Comments to the Thirty-First Legislature (2022) of the State of Hawaii on S.B. No. 3076 relating to special purpose digital currency licensure and S.B. 3025 relating to digital currency licensing program

February 10, 2022

To whom it may concern:

Coin Center is an independent nonprofit research and advocacy center focused on the public policy issues facing cryptocurrency technologies such as Bitcoin. Our mission is to build a better understanding of these technologies and to promote a regulatory climate that preserves the freedom to innovate using open blockchain technologies. We do this by producing and publishing policy research from respected academics and experts, educating policymakers and the media about blockchain technology, and by engaging in advocacy for sound public policy.

We welcome the opportunity to provide feedback on S.B. 3076 and S.B. 3025, two bills attempting to reform cryptocurrency money transmission regulations.

As drafted, both of these bills would create a dangerously overbroad licensing requirement that could impose criminal liability on an untold number of Hawaiians who are not engaged in any activity raising consumer protection concerns. Crafting a licensing requirement for persons controlling customer virtual currency is a reasonable regulatory approach. Several other states and the Uniform Law Commission have taken this approach. However, requiring licenses from non-custodial entities or individuals acting on their own behalf, as these bills would do and as no other state has done, severely damages the rights of citizens and stifles innovation unnecessarily. For these and other reasons described below, these bills must not pass as currently drafted.

The need for reform

Hawaii is in dire need of reform for virtual currency activities. To illustrate: Coinbase, one of the largest and most popular cryptocurrency exchanges in the US, is currently

unavailable to residents of Hawaii because of the state of money transmission regulation.[1]

In particular, the rules established by Hawaii's Division of Financial Institutions (DFI) requires that cryptocurrency businesses maintain liquid asset reserves equal to the aggregate value of the digital currency held on behalf of customers in addition to the digital currency they hold for their customers (effectively a 200 percent reserve requirement).[2] It is easy to see how this could be prohibitive for businesses to operate in Hawaii; and indeed, few exchanges operate in Hawaii for this reason.

The state has taken positive steps to remedy this problem. Hawaii was among the first states to consider adopting a version of the Uniform Law Commission's well-considered cryptocurrency licensing framework, the Uniform Regulation of Virtual-Currency Businesses Act.[3] In 2018, the legislature of the state of Hawaii considered SB 2129 and SB 3082, which would have adopted the URVCBA word-for-word into law. Coin Center applauded Hawaii's leadership at the time and continues to strongly recommend the URVCBA as the ideal state regulatory framework for cryptocurrency licensing.[4]

Although Hawaii did not pass the URVCBA in 2018, it did open a regulatory sandbox for digital currency companies in 2019 called the Digital Currency Innovation Lab (DCIL).[5] Since 2020, a dozen cryptocurrency exchanges have been allowed to operate in the state without procuring an expensive money transmission license with a dual reserve requirement. The results have been promising, and the DCIL and legislature is hoping to incorporate their learnings into law. As the DCIL program winds down in 2022, it is imperative that policymakers get this right in time, lest the state be left without many options for cryptocurrency exchange yet again.

Problems with SB 3076 and SB 3025

---

[1] "Coinbase accounts – Hawaii," Coinbase.com, accessed February 8, 2021, https://help.coinbase.com/en/coinbase/managing-my-account/other/coinbase-accounts-hawaii.

[2] Neeraj Agrawal, "Hawaii's issue with Bitcoin businesses has an obvious and easy solution," *Coin Center*, March 1, 2017, https://www.coincenter.org/hawaiis-issue-with-bitcoin-businesses-has-an-obvious-and-easy-solution/.

[3] "Virtual-Currency Businesses Act, Regulation of," Uniform Law Commission, 2017, https://www.uniformlaws.org/committees/community-home?CommunityKey=e104aaa8-c10f-45a7-a34a-0423c2106778.

[4] Peter Van Valkenburgh, "The ULC's model act for digital currency businesses has passed. Here's why it's good for Bitcoin." *Coin Center*, July 19, 2017, https://www.coincenter.org/the-ulcs-model-act-for-digital-currency-businesses-has-passed-heres-why-its-good-for-bitcoin/.

[5] "Digital Currency Innovation Lab," HTDC, accessed February 8, 2022, https://www.htdc.org/programs/#dcil-section.

After a two-year pilot, the DCIL has concluded that "digital currency transactions are not best regulated through existing money transmitter laws and that a new regulatory framework is appropriate."[6] Unfortunately, the alternative regulatory framework provided by SB 3076 and SB 3025 would merely create new problems. Each takes a similar approach to the state of New York's infamous "BitLicense," which spurred an exodus of cryptocurrency activity from the state.[7]
The main problem with SB 3076 and SB 3025 is that they attempt to micromanage what activities are and are not regulated and needing a license through lists of covered and exempted actions. But the descriptions here are vague and lend themselves to regulatory uncertainty. For example, "buying and selling digital currency as a business" is considered a licensable activity. So is "performing exchange services as a business." But it is not clear that there is a consumer protection element in each instance of either option. Therefore, it is not clear that there is a policy interest for such activities to be licensed.

There are similar problems in the list of exempted activities. While it is good that lawmakers want to explicitly state when activities are not licensable, and it is commendable that the legislature wisely exempts cryptocurrency mining and node maintenance from regulation, this list is similarly vague and nonsensical. For instance, "a person using digital currency including investing, buying or selling, or obtaining digital currency as payment for the purchase or sale of goods and services, *solely for academic purposes*," (emphasis added) is exempt. Why should it only be limited to academic purposes? Should a person using digital currency for their own use outside of the academy be forced to procure a license? The problems with this piecemeal approach of exemptions and requirements are obvious.

Like the BitLicense, this approach would create more confusion about who does and does not need to obtain a license. Regulators would be tasked to issue piecemeal opinions and guidance about who qualifies. Innovation and cryptocurrency activity would stall as these vagaries are worked out.

Why the URVCBA is superior

Hawaii would do much better to simply adopt the original URVCBA that the state considered years ago. Indeed, much of SB 3076 already borrows language from the URVCBA, notably in the definition of "control of digital currency," which is "the power

---

[6] S.B. No. 3076, "A Bill for an Act relating to special purpose digital currency licensure," Hawaii Senate, Thirty-first legislature, 2022, https://www.capitol.hawaii.gov/session2022/bills/SB3076_.htm.
[7] Michael del Castillo, "The 'Great Bitcoin Exodus' has totally changed New York's bitcoin ecosystem," *New York Business Journal*, August 12, 2015, https://www.bizjournals.com/newyork/news/2015/08/12/the-great-bitcoin-exodus-has-totally-changed-new.html.

to execute unilaterally or prevent indefinitely a digital currency transaction." The URVCBA is so powerful and appropriate precisely because the need to obtain a license is triggered when an action meets this clear and simple definition.

Rather than trying to lay out a list of all the activities that require a license and those that don't, the URVCBA uses a clear definition of control that can be easily applied to the myriad of cryptocurrency activities—indeed, even ones that have not been developed yet.

The URVCBA only regulates business activities, not personal use of technology or the technology itself. The activities that require a license are narrowly limited to the 1) exchange, 2) storage, or 3) control of the digital currency. These are all precisely defined [emphases added]:

> (5) "Exchange" means to *assume control* of virtual currency from or on behalf of a resident, at least momentarily, to sell, trade, or convert:
>
> (A) virtual currency for legal tender, bank credit or one or more forms of virtual currency; or
> (B) legal tender or bank credit for one or more forms of virtual currency.
>
> (20) "Store" or "storage" means *maintaining control* of virtual currency on behalf of a resident by a person other than the resident.
>
> (21) "Transfer" means to *assume control* of virtual currency from or on behalf of a resident and to:
>
> (A) credit the virtual currency to the account of another person;
> (B) move the virtual currency from one account of a resident to another account of the same resident; or
> (C) relinquish control of virtual currency to another person.

Note the use of the term "control" to trigger the regulated activity in each case. This ensures that noncustodial entities and activities such as miners, nodes, developers, key recovery service providers, Lightning network channel nodes, and signers in a sidechain federated peg need not fear that they will run afoul of the law if they do not procure a license.

Furthermore, the URVCBA explicitly exempts "a person using virtual currency solely *a) on its own behalf b) for personal, family, or household purposes*, or c) for academic purposes." [emphases added]. There is no reason why *any* personal usage, academic or no, should require a license. To fail to exempt these other forms of personal usage would merely criminalize large swaths of benign private behavior while achieving no improvement in consumer protection for, by definition, a person acting on her own behalf does not have customers whose interests she could fail to protect.

We strongly encourage the legislature of the state of Hawaii to discard the problematic language in SB 3076 and SB 3025, and instead reintroduce and pass SB 2129 and SB 3082 from the 2018 session, which adopts the URVCBA as well as special language to remove the dual reserve penalty from existing Hawaii law. At the bare minimum,

should the legislature proceed in crafting a bespoke licensing bill, the definition of virtual currency business activity and the associated exemptions should precisely match the carefully developed language in the URVCBA.

We appreciate this opportunity to comment on this important piece of legislation, and would be happy to answer any questions.

Sincerely,

Andrea O'Sullivan
Coin Center Fellow

Peter Van Valkenburgh
Coin Center Director of Research