



VIA EMAIL

July 29, 2016

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**Re: Comments on the June 30, 2016 Draft Amendments to the Uniform Money Services Act**

Dear Ms. Mele-Hetter:

After having reviewed and discussed the June 30, 2016 draft amendments to the Uniform Money Services Act (“UMSA”) (RCW § 19.230 *et seq.*) with members of the Chamber of Digital Commerce State Working Group and lawyers from Perkins Coie LLP who chair that working group, we write to provide feedback on the draft. The Chamber is pleased the Department has undertaken to incorporate decentralized digital currencies into these draft amendments and included provisions designed to address the unique characteristics they possess. The Department’s commitment to understanding the technology underlying decentralized digital currencies and considering the needs of industry actors is evidenced by these draft amendments and the request to provide comments.

At your invitation, the comments below touch on the following critical aspects of the draft amendments:

- The definitions of virtual currency and money transmission, including the concept of custody and control for digital assets;
- The definitions of stored value, closed loop stored value, and open loop stored value;
- The permissible investments provisions in Sections 19.230.200 and 19.230.201;
- The disclosure provisions in Section 19.230.325;
- The data security audit requirement in Section 19.230.070(1)(d); and
- The bonding requirement in Section 19.230.050.

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The Chamber looks forward to further discussing the comments below with the Department as time allows, and would be happy to answer questions via further correspondence or telephone.

## **A. Definitions of Virtual Currency and Money Transmission**

To begin with, the Chamber would like to commend the Department for formally incorporating a payment processor exemption, which is currently available through a license waiver program, into the exclusions provision<sup>1</sup> of the UMSA, and, in particular, for drafting the provision to include any qualifying entity, including those that might process payments in digital currency.<sup>2</sup> The Chamber believes the draft language appropriately captures the purpose of the exemption and provides certainty to those businesses engaging in such activities.

In addition, the Chamber is encouraged by the Department's decision to include a definition of digital currency into the UMSA and its willingness to engage with the industry to draft a definition that accurately reflects the nature of the activity that the Department seeks to regulate. That being said, in our view the draft definitions of "[v]irtual currency" and "[m]oney transmission" warrant further discussion and refinement to address certain ambiguities and overbreadth.

### *(a) Definition of Virtual Currency*

The definition of "[v]irtual currency" at Section 19.230.010(30) provides that digital currency includes any digital representation of value used "as a medium of exchange, a unit of account, or a store of value." Presumably, these references were intended to capture the defining characteristics of money (*i.e.*, the "currency" aspect of "virtual currency"). But to our understanding, it is a settled matter among economists that money features *all three* of those characteristics, not just one or two.<sup>3</sup> As currently drafted with the disjunctive "or," the definition could theoretically pick up digital representations of any asset, which are inherently a "store of value."<sup>4</sup> Although the carve-outs may well catch many examples of overbreadth, this is difficult

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<sup>1</sup> RCW 19.230.020(9)(b). Given that the waiver program was not available for digital currency companies, we assume that the omission of any reference to digital currency companies in the draft exclusion is meant to extend the payment processor exemption to any entity that qualifies, regardless of the form of currency processed.

<sup>2</sup> See State of Washington Department of Financial Institutions, Uniform Money Services Act Interpretive Statement 2016-1: Payment Processors (December 7, 2015), available at <http://www.dfi.wa.gov/sites/default/files/opinions/mt-2016-01.pdf>.

<sup>3</sup> See, e.g., N. Gregory Mankiw, "Principles of Economics" (7th Ed. 2012, at p. 611) (explaining that "[m]oney has three functions in the economy: It is a medium of exchange, a unit of account, *and* a store of value. These three functions *together* distinguish money from other assets in the economy . . .") (emphases added); see also Robert Clower, A Reconsideration of the Microfoundations of Monetary Theory, *Economic Inquiry* 6.1 (1967): 1-8 (observing that "any commodity may serve as a unit of account" and "every asset is, by its very nature, a potential store of value").

<sup>4</sup> See Morgan Ricks, The Money Problem: Rethinking Financial Regulation (Univ. of Chicago Press, 2016) at p. 5; see also Commissioner Daniel M. Gallagher, The Philosophies of Capital Requirements, Securities and Exchange Commission (Jan. 15, 2014), available at <https://www.sec.gov/News/Speech/Detail/Speech/1370540629644>.

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to determine with sufficient comfort given the potentially sweeping range of existing and future examples. However, the Chamber acknowledges that many commonly understood digital currencies (possibly including bitcoin) might not satisfy the “unit of account” characteristic, which could render the definition too narrow if all three characteristics were required.<sup>5</sup> To mitigate these competing risks of underbreadth and overbreadth, we recommend making clear that “virtual currency” includes only digital representations of value that exhibit the medium of exchange *and* store of value characteristics. An alternative would be to cross-reference the “[s]tored value” as defined under the UMSA to limit the extent in which a store of value would be deemed “virtual currency.” North Carolina recently enacted a similar provision in the North Carolina Money Transmitters Act (“NCMTA”), defining “virtual currency” as a “digital representation of value that can be digitally traded and functions as a medium of exchange, a unit of account, or a *store of value but only to the extent defined as stored value under [this Act]*, but does not have legal tender status as recognized by the United States Government.”<sup>6</sup> An alternate way (which we recommend as preferable) to address the current overbreadth in “virtual currency” may be to narrow the definition to what the Financial Action Task Force (“**FATF**”) defined as “cryptocurrency,” that is, “a math-based, decentralized convertible virtual currency that is protected by cryptography.”<sup>7</sup> Defining “virtual currency” the way FATF defines “cryptocurrency” (or simply replacing “virtual currency” with “cryptocurrency,” defined the way FATF defines it) would more precisely tailor the definition of digital currency to the applicable regulatory concerns while mitigating the risks of overbreadth (and the related need to rely so heavily on carve-outs) in the current definition.

(b) *Definition of Money Transmission*

The definition of “[m]oney transmission” set forth in Section 19.230.010(18) risks capturing non-currency uses of digital currency built on the Blockchain protocol. Similar to the TCP/IP Internet Protocol, which first allowed computers to communicate with one another, and the Hypertext Transfer Protocol (HTTP), which spawned the world wide web, the Blockchain protocol is transforming the way in which value is exchanged. An overly broad definition of money transmission, therefore, might capture the digital exchange of other assets—from music, to art, to real property. For example, a company tokenizing valuable digital art and transferring ownership of the artwork through the Blockchain may still be receiving “virtual currency” and

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<sup>5</sup> See [Bitcoin as Money?](https://www.bostonfed.org/economic/current-policy-perspectives/2014/cpp1404.pdf), Federal Reserve Bank of Boston (Sept. 4, 2014), at pp. 10-11, available at <https://www.bostonfed.org/economic/current-policy-perspectives/2014/cpp1404.pdf>.

<sup>6</sup> The statutory definition of “[s]tored value” within the NCMTA, subject to certain carve-outs, is “[m]onetary value representing a claim against the issuer that is stored on an electronic or digital medium and is evidenced by an electronic or digital record, and that is intended and accepted for use as a means of redemption for money or monetary value or payment for goods or services.” H.B. 289, Gen. Assemb., Sess. 2015-2016, § 53.408.32 (N.C. 2016).

<sup>7</sup> See FATF Report, [Virtual Currencies - Key Definitions and Potential AML/CFT Risks](http://www.fatf-gafi.org/media/fatf/documents/reports/Virtual-currency-key-definitions-and-potential-aml-cft-risks.pdf) (June 2014), at p. 5, available at <http://www.fatf-gafi.org/media/fatf/documents/reports/Virtual-currency-key-definitions-and-potential-aml-cft-risks.pdf>.

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transferring that digital currency between users within the meaning of the proposed definitions even though tokenized digital art was clearly not an intended object of regulation.

One way to remedy this overbreadth in the money transmission definition may be to create an additional carve-out, in Section 19.30.020's list of exempted entities, for companies that use digital currencies solely to facilitate the provision of services unrelated to the exchange, transfer or storage of digital currencies on behalf of others.<sup>8</sup> Such a carve-out would mirror the exemption from the regulations enforced by the Financial Crimes Enforcement Network (“FinCEN”) for money transmission integral to the sale of goods and services other than money transmission.

(c) *Constructive Control of Virtual Currency Funds*

The draft amendment extends the definition of “[m]oney transmission” to the “constructive control of funds” without defining “constructive control.”<sup>9</sup> Although the Chamber is generally supportive of the inclusion of “control of funds” as a limiting factor in the reach of the regulation, it is not clear how this could play out in the digital world. By including *constructive* control of funds into the definition of money transmission, multi-signature wallet providers who do not otherwise engage in other regulated services could be subject to the UMSA despite the fact that they do not have *actual* control over the funds. In a multi-signature wallet arrangement funds can only be unlocked with two of three (or more) private keys, only one of which may held by the custodian. If a multi-signature wallet provider's system is hacked, the digital currency is not accessible by the hacker because the hacker would gain access to only one key, which is insufficient to transfer and steal the funds.<sup>10</sup> It is not clear how this definition would apply without further guidance or clarity.

The Chamber proposes that the appropriate distinction between activities that should be regulated as money transmission and those that should not is whether the custodian of the funds is able to unilaterally transact or prevent transactions. This can be achieved by incorporating the following language into the definition of “money transmission” in Section 19.230.010(18):

“Money transmission” includes maintaining control of virtual currency held on behalf of others. “Control of virtual currency” means possession of sufficient virtual currency credentials or authority on a virtual currency

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<sup>8</sup> The North Carolina Commissioner of Banks recently updated its FAQ to address “Blockchain 2.0 technologies” (*i.e.*, non-financial implementations) and multi-signature wallets. The FAQ provides that multi-signature providers are not regulated by the NCMTA and Blockchain 2.0 technologies are *generally* not regulated by the NCMTA. Available at: <http://www.nccob.gov/Public/financialinstitutions/mt/mtfaq.aspx>. We recommend codification of this exception, not just dealing with it via guidance.

<sup>9</sup> RCW § 19.230.010(18).

<sup>10</sup> See Coincenter, [Regulating the Blockchain](https://coincenter.org/wp-content/uploads/2016/05/Day-3-workshop-Multisig-and-N-Lock.pdf), available at <https://coincenter.org/wp-content/uploads/2016/05/Day-3-workshop-Multisig-and-N-Lock.pdf>.

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network to execute unilaterally or prevent indefinitely virtual currency transactions.”

This definition is tailored to the applicable regulatory concern (*i.e.*, whether the entity can steal or lose customer assets) while avoiding the ambiguities and overbreadth in the proposed definition.

**B. Stored Value, Closed Loop Stored Value and Open Loop Stored Value – Section 19.230.010**

Although the inclusion of digital currency-specific provisions in the draft amendments is a significant development, the Chamber notes the impact of other provisions under the UMSA and their proposed amendments, or lack thereof, on the financial services industry. Specifically, the provisions relating to “stored value” warrant discussion and further review to address potential and continuing ambiguities, and concerns of overbreadth and underbreadth.

*(a) Definition of Stored Value*

The draft amendments remove language referring to “a card or other device” from the definition of “stored value.” While the incorporation of specific provisions relating to digital currency companies goes a long way towards providing clarity to the industry, the Chamber is concerned that so long as ambiguity remains as to the applicability of other, non-digital currency-specific provisions, uncertainty will remain. Specifically, we recommend that the Department either reconsider the proposed definition of “[s]tored value,” which removes language relating to “a card or other device,” or include a clarifying statement that digital currency is not stored value, as the proposed definition may be deemed applicable to digital currency custodial wallet providers.<sup>11</sup>

*(b) Definition of Closed Loop Stored Value*

The Department proposes removing language regarding the inclusion of affiliated merchants within the definition of “closed loop stored value.” The Chamber asks the Department to reconsider the proposed change to the definition of “[c]losed loop stored value.” The proposed definition risks underbreadth by removing stored value redeemable for goods and services provided by affiliated merchants, and limiting it to stored value redeemable for goods and services provided only by “the issuer ... or its affiliates.”<sup>12</sup> The Chamber notes that the UMSA includes a definition for “[a]ffiliate” that is based on ownership and control.<sup>13</sup> This amendment would have a significant impact on those companies engaged in joint marketing efforts that are

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<sup>11</sup> RCW 19.230.010(27). “‘Stored value’ means money or equivalent value represented in digital format and stored or capable of storage so as to be retrievable and transferable.”

<sup>12</sup> RCW § 19.230.010(6).

<sup>13</sup> RCW § 19.230.010(1).

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not under common ownership or control (merchants within a shopping mall, for instance) and that currently offer closed loop stored value products for use within their closed network.

The draft amendment also risks ambiguity when read in conjunction with the definition of “[o]pen loop stored value,” which applies to “stored value redeemable at multiple, unaffiliated merchants or service providers.”<sup>14</sup> When they are read together, the draft amendment fails to capture stored value products redeemable within a closed universe of *affiliated* merchants that are not under common ownership or control.

*(c) Stored Value Within the Definition of Money Transmission*

Although the draft amendment does not propose a change to the manner in which stored value is incorporated into the definition of “[m]oney transmission,” the Chamber notes that the inclusion of “acting as an intermediary for open loop stored value” captures industry participants that are generally not regarded as money transmitters—namely, program managers and processors.<sup>15</sup> Our review of money transmission regulation in other states revealed no other instance in which intermediaries of stored value programs are deemed money transmitters. The Chamber suggests that the Department consider removing this language and limiting “money transmission,” as it relates to stored value, to the act of selling and issuing.

**C. Permissible Investment – Sections 19.230.200 and 19.230.201**

The Department proposes amending provisions relating to permissible investments to require digital currency companies to maintain capital reserves in like-kind, and to maintain an additional 10.5% of outstanding transmissions in permissible investments. First, the Chamber and its members strongly support the Department’s proposal to allow capital reserves to be held in digital currency. The Chamber considers this change integral to encouraging industry innovation and growth, because dollar-denominated capital reserve requirements impose added burdens on digital currency companies without enhancing consumer protections. Allowing businesses to maintain reserves in like-kind digital currency ties the volatility of the outstanding obligations, thereby protecting consumers and digital currency custodians together.

While the Chamber agrees with that general assessment, we note that the Department has elected to make this provision mandatory by requiring that reserves be held in digital currencies of the same type and volume as that which is obligated to consumers.<sup>16</sup> There are concerns in the industry that such a requirement imposes a significant burden on exchanges trading in several different digital currencies. The Chamber recommends that the Department create a flexible arrangement that permits a combination of like-kind and other stable permissible investments. The Conference of State Bank Supervisors (“CSBS”), in its Model Regulatory Framework,

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<sup>14</sup> RCW § 19.230.010(20).

<sup>15</sup> RCW § 19.230.010(18).

<sup>16</sup> RCW § 19.230.200(b).

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recommends a flexible permissible investment requirement based on the licensee’s individual business model and associated risk.<sup>17</sup> Under this approach, the CSBS suggests that licensees could be authorized to hold permissible investments that are “like-kind, fiat, high quality liquid assets, or a combination thereof.”<sup>18</sup> The Chamber encourages the Department to adopt the recommendations of the CSBS Model Regulatory Framework by providing for such flexibility. A strict like-kind policy, as that reflected in the draft amendments, would undermine the goal of encouraging industry innovation without significantly enhancing consumer protection.

Further, the Chamber recommends that the Department reconsider or remove the separate requirement that licensees maintain permissible investments in “a value equal to at least ten and one half percent of the digital currency obligated to Washington consumers.”<sup>19</sup> To frame our discussion of possible options in this regard, we begin with the conceptual foundation from which the 10.5% requirement may derive (*i.e.*, bank capital) to explain why a different foundation is needed. We then convey concerns that stem from our experience and conversations with the industry, and finish with some suggestions for the Department’s reconsideration.

(d) *Conceptual Foundations*

It appears that the 10.5% threshold derives from the Basel III standard for bank capital. Banks, however, are structured in a significantly different manner than typical digital currency companies (or non-bank financial institutions, such as money transmitters), thus limiting the relevance of bank capital standards to digital currency companies. Banks are uniquely chartered to issue demand deposit instruments far in excess of the liquid assets they hold in reserve, which adds to the money supply and makes banks a key part of sovereign monetary policy.<sup>20</sup> As a result of this “fractional reserve” structure, banks are highly leveraged and fundamentally unable to satisfy more than a small percentage of depositors’ demands at any given point in time.<sup>21</sup> This leveraged structure requires capital requirements that largely address critical policy concerns (*i.e.*, monetary and macroeconomic stability) that are not presented by non-leveraged money transmitters.<sup>22</sup>

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<sup>17</sup> See Conference of State Bank Supervisors (CSBS), State Regulatory Requirements for Virtual Currency Activities CSBS Model Regulatory Framework (September 15, 2015), at p. 5.

<sup>18</sup> *Id.*

<sup>19</sup> RCW § 19.230.200(b).

<sup>20</sup> See Ricks, *supra* note 4, at p. 4.

<sup>21</sup> Although deposit insurance helps make depositors whole in the event of a bank’s failure, it is capped at a certain level per depositor. It is also important to recall that the very existence of deposit insurance increases the riskiness of banking activity by dampening typical incentives for creditor oversight (*i.e.*, moral hazard). See *IMF Working Paper* WP/14/118 (July 2014), at p. 17, available at <https://www.imf.org/external/pubs/ft/wp/2014/wp14118.pdf>. To the extent this moral hazard heightens a bank’s overall risk profile, it must also be addressed through bank capital levels—again illustrating how bank capital addresses very unique risks that are not readily analogized elsewhere.

<sup>22</sup> See Ricks, *supra* note 4, at p. 5; see also Gallagher, *supra* note 4.

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Money transmitters, regardless of whether digital currency is involved, do not operate on a fractional reserve basis. In contrast to banks, money transmitters hold value for the customer's benefit and frequently in the same form and amount in which it was received. One approach to addressing the risks that could arise from custodial digital currency wallets, contemplated by the Uniform Law Commission ("ULC") in its draft Uniform Regulation of Virtual Currency Business Act ("URVCBA")<sup>23</sup>, is to prohibit custodians from investing customer funds.<sup>24</sup>

As the Department is aware, traditional money transmitter laws provide a different benchmark for determining capital requirements based on a licensee's assets in custody. In general, to the extent money transmitters issue stored value or payment instruments, they are permitted to reflect the proceeds as assets on their own balance sheets—and the corresponding obligations to customers are the company's liabilities.<sup>25</sup> To ensure that money transmitters have sufficient liquid assets to satisfy those obligations, state laws require varying combinations and degrees of net worth, bonding, and permissible investments. While those general mechanisms may be appropriate for digital currency companies, as discussed below, the Chamber believes that the risks posed by digital currency custody are different and may actually be structurally less risky than outstanding money transmitter obligations. For example, when fiat currency is moved around within our financial system, it often passes through multiple parties for a single transaction, which increases the risk of misuse, fraud, or mistake. Money moved across borders must be exchanged for foreign currency and passed through payment processors and banks, which increases the risk of misuse, fraud, or mistake. In contrast, digital currencies move between users within a protocol without the need for exchange or intermediaries. If the perceived risk involves being able to come up with the funds to return to consumers, the risk is overstated. Most custodial wallet providers maintain customer assets in the same form and amount in which they were deposited. Therefore, most wind-down scenarios would simply involve the digital currency company returning its customers' digital assets to them directly with no need for intermediaries like banks or payment processors.<sup>26</sup>

A more relevant reference point for capital requirements might be the manner in which state securities laws treat investment advisors who maintain custody of their customers' securities. Custodied securities, like digital currency deposits, do not become assets of the investment advisor and are held for the customer's benefit. The ULC's Uniform Securities Act of 2002 provides that such advisors must post "a bond or other satisfactory form of security" for custodied securities, which may be waived if the advisor is able to satisfy certain net worth

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<sup>23</sup> See National Conference of Commissioners on Uniform State Laws, Draft Regulation of Virtual Currency Business Act (April 28, 2016), § 208.

<sup>24</sup> If a digital currency company did invest customer funds, it should be treated as a bank.

<sup>25</sup> See MoneyGram International Inc. Form 10-K (for the period ending Dec. 31, 2015), at pp. 42-44, available at [http://files.shareholder.com/downloads/AMDA-1TA9OX/2040629614x0x879800/41273702-7759-4946-918E-1C82A3B25E23/2015\\_10\\_K.pdf](http://files.shareholder.com/downloads/AMDA-1TA9OX/2040629614x0x879800/41273702-7759-4946-918E-1C82A3B25E23/2015_10_K.pdf).

<sup>26</sup> This statement is limited to pre-insolvency scenarios. While we would need to evaluate this issue further, adding language to Section 19.230.200 providing that customer assets are deemed to be held in trust for such customers could provide further protection for customers in insolvency scenarios as well.

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requirements instead.<sup>27</sup> That Act defers to state administrators in determining specific amounts, but the North American Securities Administrators Association (“NASAA”) (whose membership includes the securities administrators of all 50 states) suggests in its Model Rule that investment advisors with custody of customer securities generally maintain a net worth of at least \$35,000.<sup>28</sup> The UMSA excludes customer assets from its tangible net worth calculation; therefore, existing net worth requirements within the UMSA already impose a comparable financial obligation upon digital currency companies.<sup>29</sup>

*(e) Industry Concerns*

The Chamber acknowledges the widespread (and inaccurate) perception that digital currency custody is an inherently high-risk activity that must be addressed with correspondingly onerous capital requirements. Based on our experience, we would emphasize the materially counterproductive consequences of this approach.

Currently, the most secure custodians attract most of the digital currency deposits; but a high capital requirement, calculated as a percentage of total holdings, would result in those companies scaling back the volume of deposits they hold (e.g., companies would have to impose higher storage fees, which would be prohibitive for certain customers). Many of those displaced customers would likely disperse to a variety of less secure, smaller entities based in unregulated jurisdictions, thus frustrating the purposes of the UMSA and other efforts to protect consumer funds.

In that regard, our industry conversations have made clear that an additional 10.5% capital reserve requirement would render many custody businesses unprofitable. If the Department is determined to incorporate an additional capital reserve requirement, a more appropriate percentage would be 2% or, at most, 5%. Additionally, the Chamber understands that the requirement to recalculate permissible investment value every month could be severely destabilizing to custodial operations and custodial customers.<sup>30</sup> If a company suddenly and unexpectedly exceeds the permissible investment threshold, which could result from an unanticipated influx of deposits during the month, it would either have to undertake immediate capital-raising measures or return a substantial amount of deposits at once (and the affected customers may not have ready alternatives to store their assets).

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<sup>27</sup> Uniform Securities Act of 2002 (last revised in 2005), p. 110-11, *available at* [http://www.uniformlaws.org/shared/docs/securities/securities\\_final\\_05.pdf](http://www.uniformlaws.org/shared/docs/securities/securities_final_05.pdf).

<sup>28</sup> NASAA, Minimum Financial Requirements for Investment Advisers, Model Rule 202(d)-1 (last revised in 2011), *available at* <http://www.nasaa.org/wp-content/uploads/2011/07/IA-Model-Rule-Minimum-Financial-Requirements.pdf>.

<sup>29</sup> See RCW § 19.230.010(28).

<sup>30</sup> See RCW § 19.230.200(b).

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Furthermore, the Chamber understands from industry conversations that surety bonds have not been difficult for digital currency custodians to obtain, and the pricing is such that there could be widespread preference to satisfy capital requirements through bonding if permitted by regulation.<sup>31</sup>

*(f) Suggestions for Reconsideration*

Further thought and discussion are needed to determine the most appropriate capital requirements for asset custody, and the Chamber is still considering the tradeoffs between different approaches based on internal analysis and continuing conversations with industry participants. The Chamber would invite the Department to specifically solicit industry views on this issue, which needs to be assessed in light of specific business models and details that may not be readily available to the Department.

With that said, the Chamber would draw the Department's attention to several key principles from the discussion above. First, the 10.5% threshold is perhaps based on a banking analogy that is inapt for digital currency custody and is too high for purposes of the UMSA. It should either be replaced by a flat net worth threshold (e.g., as proposed by the NASAA in the securities custody context) or revised to a substantially lower percentage measurement (e.g., to the 2%-5% range noted above). Second, licensees should be given flexibility to satisfy capital requirements through a combination of net worth, permissible investments, and/or bonding requirements, as is permitted in the Uniform Securities Act.

In the Chamber's view, it is no understatement to characterize capital as one of the most important issues in the draft amendments; even if all other provisions are crafted perfectly, when companies can't afford to do business under the capital requirements they will not engage here in the state or with the Department. Thus, the Chamber encourages close, additional consideration from the Department and its stakeholders before finalizing a position on this issue.

**D. Disclosure Requirements – Section 19.230.325**

The Department proposes a new provision to the UMSA requiring certain disclosures by digital currency companies, which must be separate and apart from other information and provided in a “clear and conspicuous” manner. The Chamber generally agrees with the spirit of the disclosure requirements set forth in Section 19.230.325, but we are concerned that they are overly prescriptive, and worry that they may not be appropriate for some implementations or innovative services. The Chamber recommends that Subsection 325 be amended to contain an option for companies to request exemption from any of the disclosure requirements by submitting replacement disclosures and an explanation of why they are more appropriate than the disclosures prescribed in Subsection 325. This would encourage licensees to engage the

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<sup>31</sup> Surety bond premiums are typically around 1.5%-5% of the bonded amount.

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regulators in meaningful discussion regarding what notices should be given and how they should be tied to the specific operational circumstances. The requirement to provide the prescriptive disclosures as separate standalone disclosures is problematic because it would prohibit licensees from incorporating these disclosures into their terms of service or sale, where such disclosures are customarily provided. Furthermore, the provision does not provide for the frequency with which such disclosures must be made and the standards by which such disclosures would be deemed “clear and conspicuous.” The Chamber recommends that the Department remove this requirement and provide more specificity as to the method and frequency required of such disclosures.

#### **E. Information and Data Security Audit Requirement – Section 19.230.070**

The draft amendment includes a new requirement that licensees that store digital currencies on behalf of others provide a third-party security audit of their information technology systems as a condition to receiving a license.<sup>32</sup> The Chamber understands the objective of protecting consumers’ funds from risk of loss by theft and other means, and imposing such a requirement on licensees is a step towards achieving that objective; however, in our view the proposed language needs honing. As illustrated above, certain business models, such as custodians that employ multi-signature wallets, are less exposed to such risks. The Chamber recommends that the language of Subsection 070(d) be amended to exclude businesses that use multi-signature wallets by amending the language to read: “for business models that maintain control of digital currencies on behalf of other, ....”

In addition, the Chamber proposes amending the provision to require that licensees obtain the security audit during the first year of licensure and then provide a copy of such audit as a condition for renewal, as opposed to requiring it as a condition of initial issuance of the license. Many digital currency businesses are start-up companies that have not had an opportunity to engage in a sufficient volume of transactions upon which to base a data security audit. The Department could require a copy of the applicant’s security policy during the application process, while allowing the licensee adequate time to conduct a formal third-party audit during the first year of operation. In addition, the regulation does not set applicable standards regarding the type of audit required, the frequency of the audit requirement, and which third parties would be acceptable.

The Chamber also notes that subpoint (2) of Section 19.230.070, stating that the “director may for good cause ... condition the issuance of the license,” would be better understood if the provision were to include more detail regarding the basis upon which the director might impose additional conditions and what those conditions may entail.

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<sup>32</sup> See RCW § 19.230.070(d).

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Draft Legislation of the Uniform Money Services Act

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**F. Bonding requirements**

Finally, the Chamber notes that the Department proposes removing the option of presenting alternative forms of security in lieu of the bonding requirement. It is not clear what the Department's motivation is in removing this option; therefore, we respectfully request the Department to reconsider maintaining the flexibility this option provides.

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The Chamber thanks the Department for the opportunity to provide comments on the draft amendments. Should you have any further questions about these or other topics, please do not hesitate to contact us [policy@digitalchamber.org](mailto:policy@digitalchamber.org) or by phone at 202-302-6064.

Respectfully submitted,

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