

State Regulation of Virtual Currency: A Recap

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This may be the year of the virtual currency. Virtual currencies have garnered much media, investor, and government attention. But, as venture capital funding continues to pour into the industry—more than \$1 billion is expected to be invested this year alone—concerns remain over how the industry should deal with matters such as consumer protection and virtual currency's link to illegal activities. Unsurprisingly, state regulators have taken notice.

The first comprehensive regulatory framework in the United States will likely come from the New York State Department of Financial Services (NYDFS). The latest iteration of the Department's "BitLicense" applies to any entity engaged in a "virtual currency business activity," and would require that entity to register with the NYDFS. The revised BitLicense, however, narrowed the definition of "virtual currency" to exclude gift cards, digital units used solely in online games, and customer rewards programs. "Virtual currency business activity" was also limited, excluding entities that transact in nominal amounts of virtual currency or do so for non-financial purposes.

The revised BitLicense also relaxed, among other provisions, its licensing process and capital reserve requirements. Nevertheless, some industry stakeholders have expressed concern regarding the extent of the BitLicense's recordkeeping and customer identification provisions.

California also introduced virtual currency legislation. The proposed legislation contains a registration requirement similar to the BitLicense, but does not include anti-money laundering or know your customer provisions. However, it would require covered entities to maintain certain "high-quality, investment-grade permissible investments" equal to the sum of the virtual currency maintained on deposit for the licensee's customers.

In late May, the Digital Currency Jobs Creation Act was introduced in New Jersey. The bill would create a regulatory framework similar to the BitLicense, requiring entities that engage in a "digital currency custodial activity" to register with State. While the bill would impose certain cybersecurity, recordkeeping, and capital reserve requirements, it also offers incentives to regulated entities, including tax exemptions.

Commentators expect to see increasing legislative activity in this arena. New laws and regulations will likely have a profound effect on the industry, and should be monitored by interested parties. Given lawmakers' rapidly developing interest in virtual currencies, 2015 may prove to be the defining year for this nascent technology.