

February 16, 2015

Emerging Payments Task Force
Conference of State Bank Supervisors
1129 20th Street, NW
9th Floor
Washington, DC 20036

Dear Sir or Madam,

The American Bankers Association (ABA)¹ is pleased to provide the following comments to the Conference of State Bank Supervisors (CSBS) regarding their draft model regulatory framework for virtual currency activities issued on December 16, 2014. We applaud CSBS for its proactive initiative. The payments system is a critical component of our nation's economy. Payments facilitate all forms of commerce. As such the stability, efficiency, and integrity of the payments system must be maintained. Consumers must maintain enough faith in the system to continue using it.

The proposed framework was issued as a result of the CSBS Emerging Payments Task Force reviewing developments in virtual currencies to identify the appropriate regulatory structure to govern the payments. The Task Force determined that the best approach for most states would be to focus on activities-based regulation, where one party is transmitting, storing, or holding value for another party. The Task Force also noted that, in most cases, existing state laws and regulations could be applied to virtual currency activities.

The proposed framework would be used by states to develop their own virtual currency regulation program. In the proposal, CSBS identifies eight general topic areas that should be included by each state, but it allows for flexibility in setting specific requirements under each topic.

Virtual currencies – once limited to niche uses – are gaining momentum as a vehicle for facilitating real world transactions. Virtual currencies offer innovation in payments; however, they often lack consumer protections. Traditional payment systems provide extensive protections guaranteed by federal law. As such consumers have come to expect similar protections in all of their financial transactions. Unfortunately, the current limited regulation of the virtual currency marketplace and transactions often means consumers that pay with or hold virtual currencies are exposed to significant risks.

Recent events have shown that failures at a single virtual currency provider can have a large impact throughout the entire virtual currency market. Following the failure of Bitcoin exchange Mt. Gox, the value of the virtual currency fell by 50 percent in under a month. Although none of these failures have yet to feed directly through to the traditional payments system, as virtual currency usage grows it will become more tied to our traditional payments system. In the future, such failures could have system-wide consequences.

¹ The American Bankers Association is the voice of the United States' \$15 trillion banking industry, which is composed of small, regional, and large banks that together employ more than 2 million people, safeguard \$11 trillion in deposits and extend more than \$8 trillion in loans.

The CSBS proposal would take a licensing approach to regulation. This is a positive step in ensuring that the risks posed to consumers and payment system integrity are addressed.

ABA believes that our payments system must **protect consumers**, be **secure**, ensure a **level playing field of regulation**, and be **driven by consumer and market demand**. Adherence to the following fundamental principles will ensure a strong resilient payments system:

- **Consumer Protection – Consumers must have a clear understanding of their rights and responsibilities in the payments system.** Federal law provides for numerous protections for consumers when they make electronic payments, such as protection against unauthorized charges and defined procedures for disputing a charge. Consumers expect this same level of protection in all transactions, regardless of the provider. Clear uniform protections should apply to all payments systems.
- **Secure – We must maintain the integrity of the payments system.** Payments facilitate all forms of commerce, as such the stability, efficiency, and integrity of the payments system must be maintained. Consumers must have enough faith in the system to continue using it. Because of this, all participants in the payments system must maintain the necessary controls and be subject to sufficient government oversight to ensure that the integrity of the payments system is never in question.
- **Level Playing Field – The payments system must include all responsible, regulated parties.** All participants in the payments system should operate by a similar set of rules and standards. This ensures that all participants have parallel financial incentives to innovate, and eliminates anomalies in the market driven solely by government policies that apply to some players but not others. It is imperative banks of all sizes be able to continue to offer products and services on the same basis as other competitors in the marketplace.
- **Meets Consumer and Business Needs – Market forces should be allowed to drive the evolution of the payments system, in concert with the above three principles.** Enhancements in payments systems should be driven by consumer demand. This allows companies to make modifications that add value without adding unwanted costs to consumers due to government mandates.

Rules governing the payments system should encourage investment by allowing investors to price products according to consumer demand. This will encourage the investment in innovations that is critical to securing our payments system in the future.

Virtual currencies are very innovative and the underlying technologies have the potential to bring significant innovation to the payments system. However, on balance, we believe that many virtual currencies today fall short when measured by these principles. We have concerns over how consumers are protected from fraud and losses, as well as implications for systemic integrity as the virtual currency market expands. The remainder of this document will offer suggestions as to how rules can be made to ensure that virtual currencies meet our principles.

State-Based Licensing Is an Important Step Towards Regulating Virtual Currencies

Regulations regarding virtual currencies are scarce. The Consumer Financial Protection Bureau (CFPB) has indicated some concerns with consumer protection issues relating to virtual currencies, however, has yet to propose any regulations pertaining to virtual currency business or transactions. Federal prudential regulators have been hesitant to establish new regulations for virtual currencies, relying on the application of existing regulations on new payment types. As such, consumer and prudential protections and licensing requirements for virtual currencies, issued by states, would be a welcome step towards ensuring payments security.

Financial regulators in some states have begun to forge ahead and create licensing requirements for entities that facilitate virtual currency transactions. Ultimately, a uniform national standard that can be adopted by states would help additional states implement such measures as well as ensure that regulations do not differ greatly state-by-state. This will ensure that legitimate virtual currency operators can easily comply with regulations in multiple states as well as prevent others from shopping around for the least stringent regulations.

CSBS presented the Request for Comment in the form of topic areas that should be included in a model regulation as well as a number of additional questions seeking information from the public. We would provide the following suggestions to the CSBS as it develops its draft framework:

Draft Framework

Information on registered virtual currency businesses should be shared by states and made available to consumers.

The second section of the proposed framework calls for states to have “robust” licensing systems and an effective means to share data with other states in real time. The CSBS’s Nationwide Mortgage Licensing System (NMLS) already allows a number of states to administer certain mortgage lending licenses. Its expansion to include licensing of payday lenders, money transmitters, check cashers, and other financial services providers could be a model for including a registry of licensed virtual currency providers. Such a registry would allow regulators to verify a business’s status in other states and allow consumers to ensure that a business is registered before doing business with it.

This would ensure that our first principle is met, and that consumers are protected. A national database would allow consumers to quickly verify that a provider is registered and regulated.

Certain virtual currency transactions should be subject to Regulation E protections.

Section seven of the proposal states that virtual currency companies should be subject to federal requirements “including the Electronic Funds Transfer Act.” Regulation E protections under the EFTA require two conditions be met: providers must issue both an account and access device. Many bitcoin providers offer just such services. The IP address associated with a bitcoin wallet constitutes an account, while the access key is an access device. As bitcoin

transactions are irreversible once posted to the blockchain consumers have no recourse to reclaim their funds. If Regulation E applied, wallet providers would be responsible for making customers whole following fraudulent transactions just as banks are.

This will be challenging for regulators to implement in practice. Wallet providers will have relationships with their own customers and transactions between these two parties should be monitored by the provider and claims for unauthorized transactions between the provider and the customer should be easily identified. However, when a wallet customer claims an unauthorized transaction has been made from their wallet to another unknown party would the wallet provider be responsible for making the consumer whole even though they were not an active participant in the transaction? In many cases a provider will be unable to verify if a transaction was authorized. This challenge is exacerbated by the lack of rules allowing for reversals of transactions, minimizing the chance of the wallet provider ever being reimbursed for these claims. It will be difficult to apply Regulation E to direct transactions between customers that have no prior relationship or agreement to participate under any rules regarding reversals of payments. Without the participation of a clearing house or payment network, virtual currency transactions are the equivalent of cash changing hands in the street. When your pocket is picked Gucci doesn't reimburse you for your loss.

Applying Regulation E protections to virtual currency transactions would ensure that our first principle is met, and that consumers are protected from fraudulent transactions.

Questions for Public Comment

Regulations should distinguish between different use cases of virtual currencies and regulate them accordingly.

The fourth question in the proposal asks what innovations should be anticipated in virtual currencies. As virtual currency technology evolves, the uses for it may change. A number of companies have developed use cases for virtual currency technology that enable transactions without consumers ever holding a currency. As such, traditional consumer protections and disclosures may not apply. The states must carefully find the correct level of regulation that protects consumers and the payments system without unduly stifling innovation.

Distinguishing between different use cases for virtual currencies will ensure that our third principle is met and that there is a level playing field and that regulations are placed appropriately.

Virtual currency companies should be required to hold reserve funds in applicable virtual currencies so long as the funds being guaranteed are denominated in the same currency.

The fifth question in the proposal asks whether virtual currency businesses should be allowed to hold safety funds in virtual currencies. The volatility of virtual currencies relative to fiat currencies can make holding appropriate capital levels a challenge. If, for example, the value of virtual currency deposits were to triple due to currency appreciation, it would be difficult for a firm to quickly triple its capital in fiat currencies. As such, virtual currencies should be able to be used to guarantee transactions in the same currency. Virtual currencies should not, however, be used to hold capital against funds held in fiat currencies.

Ensuring that virtual currency companies can hold capital against their assets will ensure that our second principle is met and that the integrity of the payments system is maintained even if losses occur.

Virtual currency businesses should only have access to state insurance or trust funds that they have paid into fully. The eighth question in the proposal asks whether virtual currency businesses should have access to state insurance or trust funds. Allowing virtual currency companies access to insurance or trust funds would alter the risk profile of such funds. As such, in order to gain access to such protection for their customers, virtual currency companies must fully offset the additional costs and risk they add to the funds. This can either be accomplished by establishing separate funds for virtual currency activities, or charging virtual currency businesses for the additional risk they add to a fund.

Allowing virtual currency companies access to insurance funds, without undermining existing protections, will help maintain the integrity of the payments system, meeting our second principle.

Requiring virtual currency businesses to fully comply with all BSA/AML and know your customer (KYC) requirements would reduce the risk banks face in serving these companies. The sixteenth question in the proposal asks how banks can be incentivized to provide money services accounts to virtual currency businesses. Banks face significant regulatory risks in banking virtual currency companies. Currently, there is little oversight of who virtual currency businesses serve, as such these businesses may easily facilitate criminal activity that banks would be held responsible for. If virtual currency companies were to comply with all of the same BSA/AML and KYC requirements to the same level that banks do and be subject to appropriate supervision by state authorities, these risks would be greatly diminished. Reducing the risk to banks in providing these services would increase the bankability of these businesses.

Requiring virtual currency businesses to fully comply with all applicable rules ensures that our third principle is met, and that there is a level playing field.

Ensure that regulated banks are not subject to new regulations.

The purpose of a licensing regime is to create an environment where all providers offer consumers equal protections. Banks are already subject to extensive regulation and oversight. Subjecting banks to duplicative regulations would add no additional protections to consumers, and would divert bank resources from serving their communities.

Not creating duplicative regulation ensures that our third principle is met, and that there is a level playing field.

ABA believes that state-based licensing of virtual currency businesses is an important positive step to protecting consumers as well as our payments system's integrity. The recommendations made above will help bring virtual currencies in line with ABA's fundamental payments system principles.

ABA appreciates the opportunity to comment on the CSBS's draft model regulatory framework. If you have any questions please contact the undersigned at rmorgan@aba.com or by telephone at 202.663.5387.

Sincerely,

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