



January 18, 2017

Secretary Bryan A. Schneider  
Illinois Department of Financial and Professional Regulation  
100 West Randolph Street, 9<sup>th</sup> Floor  
Chicago, IL 60601

**Re: Comments on the November 30, 2016 proposed IDFPR Digital Currency Regulatory Guidance**

Dear Secretary Schneider:

After having reviewed and discussed the IDFPR's November 30, 2016 draft Digital Currency Regulatory Guidance ("Guidance") with members of the Chamber of Digital Commerce's State Working Group, we write to provide feedback on the draft Guidance.

The Chamber is the world's largest trade association representing the blockchain industry. Our membership is comprised of a wide range of companies innovating with and investing in blockchain-enabled technologies, including financial institutions, exchanges, software companies and cutting edge startups.<sup>1</sup> Our mission is to promote the acceptance and use of digital assets and blockchain-based technologies.

The Chamber is pleased that the IDFPR has provided guidance regarding the regulation of digital currencies. The IDFPR's commitment to understanding the technology underlying decentralized digital currencies and considering the needs of industry actors is evidenced by this draft Guidance and the request to provide comments.

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

- Applicability of the Illinois Transmitters of Money Act ("TOMA") to digital currency;
- The definition of digital currency and the distinction between centralized and decentralized digital currencies;
- Digital currency as a permissible investment; and
- Other licensing considerations.

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<sup>1</sup> A list of representative members can be found on the Chamber website at:

The Chamber would be pleased to further discuss the comments below with the IDFPR and answer questions at the IDFPR's convenience.

### **A. Applicability of TOMA to Digital Currency**

As a threshold matter, the Chamber agrees with the IDFPR's conclusion that the Illinois legislature only authorizes the Department to regulate the transmission of money and not the transmission of non-legal tender. To the extent digital currency has not been recognized by a government as legal tender or issued by a government's central bank, we agree that it should fall outside of the scope of TOMA.

### **B. Definition of Digital Currency**

#### *Digital Currency as a Medium of Exchange*

In light of IDFPR's distinction between money, and the fact that digital currency is not legal tender, it is not necessary for the Guidance to arrive at a codified definition of digital currency. However, it is nevertheless important for the Department to strive for accurate and consistent definitional descriptions of digital currency and its various implementations. The Guidance broadly describes digital currency as a "medium of exchange used to purchase goods and services."<sup>2</sup> This description does not adequately capture the essential characteristics of virtual or digital currency, and is not congruent with definitions currently used in the industry.

During this past year, the Chamber has worked extensively with the state of North Carolina, the state of Washington and the Uniform Law Commission ("ULC") to craft definitions that reflect both industry and regulatory understandings of how digital currency should be defined. The Chamber encourages the IDFPR to review these examples and to adopt or draw from them in its final Guidance.

The North Carolina Money Transmitters Act defines "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 G.S. 53-208.42(19), but does not have legal tender status as recognized by the United States Government.<sup>3</sup>

Similarly, a proposed amendment to the Washington Uniform Money Services Act defines "virtual currency" as:

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<sup>2</sup> See, Illinois Department of Financial and Professional Regulation: Request for Comment Digital Currency Regulatory Guidance (Nov. 30, 2016), available at, *supra* note 6, p. 2., <https://www.idfpr.com/news/PDFs/IDFPRRequestforCommentsDigitalCurrencyRegulatoryGuidance2016.pdf>.

<sup>3</sup> N.C. Gen. Stat. Ann. § 53-208.42; see also, *Money Transmitter Frequently Asked Questions*, available at: <https://www.nccob.org/Public/FinancialInstitutions/MT/MTFAQ.aspx#Renewal>.

[A] digital representation of value used as a medium of exchange, a unit of account, or a store of value, but does not have legal tender status as recognized by the United States government. Virtual currency does not include the software or protocols governing the transfer of the digital representation of value or other uses of virtual distributed ledger systems to verify ownership or authenticity in a digital capacity when the virtual currency is not used as a medium of exchange.<sup>4</sup>

Further, the latest draft to the ULC's Draft Regulation of Virtual Currency Businesses Act defines "virtual currency" as:

[A] digital representation of value that is used as a medium of exchange, a unit of account, or a store of value and that is not legal tender, whether or not it is denominated in legal tender. The term does not include:

- (A) the software or protocols governing the transfer of the digital representation of value;
- (B) stored value or digital units redeemable exclusively in goods or services limited to transactions involving a defined merchant, such as an affinity or rewards program;
- (C) digital units used within a game or game platform; or
- (D) digital units used within the same online gaming platform to purchase intangible goods or services used within the same closed platform.<sup>5</sup>

With slight variation, these definitions address the following critical objectives that our members seek when:

- They include important carve-outs, including for closed network loyalty and other points programs that pose minimal risk to consumers:
  - For stored value programs that are otherwise regulated within the existing statutory regime; and
  - For uses of distributed ledgers where the digital currency is not used as a medium of exchange.

In light of these objectives, the Chamber proposes the following description:

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<sup>4</sup> Proposed amendment to R.C.W. 19.230.010, Aug. 8, 2016.

<sup>5</sup> Uniform Law Commission, *Draft Regulation of Virtual Currency Businesses Act*, Oct. 28-29, 2016.

Digital currency is a digital representation of value used as both a medium of exchange, and either a unit of account or a store of value, but does not have legal tender status as recognized by the United States government. The term does not include:

- (A) The software or protocols governing the transfer of the digital representation of value.
- (B) Other uses of the blockchain (or other similar virtual distributed ledger system) to (i) verify or certify ownership or authenticity of physical assets in a digital capacity, (ii) authenticate, track, or consummate transactions, (iii) tokenize or digitize physical assets, or (iv) validate identity.<sup>6</sup>
- (C) Digital units redeemable exclusively in goods or services limited to transactions involving a defined merchant, such as an affinity or rewards program.
- (D) Digital units used within an online gaming platform to purchase intangible goods or services used within the same closed platform.

#### *Distinction Between Centralized and Decentralized Digital Currencies*

Although the industry frequently employs the term “decentralized digital currency,” the Guidance’s characterization<sup>7</sup> is confusing and, given the nature of various decentralized digital currencies present in the industry, is outdated. The distinction between ‘centralized’ and ‘decentralized’ digital currencies was born out of the FinCEN’s March 2013 Guidance,<sup>8</sup> but has, in practice become a distinction without a difference from a regulatory perspective. For example, despite the fact that this distinction was incorporated into the Financial Action Task Force’s report titled “Virtual Currencies Key

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<sup>6</sup> Examples of such uses include, but are not limited to: colored coins (coins that are marked specifically to represent a non-fiat-money asset), smart contracts (agreements implemented on a virtual distributed ledger), and smart property (property that is titled using a virtual distributed ledger).

<sup>7</sup> The Guidance characterizes ‘Decentralized’ digital currencies as those digital currencies that “are not created or issued by a particular person or entity, have no administrator, and have no central repository.”  
<https://www.idfpr.com/news/PDFs/IDFPFRequestforCommentsDigitalCurrencyRegulatoryGuidance2016.pdf>

<sup>8</sup> U.S. Department of the Treasury, Financial Crimes Enforcement Network [hereinafter “FinCEN”], Guidance: Application of FinCEN’s Regulations to Persons Administering, Exchanging or Using Virtual Currencies, FIN-2013-G001 (Mar. 18, 2013), available at <https://www.fincen.gov/sites/default/files/shared/FIN-2013-G001.pdf> [hereinafter “FinCEN Guidance”].

Definition and Potential AML/CFT Risks,”<sup>9</sup> published the following year, it required (by that time) clarification that a digital currency created and executed by a single entity could nonetheless be classified as ‘decentralized.’ Because the industry has undergone significant developments since the publication of the FinCEN Guidance in 2013, the Chamber encourages the IDFPR to avoid using or relying upon the outdated distinction between “centralized” and “decentralized” digital currencies. Instead, the IDFPR should adopt a definition that is consistent with emerging legislative revisions pending in Washington and current North Carolina legislation, the definition adopted by the ULC, and the way digital currency is commonly understood and accepted by industry participants.

### **E. Digital Currency as a Permissible Investment**

Although the Chamber notes that it is beyond the scope of the Guidance to amend the statutory definition of “permissible investment” under the TOMA to include digital currencies, it would like to take this opportunity to express the importance of allowing capital reserves to be held in digital currency. The Chamber considers this issue essential to encouraging industry innovation and growth, because dollar-denominated capital reserve requirements impose added burdens on digital currency companies without enhancing consumer protections. For businesses, whose services include digital currency, the Chamber recommends allowing their reserves to be maintained in like-kind digital currency, because doing so ties the volatility of the outstanding obligations and thereby, protects consumers and digital currency custodians together. In support of this position, the Chamber recommends reviewing the Conference of State Bank Supervisors (“CSBS”) Model Regulatory Framework, which recommends a flexible permissible investment requirement based on the licensee’s individual business model and associated risk.<sup>10</sup> Under the CSBS flexible approach, licensees could be authorized to hold permissible investments that are “like-kind, fiat, high quality liquid assets, or a combination thereof.”<sup>11</sup> The Chamber encourages the IDFPR to consider this approach when reviewing individual requests to allow holding digital currencies as a permissible investment, as provided under 205 ILCS 657/50(b).

### **F. Other Licensing Considerations**

Pursuant to authority granted to the Department under 205 ILCS 657/25 to waive application requirements for good cause shown, the Chamber respectfully proposes that the Department consider the following two issues of critical importance when licensing any entity that transacts in digital currency.

#### *(a) On-ramp Provision or De Minimis Exception*

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<sup>9</sup> Organization for Economic Co-operation and Development (OECD), Financial Action Task Force (FATF), Virtual Currencies Key Definitions and Potential AML/CFT Risks, published June 2014, available at: <http://www.fatf-gafi.org/media/fatf/documents/reports/Virtual-currency-key-definitions-and-potential-aml-cft-risks.pdf>.

<sup>10</sup> See Conference of State Bank Supervisors (CSBS), State Regulatory Requirements for Virtual Currency Activities CSBS Model Regulatory Framework (Sept. 15, 2015), at p. 5.

<sup>11</sup> *Id.*

As a nascent industry, nearly all companies desiring to provide digital services are new. Despite the fact that their transaction volumes are low, these early entrants seek to launch operations nationwide in order to foster mass adoption and growth of digital currency use in the market. The Chamber considers the availability of a regulatory on-ramp or a *de minimis* exception as essential to encouraging this type of industry innovation, and has been working extensively with other states and the ULC to promote this option. At this time, a 50-state money transmitter licensing application process involves substantial fees, including over \$100,000 in application fees, approximately \$7,000,000 in bonding (with annual premiums ranging between 2% and 8%), and an additional \$50,000 in other miscellaneous hard costs – all which must be borne prior to generating a single dollar in revenue. The Chamber believes that a *de minimis* threshold in the general range of \$1 million in total transaction volume is an appropriate threshold to allow market entrants to establish operations prior to undergoing the costly licensing process. To the extent the Director has the authority to waive portions, if not all, of the application requirements for digital currency companies who are deemed to trigger the licensing requirement in Illinois, such a consideration will prove beneficial to market growth and innovation in a strategic state such as Illinois.

*(b) Net Worth Requirement*

Illinois' net worth requirement of \$35,000 for applicants and licensees is generally appropriate and less burdensome than the majority of states. However, we generally encourage regulators to consider allowing applicants and licensees to include in the net worth calculation the digital currency that such applicant/licensee owns. Obviously, this would exclude any digital currency held on behalf of others because such funds are not on the licensee's balance sheet, and should therefore have no bearing on its net worth under generally accepted accounting principles.

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In conclusion, the Chamber thanks the IDFPR for the opportunity to provide comments on the draft Guidance. Should you have any further questions about these or other topics, please do not hesitate to contact us by email at [policy@digitalchamber.org](mailto:policy@digitalchamber.org).

Respectfully submitted,

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