

The Future of Bitcoin in NY

Recently, new forms of digital currency have become increasingly popular worldwide. The most obvious example, “Bitcoin”, has generated widespread media coverage and rapidly growing interest. It and other kinds of “cryptocurrency” rely on a form of technology known as “block chaining” to secure and distribute virtual money. The potential benefits and dangers of this emerging field represent a historic opportunity for New York. It can play a leading role in the digital era by encouraging the growth of blockchain financial technology while protecting consumers and safeguarding virtual investments.

Since 2008, Bitcoin has become a topic of discussion for governments and financial institutions. Early on, the systems for accessing cryptocurrency were very technical, creating a high barrier to entry. Exchanges began forming as a way for everyday users to easily purchase, maintain, and exchange Bitcoin. In 2013, a company named MtGox was handling nearly 70% of Bitcoin transactions¹; in February of 2014, MtGox revealed that nearly 750,000 of its Bitcoins valued at \$350 million had gone missing in a security hack, a theft that was not discovered until a year later. Its subsequent bankruptcy and fall sent Bitcoin prices tumbling 25% in a matter of days. This kind of volatility and vulnerability has kept traditional financial institutions skeptical and wary, even in spite of Bitcoin’s skyrocketing market value.



BitLicensing

In 2015, the New York State Department of Financial Services created a “BitLicense” as a way to develop oversight over cryptocurrencies in New York. The license is required for anyone seeking to do business in²:

- Virtual currency transmission
- Storing, holding, or maintaining custody or control of virtual currency on behalf of others
- Buying and selling virtual currency as a customer business
- Performing exchange services as a customer business

¹ Solving Modern Crime in Financial Markets: Analytics and Case Studies by Marius-Christian Frunza p. 65

² http://www.dfs.ny.gov/legal/regulations/bitlicense_reg_framework_faq.htm

- Controlling, administering, or issuing a virtual currency

However, this BitLicense leaves lingering questions with regards to both protecting consumers and fostering the future development of digital currency in New York.

Security

The distributed ledger through which cryptocurrency transactions occur is viewed as exceptionally secure, even compared to conventional currency transactions. The main concern is when consumers seek to deposit their Bitcoins or exchange them for other currencies. Bitcoin companies like MtGox, which facilitate these exchanges and store cryptocurrencies, are the weak point of the system. As depositories for thousands of user accounts, the sheer value or assets maintained by them represent a clear security risk and high-value target for thieves. Though the current NYDFS BitLicense sets security requirements for such companies, it does not address the issue of them storing all information in a centralized system, or mention protocols for decentralizing the information secured on their servers.

Cost

The application fee alone costs \$5,000 to file, regardless of outcome. Beyond that, one or more companies have reported spending over \$50,000 in legal fees and labor costs to meet the BitLicense requirements. Taken together, these expenses create a real obstacle to companies attempting to do business in New York. After the BitLicense was announced, nearly a dozen Bitcoin companies stopped doing business in New York, and as of November 2017, it has only three BitLicense holders.

Some of the companies that left acknowledged the value of government oversight, but found the requirements and fees associated with BitLicenses to be far too burdensome.³ Even though the program provides provisional licenses for newer companies, they still found the associated costs to be too high. Placing such high startup costs on a new industry, where the majority of new companies are startups, has left the state cryptocurrency industry in the dust.

A Better License and State Seal

The loss of millions of dollars by MtGox and other exchanges in hacks highlight the necessity of consumer protections. But the security limitations and crippling mandates of the current NY BitLicense suggest the need for a better, legislative approach. The goal of such legislation would be to prevent the next MtGox, and to replace the burdensome BitLicense regulation with an economically feasible program, one that receives input from both experts and local representatives. The new program would still be overseen by the New York State Department of Financial Services under the Banking Law, and cryptocurrency companies may be designated as “Money Transmitters” under Article XIII-B or as a “Safe Deposit Company” under Article VIII of the Banking Law.

Qualifying companies would still be required to:

³ <https://blog.kraken.com/post/253/farewell-new-york/>



- Be based in the state of New York
- Submit to regular and frequent auditing
- Establish security protocols to safe guard from theft
- Regularly examine holdings to ensure proper ownership of assets

However, each exchange must insure a portion of their account holders' assets in an FDICstyle insurance scheme. Such companies would create a fund either maintained internally or by the state - ensuring a capped portion of assets are protected. Such a scheme would not require the state to take a position on the underlying value of assets held, but in the event of a breach, account holders can feel confident that measures are in place to salvage assets.

The program can be funded through state allocations or a fixed per-exchange fee, which would allow the program to grow organically with the market. Fees may be gathered on the number of accounts, total number of transactions, or market value of information held. Additionally, exchanges must make a commitment to decentralizing the vast troves of information they hold; doing so would establish a better baseline level of security for the innately weak point of cryptocurrencies. To address the issue of consumer confidence, the State of New York can also establish a credential, in the form of a digital seal, for all approved cryptocurrency companies, to assure users that their assets are protected. Companies with such a "NY State Seal of Approval" would give investors' confidence in the security of their assets.

The current DFS security regulations have focused on measures that identify consumers' personal information and transactions, deterring potential consumers, investors, and companies in the process. A better licensing program would encourage companies to base their businesses in America's financial capital as an attractive and reliable investment for their customers. It would give their consumers confidence in an effective, nonintrusive system that truly protects their virtual money.

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