

TYPES NOT MAPPED YET January 31, 2018 | TTR not mapped yet | Jennifer A. Post

California takes another run at regulating virtual currencies

Few topics have been more heavily debated in the past year than the validity, value and overall outlook of Bitcoin and other cryptocurrencies. Although Bitcoin and other emerging virtual currencies have been around for years they remain largely unregulated, as do the activities that support them - exchanges, wallets, etc. However, with the spike in investor interest and the rapid escalation in the creation of new virtual currencies state lawmakers are starting to consider ways to regulate these activities.

State regulation of virtual currency

In 2014, New York was the first state to adopt a “BitLicense” requirement. Essentially, anyone involved in a “virtual currency business activity” in New York must apply to obtain a license to conduct such activities. In addition, several other states, including Alabama, Connecticut, New Hampshire, North Carolina and Washington, have adopted legislation designed to address the regulation of virtual currency activity.

California is now stepping into the mix. The state has introduced the Virtual Currency Act (A.B. 1123), which would require anyone involved in a “virtual currency business” in the state to first register with California’s Commissioner of Business Oversight.

Details about the Virtual Currency Act

The [California Virtual Currency Act](#) defines a “virtual currency business” as any business “maintaining full custody or control of virtual currency in this state on behalf of others.” This seems to suggest only businesses such as cryptocurrency exchanges or wallets that provide virtual currency accounts would need to register through this process. Nonetheless, the definition is very broad and encompasses “any type of digital unit that is used as a medium or exchange or a form of digitally stored value.”

However, there are carve-outs for certain stored value units including:

- “Digital units that are used solely within online gaming platforms with no market or application outside of those gaming platforms”;
- “Digital units that are used exclusively as part of a consumer affinity or rewards program”; or
- “Digital units that can be redeemed for goods, services, or for purchases with the issuer or other designated merchants, but cannot be converted into, or redeemed for, fiat currency.”

In addition, based on the current version of the Act, hedge funds would be excluded from the license requirement since they would own virtual currencies or related assets on their own balance sheets and not for the benefit of their investors, per se.

Finally, the Act excludes certain virtual currencies that regulators and/or consumers are already familiar with and that exist in a closed circle of value such as points that may be redeemed for rewards than for cash.

Requirements for licensing

Those that are required to obtain a license will need to do a number of things:

- Pay a nonrefundable \$5,000 application fee.

- Pay an annual \$2,500 renewal fee, plus an annual \$125 fee for each “licensee branch office in this state.”
- Submit specific information as required on the application form (ownership, management and capital related information).
- Maintain a bond or trust account in U.S. dollars for the benefit of its consumers in the form and amount specified by the Commissioner.
- Agree to annual audits and provide balance sheets, income statements, and other verification forms periodically.
- Pay \$75 an hour “whenever the Commissioner examines a licensee..for each examiner engaged in the examination plus, if it is necessary for any examiner engaged in the examination to travel outside this state, the travel expenses of the examiner.”
- Be subjected to an assessment levied by the Commissioner each fiscal year, on a pro rata basis, in an amount “sufficient to meet the commissioner’s expenses in administering these provisions and to provide a reasonable reserve for contingencies.”

There will also be a provisional license that can be obtained by those involved in a virtual currency business that has less than \$1 million in outstanding obligations by paying a \$500 fee, if the activity is found by the Commissioner to be low risk to consumers.

Licensing criteria

Based on the information submitted by an applicant, the Commissioner will evaluate whether the applicant has (and will have) such capital as the Commissioner determines is sufficient to ensure the “safety and soundness” of the applicant and maintain consumer protection.

In determining the minimum amount of capital that must be maintained by an applicant, the Commissioner shall consider a variety of factors, including, but not limited to:

- The composition of the applicant’s total assets, including the position, size, liquidity, risk exposure, and price volatility of each type of asset
- The composition of the applicant’s total liabilities, including the size and repayment timing of each type of liability
- The actual and expected volume of the applicant’s virtual currency business activity
- Whether the applicant is already licensed or regulated by a state or federal entity, and whether the licensee is in good standing in such capacity
- The amount of leverage employed by the applicant and its liquidity position
- The financial protection that the licensee provides for its consumers through its trust account or bond

Next steps for the proposed law

The Virtual Currency Act is heavily opposed by many involved in this space, including digital nonprofits, for a number of reasons, not the least of which being the broad definition of “virtual currencies” as “any type of digital unit that is used as a medium of exchange or a form of digitally stored value.” Those active in the space do want to guard against fraud and investment scams, but they do not want to be unnecessarily inhibited from innovation with respect to the way new virtual currencies are created, disseminated, exchanged and valued.

A previous version of the Act was abandoned after facing similar opposition. If the Act were to pass this time, it would come into effect on July 1, 2018.

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