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My name is Dana Syracuse and I am Counsel at BuckleySandler LLP. I appreciate this opportunity to present testimony before this Subcommittee and thank Chairman Burgess, Ranking Member Schakowsky, and the Members of this Subcommittee for their hard work in organizing this public hearing.

Up until this past August I was Associate General Counsel at the New York State Department of Financial Services. NYDFS regulates and supervises the activities of nearly 1,700 insurance companies with assets exceeding $4 trillion, nearly 300 state chartered banks with assets of $2.1 trillion, and more than 1,600 licensed financial entities. While I was with NYDFS, I was responsible for several initiatives including enforcement activities in the area of AML/BSA compliance, helping to lead our efforts in the area of cyber security, and helping lead the Department's initiative to regulate emerging payment systems including digital currency and Blockchain technologies, and the creation of the BitLicense regulation. My current practice at BuckleySandler focuses on these same areas.

Regulation of Digital Currency

State Level

For the sake of clarity, and because they are two very different things, I'd like to first discuss digital currency regulation and then move onto a discussion of Blockchain technology.

Digital currency, in the form of Bitcoin or other open-source crypto protocol, is both (i) a form of value and (ii) a mechanism to transfer such value allowing a nearly instant peer to peer payment system without the need for a financial intermediary. This revolutionary payment system has the potential to bring into the financial fold the unbanked and the underbanked, and allows one to send money to any part of the world without the benefit of a modern banking system. It is noteworthy that the global mobile penetration has been reported at 73% through 2014. This continuum of mobile adoption combined with the advent of digital currency are the catalysts driving modernization of our Apollo era payment system into one that is faster, safer, less expensive, and more reliable. The challenge faced by regulators in this new era will be how to create appropriate guard rails that protect consumers, prevent money laundering, and impose proper cyber security standards while not hindering innovation.

In the summer of 2013 New York launched an initiative to understand Bitcoin, other digital currencies, and the Blockchain. The initiative included a first in the nation two day hearing similar to the hearing we are in today; meetings with countless industry representatives, academics, attorneys, and members of the law enforcement community; consultation with regulators at the State, Federal, and International level; the issuance of two proposed regulatory frameworks; and the review of over 3,700 public comments. There were many commenters with the opinion that digital currencies should not be regulated as the cost of doing so would collapse this innovative and growing industry. There were however, equally as many on the other side of

the coin if you will, that wanted a regulatory framework to create a legal basis to operate and a structure for compliance. This fairly lengthy process and debate led to the final Bitlicense regulation issued in July 2015.

The regulatory approach we took in New York was a functional one. We started with the premise that digital currency had monetary value and didn't debate whether it was "money" or "currency" as defined under current law. We focused on the "activity" – i.e., exchanging, transmitting, selling, holding value, rather than on how to best classify the value. This meant not regulating Bitcoin, the underlying digital currency, or the Blockchain technology, but rather the licensure of those that are acting as financial intermediaries or are providing financial services to the public. Based on the voluminous feedback from the industry, our goal was draft a tailored regulation to only capture entities performing services associated with administrative, custody and exchange of the value and not regulate individual use or the underlying technology itself. Additionally, we also believed that a sound regulatory framework would also need to include key provisions to safeguard customer assets, which should include requiring capitalization to allow for sufficient funds on an ongoing basis and in the event of a wind down; consumer protections to guard against fraud and abuse; controls to prevent money laundering and other illicit activity, including examinations, anti-money laundering compliance, accounting and recordkeeping; and cyber security controls. The core concept is that entities that are providing these types of services are entrusted with safeguarding customer assets and, in exchange for receiving a license to do so, accept heightened regulatory scrutiny.

We also learned that regulators also must to be very sensitive to the need to innovate. This means that any act that seeks to regulate this type of financial services functionality must also create a permissive environment where smaller companies can innovate. There is much

debate as to whether this should be in the form of a tiered license structure, such as in New York, or in the form of a safe harbor that exempts smaller entities from licensure. In either instance, this requires an analysis of whether smaller players present a risk and whether that risk warrants the kind of regulatory structure that may be better suited to regulating a larger player. Every effort should be made to ensure that small companies who do not present a great risk to consumers are not required to implement outsized compliance programs that put them at financial risk.

Of equal importance is an understanding of who is not providing financial services or products, and should therefore not be regulated. This includes:

- Individual use of digital currency. If an individual chooses to use digital currency in a criminal enterprise that is the act that should receive legal oversight, not the fact that it was effectuated using Bitcoin.
- Non-financial use of this technology.
- Those who create software for the use of others and are not otherwise engaged in providing financial services.

Other States including California, Connecticut, Georgia, Kansas, New Hampshire, New Jersey, North Carolina, Pennsylvania, Tennessee, Texas, and Wyoming either have or are in the process of establishing their own regulatory frameworks either through existing money transmitter law or new frameworks specifically crafted for the this type of regulation. There are also efforts underway to promote uniformity among the state regulations by the Conference of State Banking Supervisors and the Uniform Law Commission. These frameworks also promote a functional approach. One last point worth making, which state's and the uniform law efforts are considering, is the need for some type of regulatory reciprocity from state to state. The

internet is borderless. Jurisdictional lines are easily crossed or blurred. People travel easily from one state to the next or one country to another and transact business. Which jurisdiction's rules should control? A fifty state regime with different requirements is a costly and time consuming venture to set up. It would be in the best interest of the regulators to consider how best to regulate various industries in the electronic age in order to foster innovation and efficiency and at the same time address needed consumer protections.

Federal Level

Since 2013 the Financial Crimes Enforcement Network has required that those in the business of virtual currency exchange to file as Money Service Businesses and meet certain compliance obligations around anti-money laundering. In May of last year FinCEN announced that it was in the process of conducting audits of those who had registered with them and that it had reached a settlement with a digital currency company who had failed to file Suspicious Activity Reports and maintain an adequate anti-money laundering program. Digital currency is also on the Consumer Financial Protection Bureau's radar. In August 2014 the CFPB issued a warning about the risks posed by digital currencies including cost, potential loss from hackers, and the fact that consumers may have fewer redress rights when dealing with custodians of virtual currency. Both FinCEN and the CFPB's approaches are of note because, like NYDFS, they also are taking a functional and/or activity based approach to oversight. Similar approaches can be seen in enforcement matters brought by the Securities and Exchange Commission and the Commodity Futures Trade Commission. Late last year in an enforcement action against a bitcoin mining company and its principal, the SEC ruled that mining contracts can be contracts and therefore were securities regulated under the Securities Act and were therefore within the SEC's jurisdiction. In September 2015, the CFTC announced a civil enforcement action against

a bitcoin options platform. This action confirmed that if bitcoin is acting like a commodity or being used like a commodity it will be regulated as such.

Regulation of Blockchain Technology

The Blockchain provides the underpinning backbone architecture on which different applications can be built – bitcoin being the most well-known. There is significant interest in the way banks, clearinghouses, and exchanges may use Blockchain to transform existing business models, whether through closed proprietary systems or on the public Blockchain, and through the use of smart contracts and electronic agents. Significant time and money is being devoted to understanding things like reducing latency in businesses and in doing so lessening counterparty and settlement risk, not to mention cyber security. Others are attempting to use Blockchain technology for services may traditionally be unregulated.

These technologies are in their infancy and beg two questions 1) are they governed by existing regulatory frameworks, and 2) is new regulation needed to regulate the underlying Blockchain protocol itself? If a function or activity that can be performed by the Blockchain has not been traditionally regulated it may not be necessary to burden it with undue regulation simply because it is effectuated through the Blockchain. To the extent that there is an existing framework in place, such as in the world of financial services, then that may be sufficient for the time being. That being said, just because a transaction is effectuated through the Blockchain does not mean that rights that were once there should be stripped away because it has been automated through a smart contract. The core concept is that though the Blockchain is a new technology the types of value and asset transfer that it permits are not. Existing frameworks, such anti-money laundering provisions, may be sufficient though regulators also need to consider issues that arise as a result of utilizing the Blockchain to effectuate transactions, such as

transparency and cyber security. The importance of a sound data privacy and cyber security program cannot be understated. Entities that are leveraging the benefits of the Blockchain and companies that are regulated under digital currency regulations exist almost entirely in a digital environment. Therefore, they must be sensitive to the safety and soundness issues that poor cyber programs may create. As for regulation of the underlying protocol, it's simply too early to act. Most of the relevant projects haven't garnered enough clients to make them viable business models and are ill understood by those outside their respective working groups. As pointed out by the European Securities and Markets Authority it is exceedingly difficult to regulate a decentralized ledger, like the Blockchain, that has no physical owner. The only alternative would be to regulate through the code itself which at this stage may only serve to stifle innovation.

Conclusion

In conclusion, we are in exciting times. Technological innovation is driving true constructive change in commerce, payments and financial services. Business processes are being redefined. It's not so much about Bitcoin per se as a competing currency, but rather Bitcoin and the Blockchain as a wedge between the past and the future –a disrupter to the current payment and asset exchange systems and as a mechanism to force industries to use technology to increase speed, accuracy, and reduce friction and costs. Regulatory frameworks can provide the necessary support to facilitate investment and growth. A functional, uniform, and reciprocal approach to regulation that is tailored to the risks posed and will act to set up guardrails that both allow the technology to flourish and protect the consumer at the same time. The states and federal agencies thus far have taken a thoughtful functional approach to regulating digital currency. The various use cases for the Blockchain, whether for clearing and settlement, supply

chain, title transfer, smarting contracting, medical records, etc. are still in their infancy and need time to develop and mature unencumbered.

Thank you for your attention, for organizing this hearing, and for providing me with the chance to discuss these important issues. I will be happy to address any questions that you may have.