February 6, 2015

Conference of State Bank Supervisors
Attention: Massachusetts Commissioner of Banks David Cotney
Chairman, Emerging Payments Task Force
1129 20th Street NW, 9th Floor
Washington, D.C. 20036

Re: Draft Model Regulatory Framework (“Draft Framework”) for State Virtual Currency Regulatory Regimes

Dear Commissioner Cotney:

Consumers Union,¹ the National Consumer Law Center (on behalf of its low income clients),² and Professor Mark E. Budnitz, Professor of Law Emeritus, Georgia State University School of Law,³ appreciate this opportunity to comment on the Conference of State Bank Supervisors’ draft model regulatory framework (“the framework”) for state virtual currency regulatory regimes.

The framework is a step toward cutting through the hype and hysteria surrounding virtual currencies and creating a structure to secure the benefits of these technologies while limiting the risks to consumers. As state lawmakers and regulators consider how to implement it, they should also undertake a vigorous review of their money transmitter statutes and update them as appropriate to ensure maximum consumer protections, including requiring surety bonds in amounts tied to volume and risk, and permissible investments at a one to one ratio to match outstanding obligations.

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¹ Consumers Union is the public policy and advocacy division of Consumer Reports. Consumer Reports is the world’s largest independent product-testing organization. Using its more than 50 labs, auto test center, and survey research center, the nonprofit organization rates thousands of products and services annually. Consumers Union works for a fair, just, and safe marketplace for all consumers and to empower consumers to protect themselves.

² Since 1969, the nonprofit National Consumer Law Center® (NCLC®) has used its expertise in consumer law and energy policy to work for consumer justice and economic security for low-income and other disadvantaged people, including older adults, in the United States. NCLC’s expertise includes policy analysis and advocacy; consumer law and energy publications; litigation; expert witness services, and training and advice for advocates. NCLC works with nonprofit and legal services organizations, private attorneys, policymakers, and federal and state government and courts across the nation to stop exploitive practices, help financially stressed families build and retain wealth, and advance economic fairness.

³ Professor Mark E. Budnitz is Professor of Law Emeritus at Georgia State University School of Law. He is on the Advisory Committee of the Atlanta Legal Aid Society, and a member of the American Law Institute, and a former member of the Consumer Advisory Council of the Board of Governors of the Federal Reserve System, former Chief, Branch of Reorganization, Atlanta Regional Office, Securities and Exchange Commission, and former Executive Director, National Consumer Law Center, Inc. Author of many articles and several books including Consumer Banking and Payments Law (Fourth edition 2009), The Law of Lender Liability (2005), and Counseling and Representing Financially Distressed Businesses (with Gary Shapiro)(1993), Professor Budnitz is a member of the Massachusetts Bar (retired), Boston Bar Association, and of the Georgia Bar.
We agree that activities-based regulation is appropriate, as virtual currency technology may ultimately have uses beyond financial services. However, at present, most consumer-facing virtual currency businesses appear to be offering financial services. Specifically, many of these businesses appear to be offering services that are typically regulated under money transmitter statutes. We think that businesses dealing in fiat or virtual currency money transmission should be licensed and supervised. Activities-based regulation is the best way to ensure that appropriate safeguards, built on sound policy, are enacted, while still allowing for appropriate regulatory flexibility.

These comments focus on three aspects of the framework: licensing, financial strength and consumer-facing protections. We believe that the framework can be improved by making explicit that covered virtual currency businesses must have:

- 100% liquidity in dollars to match consumer value, whether that consumer value is denominated in fiat or virtual currency;
- living wills, which should include procedures to ensure consumers are made whole in the event of non-performance, bankruptcy or catastrophe;
- robust error resolution policies, caps on consumer losses, and streamlined policies and procedures to re-credit consumers;
- regularly updated, comprehensive, uniform consumer disclosures, including disclosures of risks associated with virtual currencies prominently posted on websites and provided to consumers before they become customers;
- the highest data security standards; and
- ample cyber insurance.

There are a number of scams surrounding virtual currencies, particularly bitcoin. In light of these well-documented rip-offs, states should also commit to ferreting out unfair or deceptive acts and practices in the much talked about but little understood virtual currency space. We hope that Conference of State Bank Supervisors (CSBS) will accept our suggestions for how the framework can be improved.

INTRODUCTION

While much has been written about the use and abuse of virtual currencies by fraudsters and criminals, virtual currencies appear to be having a more immediate, less titillating impact, prompting increased interest in faster, more secure and cheaper payments. While improving the payments system is an excellent by-product of virtual currencies innovation, consumers may be at risk from virtual currencies.

Many of the businesses that are being built around or on virtual currency protocols are acting as financial intermediaries, accepting consumers’ value with the promise of storing, transmitting or exchanging it. Whenever businesses come between consumers and their value, they must be accountable, and basic consumer protections must be in place, regardless of the technology used.

At present, the most pressing consumer protection concerns around virtual currency – the areas in which unwitting consumers appear most likely to suffer harm in the absence of

regulation – appear to be “activities involving third party control of virtual currency.”\textsuperscript{5} We support state licensing and supervision of entities that facilitate the transmission, exchanging, holding, or otherwise controlling virtual currency, and excluding from licensing and supervision under money transmitter laws virtual currency companies not engaged in the covered activities as described in the CSBS policy statement.\textsuperscript{6}

**STATES SHOULD USE THIS OPPORTUNITY TO REVIEW THE STATE MONEY TRANSMITTER LAW PROTECTIONS FOR GAPS**

In the course of determining whether and how to cover virtual currencies under a state’s money transmitter law, regulators should review the protections provided by that law to ensure that they are up-to-date and adequate to protect consumers. A review of all 50 states’ money transmitter laws by the Pew Charitable Trusts found that the requirements vary state to state, and some state laws may not provide adequate protection to consumers.\textsuperscript{7}

Safety funds must be sufficient to cover consumer losses if a business fails. Surety bonds may not be sufficient to cover all consumers in the event of the failure of a money transmitter. The median minimum bond obligation across the states is $75,000 and the median maximum bond requirement is $500,000, and some are considerably lower:

While a money transmitter may have to hold investments meant to provide security to its customers, if the business fails and the investments that are held against debts are insufficient, the surety bond might be the only source of funds that customers can rely on to have their money returned. In Alabama, for example, the maximum surety bond requirement is $50,000 and must be issued by a licensed bonding or insurance company. If a money transmitter were to default on its obligations, all affected parties would be required to submit claims, and the payout, which would likely not be immediate as it is with the FDIC, could be limited to $50,000 for all claims.\textsuperscript{8}

When setting bond amounts, regulators should consider the volume of a money transmitters’ business and any risks to consumers’ value. Another area of weakness is that not all states require money transmitters to hold funds against outstanding debts.\textsuperscript{9} States that do have such requirements may not specify what types of investments are required or may be vague or lenient in their requirements. Most state money transmitter laws were passed decades ago. Ensuring that the protections are updated (and indexed to inflation) will protect consumers not only in the virtual currency space but also when they use other emerging payment systems such as prepaid cards, person-to-person payment, mobile payments, and other evolving products that may be covered by money transmitter laws.


\textsuperscript{6} Id. at 2-3.


\textsuperscript{8} Id. at 2-4.

\textsuperscript{9} Supra note 9 at 2.
The money transmitter law may also not provide for any process to streamline claims so that consumers would have easy or quick access to their funds after a failure. “Without a streamlined process, consumers must navigate the normal legal process in order to receive their funds. This means that [consumers] might have to wait several months for the completion of a bankruptcy proceeding” before having access to their funds, if they get access at all.”

States should ensure that processes are in place to return consumer funds quickly in the event of a money transmitter failure.

ANSWERS TO QUESTIONS FOR PUBLIC COMMENT

LICENSING (QUESTIONS 1, 2, 3, 11)

A robust money transmitter licensing system for virtual currency businesses engaged in transmitting, exchanging, holding, or otherwise controlling virtual currency provides essential consumer protections without unnecessarily hobbling non-commercial users, nor hindering virtual currency industry innovation.

The purpose behind money transmitter laws is simple: consumer protection. These laws ensure that businesses that accept consumer value are held accountable. The most prominent virtual currency, bitcoin, was developed to eliminate the need for trusted third parties in the exchange of value online. Nevertheless, many of the businesses that are cropping up around bitcoin act as intermediaries between the currency’s sellers, buyers and users. Examples of some of the services that these businesses provide include bitcoin storage, bitcoin debit cards tied to prepaid mobile wallets, and exchanging bitcoins for fiat currency and vice versa. These types of businesses are typically regulated as money transmitters.

Virtual currency protocols are no doubt different than the technology that traditional money transmitters rely upon. However, there is nothing inherent in virtual currency protocols that obviates the need for the types of consumer protections that money transmitter laws are meant to ensure. Though the technologies are different, the financial services provided and user expectations and risk are often the same. Therefore licensure and supervision are appropriate when financial services businesses are built on virtual currency protocols to ensure consumer protection. For these reasons, we agree with CSBS “that activities involving third party control of virtual currency, including for the purposes of transmitting, exchanging, holding, or otherwise controlling virtual currency, should be subject to state licensure and supervision.”

10 Id. at 4.
11 While some use uppercase B to denote the technology and lower case b to denote the currency, here all references to bitcoin will use lower case b. See http://blogs.wsj.com/moneybeat/2014/03/14/bitbeat-is-it-bitcoin-or-bitcoin-the-orthography-of-the-cryptography/.
13 According to its website, “Circle is a consumer finance company focused on transforming the world economy with secure, simple, and less costly technology for storing and using money.” See https://www.circle.com/en/about.
14 Xapo also offers wallet, storage and bitcoin purchase services. See https://xapo.com/.
15 Coinbase, for example, provides exchange services. See https://www.coinbase.com/.
17 Supra note 7 at 1.
While the vast majority of consumer protection concerns about financial services that involve virtual currencies are not technology-specific, the technological innovations that virtual currencies represent may have application far beyond financial services. For example, the central ledgers where decentralized virtual currencies transactions are recorded may one day be used to protect intellectual property rights\(^8\) or to record the transfer of real property.\(^9\) Regulating these businesses as money transmitters would be inappropriate. For these reasons, we agree with the CSBS recommendation that states should license and supervise entities engaged in the following virtual currency activities on behalf of another:

1. Transmission;
2. Exchanging:
   - Sovereign currency for virtual currency or virtual currency for sovereign currency
   - Virtual currency for virtual currency;
3. Services that facilitate the third-party exchange, storage (online or offline), and/or transmission of virtual currency (e.g. wallets, vaults, kiosks, merchant-acquirers, and payment processors).\(^{20}\)

Virtual currency businesses not engaged in covered activities should be excluded from regulation as money transmitters.

An activities-based approach provides regulators the necessary flexibility in approaching virtual currency businesses. This tailored approach will allow businesses developing other applications for virtual currencies technologies to move ahead while still requiring money services businesses to meet their consumer protection obligations.

Contrary to complaints by industry that regulation kills innovation,\(^{21}\) appropriately tailored regulation ultimately benefits businesses.\(^{22}\) While financial services regulation is essential for protecting consumers from harm, strong and consistent regulation and supervision of consumer financial services benefits industry by promoting consumer confidence and thereby driving adoption.\(^{23}\) Additionally, strong and consistent regulation ensures that businesses that take care to provide consumer protections are not at a competitive disadvantage to those businesses that do not. State regulators therefore should not hesitate to hold these new financial services businesses to the highest standards.


\(^{20}\) Supra note 7 at 2.


\(^{22}\) Daniel Carpenterrego, Justin Grimmer, Eric Lomazoff, Approval regulation and endogenous consumer confidence: Theory and analogies to licensing, safety, and financial regulation, available at [file:///C:/Documents%20and%20Settings/tetch/Desktop/Virtual%20currencies/CarpenterGrimmerLomazoff.pdf](file:///C:/Documents%20and%20Settings/tetch/Desktop/Virtual%20currencies/CarpenterGrimmerLomazoff.pdf) at 398: “Our results are also consistent with recent arguments in law and economics scholarship that approval regulation regimes may not blunt innovation but enhance it.”

\(^{23}\) Id. at 403. (Contrary to libertarian analyses of entry regulation and licensure, consumers “will more readily enter the marketplace created by approval regulation and will more readily rely upon quality data to switch to the products that present them with the most value.”)
States should have a strong and consistent licensing process for all money transmitters

A strong and consistent licensing process is necessary to ensure consumer protection. The process must ensure that only qualified, reputable and adequately trained individuals are in the business of offering financial services to the public. A common application and guide to licensure could enhance the efficiency of the licensing system and ensure that all consumers are protected from bad actors.

Regulators should undergo training and education to ensure vigorous supervision

Well-informed regulators are essential to ensure strong consumer protections. Virtual currencies involve new technology, which can be very confusing. It can require paragraphs to explain virtual currencies even when very little or no explanation of the underlying technology is included. For this reason, state regulators will likely need, if they do not have it already, special training and education in order to license and supervise virtual currency money transmitters.

State regulators should work to build their knowledge base by working with the appropriate federal and international regulators. While the Internal Revenue Service and the Financial Crimes Enforcement Network have both issued guidances on virtual currencies, a number of other federal government agencies, including the Consumer Financial Protection Bureau (which has issued a consumer advisory on virtual currencies and is accepting consumer complaints about them) and the U.S. Securities and Exchange Commission (which has developed a Digital Currencies Working Group) have demonstrated an active interest in virtual currency financial services businesses. State regulators should look to these agencies for help in approaching virtual currency businesses. Regulators and lawmakers should also look outside the United States to organizations such as FATF, the Financial Action Task Force (FATF), an inter-governmental body that works to combat money laundering, terrorist financing and related threats to the integrity of the international financial system.

To grow their virtual currency knowledge, regulators should also seek out experts, including those at consumer groups such as ours that investigate virtual currencies and their intersection with state and federal law.

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26 Supra note 25.
29 For example, Professor Sarah Jane Hughes has published a number of articles about whether and how virtual currencies might be regulated. See for example, Did New York State Just Anoint Virtual Currencies by Proposing to Regulate Them, or Will Regulation Spoil Them for Some?
FINANCIAL STRENGTH (QUESTIONS 5, 6)

All money transmitters should be required to hold safety funds to cover potential consumer losses. Surety bond amount should be set after considering the additional risks posed by virtual currencies. All money transmitters should be required to hold permissible investments at a one-to-one ratio to obligations. Surety bonds and permissible investments should be denominated in dollars. All money transmitters should be required to formulate and share plans to ensure consumers are made whole without delay in the event of non-performance, default or catastrophe.

Surety bonds should cover additional risks posed by virtual currencies

Consumer funds, whether dollars or digital assets, should be protected by surety bonds and backed by permissible investments to ensure consumers are protected even if a money transmitter business fails. State regulators should consider the additional risks posed by virtual currency businesses – such as hacking or catastrophic system failure - when determining bond requirements of virtual currency businesses.

Permissible investments should match outstanding obligations 1:1

States should also require all licensed money transmitters to hold one-to-one match of dollars to outstanding obligations. While surety bonds may provide relief to some creditors in the event of a money transmitter bankruptcy, surety bonds alone are unlikely to provide sufficient funds to cover all failed consumer transactions in the event of a money transmitter failure. The surest guarantee that consumer funds are safe is to require money transmitters to hold permissible investments against all of their outstanding obligations. Not all states that regulate money transmitters require investments, nor do all require 100% liquidity, but all states should require these things of all money transmitter businesses.

Volume, not number of locations, should determine safety funds requirements

States should look to activity level, not the number of locations, to set safety fund requirements, as virtual currency businesses, unlike traditional money transmitters, are more likely to have virtual offices rather than storefronts.

Safety funds should be denominated in dollars and consumers should be compensated in dollars should a business fail

When a money transmitter business fails, its customers expect to be made whole. Virtual currency customers are no different, as shown by consumer responses to the failure of Mt. Gox, the biggest bitcoin exchange at the time.31 For these virtual currency customers, the

30 Supra note 9 at 2.
31 One Mt. Gox customer wrote this: “I found your post just today after the Gox closed the site. I had 10,200 USD with them, which I traded just last week for gox coin. I initially deposited USD from bank account on November 2013, and traded on Gox just about 2 weeks ago, not knowing there was a trouble to withdraw any BTC from them. I do have screen shots from last week from trading and all my history since November 2013. My initial deposits in November have been 8000 USD and 2200 USD, so whatever trading I did in last weeks was for vain since gox did not let any BTC out of the site. Current standing on my account is about 27 BTC and around 2200 USD but since gox coin was never a real BTC, as I just learnt recently, I consider Gox owing me 10200 USD which I initially deposited.” Steven Perlberg, The Statements From People Who Lost Their Money On Mt. Gox Are Seriously Sad, http://www.businessinsider.com/mt-gox-commenters-2014-3.
difficulty was that most of their value had vanished, seemingly into a digital black hole, due to hacking, theft or management ineptitude. In the wake of the exchange’s failure, a number of Mt. Gox’s customers sued to get their value back. It should not take a lawsuit to ensure consumers’ value is returned in the wake of a failed money transmitter.

In the wake of a money transmitter failure, consumers should be compensated in legal tender from safety funds. These safety funds for virtual currency and fiat currency money transmitters should be denominated in dollars. That way, if something goes wrong, consumers can be paid back in currency that can be easily accessed and used.

The dollar-to-virtual-currency valuation can be challenging given the volatility of virtual currencies. Nevertheless, most of the virtual currencies that are regularly exchanged for fiat currency have been traded for dollars for a year or more, and the historic rates of exchange can be easily located online. A potential method for calculating businesses’ safety funds valuation could be an average of the exchange rate over time. Methods to calculate the dollar value due to consumers in the wake of a money transmitter failure should prevent both unjust enrichment and undue loss. For example, a calculation based on an annualized rate of exchange could be used to calculate the dollars due to consumers after the failure of a money transmitter business. For consumers whose losses occur when a transaction is not executed, the dollar value of the transaction at the time of the agreement could be the measure.

Businesses should be required to have plans in place in the event of a business collapse

Consumers entrust money transmitters with important household funds. Therefore it is crucial that states establish policies to ensure that consumers are quickly made whole if a money transmitter fails to perform a promised service, loses consumer funds or defaults on its obligations.

As part of these policies, states should require money transmitters to have resolution plans, colloquially “living wills.” A component of these plans should be streamlined procedures for ensuring that consumers get their value without undue delay. A model for how to handle the return of consumer value could be the Federal Deposit Insurance Corporation deposit insurance. Historically, in the wake of a bank failure, the FDIC makes depositor funds available within one business day, either by seamlessly providing consumers new accounts at another institution or by issuing a check to each depositor.

CONSUMER PROTECTIONS (QUESTIONS 7, 14, 19)

Virtual currency financial service providers should be required to offer consumers robust error resolution policies, caps on consumer losses, and streamlined policies and procedures to re-credit consumers, similar to protections available under the Electronic Funds Transfer

32 For example, after the failure of the Mt. Gox exchange, numerous consumers sued for not only the return of their value in fiat and virtual currency, but also for relief in dollars. See Complaint, Greene v. Mt. Gox Inc., et al, Case No. 1:14-cv-01437 (US Dist. Court for the Northern Dist. of Illinois, Eastern Division) at 45, available at http://www.mtgoxsettlement.com/Content/Documents/Complaint.pdf.
33 See for example, http://www.coindesk.com/price/.
34 12 C.F.R. 330.
Act as implemented by Regulation E. Companies should also be required to provide regularly updated, comprehensive, uniform consumer disclosures that include information not only on fees and features of their products and services, but also disclosures of risks associated with virtual currencies. Companies should also be required to adhere to the highest data security standards and carry ample cyber insurance. States should stand ready to bring enforcement actions against anyone engaged in unfair or deceptive acts and practices.

Businesses must be required to provide strong consumer protections

Proponents of virtual currencies often stress their utility for underserved consumers. For example, bitcoin proponents claim it will lower the cost of remittances and bring access to financial services to the unbanked. At present, bitcoin use is not widespread and many using bitcoin appear to be well-heeled and doing so out of curiosity. This stands in sharp contrast to the vast majority of consumers relying on money transmitters. Consumers today rely on money transmitters out of necessity and for important household purposes. It is precisely because of the targeting of underserved consumers that strong consumer protections must be in place before consumers patronize virtual currency money transmitters.

Opponents of virtual currency regulation say that it will kill innovation, drive business overseas, and relegate the United States to a backwater in virtual currency development. This is unlikely. Regulation that includes comprehensive consumer protections should increase consumer confidence, driving adoption. With such a low-uptake among mainstream consumers, consumer protection is a business opportunity for virtual currency businesses.

Money transmission poses risks to consumers, which is why states license and regulate them. Virtual currencies pose additional consumer risks over traditional money services

36 12 C.F.R. § 1005.
37 See for example, Laura Shin, Who Will Benefit From Digital Currency? Bitcoin Experiment Gives A Glimpse, http://www.forbes.com/sites/laurashin/2014/11/26/who-will-benefit-from-digital-currency-bitcoin-experiment-gives-a-glimpse/ (Quoting Stanford Business School professor and virtual currency company Ripple board member Susan Athey: “Where I see the greatest need are international payments and developing countries where people don’t have bank accounts or the ability to create banks accounts, and so are completely cut out of international financial markets and participating in the global economy.”); testimony of Jeremy Allaire, Chairman and CEO, Circle Internet Financial before the Senate Committee on Homeland Security and Governmental Affairs Hearing on “Beyond Silk Road: Potential Risks, Threats and Promises of Virtual Currencies” November 18, 2013 at 1,3; available at http://www.hsgac.senate.gov/hearings/beyond-silk-road-potential-risks-threats-and-promises-of-virtual-currencies (“The combination of ubiquitous Internet-connected mobile devices and digital currency presents a tremendous opportunity to radically expand access to financial services on a worldwide basis.”).
38 Brock Cusick, How can Bitcoin be Used for Remittances, A Backgrounder for Policymakers, https://coincenter.org/2014/12/remittances/.
40 To illustrate, there were about 106,000 bitcoin transactions worldwide on January 12, 2015 according to Blockchain.info (https://blockchain.info/stats); there are about 72 million credit card transactions per day in the United States (see Fed. Reserve System, The 2013 Federal Reserve Payments Study at 7-8, available at https://www.frbservices.org/files/communications/pdf/research/2013_payments_study_summary.pdf).
businesses and therefore may require additional consumer protections to mitigate those risks. The framework outlines seven essential consumer protections for covered entities. These protections are excellent starting points for states wishing to ensure consumer-facing protections. Each is discussed below with suggestions for additional enhancements:

- **Required consumer protection policies and documentation of such policies**

The hallmark of transactions in most digital currencies is that they are irreversible, which poses the risk of loss in the event of fraud, hacking, unauthorized use or mere processing error. Bitcoin, for example, has none of the types of protections consumers have come to expect from their payment devices, such as caps on losses due to theft or fraud, mandatory error resolution policies and procedures, and a right to re-credit. On the contrary, bitcoin transactions are - by design - irreversible. Unlike a debit transaction, where consumers are assured of limited liability, if a bitcoin transaction goes wrong, consumers are not protected. In the absence of Regulation E protections, consumers should not have to rely on the benevolence of the companies to whom they entrust their value. Therefore, the need for state-level consumer protection requirements is acute.

Strong consumer protection policies should be modeled on Regulation E, and include robust error resolution polices, caps on consumer losses, and streamlined policies and procedures to re-credit consumers. As noted in more detail below, companies should also be required to provide regularly updated, comprehensive, uniform consumer disclosures that include information not only on fees and account features, but also disclosures of risks associated with virtual currencies. These disclosures should be written in plain language, with clear formatting, and use uniform terms for common products and services. Firms should be required to make all disclosures easily accessible, including to mobile device users. However, good disclosures alone will never turn a bad product into a good one, and the disclosure requirement should not stand in for strict supervision and enforcement actions against bad actors.

- **Required policies and documentation of complaints and error resolution**

Among enthusiasts, irreversible transactions are touted as a boon for merchants, protecting them against fraudulent chargebacks. But consumers also need protection against unscrupulous merchants. Consumers need to know where to complain and how to get their money back in case of errors or unauthorized transactions or an issue with a merchant about a purchase. Errors should be investigated and resolved at no fee to consumers. Consumers cannot afford to lose precious funds due to inadequate protections.

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45 12 C.F.R. §1005.6.
46 Reversals of the transaction. Credit card using consumers have a chargeback right under federal law; consumers using debit cards have dispute rights. No such rights exist at law for users of cash. This is a problem in the digital space because many – but by no means all – digital currency transactions occur online, a place where cash transactions are impossible.
47 There is no evidence that at present consumers are being charged for error resolution services, but there have been cases where consumers were charged a fee for a basic protection. For example, at one time virtual currency...
For low-income consumers, loss of household funds may be especially acute. Error resolution policies must be required, and these companies must ensure that if something goes wrong, consumers know whom to contact in order to get resolution. If the companies are unwilling to offer error resolution, then their products are unsuitable for consumers.

- **Holding an actual amount of virtual currency in trust for customers and ensuring that amount is identifiable separately from any other customer or virtual currency business entity holdings**

Companies should not be using consumers’ virtual or fiat currencies for any purpose other than that for which consumers have entrusted them. Holders of virtual currencies should be required to hold in trust in individual accounts consumers’ virtual currency deposits.

- **Required receipt to consumers with disclosures regarding exchange rates**

Effective disclosures allow consumers to comparison shop, driving beneficial competition in industry. Money transmitters should be required to provide regularly updated, comprehensive, uniform consumer disclosures. Included in these disclosures should be information on any and all fees, a clear explanation of rates of exchange, including how these rates are determined, how long a rate is good for, and what happens if a transaction cannot be completed before the agreed exchange rate expires, and information on mark-ups. Consumers should also be warned of any hold times associated with transactions, and provided generous cancellation options.

Disclosures should be written in plain language, with clear formatting, and should employ uniform terms for common products and services. Firms should be required to make all disclosures easily accessible, including to mobile device users. However, good disclosures will never turn a bad product into a good one, and the disclosure requirement should not stand in for strict supervision and enforcement actions against bad actors.

Consumers should, where appropriate, also be provided ongoing account information, such as regular statements or full and free access to account balances and transaction history. Consumers should also be given information about how to close an account.

- **Required disclosures to consumers about risks that are particular to virtual currency**

Given the well-documented risks of virtual currencies, states should require virtual currency financial services providers to supply model disclosures such as CSBS’s to consumers before they enroll as customers.48

- **Required disclosure of virtual currency insurance coverage, which at a minimum includes notice that virtual currency is not insured or otherwise guaranteed against loss by any governmental agency**

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Virtual currencies are created and transacted entirely in the digital realm, making virtual currencies vulnerable to loss via computer bugs, hacking, user error and other misadventures. The effects can be catastrophic, resulting in the immediate and permanent loss of consumers’ value. While every financial services company is at risk of cyber crime, customers of virtual currency financial services businesses have no recourse as yet under law when crime or mishaps occur. Instead consumers at present must rely largely on the benevolence of their service providers to make them whole.

Virtual currency businesses should be held to the highest data security standards, and should be required to carry cyber insurance. Coinbase, a wallet provider, exchange and payment processor, carries cyber insurance that protects against losses due to “hacking, internal theft and accidental loss due to software bugs.” Virtual currency companies should be required to carry this type of insurance. Insurance should also be required of companies that store consumer value in so-called “cold storage,” which is to say, off-line. Value stored offline can also be subject to theft and loss, and should not be exempt from coverage just because it is not held in a device connected to the internet.

- Public disclosure of licensing information and agency contact information

Unfair and deceptive acts and practices crop up in all kinds of industries, but seem particularly prevalent in new ones. Bitcoin has been no exception. There have been problems with fraudulent investments, evidence of price manipulation, and even scams related to mining bitcoins. Regulators and law enforcement should stand ready to act against any company engaged fraud, misrepresentation, deceit, gross negligence, or any other legal violations.

Escheat should apply to virtual currencies

Virtual currencies should be treated as any other unclaimed personal property, and if left with the holder’s business and unclaimed for more than five years, should be presumed abandoned and escheat to the state. States should prepare processes and procedures for the state to take control of abandoned digital assets. Furthermore, states should establish secure storage and retrieval plans for such assets so that in the event that consumers come forward to claim them, they have not been lost to hacking, theft or misfortune. Virtual currency financial service providers should be charged with alerting consumers when property is in danger of being considered abandoned in order to prevent accidental escheat.

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51 It is alleged that Mt. Gox may have been a Ponzi scheme, with its staff attempting to drive up the price of bitcoins before the exchange failed, Report Reveals Evidence of Bitcoin Ponzi Scheme, http://www.pymnts.com/news/2014/report-reveals-evidence-of-bitcoin-ponzi-scheme/#.U4Uu23JdWPY.

52 Butterfly Labs, a company that sells mining equipment, has been the subject of numerous complaints to the FTC, http://www.coindesk.com/breaking-down-butterfly-labs-ftc-complaints-data/.
Conclusion

As states consider how to regulate virtual currency businesses, regulators should undertake a comprehensive review of money transmitter laws and regulations to ensure adequate protections are in place for all consumers. We applaud CSBS for proposing the draft model regulatory framework for state virtual currency regulatory regimes, and we appreciate the opportunity to comment on it. With the additions suggested above, the framework will go far towards ensuring that when consumers trust their digital assets to third parties their value is protected.

Sincerely,

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