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New York Proposes Conditional BitLicense Framework

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The New York State Department of Financial Services (the "NYDFS"), as a part of a series of virtual currency initiatives, proposed in June a framework for applying for and obtaining a virtual currency Conditional BitLicense. The framework is aimed at easing the process for businesses to enter the New York virtual currency marketplace and providing further clarity in a complex area of regulation.

In 2015, the NYDFS issued its first comprehensive rules for regulating firms dealing in virtual currency, 23 NYCRR Part 200. That regulatory regime outlined the NYDFS's authority to grant licenses to operate a virtual currency business in New York ("BitLicenses") and a conditional version of that license ("Conditional BitLicenses"). The NYDFS had not, however, established clear rules for applicants to obtain a Conditional BitLicense. As a result, New York virtual currency businesses have, as a practical matter, relied on the BitLicense path, despite its high bar (for example, see here and here).

The NYDFS's regulatory approach to virtual currency businesses had received criticism from industry players, particularly with respect to the BitLicense's challenging application process. The NYDFS, in its request for comments on the proposed framework, "recognize[d] that some firms may face actual or perceived hurdles in obtaining a BitLicense. These include a rigorous application process, which can involve a significant expenditure of time and resources for applicants fulfilling the regulatory requirements for strong governance, operational and compliance controls, and capital, among others." To provide firms an alternative to the BitLicense application process not only in regulation, but also in practice, the NYDFS has proposed a framework to guide applicants to obtain and utilize a Conditional BitLicense.

The proposed framework would permit a firm to engage in virtual currency business activity under a Conditional BitLicense, provided that the firm collaborates with an authorized BitLicensee (i.e., a firm that holds a BitLicense or a New York limited purpose trust charter) for "various services and support, such as those relating to structure, capital, systems, personnel, or any other support needed."

According to the NYDFS, “the framework can be utilized by a variety of entities, such as startups, growth-stage companies, established New York companies not yet conducting any virtual currency business activity, and established virtual currency companies now operating outside of New York.” While the framework permits a new entrant to initially skip the full BitLicense application process, the NYDFS’s intent is for firms to only temporarily operate under a Conditional BitLicense and eventually apply for a full BitLicense.

The NYDFS provided a general overview of the proposed process a business would follow to obtain a Conditional BitLicense. Among other requirements, an applicant firm must first provide the NYDFS a draft service level (or similar) agreement between it and a fully licensed entity governing the proposed collaboration, and later enter into a supervisory agreement with the NYDFS, which would outline, for example, the allocation of responsibilities and liabilities between the applicant firm and the fully licensed entity, the activities the applicant firm will be permitted to engage in, and the NYDFS’s continued oversight of the applicant firm.

Interested parties and the general public have until August 10, 2020 to submit comments to the NYDFS with respect to the proposed framework, an opportunity for the blockchain and virtual currency industry to help calibrate regulations in this evolving area of law.

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