exempt from this act, or has not applied for a license or filed a provisional registration under
10 this act, including a person that has obtained a license under the [Money Services Act or Money
11 Transmitter Act] whether or not that statute covers virtual currency business activity, or a person
12 that holds a charter as a trust company from this state or that does not have permission to engage
13 in virtual currency business activity with residents, is deemed to be conducting unlicensed virtual
14 currency business activity with residents in violation of this act.

15 *Legislative Note: If the jurisdiction enacting this act allows state-chartered banks with trust*
16 *powers or non-bank trust companies or limited purpose trust companies to engage in activities*
17 *that would be governed by this act, only if they have received a separate permit or approval, or*
18 *otherwise conditions their exercise of powers governed by this act, a separate savings or*
19 *transitional subsection should be added to this [article]. Such a new subsection should specify*
20 *any limitations on the powers of the trust company or limited purpose trust company as well as*
21 *its preference on reciprocal licensing of trust companies or limited purpose trust companies, or*
22 *of recognizing cross-border activities of chartered trust companies or limited purpose trust*
23 *companies not domiciled in this jurisdiction.*

24
25 **SECTION 705. SEVERABILITY CLAUSE.** If any provision of this act or its
26 application to any person or circumstance is held invalid, the invalidity does not affect other
27 provisions or applicability of this act that can be given effect without the invalid provision or
28 application, and to this end the provisions of this act are severable.

1 **SECTION 706. REPEALS.** The following Acts and parts of Acts are repealed:

2 (1)

3 (2)

4 (3)

5 **SECTION 707. EFFECTIVE DATE.** This act takes effect....

1 **Appendix**

2 **Reporter’s Notes**
3 **to Section 502 [UCC Article 8 provisions]**
4

5 Thus far, no state statute regulating virtual currencies has addressed very basic commercial
6 law questions, such as the treatment of virtual currency when the licensee or provisional registrant
7 has the control of the virtual currency for a resident and the licensee or provisional registrant is in
8 financial distress or otherwise becomes insolvent. This draft seeks to do so by requiring licensees
9 or provisional registrants to agree with residents to “opt in” to Article 8 (“UCC Article 8”) of the
10 Uniform Commercial Code (the “UCC”).
11

12 These Notes will describe the impact of a licensee or provisional registrant “opting in” to
13 UCC Article 8 as provided in Section 502. They first summarize the relevant provisions of UCC
14 Article 8. They then describe how UCC Article 8 operates generally in relation to the Act under
15 Section 502 and the benefits that result. They will then explain certain supplemental provisions
16 included in Section 502 to facilitate the operation of UCC Article 8 in relation to the Act.
17

18 Summary of Relevant Provisions of UCC Article 8

19 *Substantive law*

20 UCC Article 8 sets forth a statutory scheme for the holding and transfer of investment
21 securities, such as stocks and bonds. The statutory scheme applies to both investment securities
22 held directly by an investor from an issuer (so-called “directly-held securities”) and investment
23 securities held indirectly by an investor through a bank, broker or other intermediary (so-called
24 “indirectly-held securities”). Of relevance to the Act is the system (the “indirect holding system”)
25 for holding indirectly-held securities. While the primary focus of UCC Article 8 is generally on
26 investment securities, UCC Article 8 itself is not so limited in its provisions relating to the indirect
27 holding system.¹
28

29 The key to understanding the scope of UCC Article 8 in respect of the indirect holding
30 system is first to understand the terminology used in UCC Article 8 for the indirect holding system.
31 Under UCC Article 8, a bank, broker or other person that in the ordinary course of its business
32 maintains securities accounts for others and is acting in that capacity is referred to as a “securities
33 intermediary”.² A “securities account” is an account to which a “financial asset” is or may be
34 credited in accordance with an agreement under which the person for whom the account is
35 maintained is entitled to exercise the rights that comprise the financial asset.³ A financial asset
36 under UCC Article 8 includes not only a “security” as defined in UCC Article 8⁴ but also “*any*
37 *property* that is held by a securities intermediary for another person in a securities account if the
38 securities intermediary has expressly agreed with the other person that the property is to be treated

¹ See generally Official Comment 9 to UCC § 8-102.

² UCC § 8-102(a)(14).

³ UCC §§ 8-501(a) and 8-102(a)(9).

⁴ UCC § 8-102(a)(15).

1 as a financial asset” (emphasis added).⁵

2
3 Once the securities intermediary has indicated by book entry that a financial asset has been
4 credited to a person’s securities account, the person is referred to as an “entitlement holder”⁶ and
5 has what is called in UCC Article 8 a “security entitlement” with respect to the financial asset.⁷ A
6 security entitlement encompasses the rights and property interest of an entitlement holder with
7 respect to a financial asset as specified in Part 5 of UCC Article 8.⁸

8 The rights comprising a security entitlement with respect to a financial asset include the
9 rights of the entitlement holder to enforce the duties of the securities intermediary to the
10 entitlement holder under Part 5 of UCC Article 8. Those duties (the “Part 5 Duties”) consist of the
11 duty to maintain sufficient financial assets to satisfy all security entitlements to the financial
12 assets,⁹ the duty to take action to obtain a payment or distribution made by the issuer of the
13 financial asset,¹⁰ the duty to exercise rights in respect of the financial asset as directed by the
14 entitlement holder,¹¹ the duty to comply with the entitlement holder’s instruction (referred to in
15 UCC Article 8 as an “entitlement order”¹²) to transfer or redeem a financial asset,¹³ and the duty
16 to change the entitlement holder’s security entitlement to another form of holding for which the
17 entitlement holder is eligible, or to deliver out a financial asset, at the request of the entitlement
18 holder.¹⁴

19 The property interest comprising a security entitlement with respect to a particular financial
20 asset consists of a pro rata property interest in all interests of the securities intermediary in that
21 financial asset.¹⁵ For example, an entitlement holder may have 100 shares of XYZ stock
22 maintained for it in an account with a securities intermediary, but nine other entitlement holders
23 may each have 100 shares of XYZ stock maintained for each of them in their accounts with the
24 securities intermediary. A clearing corporation, such as Depository Trust Company, may show on
25 its books and records that, of all the XYZ stock that the clearing corporation holds, 1000 shares
26 are for the securities intermediary’s account. The securities intermediary would then reflect on its
27 books and records that 100 shares of XYZ stock are held by the securities intermediary through
28 the clearing corporation as being for the account of each of the ten entitlement holders. A particular
29 entitlement holder’s security entitlement will be to 100 of the 1000 shares of XYZ stock as the
30 entitlement holder’s pro rata share of the “fungible bulk” of XYZ stock held by the securities
31 intermediary.¹⁶

⁵ UCC § 8-102(a)(9). The quoted language is in clause (iii) of UCC § 8-102(a)(9)’s definition of the term “financial asset.”

⁶ UCC § 8-102(a)(7).

⁷ UCC § 8-501(b)(1).

⁸ UCC § 8-102(a)(17).

⁹ UCC § 8-504.

¹⁰ UCC § 8-505.

¹¹ UCC § 8-506.

¹² UCC § 8-102(a)(8).

¹³ UCC § 8-507.

¹⁴ UCC § 8-508.

¹⁵ UCC § 8-503(b).

¹⁶ See generally Official Comment 1 to UCC § 8-503.

1 The Part 5 Duties are generally enforceable by the entitlement holder against the securities
2 intermediary under the UCC by a private right of action.¹⁷ And, while the securities intermediary
3 is subject to the Part 5 Duties, the securities intermediary has certain protections under UCC Article
4 8. For example, a securities intermediary that transfers a financial asset pursuant to an entitlement
5 order generally cannot be held liable to an adverse claimant to the financial asset for the transfer,
6 whether in conversion or otherwise, unless the securities intermediary acted in collusion with the
7 wrongdoer in violating the rights of the adverse claimant.¹⁸ The collusion standard suggests that
8 the licensee or provisional registrant’s behavior must be egregious, or close to it, for the securities
9 intermediary to be liable to an adverse claimant.¹⁹

10 A financial asset giving rise to a security entitlement is generally not subject to the claims
11 of creditors of the securities intermediary in priority over the security entitlement. However, a
12 financial asset will be subject to a claim of a creditor of a securities intermediary, senior in priority
13 to the security entitlement, if (a) the securities intermediary has granted to the creditor a security
14 interest in the financial asset, whether to secure the securities intermediary’s own obligations to
15 the creditor or otherwise, (b) the creditor has “control” of the financial asset, and (c) the securities
16 intermediary has not complied with its duty to maintain sufficient financial assets to satisfy the
17 security entitlement in addition to satisfying the security interest of the creditor.²⁰ “Control” would
18 generally require the financial asset to be credited to a securities account of the creditor at another
19 securities intermediary, or otherwise to be delivered out to the creditor and registered in the name
20 of the creditor or, in the case of a certificated security not registered in the name of the creditor,
21 indorsed to the creditor or in blank.²¹ The securities intermediary is not permitted to grant a
22 security interest in the financial asset without the consent of the entitlement holder.²²

23 It follows from a securities intermediary’s duty to maintain sufficient financial assets to
24 satisfy security entitlements that, if the securities intermediary holds financial assets of a particular
25 class and issuer that in part give rise to security entitlements and in part are financial assets of the
26 securities intermediary maintained for its own account, then the security entitlements in the
27 financial assets have priority over the securities intermediary’s ownership of its own financial
28 assets unless a creditor of the securities intermediary has control of the financial asset. If for some
29 reason the securities intermediary does not maintain sufficient financial assets of a particular class
30 or issuer to satisfy all security entitlements to the financial assets, then the entitlement holders of

¹⁷ UCC. § 1-305(b)(“Any right or obligation declared by [the UCC] is enforceable by action unless the provision declaring it specifies a different or limited effect.”). A Court of Appeals case surprisingly came to the conclusion that an entitlement holder has no private right of action under Part 5 of UCC Article 8 unless a provision in Part 5 expressly provides for a private right of action. *See Harris v. T.D. Ameritrade, Inc.*, 805 F.3d 664 (6th Cir. 2015). However, the court did not address UCC § 1-305(b) in the opinion.

¹⁸ UCC. § 8-115(3).

¹⁹ *See generally* Official Comment 5 to UCC § 8-115.

²⁰ UCC §§ 8-503(a) and 8-511(a), (b).

²¹ UCC § 8-106; *see* UCC § 8-301 for when “delivery” occurs. The creditor could also obtain control by entering into an agreement (a so-called “control agreement”) with the securities intermediary by which the securities intermediary agrees that it will comply with entitlement orders originated by the creditor without further consent of the entitlement holder. UCC § 8-106(d)(2). However, the securities intermediary may not enter into a control agreement in respect of a securities account without the consent of the entitlement holder. UCC § 8-106(g). “Control” for purposes of UCC Article 8 should be distinguished from “control of virtual currency” as defined in the Act.

²² UCC § 8-504(b).

1 the financial assets share ratably in the financial assets of that class or issuer still maintained by
2 the securities intermediary and have ratable unsecured claims against the securities intermediary
3 for the shortfall.²³

4 For example, if ten entitlement holders of a securities intermediary each have security
5 entitlements to 100 shares of XYZ stock, but the securities intermediary has only 800 shares of
6 XYZ stock credited to its account at a clearing corporation (inclusive of shares held by the
7 securities intermediary for its own account) and has no other XYZ shares, each entitlement holder
8 will have a security entitlement to 80 shares of XYZ stock and an unsecured claim against the
9 securities intermediary for the value of 20 shares of XYZ stock.

10 *Choice-of-law*

11 UCC Article 8 contains choice-of-law rules.²⁴ Generally, if a dispute arises in a court in a
12 jurisdiction that has adopted the UCC (a “UCC jurisdiction”) and concerning an issue addressed
13 under UCC Article 8 with respect to the indirect holding system, the court would apply the law of
14 the jurisdiction that governs the account relationship between the securities intermediary and the
15 entitlement holder to determine the issue.²⁵ There are currently no material differences between
16 the UCC Article 8 of one UCC jurisdiction and the UCC Article 8 of another UCC jurisdiction in
17 respect of matters relating to the indirect holding system.²⁶

18
19 However, the UCC Article 8 choice-of-law rules for securities credited to a securities
20 account are affected by the Hague Securities Convention.²⁷ The Convention became effective in
21 the United States on April 1, 2017. Even though the Convention applies only to “securities” as
22 defined in the Convention, it is unclear whether the definition of “securities” in the Convention
23 might include virtual currency.

24
25 The choice-of-law rules in the Hague Securities Convention pre-empt the choice-of-law
26 rules in UCC Article 8 for the issues covered by Article 2(1) of the Convention. Those issues
27 substantially overlap with the issues addressed in the choice-of-law rules in UCC Article 8 for
28 securities held in the indirect holding system. Even so, the choice-of-law rules of the Convention
29 will in most cases produce the same results as under the choice-of-law rules of UCC Article 8.

30
31 Here is why. Under Article 4(1) of the Convention, the court would apply to an issue
32 covered by Article 2(1) the law of the jurisdiction that governs the account agreement between the
33 securities intermediary and the entitlement holder to determine the issue so long as the securities

²³ UCC § 8-503(b).

²⁴ UCC § 8-110.

²⁵ UCC §§ 8-110(b) and (e).

²⁶ If the account agreement were governed by a law of a jurisdiction that has not adopted the UCC and the account agreement did not provide that a particular UCC jurisdiction is the “securities intermediary’s jurisdiction” for purposes of the UCC, then the non-UCC substantive law of the jurisdiction whose law governs the account agreement would determine the rules for the holding and transfer of investment securities, including whether the financial assets are subject to the claims of the securities intermediary’s creditors. UCC §§ 8-110(b) and (e)(1) and (2).

²⁷ The Hague Securities Convention is formally known as the Convention on the Law Applicable to Certain Rights in respect of Securities held with an Intermediary. The Convention is available at <https://www.hcch.net/en/instruments/conventions/full-text/?cid=72>.

1 intermediary maintains an office (a “qualifying office”) that deals with securities in the country of
2 the jurisdiction.²⁸ As a result, assuming that the qualifying office test is met, the issues to be
3 determined by the choice-of-law rules of either the Convention or UCC Article 8 would generally
4 be determined by the law governing the account agreement.

5
6 If the parties wish for the law of another jurisdiction to determine the UCC Article 8 choice-
7 of-law issues, they can choose for the “securities intermediary’s jurisdiction” to be that
8 jurisdiction.²⁹ If the parties wish for the law of another jurisdiction to determine all of the Article
9 2(1) issues, they can so specify in the account agreement so long as the qualifying office test is
10 met.³⁰

11 How UCC Article 8 Operates in Relation to the Act

13 It may be counterintuitive to think that UCC Article 8, which generally deals with
14 investment securities, would have any relevance to the Act and virtual currencies. However, UCC
15 Article 8 is a broad statute that in some circumstances, applicable here, permits parties to “opt in”
16 to the UCC Article 8 scheme, and for their transactions to be governed by the rules of UCC Article
17 8, for purposes of the indirect holding system. Here is how the “opt-in” operates in the context of
18 the Act and what the effect of the “opt-in” would be.

19 *More on terminology*

20 For a licensee or provisional registrant to be subject to UCC Article 8, the licensee or
21 provisional registrant must be a “securities intermediary” maintaining a “securities account” to
22 which a “financial asset” is or may be credited. The definitions of these three terms, taken together,
23 indicate that a licensee or provisional registrant, which maintains accounts for residents to which
24 virtual currency is or may be credited, could expressly agree with the residents to be subject to the
25 rules of UCC Article 8.

26 The definition of “securities intermediary” in UCC Article 8 is not confined to a bank or
27 broker. Moreover, it is not confined to a person who is regulated under banking or securities law.
28 The definition includes “a person...that in the ordinary course of its business maintains securities
29 accounts for others and is acting in that capacity.”³¹

30 Likewise, the definition of “securities account” is not confined to an account at a bank or
31 broker or to an account maintained by a person regulated under banking or securities law. The
32 term is defined as “an account to which a financial asset is or may be credited in accordance with
33 an agreement under which the person maintaining the account undertakes the treat the person for

²⁸ The second sentence of Article 4(1) of the Hague Securities Convention sets forth the minimal office activity that is required for the qualifying office test to be met. Because the United States is considered to be a “multi-unit” country under the Convention, the qualifying office test for the choice-of-law in the account agreement is met if the account agreement between the securities intermediary and the entitlement holder selects the law of a particular state in the United States and the qualifying office is located in any state of the United States. Hague Securities Convention, Art. 12(1)(b).

²⁹ UCC § 8-110(e)(1).

³⁰ Hague Securities Convention, Art. 4(1). The parties may not select for less than all of the Article 2(1) issues to be determined by the law of the other jurisdiction.

³¹ UCC § 8-102(a)(14)(ii).

1 whom the account is maintained as entitled to exercise the rights that comprise the financial
2 asset.”³²

3 Similarly, the definition of “financial asset” is not confined to a security. The term is
4 defined to include “any property that is held by a securities intermediary for another person in a
5 securities account if the securities intermediary has expressly agreed with the other person that the
6 property is to be treated as a financial asset under [UCC Article 8].”³³

7 Notice how a financial asset may be “any property” so long there is an express agreement
8 between the securities intermediary and the entitlement holder that the property be treated as a
9 financial asset. As Official Comment 9 to UCC § 8-102 states: “The term financial asset is defined
10 to include not only securities but also a broader category of obligations, shares, participations, and
11 interests.”³⁴

12 *Opt-in*

13 It follows that a licensee or provisional registrant in the business of maintaining control of
14 virtual currencies for residents may expressly agree with the residents that virtual currency of
15 which the licensee or provisional registrant has control for the residents will be treated as “financial
16 assets” credited to the residents’ “securities accounts” under UCC Article 8. UCC Article 8 does
17 not dictate what form the express agreement might take, but it would certainly permit the express
18 agreement to be contained in the account agreement between the licensee or provisional registrant
19 and a resident. Assuming that the express agreement is contained in the account agreement, then,
20 in order for a court in a UCC jurisdiction to apply the substantive law of UCC Article 8 to the
21 financial assets held in the account, the law governing the account agreement would need to be
22 that of a UCC jurisdiction or the agreement would need to provide for a UCC jurisdiction to be the
23 “securities intermediary’s jurisdiction”³⁵ and for the issues governed by Article 2(1) of the Hague
24 Securities Convention to be governed by the law of the UCC jurisdiction.³⁶

25 *Part 5 Duties of the licensee or provisional registrant*

26 If the licensee or provisional registrant does expressly agree with residents to treat virtual
27 currency of which the licensee or provisional registrant has control for the residents as financial
28 assets credited to the residents’ securities accounts, then the licensee or provisional registrant has
29 the following Part 5 Duties relevant for a virtual currency and enforceable by the residents by
30 private right of action:

- 31 • *The duty to maintain sufficient financial assets to satisfy all security entitlements to the*
32 *financial assets.*³⁷

³² UCC § 8-501(a).

³³ UCC § 8-102(a)(9)(iii)

³⁴ For a case in which a bank certificate of deposit was treated as a financial asset credited to a securities account, see *Flener v. Alexander (In re Alexander)*, 429 B.R. 876 (Bankr. W.D. Ky. 2010, *aff’d*, 2011 WL 9961118 (6th Cir. 2011).

³⁵ UCC §§ 8-110(b) and (e)(1) and (2).

³⁶ Hague Securities Convention, Art. 4(1).

³⁷ UCC § 8-504.

1 The licensee or provisional registrant would need to maintain control of sufficient virtual
2 currency of each type to satisfy all entitlements of the residents to virtual currency of that
3 type.

- 4 • *The duty to comply with the entitlement holder's entitlement orders to transfer or redeem*
5 *a financial asset.*³⁸

6 The licensee or provisional registrant would need to comply with a resident's instructions
7 to transfer virtual currency of which the licensee or resident has control for the resident to
8 another person, as and when, for example, the resident wishes to exchange the virtual
9 currency for goods, services, fiat currency or any other type of virtual currency.

- 10 • *The duty to change the entitlement holder's security entitlement to another form of holding*
11 *for which the entitlement holder is eligible, or to deliver out a financial asset, at the request*
12 *of the entitlement holder.*³⁹

13 The licensee or provisional registrant would need to comply with a resident's instructions
14 to transfer virtual currency of which the licensee or provisional registrant has control for
15 the resident to another licensee or provisional registrant for the account of the resident or
16 to another eligible account of the resident.

17 These Part 5 Duties would not appear to be controversial. They seem to be consistent with
18 a resident's expectations of the licensee's or provisional registrant's performance with respect to
19 virtual currency of which the licensee or provisional registrant has control for the resident.

20 *Licensee or provisional registrant protections*

21 If licensee or provisional registrant transfers a virtual currency as instructed by the resident,
22 the licensee or provisional registrant generally cannot be held liable to an adverse claimant to the
23 virtual currency for the transfer unless the licensee or provisional registrant acted in collusion with
24 the wrongdoer in violating the rights of the adverse claimant.⁴⁰

25 *Creditor claims*

26 If the licensee or provisional registrant expressly agrees with residents to treat virtual
27 currency of which the licensee or provisional registrant has control for the residents as financial
28 assets credited to the residents' securities accounts, then a financial asset giving rise to a security
29 entitlement is generally not subject to the claims of creditors of the securities intermediary in
30 priority over the security entitlement.⁴¹ Accordingly, virtual currency of which a licensee or
31 provisional registrant has control for a resident would not be subject to claims of creditors of the
32 licensee or provisional registrant.

³⁸ UCC § 8-507.

³⁹ UCC § 8-508.

⁴⁰ UCC. § 8-115(3).

⁴¹ See UCC § 8-503(a).

1 That being said, under UCC Article 8 the virtual currency would be subject to a claim of a
2 creditor of the licensee or provisional registrant, senior in priority to the resident’s entitlement, if
3 (a) the licensee or provisional registrant has granted to the creditor a security interest in the virtual
4 currency, (b) the creditor has “control” of the virtual currency,⁴² and (c) the licensee or provisional
5 registrant has not complied with its duty to maintain sufficient virtual currency of that type to
6 satisfy the entitlement in addition to satisfying the security interest of the creditor.⁴³ The licensee
7 or provisional registrant, though, is not permitted under UCC Article 8 to grant a security interest
8 in the virtual currency without the consent of the resident.⁴⁴

9 *Secured transactions*

10 If the licensee or provisional registrant expressly agrees with residents to treat virtual
11 currency over which the licensee or provisional registrant has control for the residents as financial
12 assets credited to the residents’ securities accounts, then several problems that exist today under
13 secured transactions law will be addressed. Addressing these problems will facilitate the greater
14 availability of credit or lower its costs for a resident who wishes to offer the resident’s virtual
15 currency account of the licensee or provisional registrant has control as collateral for a loan or
16 other obligation and will otherwise facilitate the utility of virtual currency as a medium of
17 exchange.

18 Competing security interests

19
20
21 One problem concerns the method of perfection and the priority of a security interest that
22 the resident might grant in the resident’s virtual currency account. Absent the licensee or
23 provisional registrant expressly agreeing with residents to treat virtual currency of which the
24 licensee or provisional registrant has for the residents as financial assets credited to the residents’
25 securities accounts, a resident’s entitlement to virtual currency maintained for the resident by the
26 licensee or provisional registrant would be considered under Article 9 (“Article 9”) of the UCC to
27 be a “general intangible.”⁴⁵ The filing of a financing statement would be the sole method for the
28 secured party to perfect its security interest in the virtual currency account.⁴⁶ The priority of
29 competing security interests in the virtual currency account would be determined in favor of the
30 first secured party to file or perfect its security interest.⁴⁷

31
32 However, if the licensee or provisional registrant expressly agreed with residents to treat
33 virtual currency of which the licensee or provisional registrant has control for the residents as
34 financial assets credited to the residents’ securities accounts, a resident’s virtual currency account
35 would be considered to be “investment property” under Article 9.⁴⁸ The method of perfection of
36 a security interest in the resident’s virtual currency account as investment property would be by

⁴² “Control” in this context means “control” as defined in UCC. § 8-106 in contrast to “control of virtual currency” as defined in the Act.

⁴³ UCC §§ 8-503(a) and 8-511(a), (b).

⁴⁴ UCC § 8-504(b).

⁴⁵ UCC § 9-102(a)(42).

⁴⁶ UCC § 9-310.

⁴⁷ UCC §§ 9-322(a)(1).

⁴⁸ UCC § 9-102(a)(49)(defining “investment property” to include a “security entitlement” and a “securities account”).

1 either the filing of a financing statement or the secured party obtaining control of the investment
2 property.⁴⁹ A secured party who obtains control would have priority over a secured party who
3 perfects by filing even if the filing preceded in time the control secured party obtaining control.⁵⁰
4

5 It would appear to be preferable as a policy matter for the investment property perfection
6 and priority scheme to apply to the virtual currency account instead of the scheme for general
7 intangibles. The policy rationale is analogous to that for the perfection and priority of security
8 interests in investment property generally. A secured party taking a security interest in investment
9 property and relying upon that collateral in extending credit should demonstrate that reliance by
10 taking the steps to obtain control. If the secured party takes those steps, its security interest is
11 entitled to priority over a secured party who had perfected its security interest merely by the filing
12 of a financing statement and who, presumably by not taking the steps to obtain control, was not
13 relying on the investment property in extending credit.
14

15 Likewise, a secured party that extends credit in reliance on the virtual currency account as
16 collateral would want its security interest to be senior. It would take the necessary steps to obtain
17 control. Absent “investment property” treatment of the virtual currency account, though, control
18 would not be a permitted method of perfection or a method for obtaining priority. The secured
19 party would need to bargain with any other secured party who had already filed a financing
20 statement covering general intangibles in order to obtain a release or subordination of the other
21 secured party’s security interest and who presumably is not relying on the virtual currency account
22 as collateral. There would seem to be no policy justification for the filed secured party to be
23 entitled to the priority benefit and negotiating leverage over the later secured party, that would be
24 relying on the account as collateral, merely because the filed secured party has, without that
25 reliance, taken a general security interest in all of the resident’s assets that includes a security
26 interest in general intangibles.
27

28 Still, for a secured party to take control of a virtual currency account, some new techniques
29 may need to be developed. Unless the licensee or provisional registrant itself is the secured party
30 or the virtual currency is credited to an account of the secured party at another licensee or
31 provisional registrant, the secured party, the resident and the licensee or provisional registrant
32 would need to enter into a control agreement by which the licensee or provisional registrant would
33 agree to follow instructions from the secured party to transfer the virtual currency without any
34 further consent of the resident.⁵¹ Such an agreement may require a mechanism for the resident
35 confidentially to inform the secured party of the resident’s private key, or for the secured party to
36 have its own private key, to the virtual currency account.
37

38 Transferees

39

40 Another problem concerns the rights of transferees of virtual currency. If a secured party’s
41 security interest in a virtual currency account is perfected as a general intangible, any transfer of
42 the virtual currency by the resident out of the account will be subject to the secured party’s security

⁴⁹ UCC §§ 9-312(a) and 9-314(a).

⁵⁰ UCC § 9-328(a).

⁵¹ See UCC §§ 8-106(d) and (g) and 9-106(a).

1 interest unless the secured party had authorized the transfer free of the security interest.⁵² This is a
2 problem under current law since there is no rule under Article 9 that otherwise cuts off a security
3 interest in a virtual currency account perfected as a general intangible by the filing of a financing
4 statement. A secured party of the transferee, thinking of extending credit against the virtual
5 currency account, may have no practical way of assuring itself that the virtual currency credited to
6 the account is not subject to a security interest in favor of a prior transferor's secured party.

7
8 However, if the licensee or provisional registrant expressly agreed with residents to treat
9 virtual currency over which the licensee or provisional registrant has control for the residents as
10 financial assets credited to the residents' securities accounts, then the adverse claim cut-off rule of
11 UCC Article 8 would apply. Under that rule, when a transferee acquires for value a "security
12 entitlement" in the transferred virtual currency resulting from a credit of the virtual currency to the
13 transferee's account at its licensee or provisional registrant, the transferee will have acquired its
14 interest in the virtual currency free any "adverse claims" of which the transferee did not have
15 notice.⁵³

16
17 An "adverse claim" is defined is defined in UCC § 8-102(a)(1) as "a claim that a claimant
18 has a property interest in a financial asset and that it is a violation of the rights of the claimant" for
19 the transferee to acquire an entitlement in the financial asset. Notice of an adverse claim under
20 UCC § 8-105 means generally that the transferee knows of the adverse claim (which under UCC
21 § 1-202(b) means actual knowledge) or has acted with willful blindness to avoid knowing about
22 the claim.⁵⁴

23
24 The mere fact that the transferee may suspect or even be aware that its transferor may have
25 granted a security interest in the transferor's virtual currency account at its licensee or provisional
26 registrant does not put the transferee on notice of an adverse claim to the virtual currency. Often,
27 the secured party will have authorized the transfer of the virtual currency free of the security
28 interest. For a transferee to be on notice of an adverse claim, the transferee must know, or have
29 been willfully blind in avoiding knowing, that the acceptance by the transferee of a security
30 entitlement in the transferred virtual currency violates the rights of the adverse claimant.

31 Benefits the UCC Article 8 "Opt-in" for the Act

32
33
34 Section XXX's requirement for a UCC Article 8 "opt-in" will have some clear benefits for
35 residents that in turn support responsible behavior by licenses and provisional registrants:

- 36
37 • Protecting the virtual currency of a resident from the claims of the licensee's or provisional
38 registrant's own creditors.

39

⁵² See UCC § 9-315(a)(1).

⁵³ UCC § 8-502 ("An action based on an adverse claim to a financial asset, whether framed in conversion, replevin, constructive trust, equitable lien, or other theory, may not be asserted against a person who acquires a security entitlement under section 8-501 for value and without notice of the adverse claim.").

⁵⁴ A notice of an adverse claim can also arise if the transferee were under a statutory or regulatory duty to investigate whether an adverse claim exists and the investigation would have revealed the adverse claim. See UCC §8-105(a)(3). Such a statutory or regulatory duty in this context seems unlikely.

- 1 • Requiring the licensee or provisional registrant to maintain control of sufficient virtual
2 currency of each type to satisfy each resident’s entitlement to the virtual currency of that
3 type.
4
- 5 • Subordinating the licensee’s or provisional registrant’s proprietary interest in virtual
6 currency of a type, and establishing a ratable loss sharing rule among residents, if there is
7 a shortfall in the virtual currency of that type of which the licensee or provisional registrant
8 has control for residents.
9
- 10 • Requiring the licensee or provisional registrant to comply with a resident’s transfer
11 instructions as to the virtual currency and, absent collusion with the wrongdoer, protecting
12 the licensee or provisional registrant from liability to an adverse claimant for the transfer.
13
- 14 • Establishing that the commercial law relationship between the licensee or provisional
15 registrant and the resident is the relationship that a securities intermediary has to an
16 entitlement holder with respect investment property and is not to be viewed as falling under
17 other relationships, such as an agency relationship or a relationship arising from a
18 transaction to which UCC Article 2 applies or from a mere bailment under the common
19 law.
20
- 21 • Clarifying secured transactions law on the perfection and priority of a security interest in a
22 resident’s virtual currency account at a licensee or provisional registrant.
23
- 24 • Using UCC Article 8’s adverse claim cut-off rule to facilitate the transfer of virtual
25 currency free of a secured party’s adverse claim of a security interest in the virtual currency.
26

27 Supplemental Provisions

28
29 In addition to requiring a licensee or provisional registrant and a resident to “opt-in” to
30 UCC Article 8, Section XXX contains provisions designed to insure that the benefits of UCC
31 Article 8 are indeed obtained for the resident.
32

33 *Choice-of-law*

34
35 Subsection (b)(1) requires that the agreement between the licensee or provisional registrant
36 and a resident providing for the UCC Article 8 “opt in” be governed by the law of UCC
37 jurisdiction. The agreement may provide for the law of a non-UCC jurisdiction to apply to the
38 agreement, but only if the agreement also provides for the “securities intermediary’s jurisdiction”
39 to be that of a UCC jurisdiction and for the issues addressed in Article 2(1) of the Hague Securities
40 Convention to be governed by the law of the UCC jurisdiction.
41

42 Subsection (e) requires the licensee or provisional registrant to maintain an office that
43 satisfies the “qualifying office” test of the second sentence of Article 4(1) of the Hague Securities
44 Convention. It is not necessary under subsection (e) or the Hague Securities Convention for the
45 qualifying office to be located in the enacting state. The test requires only that the qualifying office

1 be located anywhere in the United States.⁵⁵

2
3 The requirements to satisfy the “qualifying office” test within the United States under the
4 Hague Securities Convention are minimal. The requirements may be met by the licensee or
5 provisional registrant in a variety of ways: effecting transactions in virtual currency accounts from
6 the office in the United States, monitoring virtual current transactions from the office in the United
7 States, or administering payments, or otherwise being engaged in a regular activity of maintaining
8 virtual currency accounts, from the office in the United States.⁵⁶ The test may also be met if the
9 licensee or provisional registrant, by a specific means of identification, identifies on its books and
10 records that virtual currency accounts are maintained in the United States.⁵⁷ Moreover, it is not
11 necessary that the test apply to the virtual currency of which the licensee or provisional registrant
12 has control for a particular resident so long as test is met for any virtual currency accounts of which
13 the licensee or provisional registrant has control for any residents or non-residents.

14
15 Subsections (b)(1) and (e) are necessary to be sure that, once the UCC Article 8 “opt-in”
16 provisions are contained in the account agreement between the licensee or provisional registrant
17 and the resident, the UCC Article 8 or, if applicable, Hague Securities Convention choice-of-law
18 rules point to the law of a particular jurisdiction where the substantive rules of UCC Article 8
19 actually apply. For example, subsection (b)(1) protects the resident from the governing law of the
20 account agreement being that of a foreign jurisdiction that does not have the UCC Article 8
21 protections for the resident contemplated by the Act. Likewise, if the governing law of the account
22 agreement does point to a jurisdiction in which UCC Article 8 is in effect and if the Hague
23 Securities Convention is applicable, subsection (e) protects the resident from the choice of
24 governing law being ineffective under the Convention because the licensee or provisional resident
25 failed to maintain a qualifying office in the United States.

26 27 *Part 5 Duties*

28
29 UCC Article 8 permits a securities intermediary and an entitlement holder to vary by
30 agreement the standard of care for a securities intermediary to comply with the Part 5 Duties. In
31 the absence of variation the standard of care is “due care in accordance with reasonable commercial
32 standards.”⁵⁸

33
34 Subsection (b)(3) does not permit the parties to vary the standard below the “due care”
35 default standard. This provision protects the resident from the licensee or provisional registrant
36 lowering in the account agreement the standard of care that the licensee or provisional resident
37 must follow in complying with its Part 5 Duties.

38 39 *No Dealings with Resident’s Virtual Currency Account*

40
41 Under UCC Article 8, without the consent of the entitlement holder, a securities
42 intermediary may not, for the proprietary account of the securities intermediary, grant a security

⁵⁵ Hague Securities Convention, Art. 12(1)(b).

⁵⁶ Hague Securities Convention, Art. 4(1)(a).

⁵⁷ Hague Securities Convention, Art. 4(1)(b).

⁵⁸ See UCC §§ 8-504(c), 8-505(a), 8-506, 8-507(a) and 8-508.

1 interest in or otherwise deal with financial assets held in a securities account for the entitlement
2 holder.⁵⁹

3
4 Subsection (d) prohibits the registrant from entering into an account or other agreement
5 with the licensee or provisional registrant that permits the licensee or provisional registrant to use
6 for its own proprietary purposes the virtual currency of which the licensee or provisional registrant
7 has control for the resident. An exception is made for the virtual currency being used to pay the
8 fees, charges and other amounts owing by the resident to the licensee or provisional registrant for
9 the virtual currency business activity conducted in the account.

10
11 *Failure to “Opt in”*

12
13 Subsection (c) provides that, if the licensee or provisional registrant and the resident fail to
14 “opt in” to UCC Article 8, their respective rights and obligations will be determined as if the “opt
15 in” has occurred.

16
17 Subsection (c) assures a resident that the resident will have the protections of UCC Article
18 8 even if there is no account agreement between the licensee or provisional resident and the
19 resident or the account agreement does not include the “opt-in” provisions required by subsection
20 (b). However, if the Hague Securities Convention is applicable, the licensee or provisional
21 registrant must still maintain a qualifying office in the United States under subsection (e) for
22 subsection (c) to be effective.

⁵⁹ See UCC §§ 1-302 and 8-504(b).